The New Revenue Recognition Rules:

Industry Considerations and Cross-Functional Implications

July 23, 2015

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FEI Resources on Revenue Recognition

Find additional resources on revenue recognition, including webcasts and more at:
www.financialexecutives.org/revrec

Speakers

Jeff Anderes is currently the Senior Director – Accounting Policy in the Global Controller's Office of Wal-Mart Stores, Inc. (Walmart). He leads Walmart's technical accounting team that is responsible for global accounting policies, technical accounting requirements and other accounting policy related projects.

Prior to joining Walmart, Jeff spent approximately 14 years with PwC in their business assurance practice. During this time, Jeff performed a two year assignment in PwC's National Office in the SEC Services Group where he consulted on complex SEC and financial reporting issues. Jeff also served as the senior manager responsible for PwC's participation on the AICPA SEC Regulations Committee.

Jeff holds his CPA license in Nevada and is a member of the American Institute of Certified Public Accountants.

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Speakers

Curtis Baron joined Crane Co. as the Assistant Corporate Controller in August 2007 and was promoted to Vice President, Controller in December 2011. His responsibilities include the internal and external financial reporting for Crane, corporate accounting (including asbestos, environmental and other significant reserves), the HFM financial system and the coordination of the external audit process with Deloitte & Touche. Prior to joining Crane, Curtis worked at Paxar Corporation as their Assistant Corporate Controller (2005 to 2007) and Manager of International Accounting (2003 to 2005). From 1997 to 2003, Curtis was employed by Pepsi Bottling Group, most recently as a Financial Systems Project Lead. From 1991 to 1997, Curtis was with Ernst & Young, last serving as Manager in their audit services practice.

To learn more about Crane Co., visit www.craneco.com.

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Speakers

Mark Flournoy has served as Vice President, Corporate Controller and Chief Accounting Officer of Intuit Inc. since 2012. His areas of responsibility include general accounting functions, internal and SEC financial reporting, corporate governance and internal controls, staff management and training, software and SaaS revenue recognition, mergers, acquisitions and divestitures, systems implementations for accounting and order to cash areas. He joined Intuit in 2003 as director of general accounting and internal controls and was named Corporate Controller in 2012. From 1996 to 2003, Mr. Flournoy served as a corporate controller for various private and public companies in California. He began his career in public accounting at Ernst & Young, where he served from 1992 to 1996.

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Speakers

Pete Graham is currently the Director, Finance Solutions and Mobility at SAP. He currently leads multiple finance and accounting topics including revenue recognition and lease accounting. He is actively working with customers as they tackle the revenue accounting standards with SAP Revenue Accounting and Reporting.

Pete frequently helps customers and partners understand the latest information about next-generation in-memory solutions like SAP S/4 HANA & SAP Simple Finance and how SAP S/4 HANA & SAP Simple Finance allows any business to Run Better.

Pete also works with SAP customers, colleagues, and partners to bring new financial solutions to the market. He has over 15 years of experience in the enterprise software industry in a variety of Product Strategy, Finance, and operational roles.

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Speakers

Russ Collins is a Managing Director in the Dallas office of Protiviti, where he has been since 2005. He has over 25 years of experience providing business consulting and financial reporting services to clients in various industries, primarily consumer products and services entities. He also leads the Public Company Transformation Practice in Texas. Prior to joining Protiviti in June 2005, Russ spent his career in public accounting, most recently as an external audit partner with KPMG for three years. Prior to KPMG, Russ was a partner at Arthur Andersen in their external audit practice. Russ is a CPA and a graduate of Baylor University. He and his wife Julie have three children. He also serves on the boards of three not-for-profit organizations.

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Speakers

Steve Hobbs is a Managing Director in the San Francisco office of Protiviti and is the global leader of the firm's Public Company Transformation solution. He has over 30 years of experience providing business consulting and financial reporting services to clients in various industries, primarily technology and consumer products entities. Prior to joining Protiviti in 2006, Steve was a partner at KPMG for three years and spent nearly 20 years at Arthur Andersen, where he was also a partner. He has served on the board of directors at three companies, one as Chairman and two as Audit Committee Chair. Steve has served over 100 public companies during his career with assistance in corporate governance, financial reporting, and numerous business transformation issues.

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Speakers

Gordon Tucker is a Managing Director with Protiviti and has over 30 years of experience providing management consulting, internal and external audit services to Technology, Software, Internet, and Life Science companies. His client experience includes serving companies ranging in size from IPO to Global 1000. Gordon leads Protiviti's Bay Area practice and also the firm's Technology, Media and Communication Industry and is responsible for the creation and delivery of thought leadership and services to industry practitioners and their clients.

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Speakers

Chris Wright, from Protiviti's New York office, is the firm-wide Managing Director of our Finance Remediation and Reporting Compliance group. Chris is also the Regional Managing Director for Protiviti's Eastern Region in the United States. He has over twenty-five years of experience serving clients as an external auditor, including 6 years as a partner at two global accounting firms (Arthur Andersen and KPMG), and as an internal auditor and financial reporting risk consultant.

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Revenue Recognition Webinars

Webinar Series

Protiviti and FEI are pleased to offer a five-part webinar series on the new Revenue Recognition Standard, recently issued by the Financial Accounting Standards Board (FASB). Participants will learn how to implement an appropriate transition plan to the new standard and why this plan must be cross-functional in nature. These webinars occurred approximately every 60 days November 2014 though July 2015.

Revenue Recognition Webinars

- Listen to the recorded version of our four previous revenue recognition webinars: http://www.protiviti.com/revenuerecognition
- Past webinar topics:
  - **Webinar #1** – Revenue Recognition: It's Here, Are You Ready? Transitioning to the New Revenue Recognition Standard
  - **Webinar #2** – Revenue Recognition: The People Elements – A Collaborative and Cross-Functional Collaboration Process
  - **Webinar #3** – Revenue Recognition: Using a Methodology to Identify Gaps in Current Business Processes
  - **Webinar #4** – The New Revenue Recognition Rules: Systems, Data, Reporting and a Transparent Audit Trail

Today We Will Cover…

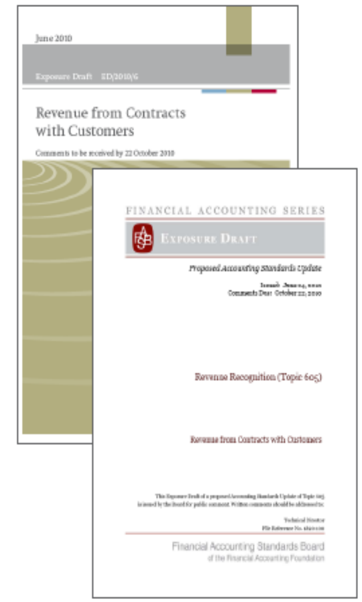
- New Standard Update
- Cross-Functional Impact
- Industry Considerations
- Q&A

New Standard Update

New Revenue Recognition Standard – Overview

Final Standard Released May 28, 2014

- As expected, on July 9, the Financial Accounting Standards Board (FASB) approved a one-year deferral of the effective date of the new revenue recognition standard it has developed in collaboration with the International Accounting Standards board (IASB)
- IASB also delayed the IFRS 15 adoption by 1 year to be aligned with the FASB



Transition Approaches

- Retrospective, or
- Cumulative effect at the date of adoption

Objective of project

- Achieve a single, comprehensive revenue recognition model

Removes existing industry specific guidance

Expands qualitative and quantitative disclosures

Still a lot of uncertainty on the impact of this new standard

Core Principle: Revenue recognition depicts transfer of promised goods or services to customer in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services

Impact on Public and Private Companies

Public Companies

- In the original release, the new standard is effective for fiscal years including interim periods beginning after December 15, 2016
- The deferral requires application of the new standard no later than annual reporting periods beginning after December 15, 2017, including interim reporting periods therein
  - ✓ For example, a calendar year reporting company would now be required to apply the new standard during 2018, including the interim periods therein

Private Companies

- The standard, as originally issued, is expected to be effective for fiscal years beginning after December 15, 2017, and interim periods thereafter
- Now requires application of the new standard no later than annual reporting periods beginning after December 15, 2018, including interim reporting periods therein
  - ✓ For example, a calendar year reporting company would be required to apply the new standard during 2019, including the interim periods therein

What Does the Deferral Mean?

1 **Not a Surprise**

Not only was it expected, but it has been an assumption baked into the planning and implementation practices among many companies that have started the transition to the new standard in earnest

2 **“Full Steam Ahead”**

Public companies should continue to work on transitioning to the standard, especially for those who many not have begun working on the transition process

3 **Over Half of the Year is Gone**

The only delay is in the effective date of the standard; there should be no delay in management’s efforts to position the organization in a prudent state of readiness

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Cross-Functional Impact

Revenue Recognition – Transition Strategy Roadmap

Each conversion project is a change management process that runs through multiple phases. Every phase can be addressed in a structured way.

Phase I – Preliminary Diagnostic

- Step I – Preliminary Diagnostic
- Step II – Develop Project Management

Phase II – Project Implementation

- Step III – Detailed Project Set Up
- Step IV – Detailed Gap Analysis/Transition Method

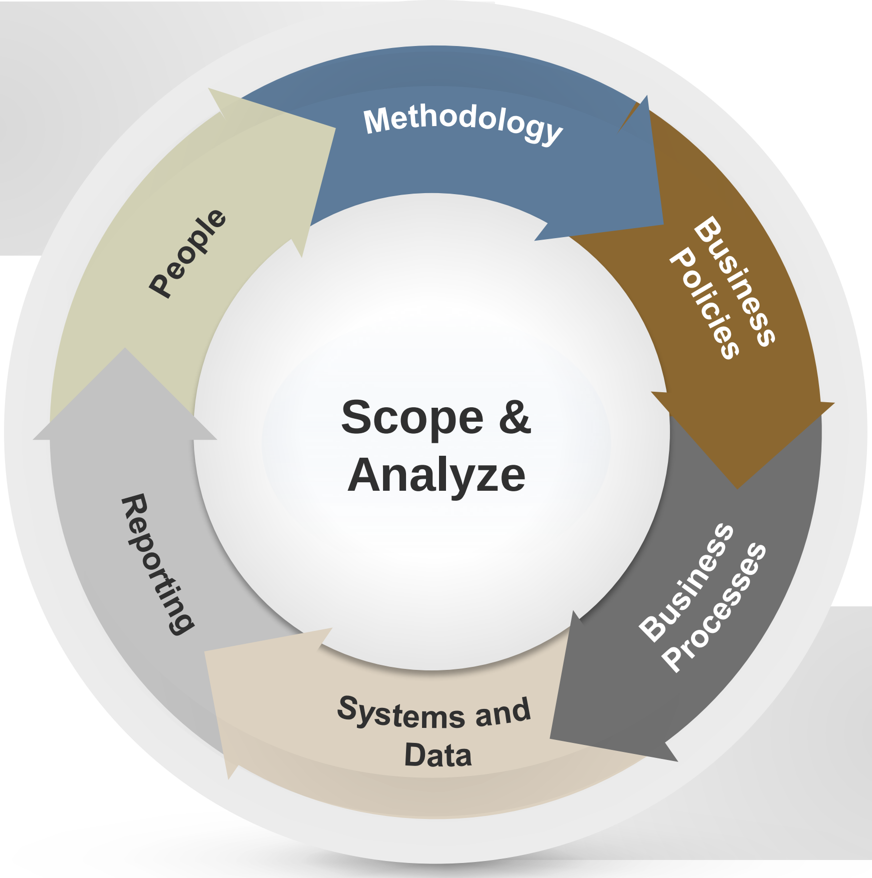
Phase III – Embedding

- Step V –Transition Year 1 Reporting
- Step VI –Integrate Change & Ongoing Compliance

Deliverables

What Does This Mean to Me?

During the **Scope and Analyze Phase**, it is important to consider the implications to your organization's infrastructure. You can do this by using the Protiviti Six Elements of Infrastructure Model.



Revenue Recognition – Impact on Six Elements of Infrastructure

Methodology
- Gap analysis
- 5 step analysis framework
- Transition strategy – PMO
- Update risk assessment and/or control framework
- Cross functional awareness, training and deployment
- Multiple-performance obligations revenue allocation
- Consistent performance measures/metrics

Business Policies
- Transition - retrospective vs cumulative effect
- Impact on contracting, pricing, performance obligations
- Update documented policies and guidelines
- Judgment considerations – evidence of an arrangement, collectability
- Established materiality thresholds

Business Processes
- Transition timeline defined and monitored
- Identify processes impacted – contracting, order entry, deal desk, revenue allocation, reporting, forecasting
- Identify performance metrics to track/control the Rev Rec process
- IA/SOX program modifications
- Clearly-defined review/approval processes

Systems and Data
- Determine data elements allowing systems to process automatic and judgmental rules differently
- Define integration points between contracts T&Cs/ sales orders
- Define revenue allocation rules based on contract groupings
- Design solutions to rebuild the current systems and support multiple/ parallel rev rec principles

Reporting
- Significant new disclosures – quantitative and qualitative
- Updated executive level dashboards and performance metrics
- Revenue allocation drill-down capabilities that enable quick reference to supporting detail
- Transparent audit trail

People
- Identify cross-functional collaboration team
- Appropriate segregation of duties for key revenue/issue resolution
- Clearly defined responsibility and accountability framework linked to periodic performance evaluations
- Training on policies, procedures, and enabling tools

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A Cross-Functional Impact

Methodology → Business Policies → Business Processes → Systems and Data → Reporting → People

HR	Accounting/Finance	Internal Audit	Treasury
• Metrics for measuring performance • Sales commission, compensation and bonus plans • Resources required by all areas to ensure compliance during transition • Training • Target staffing operating model (ongoing)	• Accounting policies and procedures • Forecasts, budgeting and financial metrics • Analytical reviews • Data accuracy • Financial reporting of results and associated disclosures (reconciliation of contract balances, disaggregation of performance obligations, qualitative disclosures, interim period disclosures • Accounting deviations • Increased judgment and estimates (allocation of transaction price, variable considerations, discounts) • Revenue process • Capitalizing contract costs • Margin • Net income • Bonuses and other key performance metrics • Investor relations	• Impact on systems and controls due to changes in policies and processes • Controls and processes surrounding additional estimates and required disclosures • Awareness of fraud indicators • Audit skills enhancement • ERM augmentation • Change management • Controls adjusted (real-time)	• Debt covenants (potential modification to maintain original intent) • Cash flow projections/analysis • Foreign currency • Provisions for significant financing component • Hedging/Derivative considerations on long-term contracts with interest • Contract review (embedded features)

A Cross-Functional Impact (cont'd)

Methodology → Business Policies → Business Processes → Systems and Data → Reporting → People

Sales & Marketing

- Structure of deals
- Product bundling
- Assessment of performance obligations
- Consideration of extended payment terms (financing component, time value of money factor)
- More leeway in determining the information shared with customers
- Pricing strategy
- Contract terms and conditions (multiple deliverables, variable consideration terms, discounts, special provisions)
- Order entry
- Sales commissions

IT

- Changes to the processes used for processing transactions
- Capturing and reporting on required data
- Modification to support the computing of selling price allocation and estimate the standalone selling price for software elements
- Impact to enterprise business systems landscape

Operations

- Changes to different revenue streams
- Evaluation of satisfaction of performance obligations
- Right of return and warranties
- Determining control transfer
- Professional services
- Logistics (shipping)

Legal/Taxes

- Investor relations (informing shareholders on impact of standards)
- Timing of tax payments
- Sales tax
- Additional book-tax adjustments
- Inventory revenue arrangements and review contracts
- Reexamine contract terms and strategies
- Contract compliance and monitoring
- Transfer pricing

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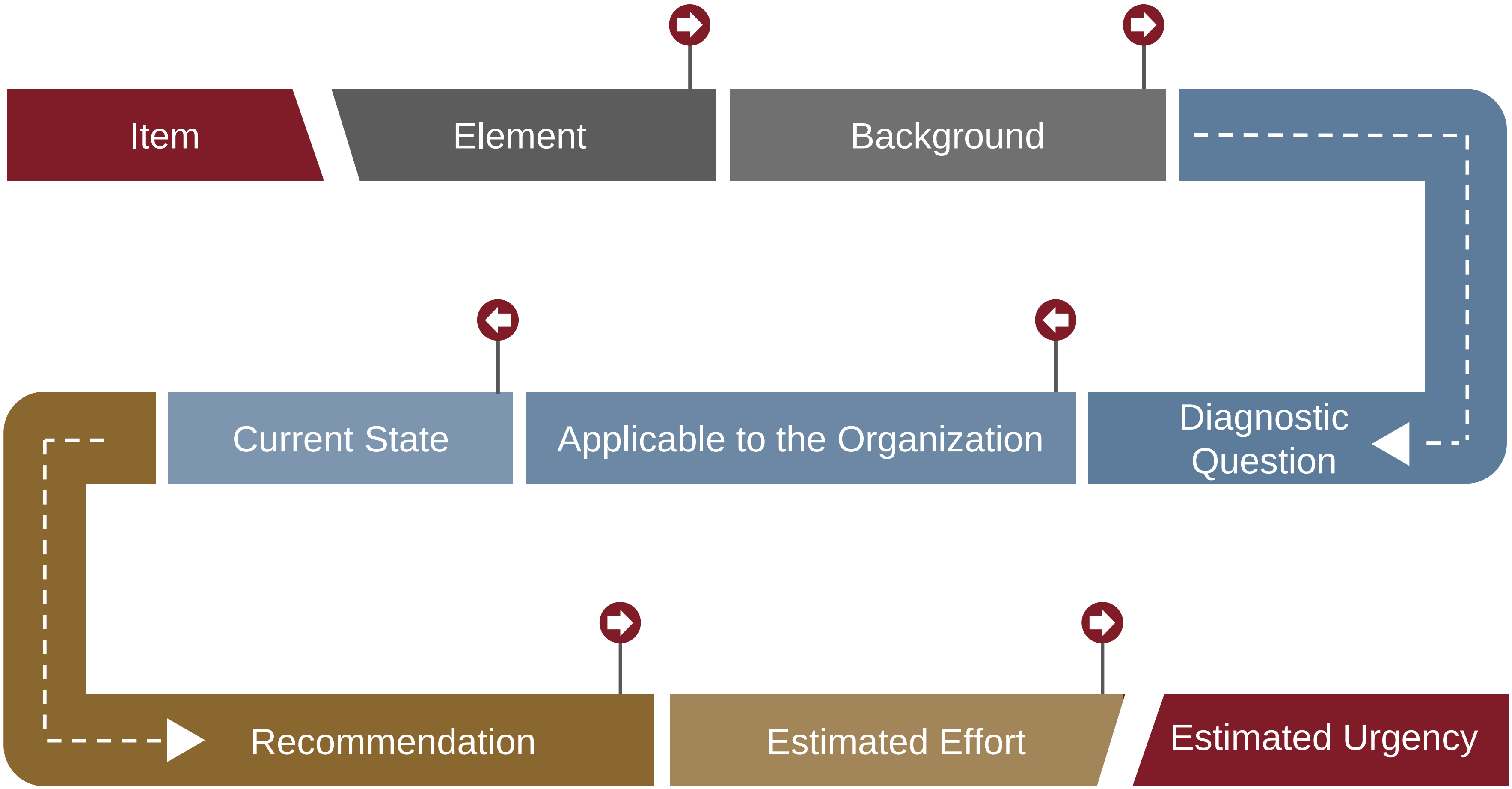
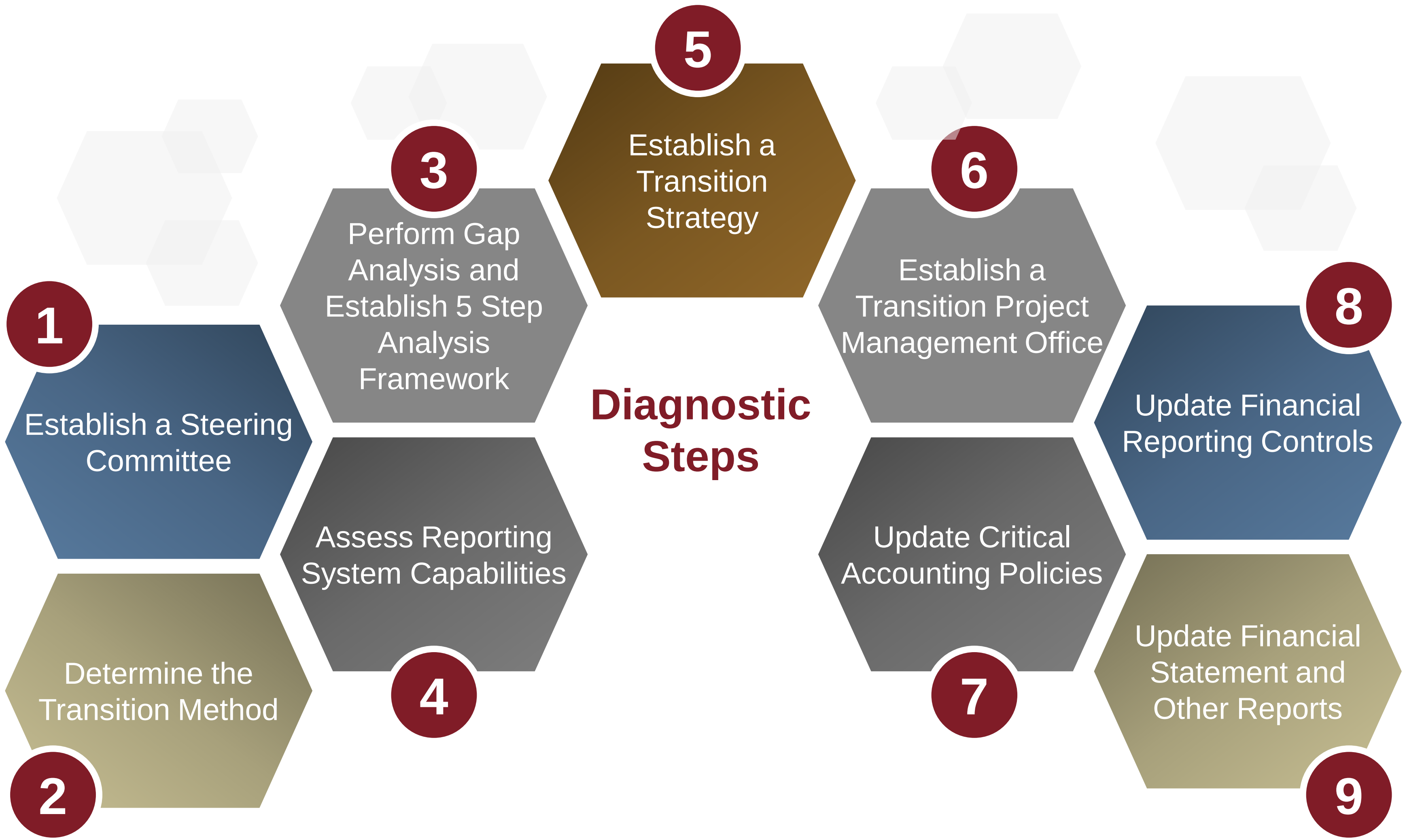
The Revenue Recognition Diagnostic Process



Revenue Recognition Diagnostic Steps



Example Diagnostic – Establish a Steering Committee

Ref #	Item	Element	Background	Sub Ref	Diagnostic Question
1	Establish a Steering Committee	Business Process	A dedicated task force should be established to provide oversight to the transition process. The task force should include resources from areas likely to be impacted by the transition, including accounting, financial reporting, tax, internal audit, sales operations, IT, legal and human resources.	1a	Has the company's functional framework been evaluated to identify which processes will be impacted by transition and to what extent?
		People		1b	Has a transition steering committee been formed? Does the committee include resources from each critical process impacted by the transition?
		People		1c	Have all members of the transition steering committee been provided sufficient training on the new revenue recognition standard?

Key Learnings from SAP

1. The **technical accounting assessment/diagnostic has to be completed or started up-front or in advance** of implementing the system or any parts of the system solution
2. This is **not a "big bang" project**; work in iterations across accounting, technology (system), and people (processes)
3. Companies make better progress when **IT and Finance/Accounting are working very closely together**, usually daily collaboration
4. Use the new standards as an **opportunity to improve systems, processes, and lower TCO** for revenue recognition and lease administration activities within your finance departments
5. Remember that revenue recognition **may have impacts on parallel reporting and on the financial close**

- Be well prepared to handle such situations

Industry Considerations

High-Level Application of Revenue Model in Five Steps

1. **Identify the contract(s) with a customer**
2. **Identify the performance obligations in the contract**
3. **Determine the transaction price**
4. **Allocate the transaction price to the performance obligations in the contract**
5. **Recognize revenue when (or as) the entity satisfies a performance obligation**

New Revenue Model – Potential Significant Accounting and Reporting Changes

Multiple Element Arrangements	• Entities that enter into contracts with customers to provide a series of promised goods or services delivered consecutively will need to assess whether the contract is a single performance obligation or contains multiple separate performance obligations
Estimated Selling Price	• Use of observable inputs should be maximized, but if the stand alone selling price of a good or service is variable or uncertain, the residual approach would be allowed
Variable Consideration	• Variable consideration is reasonably assured if **BOTH** of the following criteria are met: (i) The entity has experience with similar types of performance obligations and (ii) the entity's experience is predictive of the amount of consideration to which the entity will be entitled in satisfaction
Time Value of Money	• The transaction price should reflect the time value of money when the contract includes a significant financing component; a practical expedient allows entities to disregard the time value of money for short-term contracts
Timing of Revenue Recognition	• Each performance obligation would be evaluated to determine whether it is satisfied (a) over time or (b) at a point in time; might lead to more “over time” recognition

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New Revenue Model – Potential Significant Accounting and Reporting Changes (Cont'd)

Contract Costs	• Certain contract acquisition costs would need to be capitalized
Construction-Type Contracts	• Recognition of contract revenue and contract cost would be separated from each another. Predictive margins would only be possible if a company uses a cost-to-cost method of measuring progress towards satisfaction of the performance obligations
Construction-Type Contract Costs	• Contract costs not eligible for capitalization (e.g., as inventory or direct fulfillment costs) would be expensed as incurred
Software Subscription Accounting	• Further guidance is expected to help determine whether a license transfers a right or provides access
Separation Criteria for Elements in Software Arrangements	• VSOE of the FV of the undelivered items would no longer be required to separately account for elements in a software arrangement
Disclosures	• The standard includes a number of disclosure requirements intended to enable users of financial statements to understand the amount, timing, and judgments related to revenue recognition and cash flows

Notable Implications

1 Industries that are likely to experience the most significant changes include software, telecommunications, asset management, airlines, real estate, aerospace and construction

2 Changes won't be limited to these industries, of course, so all companies should consider the need to assess the implications of the new standard and develop implementation plans to address those implications of the new standard and develop implementation plans to address those implications

3 The new guidance may enable some companies to recognize revenue sooner than they typically do under existing accounting standards

4 Companies with longer delivery cycles, or those with nonstandard and complex contract terms, will be the most affected

- These organizations will require greater resources from systems or process to provide the necessary information to meet the data requirements to account for and describe revenue recognition

While no industry will be exempt…

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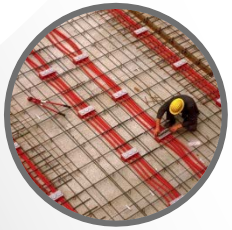
Industry Issues Under the New Revenue Recognition Rules

The **Industrial Products industry** at Protiviti encompasses four key sub-industries: automotive, chemicals, distribution and logistics, and heavy machinery

Industrial Products

Bundled Product Offerings
(service contracts and warranties; delivery, installation and maintenance; software embedded in hardware)

Rental, Leasing Arrangements



Long-Term Contracts
(engineer, design, build; services; milestones)

Gross vs. Net

Shipping Terms and Logistics
(consignment, replenishment, bill-and-hold)

Industry Perspective on the New Standard

Commentary from
Curtis Baron
Crane Co.

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Industry Perspective on the New Standard

Commentary from
Jeff Anderes,
Wal-Mart Stores, Inc.

Industry Issues Under the New Revenue Recognition Rules

The **Consumer Products and Services Industry** at Protiviti includes six sub-industries: business services, consumer packaged goods, education, hospitality, leisure and travel, not for profit and retail

Gross vs. Net Considerations

Customer Incentives

Customer Loyalty Programs

Gift Cards / Breakage

Right of Return

Warranties

Franchise and License Agreements

Expanded Disclosure

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Industry Issues Under the New Revenue Recognition Rules

The **Technology, Media and Communications Industry** at Protiviti includes four sub-industries: communications, software, high-tech and electronics, and internet and media

Significant impact on technology and software companies given specific industry guidance is going away

Impacts include:

- Reduction of “bright lines” replaced by greater flexibility in business models, contracts, pricing, product offerings requiring increased judgements and estimates
- Increased complexity and will require an assessment of changes to policies, procedures, systems

Specific impact areas:

- Variable consideration, “sell in” vs. “sell through”, best estimate of stand alone selling prices vs. VSOE, compensation & bonus plans, time value of money, taxes
- Multiple element contracts – impact on multiple performance obligations and allocation of price
- Intellectual property licenses
- Product warranties and rights of return

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Industry Perspective on the New Standard

Commentary from
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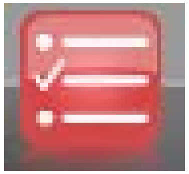
Intuit Inc.

Submit Your Questions

Q & A



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New Revenue Model – The Next Steps?

Take Time to Learn, Diagnose and Assess Now…..

1. **Education:** Review final standard and implementation guidance
2. **Analyze current revenue policy vs. the proposed standard to identify expected changes:**
   - Customer contracts with unique terms
   - Changes to cost recognition policies
3. **Depending on significance of accounting policy gaps, consider extent of tax (or legal) involvement that may be required**
4. **Perform a high level analysis of data gaps:**
   - Will required information be available from your existing processes?
   - Will system changes be required?
5. **Develop high level approach regarding transition method:**
   - Retrospective versus cumulative effect
   - Consider complexity of performing the transition and whether specific tools/systems may be required
6. **Identify and assess additional resource needs; internal / external; temporary or permanent**
7. **Educate senior management team, key stakeholders and board of directors**

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Thank You