

Structuring Software Sales Transactions for Optimal Revenue Recognition

An Executive Webcast With Jeffrey Werner

April 17, 2013

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- Introduction to today's speaker
- **Presentation: "Structuring Software Sales Transactions for Optimal Revenue Recognition"**
- Q & A

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- 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 RCM Revenue Management

Sales Transaction

- Generated based on Go-To-Market Model

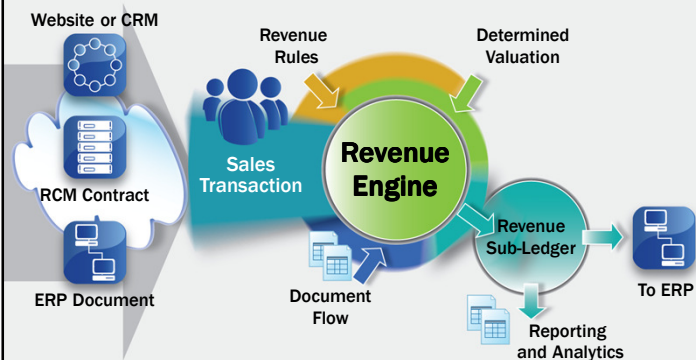
Revenue Agreement

- Workflow / policy for document type
- Revenue fair value allocation
- Revenue Rules

Revenue Recognition and Analysis Processes

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Tensoft RDM Process Flow



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Today's Presenter:
Jeffrey Werner,
Werner Consulting Group

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Introduction to 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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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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Revenue Recognition Class

Revenue Recognition Webcast

Tuesday June 11 Part One

9 am – 12:30 pm PDT

Thursday June 13 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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Software Sales Outline

- Introduction
- Optimal Revenue Recognition
- Business Model and Desired Outcomes
- Software Revenue Recognition Residual Method
- Importance of VSOE
- Significant Contract Terms
- Troublesome Terms and Issues
- Services and Software
- Software in Combination with Other Elements

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What is Optimal Revenue Recognition?

Different Objectives and Business Models

- Maximum upfront Revenue Recognition
- Ratable Revenue Recognition
- Flexibility

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Software Business Models

- Perpetual Licenses with Support and Services
- Term Licenses
- Subscriptions
- Cloud Software – SaaS -Software as a Service

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What To Do / What to Avoid

What To Do

- Clear Understandable Contract Terms
- Clear Pricing
- Consistent Pricing for VSOE
- Establish and Maintain VSOE
- Price Support as % of Net License Fee
- Understand Revenue Recognition
- Deal Review before Signing

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What To Do / What to Avoid

What To Avoid

- UnClear Contract Terms
- UnClear Pricing
- Variable Pricing
- Lack of VSOE
- Price Support as % of List
- Future Obligations without VSOE
- Troublesome Terms and Issues

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General Principles of Revenue Recognition

All Four Principles must be met to recognize revenue

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

- Easy to Remember – C D E F

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Residual Method

Residual Method

- 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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Residual Method

Residual Method

- Applies all discount to delivered elements
 - Generally backloads revenue
- Without VSOE
 - Revenue recognition is ratable
or
 - Revenue Deferred until elements without VSOE are delivered

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Importance of VSOE

Vendor Specific Objective Evidence

VSOE is the value of an element when sold separately

The contract value may not be VSOE

VSOE Established by Analysis of Historical Stand Alone Transactions

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Importance of VSOE

VSOE is critical in multiple element arrangements

Lack of VSOE results in deferral of revenue until the last element is delivered or ratable recognition over a period of time

Discounts applied to delivered elements

Undelivered elements deferred at full VSOE

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Importance of VSOE

- A software license sold with maintenance is considered two elements and therefore not sold separately
- Few software companies are able to demonstrate enough consistent software transactions sold separately to have VSOE for software

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Importance of VSOE

VSOE - the value of an element sold separately

- Services are often times sold independently of a product or software license – allowing us to determine our 'fair value' of those services.
- Maintenance/Support VSOE can be established by a stated renewal rate in the contract as long as it is substantive and generally consistent with overall maintenance pricing

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Contract Terms

Importance of Clear and Comprehensive Contracts

All Terms Defined and Considered

Don't leave out Anything Necessary to Accounting

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Contract Terms

General License Terms - basics

- Contract Date / Effective Date
- Signature date
- Pricing of Elements
- Payment Terms
- Intellectual Property
- Indemnification
- Page #s
- Definitions

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Contract Terms

License Contract Terms

- Name and nature of software
- License Fees
- Delivery Method and Terms
- Contract Date / Effective Date
- Future discounts and pricing
- Future Obligations
- Clear Pricing and Calculation of Fees
- Discounts – specific items vs invoice

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Contract Terms

Support Contract Terms

- Support Fees
- Support Terms
- Support Start and End Dates
- Support Levels – 24 x 7, 5 x 8, Worldwide
- Support Renewal Process
- Support Pricing – % of Net License Fee
- Discounts – specific items vs invoice

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Troublesome Terms and Issues

- Elements without VSOE
- Undelivered Elements
- Specified Deliverables
- Unclear Terms / Conflicting Terms
- Variable pricing
- Rebates and Credits
- “Free” items
- Concessions

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Troublesome Terms and Issues

- Lapsed Support
- Service Levels and Other Penalties
- Acceptance
- Future Obligations
- Linked Contracts
- Sunset Provisions

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Linked Contracts

- Linked Contracts - Multiple transactions with a Customer in a short time period
 - Can be considered one contract for accounting
 - An element without VSOE in one contract can effect other contracts with same customer
 - All related contracts must be complete and signed for any revenue to be recognized
 - Services SOW referenced or negotiated or being negotiated within the similar timeframe as the license could be considered a related contract
 - All related contracts must be executed for any to be valid

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Linked Contracts

- The negotiations are conducted jointly for a single project.
- The separate contracts require delivery of the same product(s) or service(s)
- The separate contracts relate to the delivery of the same product(s) or service(s) to multiple customer locations
- The contracts were negotiated in contemplation of one another

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Linked Contracts

- The contracts are negotiated or executed within a short time frame
- The elements are closely interrelated or interdependent
- The fee for one or more contracts or agreements is related to another
- One or more elements are essential to the functionality of another contract
- Payment terms under one contract coincide with performance criteria of another

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Services And Software

Service Contract Issues

- Time and Materials
- Fixed Fees
- Statements of Work (SOWs)
- Essential to Functionality
- Funded Research & Development

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Multiple Element Arrangements

- Multiple Element Arrangements (MEA) - more than one element in a single transaction
- Software
 - Tangible Product
 - Support and Maintenance
 - Installation
 - Services Training and Consulting
 - Future discounts and pricing

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Software and Other Elements

- With only Software Related Elements
- With Tangible Elements

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Software and Other Elements

With only Software Related Elements

- Apply Residual Method
- VSOE
- Carve-outs

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Software and Other Elements

With Tangible Elements

- Use Relative Selling Price Method to Allocate Revenue
- Follow Software Revenue Recognition
- Still need VSOE for software undelivered elements

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Cloud or SaaS

Cloud and SaaS Arrangements without Software Licenses

- Use Relative Selling Price Method to Allocate Revenue
- Individual Elements Need Stand Alone Value
- ESP instead of VSOE
- Essential and Non-Essential Elements

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Conclusion

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Additional questions or comments?

Please contact:

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Werner Consulting Group

Revenue Recognition Consultant

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for Optimal Revenue Recognition

Thanks for Joining Us today

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