BearingPoint. Management & Technology Consultants

SOFTRAX®

World Class Finance Solutions

Laying the foundation for automating revenue accounting

In this white paper

World Class Finance Solutions

Revenue accounting: a decade of change

Complexities in today's revenue recognition accounting are the result of multiple changes affecting business since 1998. In the ensuing years, we have seen the rapid introduction of innovative new products, vertical and horizontal integration and new business techniques. During that time, there have been five major pronouncements on revenue recognition, which affected the software industry first and then expanded to include other industries.

Today, software and services are increasingly significant components of hardware—think cell phones, networks, medical imaging devices and more. As a result, companies not previously enmeshed in the complexities of revenue recognition now deal with multi-element arrangements that require fair value determinations and deferrals that may affect even simple contracting structures. Financial services is not immune either with Financial Accounting Standards Board (FASB) 163 Accounting for Financial Guarantee Contracts effective fiscal years after December 15, 2008.[1]

Recently, the Securities and Exchange Commission (SEC) has increased enforcement action and expansion in its focus areas. Revenue misstatements have had a devastating effect on shareholder value. With the Sarbanes-Oxley Act of 2002 (SOX) in full force, scrutiny around revenue and revenue accounting processes has never been greater. The process of obtaining reliable numbers is as important as the numbers themselves, because SOX prescribes controls and standards that help with transparency, auditability and accuracy. When SOX standards are held up to many companies' spreadsheet-based revenue recognition processes, confidence in their numbers often suffers.

Five major pronouncements on revenue accounting since 1998

- SOP 98-9 (Revised SOP 97-2)
- EITF 00-21 Fair Value of Multiple-Element Arrangements
- SAB 104 SEC Guidance on VSOE
- EITF 04-13 Exchanges of Inventory Between Two Parties
- EITF 06-01 Sales through Service Providers and Resellers

[1] http://www.fasb.org/news/nr052308.shtml

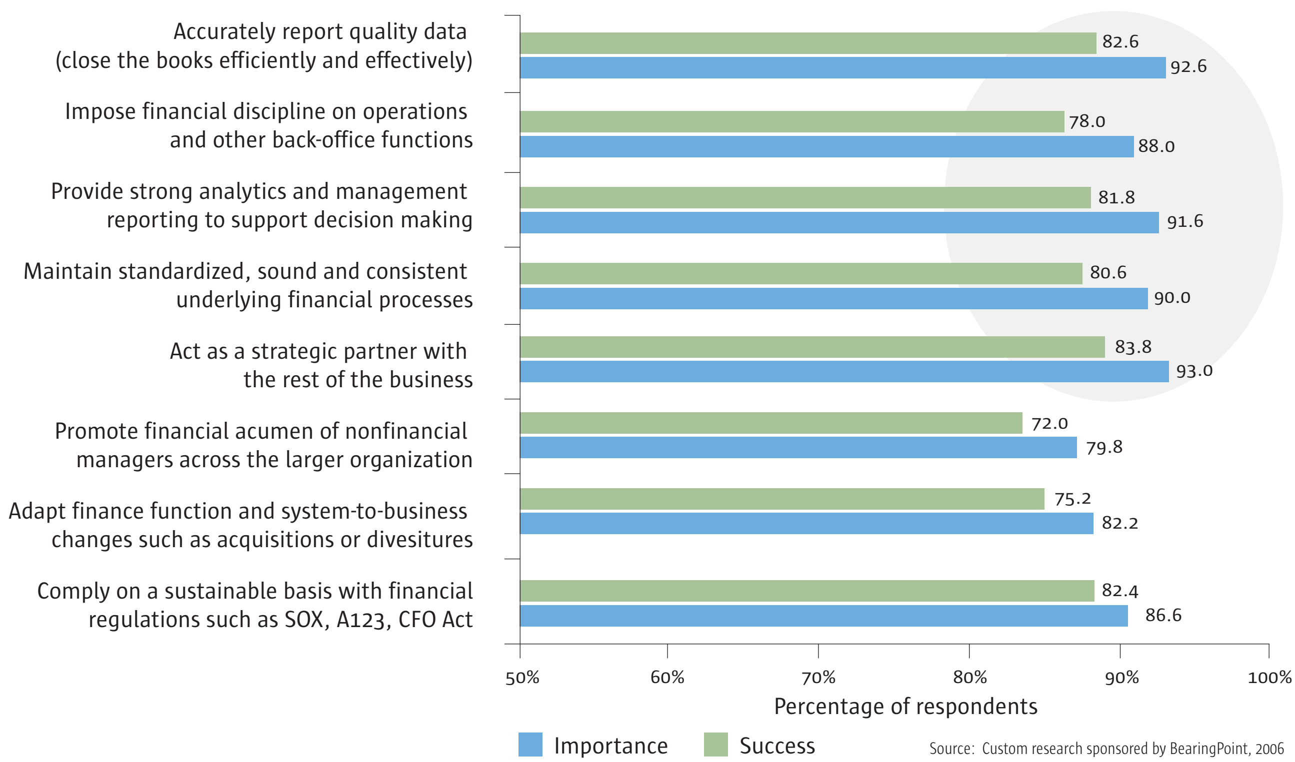
Gaps in finance's capabilities and key performance metrics

Despite exponential changes in the accounting field, enterprise resource planning (ERP) systems designed to process orders and cash did not evolve for revenue processing in concert with the changing revenue cycle. As a result, in many companies revenue accounting — and its complications — is still a manual process using people and spreadsheets to handle calculations and allocations. Unfortunately, these methods are often inefficient, costly and rife with reporting and compliance risks. Using them has left the finance function focusing on operations rather than meeting the needs of its customers.

A chief financial officer (CFO) research study sponsored by BearingPoint[2] shows finance struggling with gaps on key performance metrics of the finance function (Figure 1). The bottom line is that finance lacks the cycles, data and other means necessary to make essential contributions as a planning partner in the overall strategy of the business.

Automation of revenue accounting can address operational gaps and provide a variety of strategic benefits.

Figure 1. Finance struggling with gaps in key performance metrics



Source: Custom research sponsored by BearingPoint, 2006

[2] *The Chief Finance Officer — a Balancing Act,* December 2006

World Class Finance Solutions

Customer perspectives:

"The automation of our revenue accounting has been of tremendous benefit. Everything virtually flows through an automated process and is done. We now have the time and capability to really analyze the business and improve revenue performance."
–Vice president, finance; software industry

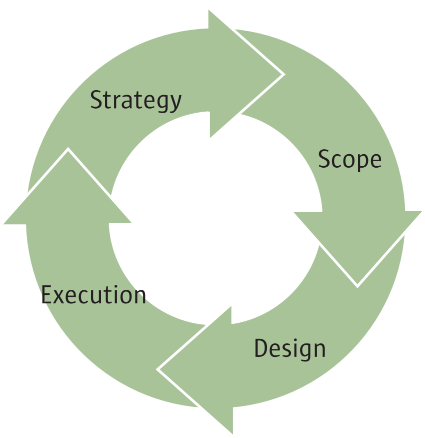
"Automation has cut our close process from two weeks to two days, which means we can shift our focus onto more valuable activities and grow without adding headcount."
–Controller; subscription services industry

The value of automating revenue accounting

Automating revenue recognition processes provides tangible improvements to the operations and finances of companies. Eliminating most manual revenue accounting processes results in greater efficiency, acceleration of close processes and reduced cost of finance. With more extensive insight into backlog, companies can make better performance management decisions and improve resource alignment in both operations and delivery centers. Automation also may help with collaborative product marketing and customer management focused on streamlining operations and managing change. It aligns earned revenue recognition processes with accounting requirements, providing improved controls and compliance — and lowered risk.

Financially, automating revenue recognition processes helps companies generate deferred revenue forecasts. This structured deferred revenue information provides value-added feedback to the refinement of the company's sales goals during the fiscal year and to strategic planning processes. Backlog data on pricing, bundles, channels and regions is invaluable for refining pricing and offers, developing new offers and understanding which levers drive financial results. Although sales and cash collection are good indicators of a company's health, efficient management of the deferred revenue liability increases shareholder value and demonstrates organizational maturity.

Figure 2. Revenue automation life cycle



Tradeoffs in each phase drive the ultimate success of the project and the longevity of the revenue recognition automation solution.

Laying the foundation for automating revenue accounting

Automation is not a matter of adding macros to spreadsheets, creating faster databases or automating current processes. Experience shows that the current state at many companies is usually not the appropriate model for the future. Still, many companies assume that what they are doing now is "good enough."

Revenue accounting automation involves implementing solutions that can withstand personnel turnover in structured, change-managed situations. When examining company policies, procedures and business rules, major operational gaps often are found between these written practices and current revenue accounting practices. Similarly, policies frequently are written at such an elevated level that they do not provide the specificity required to align processes with accounting requirements. Today, "human glue" fills the gaps. An automation effort should include reducing gaps so that human intervention is required primarily to set up and manage the environment, rather than in day-to-day processing.

There are four critical elements in revenue recognition automation: strategy, scope, design and execution. As Figure 2 indicates, revenue automation is not a linear task with an end, but rather a cycle that evolves with the business and feeds information from one phase to the next. This design allows for continual business improvement. It also permits planning for subsequent waves and contributes to ongoing refinement of the revenue automation cycle.

Leading revenue automation practices: strategy

Know where the company is heading

It is important to understand how business strategy will influence the solution. Where is the solution risk? Who needs to be managed? What needs to be factored in today? How will the organization and the solution need to evolve? It's worth understanding that companies often attempt to implement solutions that meet today's business strategy but may not support future evolution to products, services and business models, which could occur at any time. Strategy affects automation on three levels:

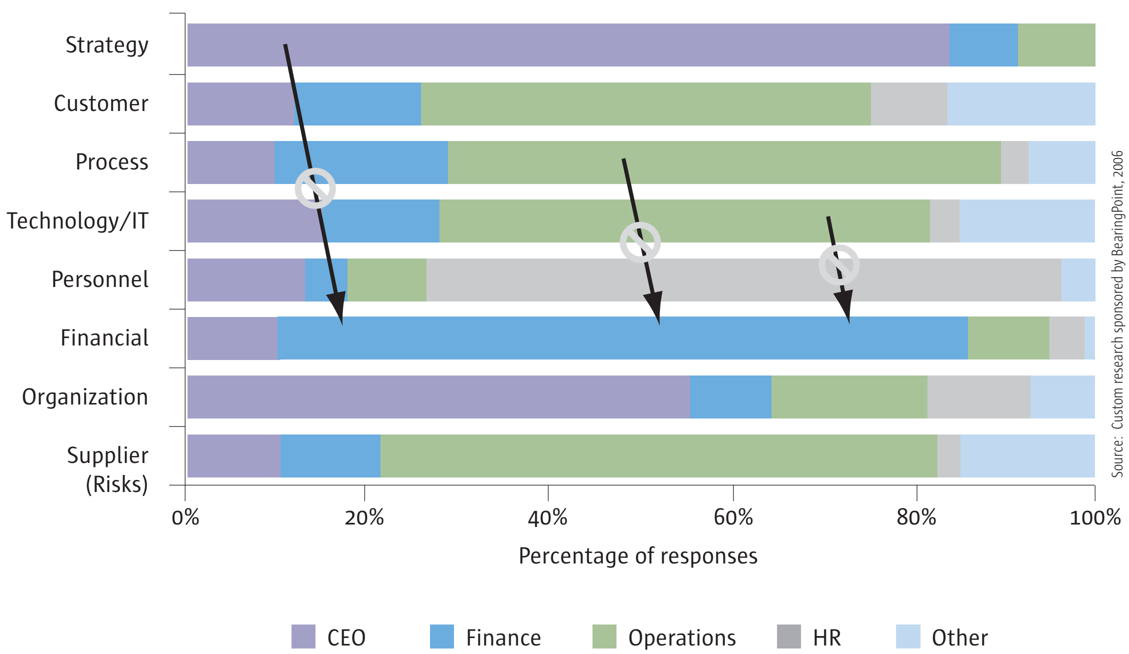
- Corporate — what lines of business do we want to conduct?
- Operational — how do we capture this business in our operational systems so that we can use the data?
- Financial — how can we understand the effect of new contract types on our revenue?

In a BearingPoint study[3] when respondents were asked, "Who within the organization is responsible for addressing specific types of risks?" the results, as depicted in figure 3, demonstrate the diversity of types and sources of risks faced when implementing new solutions.

Align goals and strategies across the business. Misalignment at the C level is a fatal flaw—the challenge is knowing with whom to align.

Strategy: know where the company is heading, determine the solution risk and identify whom to manage.

Figure 3. Stakeholder ownership of risks



[3] *Understanding Enterprise Risk and Compliance: Achieving Optimal Growth and Performance,* December 2006

Define a value proposition

In our experience with a variety of business cases, there are typically three major levers in developing a value proposition: efficiency, controls and value (Figure 4).

Typically, the organization's initial focus may be either on efficiency or on controls and compliance. When efficiency is the driving factor, the emphasis is put on automating the 80 percent of transactions that can be streamlined, leading to acceleration of close processes and lowered costs. In this approach, the design supports efficient processing with little emphasis on reporting. An offline process addresses complex contract types.

When the top priority is confirming the integrity of financial statements and controls/compliance, the project is driven toward automating complex transactions that are otherwise subject to human judgment and error.

If either of these first two levers is chosen, the human glue factor can be reduced considerably. However, the business case for either is essentially qualitative, making it difficult for finance to secure funding against competing organizational priorities.

The third major lever involves the value of better information and its utility in managing the business. When information and empowerment are the drivers, organizations focus on automation and the reporting capabilities needed to support diverse analyses. Study of deferred revenue, business and sales management can determine effective courses of action for revenue bottlenecks, operations streamlining and triggers that affect the recognition of revenue.

Figure 4. Typical value propositions for automating revenue accounting

Efficiency, close acceleration and cost of finance—drives focus toward the 80 percent of transactions that can be streamlined, excluding from scope those transactions that have complex or judgmental accounting interpretations

Risk, control and compliance—drives focus toward automating complex transactions that are subject to human judgment and error

Value of:

- **The attributes within deferred revenue**—drives focus toward reporting, data cleansing and quality vs. scope of the effort
- **Collaborative product marketing/customer management**—drives focus toward operations streamlining, change management and communication processes
- **Deferred revenue**—drives focus toward active management of revenue triggers to accelerate recognition

Define policies and procedures

Policies and procedures tend to be a challenge for many organizations. Experience shows that many policies lack detail, are too elevated and cannot be translated into executable design. They also lack backing of a vision—where actionable policies do exist, they are written to the design of current state processes and not designed for state-of-the-art automation technology. Finally, they do not inspire sufficient confidence. Without significant due diligence and confidence in the finance function up front in policies and procedures, more spreadsheets will be cobbled together to address future management decisions.

Leading revenue automation practices: scope

Set strict inclusion and exclusion criteria to manage scope creep

Managing scope is one of the simplest practices for managing risk and exposure in an automated revenue accounting solution. Over time, organizations tend to misplace the reasoning behind prior business decisions and begin to ask why today's solution cannot support other permutations of the business as it evolves.

It is critical to verify that, as part of the initial project decision process, formal documentation is included. The documentation should detail rationales for current processes, what is currently excluded and why it is excluded and describe what will trigger the evaluation of future types of transactions or revenue for inclusion in revenue recognition automation. This makes it possible to plan an initial deployment that includes critical elements, with subsequent implementation of less critical elements. Formal documentation answers questions that may arise later about why other transactions are not automated or why the system did not catch a mistake. Second-guessing adds to scope creep and to total cost of ownership.

Managing scope by planning an open design, with an initial deployment and subsequent waves, will help with a successful delivery and provide levers for the future.

Plan, but don't stress, for the future

Because the environment is constantly evolving, design change is always a risk — one which the value of automation outweighs. Typical questions to consider about the future include:

- What are the market demands on your organization? What different business services and products might your organization want to offer?
- How are industry business models evolving?
- How are auditor and SEC interpretations changing?
- How much automation should be implemented given impending changes in accounting rules, including those involving International Financial Reporting Standards (IFRS) and U.S. Generally Accepted Accounting Principles (GAAP)?

There are common denominators in these areas that can create design synergies. Client experience with revenue automation demonstrates that when solutions are appropriately planned, designed and implemented, many organizations can manage evolution methodically while reaping benefits unachievable prior to automation.

Company situation:

A service provider organization undertook an automation project without giving sufficient thought to business evolution. The custom solution it designed was not flexible enough to accommodate changes in packaging and pricing. Two years after the solution went live, the company was back to using spreadsheets and redesigning a new project.

Leading revenue automation practices: design

Consider your options in solution evaluation

In evaluating solutions, companies frequently focus their selections on cost or specific technologies rather than on holistic needs. This is a difficult conversation from the outset, with camps taking sides and stakeholders forming opinions quickly on which processes appropriately support their needs. Experience demonstrates that solution evaluation must consider the needs of the business and options (Figure 5).

Figure 5. Areas to consider in solution evaluation

Technology	• Provides flexibility in integration options • Reconfigures to evolve with business
Scheduling	• Prevents leakage of transactions and manages balance sheet backlog • Aligns transaction activity with revenue activities
Compliance	• Reduces "human glue" • Improves accuracy and timeliness
Forecasting	• Delivers better data for marketing and decision management • Supports right-sizing of business activities and service levels

These considerations inevitably lead management to ask why revenue recognition automation cannot be accomplished within existing ERP systems. Often the answer is that they are too late. They should have made revenue accounting a design requirement at the outset of ERP—it cannot be added efficiently as an afterthought. The revenue process, which ERP systems cannot support, needs to be managed separately from operational processes.

Ultimately, each environment is different. Selecting solutions is the result of many variables—of which most will eventually change. What's needed is a solution that can be configured to evolve and leverages the lessons learned from others who have already automated revenue accounting.

Company situation:

One company that was undertaking automation had more than 50 operational transaction types. The firm's initial goal was to manage accounting for those transactions within the company's existing ERP environment. When evaluated in detail, the various operational transaction types actually amounted to less than 10 accounting transaction types: variants existed only because of the way operational systems were managed.

Verify linkage from policy to solution

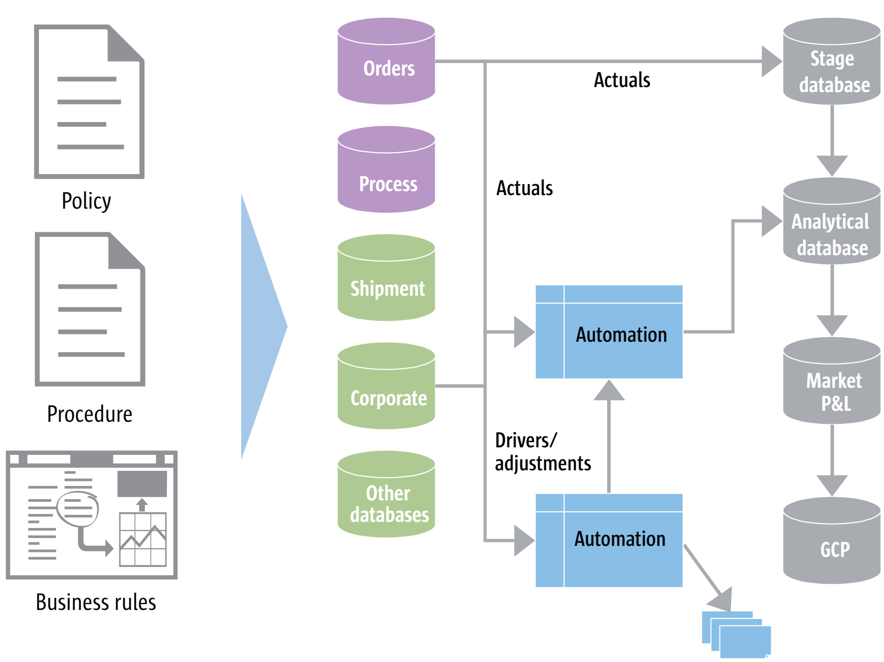
An examination of overall client processes frequently demonstrates that existing spreadsheets and processes have no bearing on policies, procedures or business rules. It also often shows that the policies are not adequate. In these cases, it is essential to reformulate accounting policies and procedures as the basis for developing appropriate business rules for transaction flows. The goal of the automation process is to implement those policies, procedures and rules in technology — not to define them. Ambiguity between procedures and the underlying technology may cause solutions to fail.

Capture the broadest requirements for detailed design

Shortsighted design is the primary cause of obsolescence. For generation zero, it's important to capture the broadest requirements and define solutions across geographies, business units and applications. This requires creative thinking from finance, marketing and IT. Implementation and maintenance efforts require an experienced team that can operate seamlessly within each function, understanding each terminology and perspective. Many organizations do not have resources that can operate at this level, resulting in poor communication, inadequate results and, often, blame.

One basic, yet important, consideration in design is that accounting transactions are different from operational transactions. Because implementation and maintenance teams often take time to arrive at this understanding, it is important to make this distinction in designing and implementing systems so that operational processes can work with accounting processes, and each can evolve at different speeds.

Figure 6. An automated revenue accounting example



World Class Finance Solutions

Leading revenue automation practices: execution

Prepare for ownership

From an automation perspective, implementing a revenue accounting solution is similar to implementing an ERP solution. The organization must understand and prepare for implementation and for owning and operating such an environment. The revenue accounting solution is both a revenue system issue and an organizational management issue. Too often, there is a divide among operations, marketing, IT, finance and accounting.

In many cases, staff must be retrained for transactions entered into source systems; each transaction has its own financial implications. Finally, data cleansing may be required to begin the conversion. Many organizations underestimate the importance of this area.

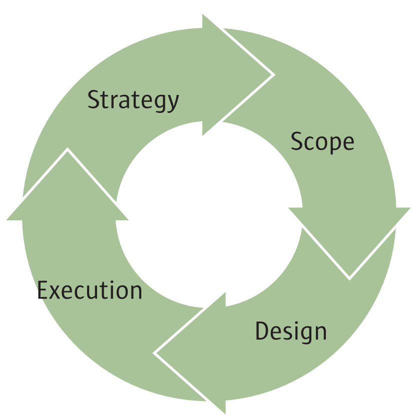
Ownership and management issues must be well articulated in advance in order to meet project budgets, cost objectives, as well as to make the value proposition pay off.

Keep solutions ahead of the strategies

Staying ahead of changes is one part science and two parts art. Proactive collaboration among legal, finance, marketing, operations and IT during the development of new products, prices and distribution channels is essential. That is no easy task in today's world. Collaboration will identify gaps in current business rules, improvements to revenue forecasts through modeling and guidance on proper acceleration of revenue recognition. Many companies use a structured product-change control process to help manage the linkage. The challenge is not the methodology, but appreciation of the effect if not managed proactively.

Revenue automation life cycles should be treated as continual processes rather than as a one-time event. Changes to revenue recognition create new or revised business rules for automated solutions rather than new sets of interim manual processes. Trailing changes mean that investments are at risk of obsolescence and inaccurate or incorrect accounting treatment.

Figure 7. Revenue automation life cycle leading practices



Strategy
- Direction for the organization
- Clarity in value proposition
- Define policies and processes

Scope
- Inclusion/exclusion criteria for functionality
- Plan, but don't stress for the future

Design
- Select the solution carefully
- Capture broadest requirements
- Align linkage from policy to technology

Execution
- Organization must be prepared
- Lead the strategy not trail

Summary

The foundation for automating revenue accounting is composed of 10 leading practices.

While automation can take effort, the value greatly outweighs the effort if designed effectively and managed throughout its life cycle. This approach treats automation as a life cycle rather than a systems implementation project. Organizations should approach automation efforts and ecosystems with the same rigor and discipline they would put into maintaining the corporate general ledger. Without that discipline, the results of automation cannot be trusted. However, companies that approach such projects appropriately can expect significant benefits.

Preparation checklist

Are you ready? A 10-step checklist

Accounting policies and procedures

- ☐ Have you documented policies that can drive an implementation?
- ☐ Do you understand the gaps between documented procedures, actual current practices and future objectives?
- ☐ Are your policies aligned with accounting guidance?

Operations

- ☐ Can you map your enterprise revenue process from order entry through reporting and analysis?
- ☐ Have you identified and documented your revenue transaction types?
- ☐ Have you inventoried and evaluated spreadsheets used for revenue-related tasks such as deferred revenue, fair value reallocations, scheduling, reporting and analysis?

Vision and leadership alignment

- ☐ Have you identified relevant value propositions for your business and decision makers?
- ☐ Have you obtained alignment and sponsorship at the appropriate levels and areas?

Technology and capabilities

- ☐ Are the necessary skills available within the organization to review your revenue process and develop a functional request for proposal?
- ☐ Have you thoroughly evaluated the total cost ownership of the options you are considering?

SOFTRAX®

About Softrax

Softrax Corporation is a leading provider of enterprise revenue management and billing software solutions that fundamentally change the way companies manage, analyze, report and forecast their revenue. Softrax solutions automate the entire revenue cycle, from revenue recognition, reporting and forecasting through complex billing and contract renewals. Hundreds of corporations benefit from using Softrax to optimize their revenue, reduce operating expenses, comply with revenue recognition regulations and Sarbanes-Oxley requirements and gain unprecedented visibility into their businesses performance. Softrax Corporation, headquartered in Canton, Mass., is privately held. More information can be found at www.softrax.com, www.revenuerecognition.com, and by calling 1.888.4.SOFTRAX.

BearingPoint. Management &Technology Consultants

SOFTRAX®

Helping our clients get sustainable, measurable results

BearingPoint is a leading management and technology consulting company serving the *Forbes* Global 2000 and many of the world's largest public services organizations. Our thousands of passionate, experienced consultants help organizations around the world solve their most pressing challenges, day in and day out. Through our collaborative and flexible approach, we help our clients get practical, sustainable, measurable results, make the right strategic decisions and implement the right solutions

We are BearingPoint, management and technology consultants.

To learn more, contact us at 1 866 BRNGPNT (+1 508 216 2523 from outside the United States and Canada), or visit our Web site at www.bearingpoint.com.

BearingPoint, Inc.
1676 International Drive
McLean, VA 22102

www.bearingpoint.com