Risk and Complexity in Revenue Reporting under US and International Standards

FINANCIAL EXECUTIVE BENCHMARKING SURVEY

International Edition

RevenueRecognition.com
Revenue Management Resources for Today's Financial Executive

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EXECUTIVE SUMMARY

RevenueRecognition.com recently surveyed senior financial professionals from 652 businesses in the US and 34 other countries about risk and complexity in revenue reporting. The survey was conducted by email in June 2008 in the US and in October 2008 internationally. More than 75% of respondents are senior finance executives including CFOs and Controllers. 141 respondents are from outside the US.

(References to the data and narrative in this report should be sourced: www.RevenueRecognition.com, 2008)

Key Findings:

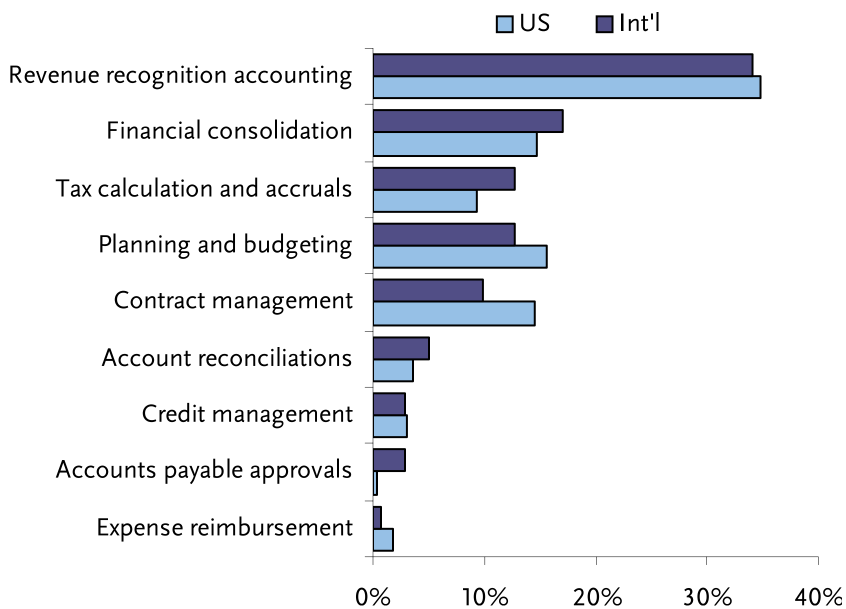
- **IFRS does not appear to reduce the risk or complexity** of revenue reporting.
- Revenue reporting risk and complexity are **similarly high for US and non-US companies**.
- Among nine key accounting processes, companies in the US and Internationally said **revenue recognition accounting represents the:**
  - **Greatest risk** of errors and inaccuracies
  - **Most complex** to manage
  - **Highest risk of material error on** financial statements.
- **Infrastructure weakness leads to fragmentation:** on average, companies require at least nine data sources to support an audit of revenue transactions.
- **92% of public companies use spreadsheets for key revenue accounting tasks**, consistent with past findings.

NO RELIEF FROM COMPLEX REVENUE PROCESSES UNDER INTERNATIONAL REPORTING STANDARDS

One of the misperceptions in the US regarding the possible adoption of IFRS is the assumption that because there is significantly less text to IFRS, particularly when it comes to revenue recognition, everything will get much easier. The fact of the matter is that revenue remains by far the most complex of all the financial and accounting processes we surveyed for both US and International companies. 35% of US companies and 34% of international companies identified revenue recognition accounting as most complex, a margin of two to one over the next most complex process. Of the international respondents, 46 were from countries requiring IFRS, and an even higher percentage of them selected revenue (46%) - three times more than any other process.

Figure 1

In your business, which process is the **most complex to manage**?
(n= 511 US; 141 Int'l)

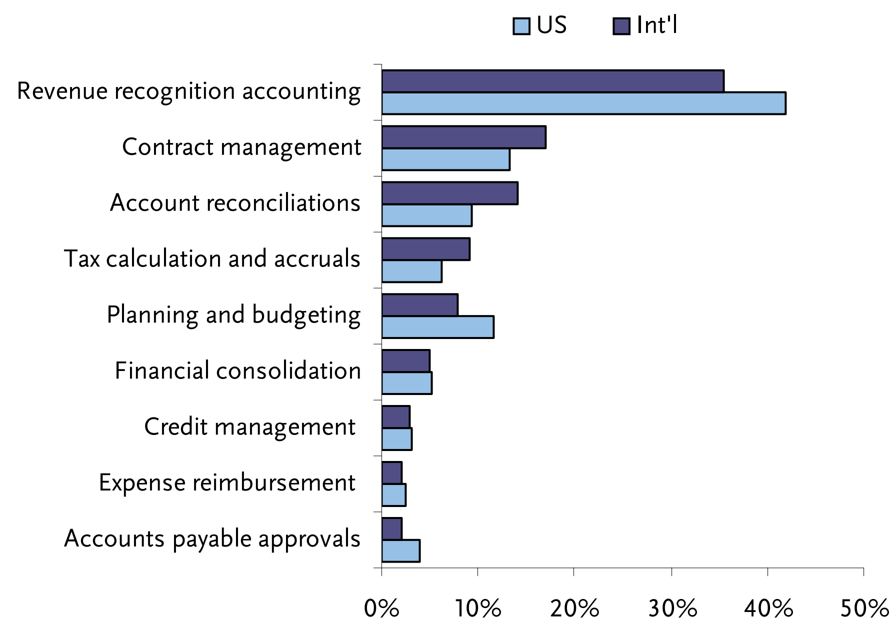


IFRS DOESN'T REDUCE RISK OF ERRORS AND INACCURACIES IN REVENUE REPORTING

Both US (42%) and International companies (35%) see revenue reporting as being substantially more vulnerable to errors and inaccuracies than other key accounting and financial processes. There was more than a three to one margin between revenue recognition accounting and the next process for US companies – and a two to one margin for international respondents. The results from companies in countries that require IFRS reporting were much closer to the US, 43% said revenue recognition accounting.

Figure 2

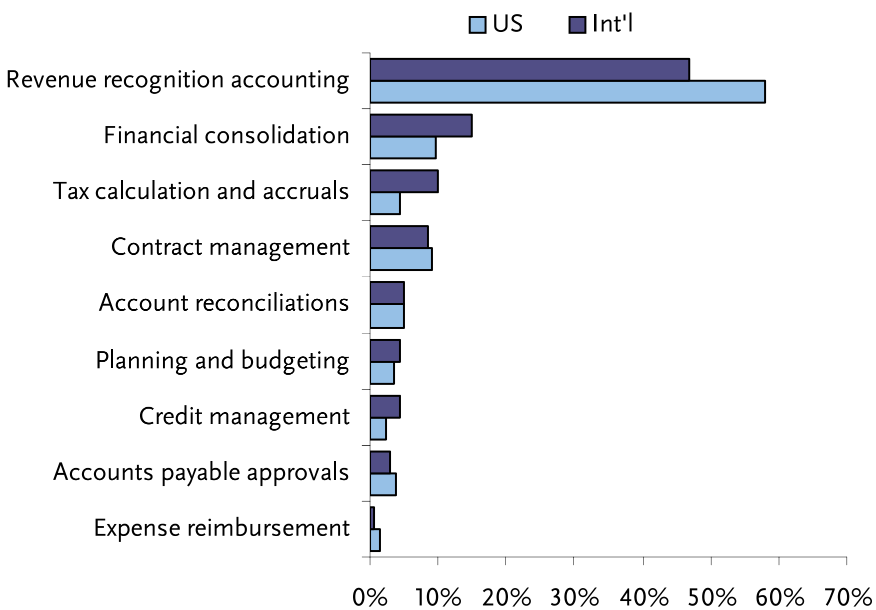
In your business, which process represents the **greatest risk of errors/inaccuracies**? (n= 511 US; 141 Int'l)



REVENUE REPORTING ERRORS HAVE GREATEST IMPACT ON FINANCIAL STATEMENTS

When errors occur in the revenue recognition accounting process, they are far more likely to be material to a company's financial statements than errors in any of the other processes. 58% of US companies said it was number one, while 47% of international respondents did. Revenue got 54% of the vote from companies in countries that require IFRS reporting, again results more similar to the US than international overall.

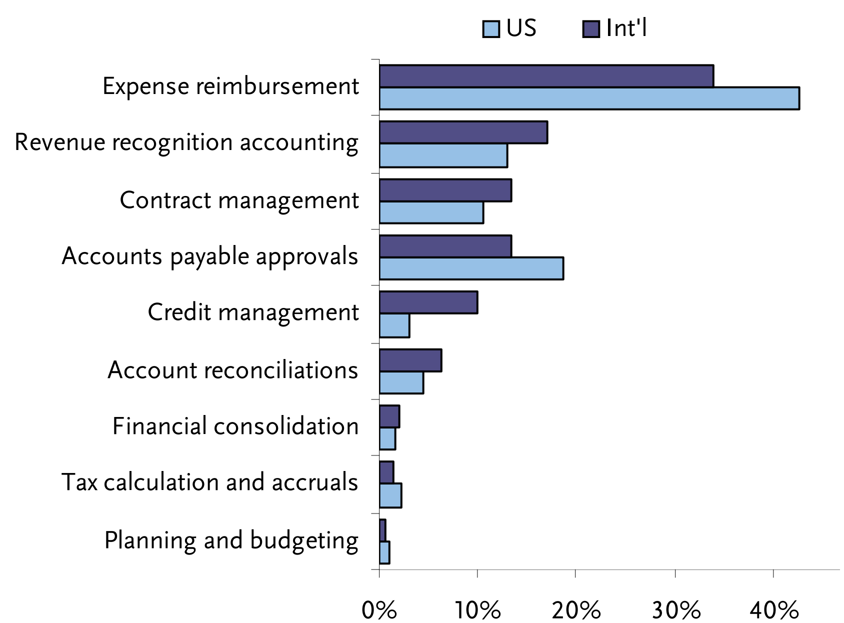
Figure 3
Were errors to occur, in which process would they have the **highest level of materiality** to your financial statements? (n= 511 US; 141 Int'l)



REVENUE A TOP FRAUD RISK

Expense accounting outweighed other processes for its vulnerability to fraud. However, revenue accounting fraud is much more likely to have devastating ramifications for companies and their executives than expense account manipulations because the potential magnitude is so much greater. As a result, organizations must remain vigilant, especially when performance threatens to slow after long stretches of record breaking numbers. This is when most companies are most vulnerable to bad decision making, and they should carefully review how they have structured compensation and commissions so they do not inadvertently provide an incentive for cheating.

Figure 4
In your business, which process represents the **greatest risk of fraud**? (n= 511 US; 141 Int'l)



LACK OF ERP FUNCTIONALITY LEADS TO FRAGMENTATION OF REVENUE DATA

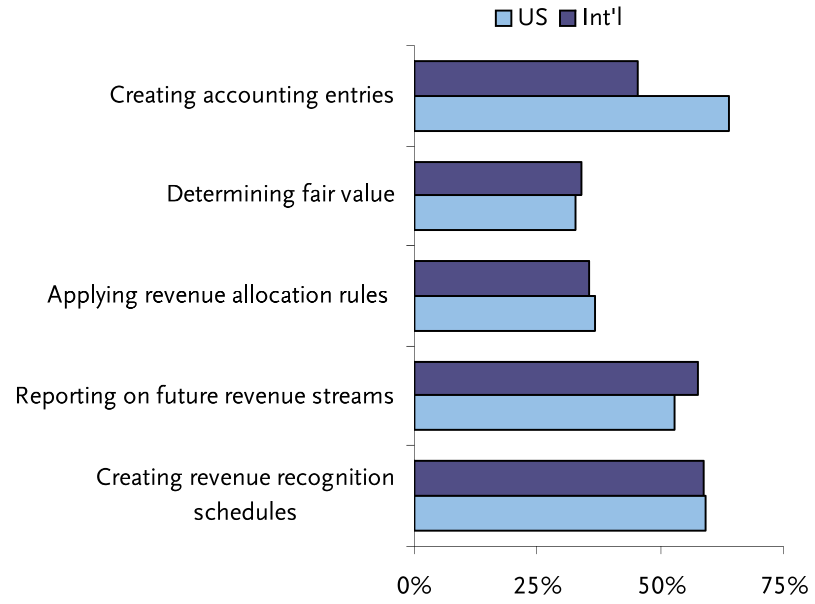
An oft-quoted finding from our previous studies is that **92% of US companies use spreadsheets for one or more key revenue reporting activities**. In this survey, the percentage of non-US companies using spreadsheets for these tasks was 100%.

In the typical organization, revenue data is in fact strewn around many disparate sources, including: spreadsheets, ERP modules, custom in-house systems, billing systems, order management systems, project management systems, financial system modules, CRM modules, price books, and word docs. To put a finer point on the issues, respondents were asked how many of each type of data source were needed. They were given choices of "none", "one", and "two or more". As a result, the average numbers shown below are extremely conservative. Large companies could easily have hundreds of sources.

	US	International
Minimum number of revenue data sources needed to support an audit on average.	9.6	9.9

The result of this infrastructure failure is that the revenue reporting process is laden with manual intervention, lacks highly enforceable controls, and is not optimized to support the demands of executive decision making nor auditing. In addition, the process is inflexible and not easily adapted to changes brought on by new business models or new regulations.

Figure 5
Do you use spreadsheets for any of the following activities?
(n= 511 US; 141 Int'l)



SUMMARY

The primary conclusion from our findings is that IFRS – in whatever form – will not be a panacea for the challenges of complex revenue reporting. Revenue is by its nature a difficult number and it will remain so. Both IFRS and US GAAP have, at their base, the principle that earned revenue is different from that which has been merely sold or booked. Companies will face the very same challenge under either system - to pull together a myriad of data to produce and document their earned revenue.

Therefore, in preparing for IFRS, companies should not make the mistake of waiting. Processes and infrastructure that are well managed, flexible, and transparent will help produce better performance under both sets of guidelines. In fact, the more companies do today to consolidate and optimize their revenue reporting processes, the easier the transition may be, because, of course spreadsheets and a myriad of disconnected systems will not provide the proper foundation when the IFRS switch is thrown.

DEMOGRAPHICS

Figure 6
What is your title?
(n= 511 US; 141 Int'l)

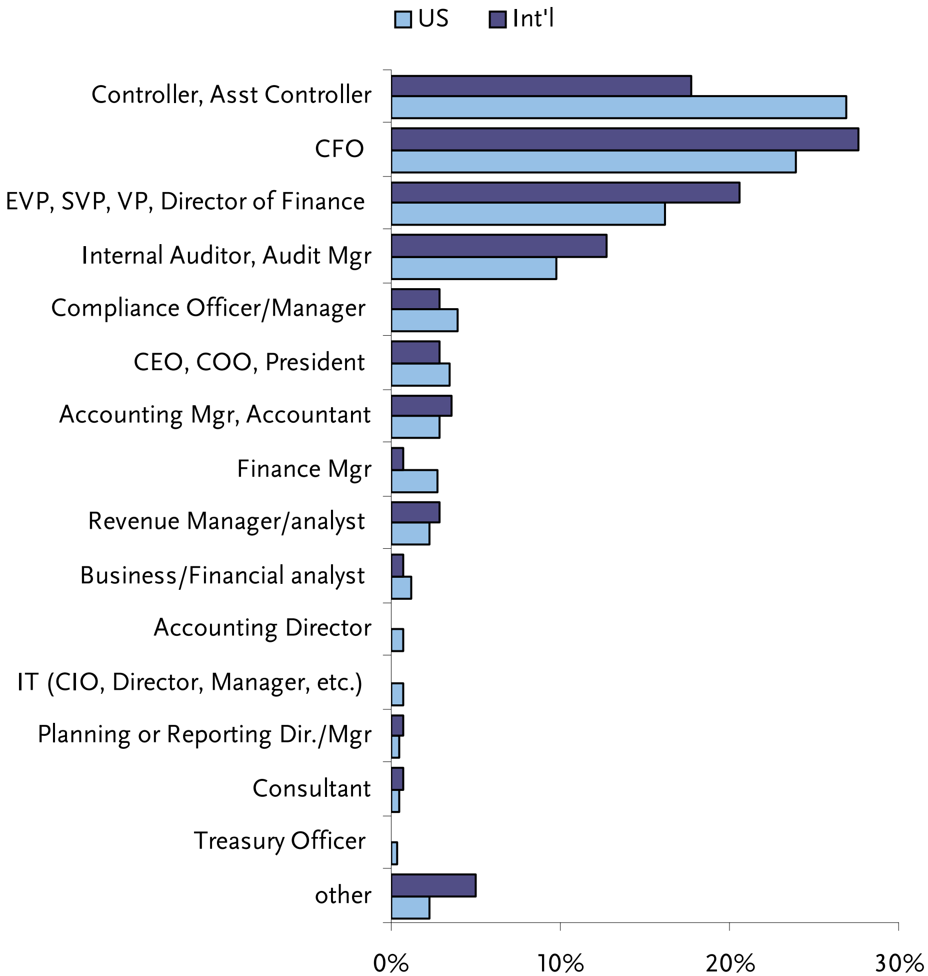
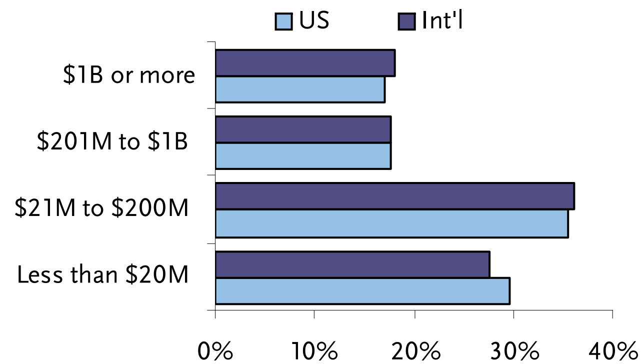


Figure 7
What was your company's approximate revenue?
(n= 511 US; 141 Int'l)



DEMOGRAPHICS

Figure 8
What is your company's main industry?
(n= 511 US; 141 Int'l)

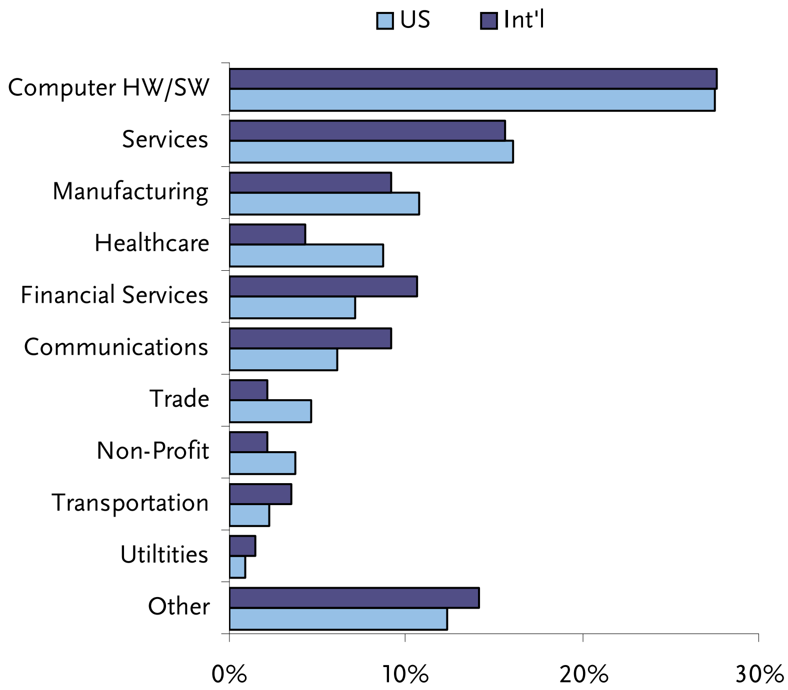
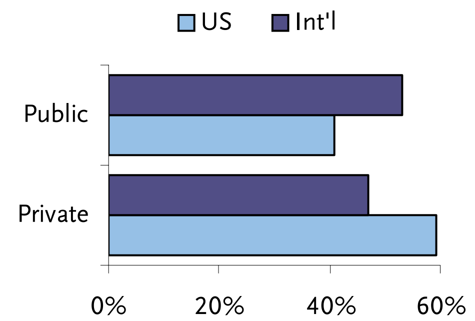


Figure 9
What is the ownership structure of your company?
(n= 511 US; 141 Int'l)



ABOUT REVENUERECOGNITION.COM

RevenueRecognition.com is dedicated to educating finance professionals on revenue management and related issues. The site focuses on revenue accounting; revenue recognition; revenue reporting and forecasting; internal controls; Sarbanes-Oxley compliance; SEC, FASB, and international accounting guidelines; contract management; and industry specific revenue challenges. Contact us at: info@revenuerecognition.com.

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