

Services and Contract Accounting



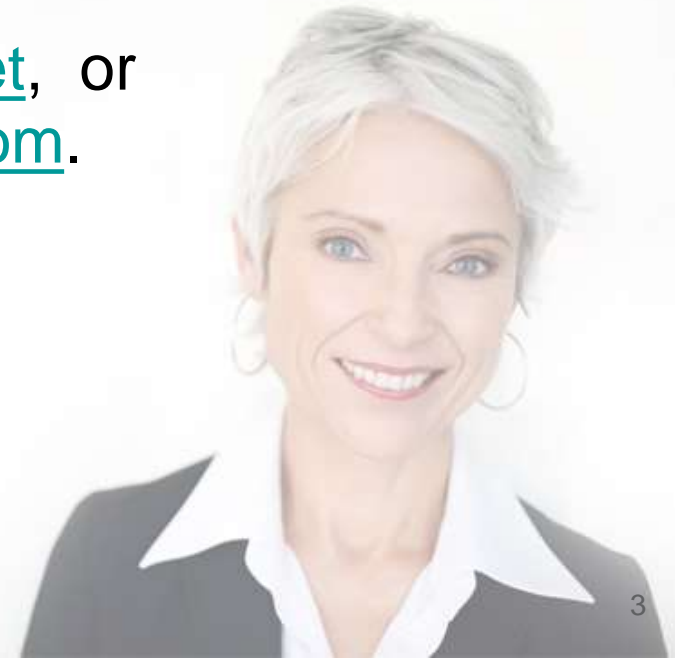
Jeffrey Werner, Werner Consulting Group
February 24, 2015

Welcome to Today's Event



Caprice Murray, Tensoft

- Submit questions any time using the “Question and Answer” pane.
- ***CPE certificates will be emailed to everyone who is eligible by end of business on Friday 2/27.***
- Submit questions after the webcast to Jeffrey Werner, wernerj@sbcglobal.net, or to Caprice Murray, caprice@tensoft.com.



Tensoft, Inc.

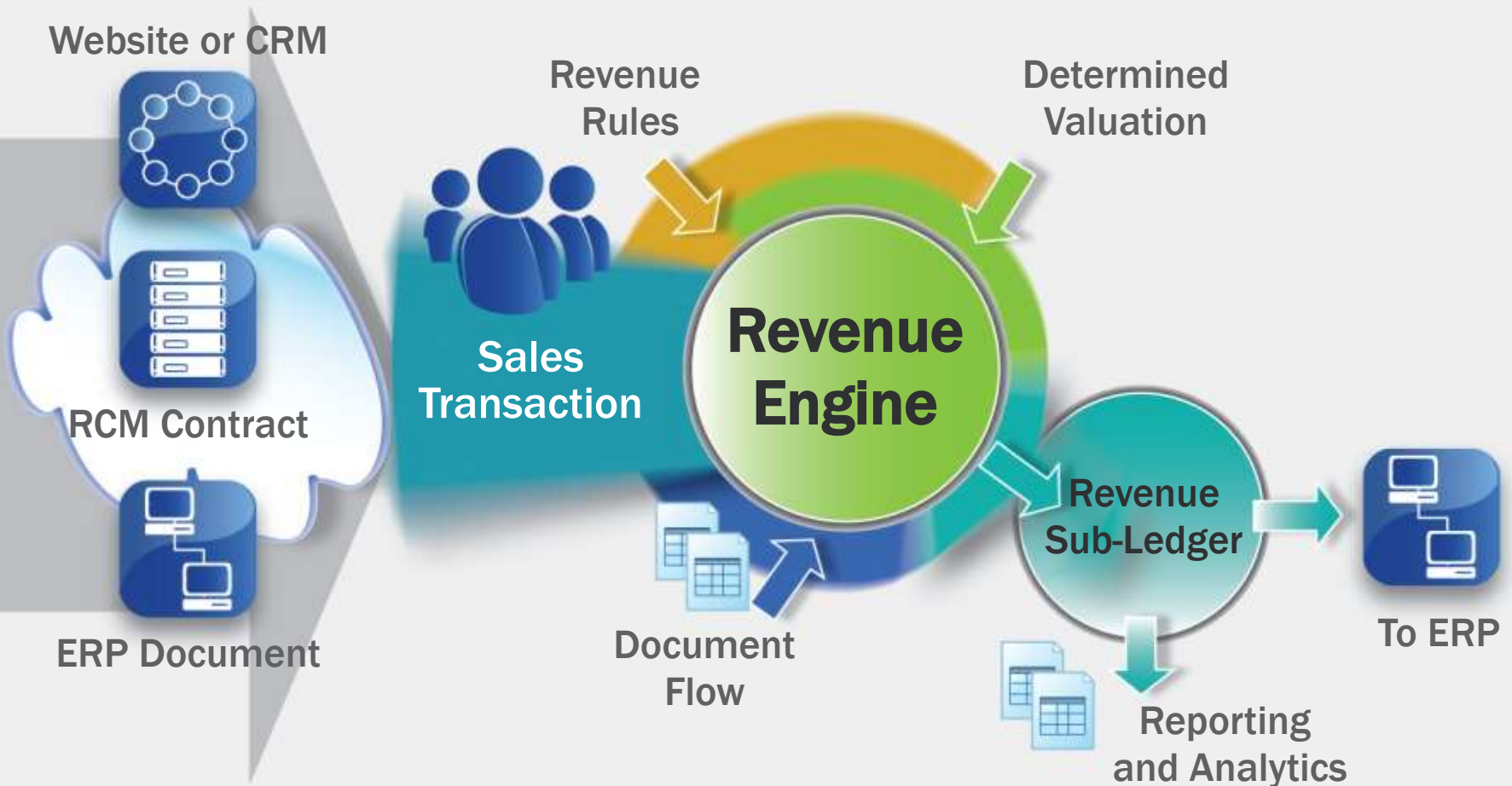
- Business software solutions provider
- Revenue and billing management for Technology Companies

Tensoft Product Line

- Contract Billing Management (CBM)
 - Contract based customer management
 - Contract based revenue option
- Revenue Recognition Management (RRM)
 - Sales contract creation and management
 - Revenue rules and delivery models
 - Workflow for sales contracts
 - Compliance Module for Fair Value management



Tensoft RRM Process Flow



Revenue Management

Sales Contract (Agreement):

- **Rules Based Methodology**
 - Document workflows
 - SKU Business Rules
 - Hold and approval options
 - Fair value allocation models
- **Agreement Management**
 - Living, editable document
 - Separate from cash & A/R process
 - Updatable for fulfillment, change
- **Source Options**
 - Agreement defined by go-to-market
 - Multiple integration models standard
 - Updates from appropriate source(s)

Revenue Recognition:

- **Compute Process**
 - Revenue agreement to date
 - Always self correcting
 - Available for review / edit prior to final
 - Multiple options to compute/review
- **Final Revenue**
 - Finalize / post process
 - Revenue journal
 - Revenue history
- **Reporting and Analytics**
 - Deferred revenue sub-ledgers
 - Revenue change analysis
 - Forecast deferred revenues
 - Excel-based reporting options

Today's Presenter:
Jeffrey Werner,
Werner Consulting Group





Services and Contract Accounting

February 24, 2015

Presentation Outline

- Introduction and Agenda
- Time and Materials Contracts
- Fixed Fee Contracts
- Bundled Services, Products and Software
- Milestone Method
- Funded R & D
- Loss Contracts

Revenue Recognition Class

**Revenue Recognition for Technology
Companies Webcast**

Tuesday May 12 Part One

9 am – 12:30 pm PDT

Thursday May 14 Part Two

9 am – 12:30 pm PDT

CPE Credit – 7 hours

Pay per attendance

Registration and details soon

Revenue Recognition Class

Revenue Recognition

Agenda Day One

- **General Principles of Revenue Recognition**
- **Multiple Element Arrangements**
- **VSOE**
- **Software Revenue Recognition**
- **Services and Contract Accounting**

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 New Revenue Standard**

Presentation Outline

- Introduction and Agenda
- Time and Materials Contracts
- Fixed Fee Contracts
- Bundled Services, Products and Software
- Milestone Method
- Funded R & D
- Loss Contracts

General Principles of Revenue Recognition

- **Persuasive Evidence of an arrangement exists**
- **Delivery has occurred**
- **The fee is fixed and determinable**
- **Collectability is probable**

Services Contract Types

- Services Contract Types
 - Time and Materials
 - Fixed Fee
 - Multiple Element Arrangements
 - Services Essential To Functionality of Software

Issues to Consider – Services

- Statements of Work – Time and Materials
 - Specific Scope of the Work to be performed
 - Time and Materials Basis
 - Estimates are not guarantees
 - Provision for additional days after initial estimated days
 - Include Expiration date for SOW
 - Any extensions for an additional fee

Issues to Consider – Services

- SOWs - Fixed Fee Engagements
 - Non-standard
 - Fee is fixed for specific deliverable or completed project
 - No VSOE for fixed fee engagements, if part of multiple element software arrangement results in contract accounting
 - License is considered as part of the service
 - Generally, revenue is recognized on percentage of completion or completed contract methods

Issues to Consider – Services

- Acceptance Provisions
 - Revenue deferred until acceptance
- Multiple Element Arrangements
 - Services without VSOE result in deferral of license and other revenue until services provided or ratable
 - Services sold below VSOE require carve-out from license revenue
- Services Essential To Functionality of Software
 - Generally, if software must be customized to work, license and services are accounted for together and revenue is recognized when the project is completed

Services Contract Accounting

- Time and Materials Services – Single Element
 - Recognize Daily Rate as the Services are provided

Examples – Time and Materials

- Example – Time and Materials Contract
 - Single Element Arrangement
 - SOW and PO dated October 10, 2014
 - Ten Days US Senior Consultant at \$2,000 per Day (\$20,000)
 - US Senior Consultant VSOE is \$1,800 - \$2,200
 - At December 31, 2014 Six Days have been Completed

Examples – Time and Materials

- Example – Time and Materials Contract
 - Single Element Arrangement
 - SOW and PO dated October 10, 2014
 - Ten Days US Senior Consultant at \$2,000 per Day (\$20,000)
 - US Senior Consultant VSOE is \$1,800 - \$2,200
 - At December 31, 2014 Six Days have been Completed
- Revenue Recognition at December 31, 2014
 - Six Days at \$2,000 = \$12,000 Consulting Revenue Recognized
 - Four Days \$8,000 Deferred Consulting Revenue
 - Recognize Remaining 4 Days as Completed

Services – Fixed Fee Contracts

- SOWs - Fixed Fee Engagements
 - Non-standard
 - Fee is fixed for specific deliverable or completed project
 - No VSOE for fixed fee engagements, if part of multiple element arrangement results in contract accounting
 - License is considered as part of the service
 - Generally, revenue is recognized on percentage of completion, completed contract or zero margin methods

Services Contract Accounting

- Fixed Fee Arrangements – Single Element
 - Fee is Fixed for the Arrangement
 - Based on a Specific Result or Deliverable
 - Recognize Using One of The Three Methods
 - Percentage of Completion
 - Completed Contract
 - Zero Margin Method

Services Contract Accounting

- Percentage of Completion
 - Ability to make Reasonable and Dependable Estimates of the Effort to Complete the Project
 - History of Performance on Similar Projects
 - Low Technological Risk
 - Typically Use the Number of Consultant Days to Complete Project
 - Recognize Revenue in the Proportion of the Completed Days to the Estimated Total Days

Examples – Fixed Fee Arrangement

- Example – Fixed Fee– Percentage of Completion
 - Single Element Arrangement
 - SOW and PO dated October 10, 2014
 - Fixed Fee of \$100,000
 - Able to Reasonably and Dependably Estimate Time to Complete
 - History of Similar Engagements
 - Estimated at 50 Days to Complete
 - At December 31, 2014
 - 30 Days have been Completed

Examples – Fixed Fee Arrangement

- Example – Fixed Fee– Percentage of Completion
 - Single Element Arrangement
 - SOW and PO dated October 10, 2014
 - Fixed Fee of \$100,000
 - Able to Reasonably and Dependably Estimate Time to Complete
 - History of Similar Engagements
 - Estimated at 50 Days to Complete
 - At December 31, 2010 - 30 Days have been Completed
- Revenue Recognition at December 31, 2014
 - $30 \text{ Days} / 50 \text{ Days} = 60\% \text{ Complete}$
 - $60\% \times \$100,000 = \$60,000 \text{ Consulting Revenue Recognized}$
 - $40\% - \$40,000 \text{ Deferred Consulting Revenue recognize when performed}$

Services Contract Accounting

- Completed Contract Method
 - Unable to make Reasonable and Dependable Estimates of the Effort to Complete the Project
 - No History of Performance on Similar Projects
 - High Technological Risk
 - Capitalize Costs as Incurred
 - Recognize Revenue When Project is Complete
 - Recognize the Costs as Cost of Revenue at Completion

Examples – Fixed Fee Arrangement

- Example – Fixed Fee Completed Contract
 - Single Element Arrangement
 - SOW and PO dated October 10, 2014
 - Fixed Fee of \$100,000
 - Unable to Estimate Time to Complete
 - Daily Consultant Cost is \$1,000

Examples – Fixed Fee Arrangement

- Example – Fixed Fee Completed Contract
- Completed Contract Revenue Recognition at 12/31/14
 - At December 31, 2014 30 Days Completed
 - \$0 Revenue Recognized
 - \$30,000 Costs of 30 days Capitalized (30 x \$1,000)

Examples – Fixed Fee Arrangement

- Example – Fixed Fee Completed Contract
- Completed Contract Revenue Recognition at 3/31/15
 - Project Completed – 50 Days Consultant Time
 - \$20,000 additional costs incurred (20 days x \$1,000)
 - Total accounting at 3/31/15
 - \$100,000 Consulting Revenue Recognized
 - \$ 50,000 Costs in Cost of Services Revenue

Services Contract Accounting

- Zero Margin Method
 - Unable to make Reasonable and Dependable Estimates of the Effort to Complete the Project
 - No History of Performance on Similar Projects
 - High Technological Risk
 - High Confidence That the Project Will Be Profitable
 - Recognize Revenue Equal to the Costs As Costs are Incurred (No Margin or Profit)
 - Recognize Balance of Revenue at Completion (All of the Margin)

Examples – Fixed Fee Arrangement

- Example – Fixed Fee Zero Margin Method
 - Single Element Arrangement
 - SOW and PO dated October 10, 2014
 - Fixed Fee of \$100,000
 - Unable to Estimate Time to Complete
 - Daily Consultant Cost is \$1,000
 - Contract Will Be Profitable

Examples – Fixed Fee Arrangement

- Example – Fixed Fee Zero Margin Method
- Zero Margin Revenue Recognition at 12/31/14
 - At December 31, 2014 - 30 Days Completed
 - \$30,000 Revenue Recognized
 - \$30,000 Costs of Services Revenue

Examples – Fixed Fee Arrangement

- Example – Fixed Fee Zero Margin Method
- Zero Margin Revenue Recognition at 3/31/15
 - Project Completed – 50 Days Consultant Time
 - \$ 70,000 Consulting Revenue Recognized
 - \$ 20,000 Additional Costs of Services Revenue
- Zero Margin Total Revenue Recognition at 3/31/15
 - \$100,000 Consulting Revenue Recognized
 - \$ 50,000 Costs in Cost of Services Revenue

Services - Multiple Element Arrangements

Services Multiple Element Arrangements

- Products & Other Services (Non-Software) -
Relative Selling Price Method
- Software -
Residual Method

Services - Multiple Element Arrangements

Products & Other Services (Non-Software) - Relative Selling Price Method

- Four Step Process
 - Separate Individual Elements
 - Determine Value of Each Element
 - Allocate Revenue to Elements
 - Recognize as Delivered

Services - Multiple Element Arrangements

Products & Other Services (Non-Software) -
Relative Selling Price Method

Determine Value of Each Element

- VSOE – Vendor Specific Objective Evidence
- TPE – Third Party Evidence
- ESP – Estimated Selling Price (BESP)

Services - Multiple Element Arrangements

Software – Residual Method

- Different Four Step Process
 - Separate Individual Elements
 - Determine VSOE of Undelivered Elements
 - Determine Residual Value of Delivered Elements
 - Recognize as Delivered

Services - Multiple Element Arrangements

Software – Residual Method

- Determine VSOE of Undelivered Elements
 - VSOE Analysis of Stand Alone Transactions
 - Rigorous process based on historical data
- Absence of VSOE
 - Delayed revenue
 - Ratable revenue
 - Contract method applied as if one element

Services - Multiple Element Arrangements

Software – Residual Method

- Determine VSOE of Undelivered Elements
 - VSOE Analysis of Stand Alone Transactions
 - Rigorous process based on historical data
- Absence of VSOE
 - Delayed revenue
 - Ratable revenue
 - Contract method applied as if one element

Services Contract Accounting

- Loss Contracts
 - Recognize Any Loss on a Contract At the Time It Becomes Known That the Contract will Result in a Loss

Services Contract Accounting

- Milestone Method
- Milestones consistent with performance
- Acceptance
- Typically results in lessor of
- Milestone or Percentage of Completion
(Proportional Performance)

Funded R & D

- **Funded Research and Development Contracts**
 - Third party (not a customer) is funding R & D
 - There is no deliverable
 - Goal is to make a product or technology available
 - Accounting is to reduce R & D expense
 - No revenue is recognized
 - Different from purchasing technology before available
 - that is revenue

Funded R & D

- Example

- Third Party contracts to pay \$100,000 to accelerate the development and release of new version of software
- There is no deliverable
- There is acceptance
- Record a reduction of R & D expense of \$100,000 on acceptance

Funded R & D

- Example

- Customer contracts to prepay \$100,000 for delivery of new technology or software licenses when available and in general release
- There is deliverable, when release occurs
- Record revenue when software is released and delivered and all other revenue recognition requirements are met

Presentation Recap

- Introduction and Agenda
- Time and Materials Contracts
- Fixed Fee Contracts
- Bundled Services, Products and Software
- Milestone Method
- Funded R & D
- Loss Contracts

Conclusion

- **Questions after class by email**
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Thanks for Joining Us today