Revenue Recognition Accounting for Cloud Computing (SaaS)

October 17, 2012
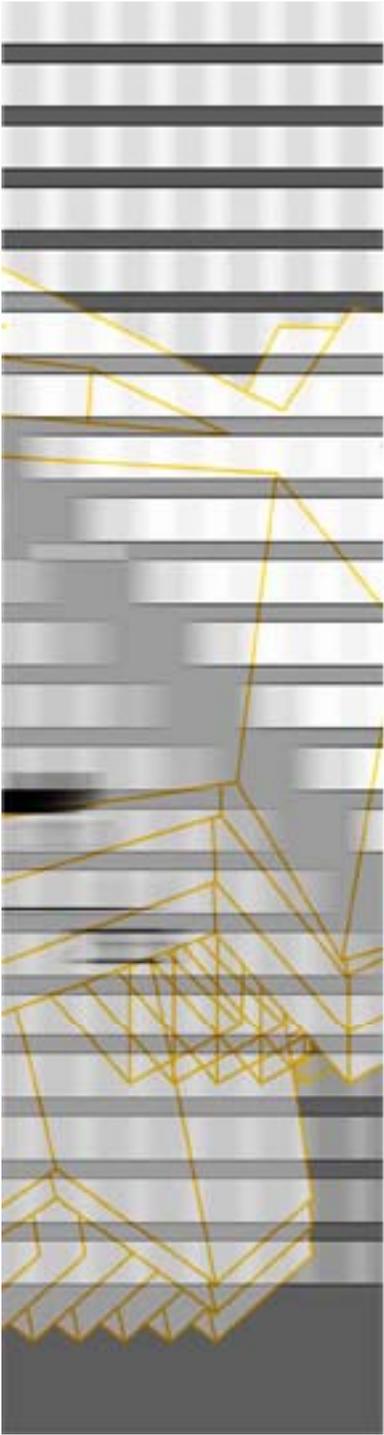
Presenter and Content for Today's Tensoft Executive Webcast Courtesy of:

Jeffrey Werner, Werner Consulting

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Welcome to Today's Event

- Viewing tips & CPE credit information

- About the webcast sponsor, Tensoft

- Introduction to today's speaker

- Presentation

- Q & A

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Viewing Tips & CPE Credit

- For "Full Screen," go to "View" on the Control Panel

- Submit questions any time using the "Question and Answer" pane

- CPE certificates will be emailed to everyone who is eligible within 1 week

- Slides and webcast recording available on Tensoft's Resource Center at www.tensoft.com
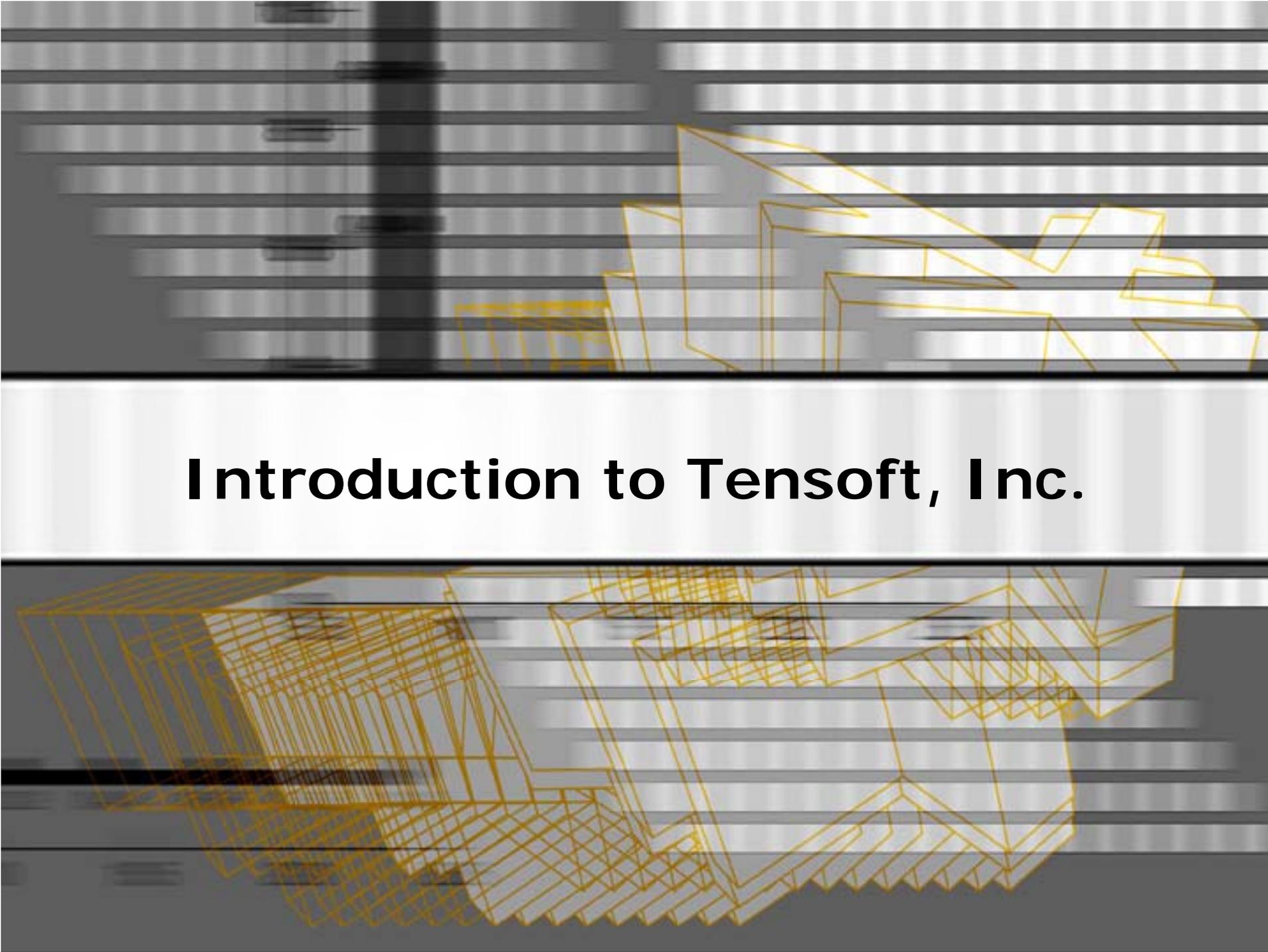
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Introduction to Tensoft, Inc.

Who is Tensoft?

Tensoft, Inc.

> Business software solutions provider

> Focus on technology companies

> Software for revenue management (RCM)

Tensoft RCM Product Line

> Complete revenue management suite

> Business model transaction flow support

> Billing management for contracts

> Visibility, Productivity, Compliance

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Tensoft RCM – Revenue Management

Website or CRM

RCM Contract

ERP Invoice

Sales Transaction

Revenue Rules

Determined Valuation

Revenue Base and Method

Document Flow

Revenue Sub-Ledger

To ERP

Reporting and Analytics
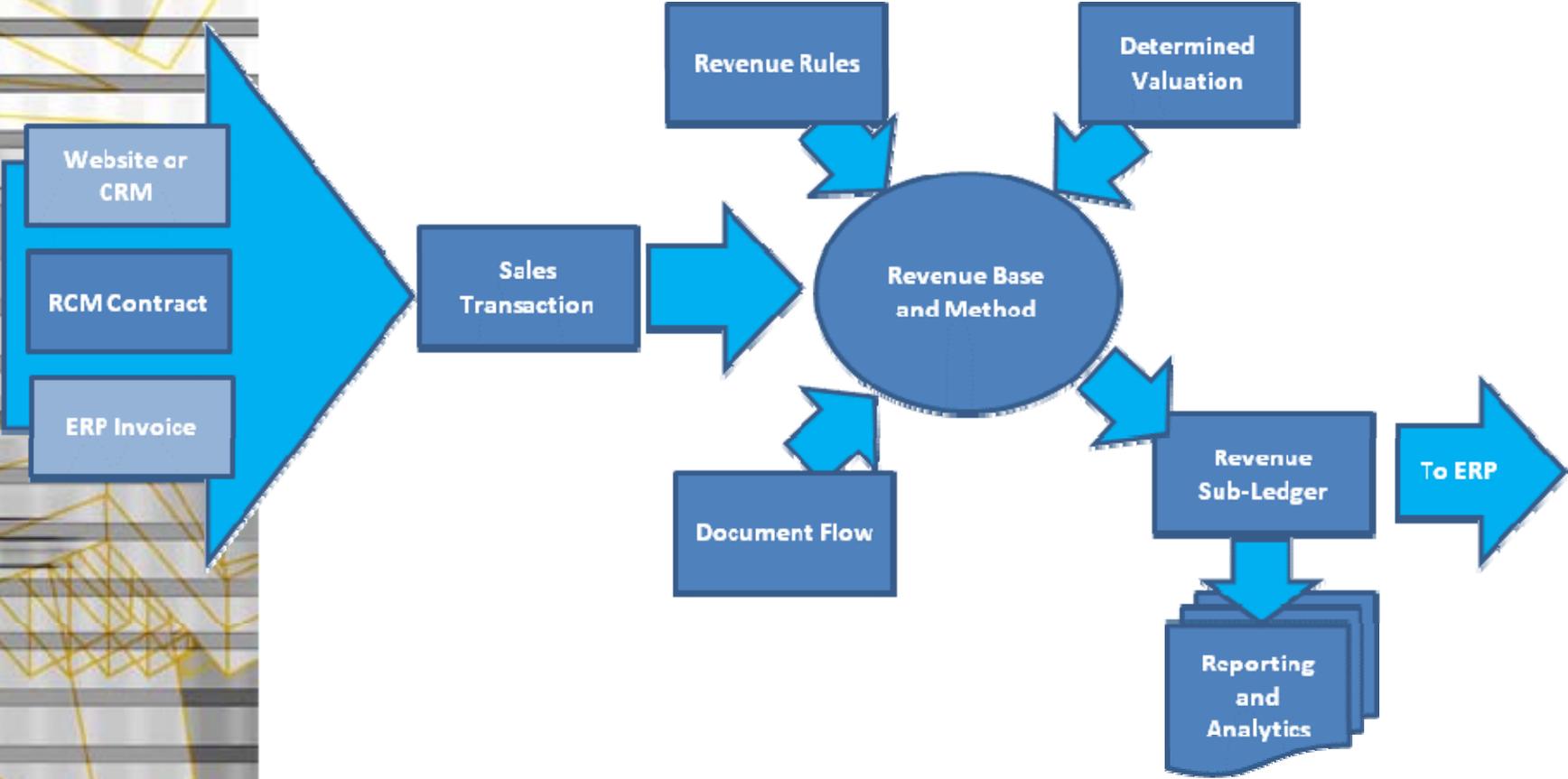
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Tensoft RCM - Revenue Management

Sales Transaction

- Generated based on Go-To-Market Model
- Generated from website, ERP, Tensoft RCM Contract

Revenue Basis

- Determination of policy for document type
- Revenue base determination
  - Sales Transaction Based
  - SOP 97.2 based – residual method
  - EITF 08-01 based – relative value method
- Revenue rules, sub-ledger, and analysis

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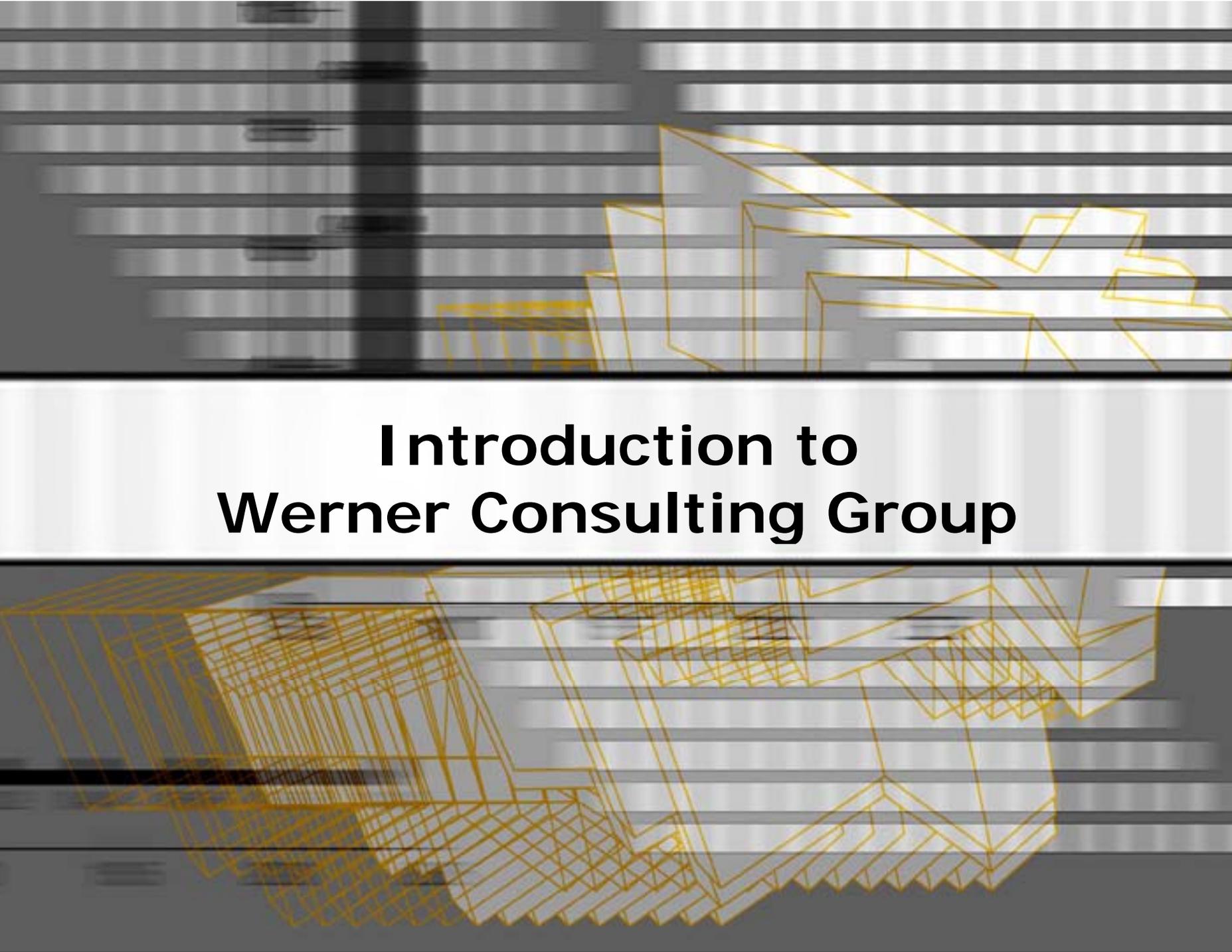
Introduction to
Werner Consulting Group

Werner Consulting Group

Jeffrey Werner
Werner Consulting Group
Revenue Recognition Consulting
Since 2001

Background
> Senior Manager KPMG 1987 - 1998
> VP Finance TelePost 1998 - 2000
> CFO Antrim Design 2000 - 2001

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Werner Consulting Group

Revenue Recognition Services Include:

> Pre-Contract Negotiations and Deal Structuring
> Post-Contract Review, Analysis and Accounting
> Best Practices Implementation
> VSOE Studies and Analysis
> Customized Training Classes
> Revenue Recognition Technical Research and Whitepapers
> Revenue Recognition Policy Implementation and Improvement
> Peak Demand Contract Review
> Revenue Management Outsourcing
> Audit Assistance
> Revenue Management Software Implementation
> EITF 08-1 Implementations

Revenue Recognition Class

Revenue Recognition Webcast

Tuesday November 13 Part One

    9 am – 12:30 pm PDT

Thursday November 15 Part Two

    9 am – 12:30 pm PDT

CPE Credit

Pay per attendance

Registration and details soon

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Revenue Recognition Class

Revenue Recognition

Agenda Day One

> General Principles of Revenue Recognition

> Multiple Element Arrangements

> VSOE

> Software Revenue Recognition

> Services and Contract Accounting

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Revenue Recognition Class

Revenue Recognition

Agenda Day Two

> Review - General Principles

> Services Contract Accounting

> Relative Selling Price Method (EITF 08-1)

> Cloud Computing (Saas)

> FASB IASB Revenue Project

> Other Rev Rec Issues

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Cloud Computing (SaaS) Outline

> Introduction

> Cloud Computing (SaaS) Business Model

> Cloud Computing (SaaS) Accounting

  When SaaS is Software

  When SaaS is Service

> Set Up Fees and Related Costs

> Consulting and Training Services

> Fees based on Usage

> Cloud Computing (SaaS) and Software MEA

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SaaS Business Model

History of Software as a Service

Application Service Provider (ASP)

Software as a Service (SaaS)

Cloud Computing
  The HOT new business model
  Recurring Revenue Model
  Use instead of owned / installed software

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SaaS Business Model

Cloud Services - SaaS

Applications

Platforms

Infrastructure

Other Services

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SaaS Business Model

Cloud Computing (SaaS)

Evolution of the Internet

Service vs ownership

SalesForce.com

Industry Leader

Made SaaS Acceptable

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SaaS Business Model

Software as a Service – SaaS

Customer Advantages

Easy to implement – ready to go, standard set-up

Low upfront cost

Cost over time – pay as you go

Vendor keeps it running – lower internal IT costs

Less administration of licenses – how many to buy

Automatic updates

Easy access over the internet – browser interface

Network based rather than PC based

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SaaS Business Model

Software as a Service – SaaS

Vendor Advantages

    Easier Sale – Lower Upfront Cost of Ownership

    Predictable Ratable Revenue

    Easy To Upgrade and Change Features

    Customers Locked in to Usage – hard to change to another Vendor

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SaaS Business Model

Software as a Service – SaaS

Customer Disadvantages

Mission Critical Resource in Control of Vendor

Data in Control of Vendor – Privacy Concerns

Uptime dependent on Vendor and Internet

Vendor Disadvantages

No One Time Large Sales Revenue

Must have customer service focus

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Cloud Computing (SaaS) Accounting

Accounting for Cloud Computing and SaaS Services

Revenue Recognition Changed
   ASU 2009-13
   Relative Selling Price Method

   Changes to what is a separate element
   Changes to allocation of revenue to elements
   Required in 2011

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Cloud Computing (SaaS) Accounting

Is it Software or Service?

Software

- Take possession – on customer server or right to take possession from vendor without significant costs
- Right and Ability to use without vendor
- Perpetual and Term right of use
- License Fees and Support Fees
- Upgrades – part of maintenance or upgrade fees
- Data at customer
- Contract may not be clear

Cloud Computing (SaaS) Accounting

Is it Software or Service?

Service

- Hosted by Vendor
- Monthly or Usage Fees
- Data on Vendor Server
- Data Transition or Conversion Rights at End of Use
- Right to Use only
- Significant additional cost to take possession
- Contract may not be clear

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Cloud Computing (SaaS) Accounting

Four Principles of Revenue Recognition

Persuasive Evidence of an arrangement exists

Delivery has occurred

The fee is fixed and determinable

Collectability is probable

Not ABC - CDEF

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Accounting for Elements of an Arrangement

Revenue Recognition Steps

1 – Separation into elements

2 – Allocation of revenue to elements

3 – Recognition of revenue

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Accounting for Elements of an Arrangement

Elements or Obligations of an Arrangement

Named in the contract

Require distinct action of vendor

Transaction price would vary if not included

Lack of performance reduces price / penalty

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Accounting for Elements of an Arrangement

Separation of the Elements

Individual elements are independent

- Functionally – one is not essential to the other
- Contractually – payments not linked or contingent
- No related refunds or rights of return

Individual elements have stand alone value

- Sold separately by any vendor
- Have resell value

If can't be separated, treat as one unit of accounting

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Accounting for Elements of an Arrangement

Allocation of Revenue to the Elements

Software revenue recognition uses the Residual Method

Service revenue recognition uses EITF 08-1 Relative Selling Method

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Accounting for Elements of an Arrangement

Residual Method - Software

Defer the full value of undelivered elements using Vendor Specific Objective Evidence (VSOE)

Allocate the remaining value or residual to the delivered elements

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Accounting for Elements of an Arrangement

Relative Selling Price Method (SaaS)

Allocate to each element based each element percentage of total (relative value)

Value is based on VSOE, TPE or ESP

Defer revenue for undelivered elements

Recognize revenue for delivered elements

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Accounting for Elements of a Cloud Computing (SaaS) Arrangement

SaaS – Multiple Element Arrangements

Subscription Fees

Set-up Fees

Implementation

Data Migration / Content

Consulting

Business Process

Training

Project Management

Usage Fees

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Accounting for Elements of a Cloud Computing (SaaS) Arrangement

SaaS – Multiple Element Arrangements

Is there Stand-Alone Value?

Often in SaaS the elements do not have stand alone value

Stand-alone value includes items sold separately by another vendor

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Up-Front Fees

SaaS – Up-Front Services (Set-Up Fees)

If Up-front services are a necessary and inseparable part of obtaining the services

If Up-front services have little or no value without the ongoing services

If Customer cannot buy the up-front services from another vendor

No stand alone value – account for as one element

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Set-up Fees

Currently no consensus on set-up fees

Some Companies and Auditors take the position that there is no stand alone value for set up fees and treat as one unit of accounting over the contract period

Some Companies and Auditors take the position that set up fees are an asset created for the customer that has value after the initial contract period and should be allocated revenue and the revenue recognized over the customer relationship period

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Up-Front Fees and Costs

Costs that are incremental and directly related to up-front services should be accounted for either:

- Expensed as incurred, or

- Deferred and charged to expense proportionally over the over the same period as the related revenue

The accounting is an option of the vendor and should be applied consistently

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Accounting for Elements of an Arrangement

Usage Fees Revenue Recognized When
Usage occurs

Monthly fees with usage fees
like cell phone bills
set number of minutes, overage
no rollover to next period

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Accounting for Elements of an Arrangement

Example # 1

Vendor sells online service

$12,000 $1,000 monthly service fee - one
year contract

Renewable in year two for $12,000

$10,000 Consulting – 5 days at $2,000 day
VSOE

$22,000 Total Transaction Fee

Does the Consulting have a separate value from
the monthly service?

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Accounting for Elements of an Arrangement

Example # 1 –

$ 1,000 monthly service fee - VSOE

$10,000 Consulting

Defer monthly fee at VSOE

Recognize service fee $1,000 monthly

Recognize Consulting when completed (assuming Consulting has separate stand-alone value)

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Accounting for Elements of an Arrangement

Example # 2 Relative Selling Price Method

Vendor sells online service

$12,000	$1,000 monthly service fee - one year contract
	Renewable in year two for $12,000
$ 8,000	Consulting - $2,000 day VSOE discounted
$20,000	Total Transaction Fee

Account for based on relative value

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Accounting for Elements of an Arrangement

Example # 2 – Relative Selling Price Method

$12,000 55% Subscription VSOE/ESP Value
$10,000 45% Consulting – VSOE/ESP Value
$22,000 100%

$11,000 55% Subscription Revenue
$ 9,000 45% Consulting Revenue
$20,000 100% Total Revenue

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Accounting for Elements of an Arrangement

SaaS – Multiple Element Arrangements
That include SaaS, Products and Software

Separate and Allocate under EITF 08-1

Then Recognize based on type of element
Product
Service
Software
SaaS
Etc

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SaaS and Software

> **Example Facts – Software and SaaS**

> A Software Company enters into an arrangement with a customer to delivery software License A, support on License A, one year SaaS service B and other services.

> **Contract Elements and Pricing**

$ 100,000 License A

$ 20,000 Support on License A

$ 50,000 SaaS Service B

$ 30,000 Services

$ 200,000 Total Contract Price

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SaaS and Software

> Example – Software and SaaS

> Element Values

  $ 130,000 License A based on ESP

  $ 20,000 Support on License A based on VSOE

  $ 60,000 SaaS Service B based on VSOE

  $ 40,000 Services based on VSOE

  $ 250,000 Total Element Values

> Relative Values

  $ 130,000   52% License A

  $ 20,000   8% Support on License A

  $ 60,000   24% SaaS Service B

  $ 40,000   16% Services

  $ 250,000 Total Element Values

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SaaS and Software

Example – Software and SaaS Revenue Allocation

$ 104,000	52%	License A
$ 16,000	8%	Support on License A
$ 48,000	24%	SaaS Service B
<u>$ 32,000</u>	16%	Services
$ 200,000		Total Contract Price

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More Examples - Software & SaaS

> Example – Software and SaaS

> Revenue Recognition - software

    $100,000 License A on delivery

    <u>$ 20,000</u> Support ratably over one year at VSOE

    $120,000 Total Contract Price revenue

> Revenue Recognition – non-software

    $ 48,000 SaaS Service B ratably over one year

    <u>$ 32,000</u> Services as provided on a daily basis

    $ 80,000 Total non-software revenue

    $200,000 Total revenue

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Cloud Computing (SaaS) Recap

> Cloud Computing (SaaS) Accounting

    When SaaS is Software

    When SaaS is Service

> Multiple Element Arrangements

> Set Up Fees and Related Costs

> Consulting and Training Services

> Fees based on Usage

> SaaS and Software MEA

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Additional questions or comments?

Please contact:

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Werner Consulting Group

Revenue Recognition Consultant

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Thanks for Joining Us Today for "Revenue Recognition Accounting for Cloud Computing (SaaS)"