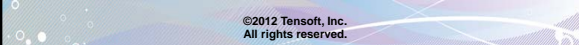



FASB IASB Exposure Draft: Revenue from Contracts with Customers

An Executive Webcast With Jeffrey Werner




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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: "FASB IASB Exposure Draft: Revenue from Contracts with Customers"**
- Q & A




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Questions / Slides

- Submit questions any time using the "Question and Answer" pane
- Submit questions after the webcast to Jeffrey Werner, wernerj@sbcglobal.net, or to Caprice Murray, caprice@tensoft.com.
- Questions and responses by email and on Tensoft Blog
- Slides will be available to download after the presentation



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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
- Billing management for contracts
- Business model transaction flow support
- Visibility, Productivity, Compliance




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Tensoft Vital Statistics

- *Customer Demographics*
 - Locations Worldwide – North America & EMEA
 - Pre-revenue to Large Public Companies
- *Tensoft Organization*
 - Founded in 1996
 - Silicon Valley: Corporate Headquarters
 - Operations Spanning 3 Continents (North America, Europe, Asia)
- *Industry Knowledge*
 - Tensoft Product Stack: Cloud based applications, Industry specific functionality, Focus on Visibility, Productivity, and Compliance
 - Experience with 150+ **Technology Clients**
 - Technology Industry Subject Matter Consultants



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Tensoft RCM Revenue Management

Sales Transaction

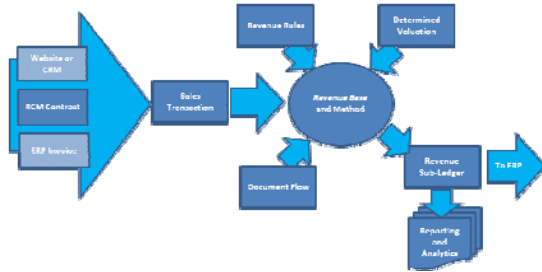
- Generated based on Go-To-Market Model
- Generated from website, ERP, Tensoft RCM Contract

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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Tensoft RCM Revenue Management



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Today's Presenter:

Jeffrey Werner,
Werner Consulting Group

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Introduction to 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

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Agenda

- **Overview – Who, What, When, Where, Why**
- **Process and Scope**
- **Exposure Draft Outline**
- **Five New Principles of Revenue Recognition**
- **Differences from Current US GAAP**
- **Implementation Guidance**
- **Effect of Changes on Technology Companies**

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• Overview

Who Is Issuing the Exposure Draft?

What Is the Exposure Draft?

When Is the Exposure Draft Final and Effective?

Where Is the Exposure Draft Effective?

Why Is This Happening?

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Who Is Issuing the Exposure Draft?

- Jointly issued by the FASB (US) and IASB (Worldwide)
- Will be part of US GAAP when final
- Will be part of IFRS when final

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What Is the Exposure Draft?

- A 217 page set of proposed accounting standards for revenue recognition
- Currently in second round of review for comments prior to finalization by FASB & IASB
- Copies at FASB.org
 - webcast, podcast, roundtable schedule

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When Is the Exposure Draft Final and Effective?

- Exposure draft planned to be final sometime in 2012
- Effective date is planned for no earlier than 2015
 - Although one or two prior years will be required

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Where Will The Proposal Be Effective?

- The new standard when adopted will be required accounting:
- In the US under US GAAP issued by the FASB
- In Countries following IFRS
 - (more than 113 countries Worldwide)

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Why Is This Happening?

- Part of ongoing process to align or “harmonize” accounting worldwide
- To establish one comprehensive revenue recognition approach for all customer contracts
- Remove current inconsistencies
- Improve comparisons between companies
- Provide more information and disclosures
- Simplify accounting and guidance

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• Process

- Years of discussions
- Exposure Draft # 1 June 2010
- Comment period closed October 2010
- Exposure Draft # 2 November 2011
- Second Comment period closes March 13, 2012
- Issue final standard in 2012
- Effective Date to be determined
 - No earlier than January 2015

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• Scope

All Contracts with customers
(except those covered by another rule
Leases, Insurance and Financial
Instruments)

Retrospective adoption

Requires 2 or 3 years comparable
presentation so start 2013 or 2014 if effective
in 2015

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Exposure Draft Outline

- Summary (pages 1 – 10)
- Proposed Guidance (pages 11 – 42)
- Proposed Implementation Guidance and Examples (pages 43 – 85)
- Background Information, Basis for Conclusions (pages 89 -209)
- Appendices and other (pages 210 – 217)

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Summary of Proposed Guidance

- Five Steps to Revenue Recognition
- Constraints on cumulative amount of revenue recognized
- Onerous Performance Obligations (loss contracts)
- Contract Costs
- Disclosures
- Effective Date
- Questions for Respondents

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Implementation Guidance

- Sale with right of return
- Warranties
- Principle versus agent
- Customer options for additional goods and services
- Customer unexercised rights
- Nonrefundable upfront fees
- Licensing and rights to use
- Repurchase agreements
- Consignment arrangements
- Bill and hold arrangements
- Customer acceptance

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Background Information, Basis for Conclusions and Alternative Views

- BC1 – BC 300
- Definitions
- Reasoning on proposed guidance
- Additional details on proposed guidance

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Current Revenue Model

- Four Principles of Revenue Recognition
 - Evidence of Arrangement
 - Fixed and Determinable Fee
 - Delivery
 - Collectability

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New Revenue Model

Core Principle

- "Recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services"
- Five Steps to Apply Core Principle

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• Current Revenue Model

- Residual and Relative Selling Price Methods
- Industry Specific Methods

• New Revenue Model – 5 Steps

- Relative Selling Price Method Only
- Allocation on Relative Value
- Discount Applied to all Elements

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Five Steps to Revenue Recognition

- Identify the Contract with Customer
- Identify the Separate Performance Obligations
- Determine Transaction Price
- Allocate Transaction Price to Obligations
- Recognize Revenue on Satisfaction of Performance Obligation

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Identify the Contract with Customer

- Commercial Substance
- Parties have approved
- Identifiable rights and obligations on goods or services
- Identifiable payments terms

Combination of Contracts

Contract Modifications

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Identify the Separate Performance Obligations

- Identify distinct goods and services
- Distinct if sold separately
- Distinct if customer can benefit independently of other elements or customer can combine with other resources
- Treat as one obligation if performed together or at same time

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Determine Transaction Price

- Amount vendor expects to be entitled to in transaction
- Variable consideration
- Time value of money
- Non cash consideration
- Consideration payable to customer

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Allocate Transaction Price to Obligations

- Determine stand alone selling price of each performance obligation at contract inception
- Estimate stand alone selling price if not readily available
 - Adjusted market assessment approach
 - Expected cost plus margin
 - Residual approach (if highly variable or uncertain)

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Allocate Transaction Price to Obligations

- Allocate revenue based on the relative value
- Discounts and contingent revenue may relate to a specific contract obligation and therefore may be applied to that contract obligation
- Adjust for changes in contract price after inception on same basis as original allocation

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Recognize Revenue on Satisfaction of Performance Obligation

- Recognize each performance obligation as it is satisfied
- Over a period of time or a point in time
- Obligations are satisfied when the vendor transfers control of the good or service to the customer

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Control is transferred to the customer over time when:

- An asset is created or enhanced and the customer controls the asset or enhancement
- No asset is created but
 - Customer receives and consumes the benefit as the vendor performs the service
 - Another entity would not need to re-perform the work completed if another entity fulfilled the remaining portion of the obligation
 - Vendor has the right to payment for performance completed to date and expects to get payment

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Control is transferred to the customer at a point in time when:

- Vendor has right to payment for asset
- Customer has legal title to asset
- Vendor transferred physical possession to customer
- Customer has the significant risks and rewards of ownership of the asset
- Customer has accepted the asset

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What's Different from Current GAAP?

- Evidence of Arrangement
- Delivery
- Delivery on "Transfer of Control" to Customer
- Collectibility
- Credit Risk
- Fixed and Determinable Amounts
- Variable and contingent revenue is estimated instead of deferred
- Multiple Element Arrangements
- Constraints on Revenue Recognized
- Revenue over time / point in time
- Contract Modifications

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- **What's Different from Current GAAP?**
 - Significant Use of Estimates
 - Significant increase in Disclosures
 - Determining value of elements
 - Allocation of revenue to elements
 - Relative Selling Price Method Allocation of Revenue
 - Time Value of Money (revised to greater than 1 year)
 - Collectability is estimated and reduces revenue
 - Re-measurement and Adjustments to recorded revenue
 - Disclosures

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- | <u>Current Revenue Model</u> | <u>New Revenue Model</u> |
|--|---|
| Evidence of Arrangement | Contract exists |
| <ul style="list-style-type: none"> • Persuasive evidence • Written contracts • Signed | <ul style="list-style-type: none"> • Oral, written, implied • Commercial substance • Parties approved and committed to perform • Rights are identifiable • Payment terms are identifiable. |

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- | <u>Current Revenue Model</u> | <u>New Revenue Model</u> |
|--|--|
| <u>Delivery</u> | <u>Performance</u> |
| <ul style="list-style-type: none"> • Substantive performance • Risks and Rewards pass to customer • Acceptance • Point in time / over time • Multiple Element Rules | <ul style="list-style-type: none"> • Goods or services transferred to customer • Transfer of control: <ul style="list-style-type: none"> – Right to payment – Passage of legal title – Physical possession – Risks and rewards – Customer acceptance |

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- | <u>Current Revenue Model</u> | <u>New Revenue Model</u> |
|--|--|
| <u>Collectibility</u> | <u>Credit Risk</u> |
| <ul style="list-style-type: none"> • Must be collectible to recognize • Defer if uncollectible or not reasonably assured • Cash basis if collectibility a concern | <ul style="list-style-type: none"> • No deferral of revenue • Recognize amount expected to be entitled • If significantly in doubt, the contract may not exist • Impairment presented as item in revenue |

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- | <u>Current Revenue Model</u> | <u>New Revenue Model</u> |
|---|---|
| <u>Fixed and Determinable</u> | <u>Expected Amount</u> |
| <ul style="list-style-type: none"> • Recognize only fixed and determinable amounts • Contingent revenue deferred for potential reductions • Potential increases when occur | <ul style="list-style-type: none"> • Recognize estimated amount • Expected value or • Most likely amount • Estimate variable revenue • Future period adjustments |

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- | <u>Current Revenue Model</u> | <u>New Revenue Model</u> |
|--|---|
| <u>Multiple Elements</u> | <u>Distinct goods or services</u> |
| <ul style="list-style-type: none"> • Stand alone value • Right of return under vendor control • Sold separately • VSOE in Software | <ul style="list-style-type: none"> • Sold separately • Customer benefit of element on own or with other available resources |

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<p><u>Current Revenue Model</u></p> <p><u>Defer revenue</u></p> <ul style="list-style-type: none"> • If not fixed and determinable • Contingent revenue deferred • Contingent vs allocated revenue • Software – VSOE required for undelivered elements 	<p><u>New Revenue Model</u></p> <p><u>Constraint on revenue</u></p> <ul style="list-style-type: none"> • Estimate variable revenue • Reasonably assured revenue • Relevant, predictive experience with similar items • Adjust estimates in subsequent periods
---	--

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<p><u>Current Revenue Model</u></p> <p><u>Revenue over time</u></p> <ul style="list-style-type: none"> • Straight line, unless different pattern • Proportional performance • Percentage of completion <ul style="list-style-type: none"> – Reasonable dependable estimates – Enforceable right to payment 	<p><u>New Revenue Model</u></p> <p><u>Revenue over time</u></p> <ul style="list-style-type: none"> • Control transferred to customer • Customer asset has no alternative use and <ul style="list-style-type: none"> – Customer benefits – Another entity not have to re-perform to finish project • Otherwise recognize at a point in time
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<p><u>Current Revenue Model</u></p> <p><u>Revenue at point in time</u></p> <ul style="list-style-type: none"> • Delivery is complete • Customer acceptance • Rights and Risks transferred • Impact of undelivered elements <ul style="list-style-type: none"> – Lack of standalone value – Lack of VSOE 	<p><u>New Revenue Model</u></p> <p><u>Revenue at point in time</u></p> <ul style="list-style-type: none"> • Vendor right to payment • Customer has legal title • Customer has physical possession • Customer has significant risk and rewards • Customer acceptance
---	---

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<p><u>Current Revenue Model</u></p> <p><u>Contract modifications</u></p> <ul style="list-style-type: none"> • Account on a go forward basis • Concessions if additional goods or services without consideration • Estimates and contingent amounts recognized when occur 	<p><u>New Revenue Model</u></p> <p><u>Contract modifications</u></p> <ul style="list-style-type: none"> • Change in price after inception, adjust price in same as original allocation (+ & -) • New contract if <ul style="list-style-type: none"> – New goods and services are distinct – Consistent with stand alone selling price
--	---

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<p><u>Current Revenue Model</u></p> <p><u>Determining value of elements</u></p> <ul style="list-style-type: none"> • Multiple Elements <ul style="list-style-type: none"> – VSOE – TPE – ESP • Software <ul style="list-style-type: none"> – VSOE 	<p><u>New Revenue Model</u></p> <p><u>Determining value of elements</u></p> <ul style="list-style-type: none"> • Adjusted market assessment • Expected cost plus margin • Residual (if highly variable or uncertain)
--	--

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<p><u>Current Revenue Model</u></p> <p><u>Allocation of Revenue</u></p> <ul style="list-style-type: none"> • Relative Selling Price Method • Residual Method • Other Industry specific 	<p><u>New Revenue Model</u></p> <p><u>Allocation of Revenue</u></p> <ul style="list-style-type: none"> • Relative stand alone selling price
--	---

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Current Revenue Model

IP Licenses, Software

- Revenue when license term begins
- Different recognition for different industries
- Over time
- Point in time

New Revenue Model

License and Right to Use

- Revenue when license period begins
- Revenue at point in time unless:
 - Fee sales based
 - Constraint by reasonably assured criterion
 - Right to use is combined with other obligations (not distinct)

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Current Revenue Model

Contract Costs

- Depends on transaction and specific industry
- Incremental direct costs incurred related to acquisition capitalized and expensed

New Revenue Model

Contract costs

- Recognize asset for incremental costs to obtain contract if recoverable
- Capitalized costs recognized consistent with the related revenue
- If one year or less, expense

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Current Revenue Model

Disclosures

- General requirements
- Specific requirements
 - Multiple elements
 - Non monetary
 - Bill and hold
- Industry requirements

New Revenue Model

Disclosure

- Contracts with customers
- Significant judgments and changes in judgments
- Assets recognized from costs
- Reconciliation of revenue balances

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• **Reconciliation of revenue balances**

- Recognition from performance satisfaction
- Recognition from adjustments
- Cash received
- Amounts transferred to A/R
- Non-cash consideration
- Effects of business combinations
- Additional line items necessary to understand changes in contract assets and revenue recognized

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Current Revenue Model

Time value of money

- Generally not an element of revenue recognition

New Revenue Model

Time value of money

- Consider whether there is a significant financing component
- Time value of money calculation unless period between delivery or transfer and payment is one year or less

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• **Effect of Changes On Companies**

- Retrospective Adoption
- One Method for All Contracts
- ERP and Accounting Systems
- Revenue Recognition Policies and Processes
- Development of best practices
- Evolution of auditor and regulatory agencies views
- Acceleration of Revenue
- More flexibility on estimates
- Estimates vs Objective values
- Estimates for all elements
- Transfer of control issues

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- **Effect of Changes On Companies**
 - Software companies adopt relative selling price
 - Software PCS as separate deliverables
 - Software use of Residual Method
 - Residual method for only one item
 - New Revenue Recognition Policy and Model
 - Revenue Recognition Policies and Processes
 - Development of best practices
 - Evolution of auditor and regulatory agencies views
 - Disclosures
 - Estimates
 - Stand alone value / Distinct Obligations
 - Revenue Reconciliation

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- **What you need to consider**
 - New Rules Independent of Adoption of IFRS
 - When issued by FASB will be US GAAP
 - Retrospective Adoption
 - Must present all years in first financials
 - 2 years private companies
 - 3 years public companies
 - Calculate revenue both ways in years before transition
 - Accounting System Changes
 - Both ways in transition years
 - Current Systems may not be able to address new methods
 - Plan Ahead

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Additional questions or comments?

Please contact:

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Revenue Recognition Consultant

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Revenue from Contracts with Customers
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