NEW STANDARDS IN REVENUE RECOGNITION

On May 28, 2014, the Financial Accounting Standards Board (FASB) issued new guidelines for revenue recognition, affecting most public and private businesses. Although improving many inadequate revenue recognition practices, the new standards introduced more complexity into an already complicated system. Professional services organizations are impacted the most, and struggle to enact these new measures.

As Denis Pombriant of Beagle Research explained to Forbes, "We have before us a perfect accounting storm, the likes of which has not been seen since the late 1990s."

To comprehend these changes and how they impact businesses, it helps to start from the beginning:

What is Revenue Recognition to Professional Services?

Revenue is one of the core tenets of financial health and performance, and defining it is never easy. For example: your company is working on a three-year project for which they will be paid a lump sum. How do you determine the specific conditions in which the project's billings may be recognized as revenue? Alternatively, in case you are paid at the end of the three year project, how do you recognize revenue when it has not been billed yet? Would it be based on the number of completed milestones, project progress, or when the cash finally comes in? Relying solely on cash flow to gauge the health of this company is incorrect. The first and second year would look terrible, while the third year would look unsustainably good.

As defined by [Investopedia](), "Revenue Recognition is an accounting principle whereby revenues are recognized when they are earned (usually when goods are transferred or services rendered), no matter what period the cash is received or a contract is signed."

When each company has their own way of recognizing revenue, it becomes difficult for auditors, analysts, and investors looking at services businesses to compare performances and understand the true financial health of an organization. The new standards are designed to provide a uniform measuring stick with which to measure the health of various companies / organizations.

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Why Is It Important?

Financial metrics affect all stakeholders in a company - such as owners, employees, and shareholders. Meeting them or missing them impacts things like determining the difference between giving a bonus, selling and holding stock, or being out of a job. Along with cash flow, revenue metrics are used to gauge overall profitability. Accurately recognizing revenue then, is essential.

New Standards

ASC 606 and IFRS 15 were introduced to combat the complications brought on by industry-specific norms and complex, fragmented practices across companies. They provide a common framework for businesses to recognize revenue consistently, proposing companies recognize revenue in the year that it is earned. Public companies were required to comply with these standards as of January 2018; private companies have until January 2019 to implement these changes.

IFRS 15 compliant revenue recognition consists of:

- Identifying the contract with a customer
- Identifying all the individual performance obligations within the contract
- Determining the transaction price
- Allocating the price to the performance obligations
- Recognizing revenue as the performance obligations are fulfilled

Percentage Completion

For professional services organizations, complying with IFRS 15 likely means they will use the percentage completion method. Conceptually, it is fairly straightforward for the normal case: every project has the actual costs incurred. If those costs are divided by the total estimated cost, you have calculated what a percentage of completion the project has reached. For example: if a project that was estimated for $10,000 had a $2,000 burn, the project could be estimated as 20% complete. This number is then multiplied with the total contract value to get the total amount of revenue that can be recognized for that project. So, with a total revenue of $20,000, 20% completion would allow for $4,000 of revenue to be recognized. This method provides a much more accurate picture to investors and other parties interested in the financial standing of the organization.

While the normal case seems fairly intuitive, finance and accounting are all about the corner cases and accounting for their complexities properly. For example, how do you account for cost / time overruns?

When the Solution Needs a Solution

Although these changes are necessary and will ultimately help businesses, in the short term they will cause pain as companies struggle to meet these new standards. These changes are complex and the challenges mount when businesses rely on existing software or manual solutions to meet these needs. According to a recent PwC survey, a whopping

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76% of finance executives describe the documentation requirements under the new revenue recognition standards as either "somewhat" or "very" difficult. To truly understand the magnitude of the challenge that organizations are facing, consider that 31% of companies have over 5,000 contracts that must be made compliant, according to another PwC survey.

This is especially true for professional services organizations, where transactions are more complex than selling a single, stand-alone product. What's more, current financial, accounting, or ERP systems are often too large and dated to make the necessary changes efficiently and effectively. Unfortunately, today revenue teams are settling on manual, multi-system, or ad hoc processes to meet these requirements. This exposes them to additional overhead, increased errors, and potential penalties due to non-compliance. Additionally, this slows the information flow about project statuses and financial metrics within an organization. They are no longer working in real time. This leads to even more errors and reworks necessary to manage the service delivery workflow.

The resulting economic consequences are significant. Administrators are forced to invest far too many hours ensuring compliance with the new standards and work with guesstimates for actual progress, invariably resulting in errors. Best-case scenario: They find the errors, and then have to re-do the whole process. Worst-case scenario: They don't, and face penalties or take on unnecessary liabilities / reputational risk.

Time Intelligence™ to the Rescue

Replicon's Time Intelligence platform mitigates these challenges by providing a Professional Services Automation (PSA) solution with a built-in revenue recognition component. While many organizations attempt to shoehorn revenue recognition into their ERP or Accounting software, the revenue workflow is actually

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parallel to the service delivery and billing workflows. Thus it makes sense to place it within the core of a PSO's ecosystem - the Professional Services Automation solution. This enables professional services firms to manage service delivery, billing, and revenue recognition from a single platform.

Replicon provides out-of-the-box support for IFRS 15 and ASC 606 based on the percentage of completion method. This allows services organizations to easily map out revenue forecasts, make adjustments in real-time based on actual data, and complete reconciliation with the contracts, WIP, and billing workflows. More complex scenarios or different revenue recognition methods are supported via custom revenue contracts. An intuitive revenue workbench allows customers to manage this functionality and visualize when revenue is recognized via a series of what we call revenue runs.

Managing the financial metrics of a PSO is now simplified. Global revenue contracts, or customized versions of them, are attached projects. Resources are then allocated to the project, creating an overall work estimate. As resources submit their time and enter project statuses, percentage completion is easily calculable. If the project appears to be falling behind or ahead of schedule, resources may be added or removed accordingly. Periodic revenue runs are then conducted either quarterly, monthly, weekly, or even daily based on how tight a view of revenue the organization or project manager wishes.

Any professional services organization confronting these new standards should be aware of the best practices:

1. Familiarize your services and revenue teams with a fundamental knowledge of the changes.

Equipping your teams with the know-how beforehand will pay off in the long run. Have everyone read and digest the new standards, and provide an open space to ask questions. Being caught unawares will cause more complications than a little extra explanation beforehand.

2. Increase collaboration between Service Delivery and Revenue teams.

To maintain a seamless transition into accurately recognizing revenue under the new standards, service delivery and revenue need to understand each other. Teamwork and collaboration will be key here.

3. Recognize the importance of real-time management of Service Delivery.

One of the most common methods used for modelling Revenue Recognition is the percentage complete method; this is based on how projects and services are progressing, and what value has been delivered thus far to customers. In order to work, this method requires accurate and timely project estimates for time / materials and progress against those estimates. Without monitoring progress in real time against these estimates, time can go missing - and the forecasts can wind up wrong. If the forecast is wrong, and the progress is wrong, how can you recognize revenue properly?

4. Include Revenue Recognition in your Service Delivery Solution

Usually, Revenue Recognition is considered a function of ERP systems, despite the fact that service delivery is managed via a separate PSA solution. When ERPs don't talk to the PSA, vital data regarding the actual value delivered or revenue earned goes missing. Integrating Revenue Recognition into the PSA solution solves this problem.

5. Use a platform approach for long-term benefits

In professional services industries, business requirements can change with each project and client. This can result in pressuring the organization to find workarounds to meet unique demands. Fragmented and complex processes in billing and accounting arise, and customization can seem next to impossible. When the entire operation flows within one seamless platform, Change Management is less daunting. When changes or other unique needs occur in the future, a centralized platform is configurable enough to support them.

Hassle-Free Professional Services Automation

It's easy to make incorrect conclusions about your organization's profitability when it's based on partial data assumed to be the whole picture. Failing to account for all time - and consequently all expenses - creates and perpetuates the Profitability Myth. By combining a complete view of resource time and availability with a configurable framework for an organization's unique workflows, Replicon's Time Intelligence Platform busts the Profitability Myth once and for all.

Replicon's Time Intelligence platform provides a time-focused system of record for professional services organizations, which keeps them from having to adapt to a solution-dictated process. The Time Intelligence platform tracks and details how all the time in an organization is used. All of an organization's resources' time - project or not, billable or not - is tracked and tied to the outcomes produced. This provides businesses a comprehensive picture of their current and future projects, profitability, resource utilization, and cash flow.

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Replicon's Time Intelligence Platform also supports the five key pillars every professional services organization should implement: Service Delivery Management, Financial Management, Current Utilization, Future Utilization, and Project Accounting.

Replicon's Revenue Recognition capabilities empower PSOs to easily configure how and when to recognize revenue from their operations. With the unified system and platform approach, Replicon provides flexibility, visibility, and out-of the-box compliance. The streamlined process reduces stress, avoidable mistakes, and admin overhead for revenue teams. With a platform based model, Replicon is able to offer advanced configurability to map out revenues while ensuring all business process needs are met.

About Replicon

Replicon, the Time Intelligence™ company, has over 20 years of industry leadership and is pioneering a new approach to time management. Time Intelligence elevates time as a strategic asset within an organization, to improve operational productivity, performance, and profitability.

Replicon's Time Intelligence Platform offers solutions for global time and gross pay compliance, enterprise time management for ERP, professional services automation, and an SDK for continued development - expanding the company's award-winning portfolio of cloud-based products, including complete solution sets for client billing, project costing, and time and attendance.

Replicon supports thousands of customers across 70 countries, with over 400 employees around the globe including the United States, Canada, India, Australia, and the United Kingdom.

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