Revenue Recognition – A Major Challenge!

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Learning Points

- Motivation of SAP’s product vision
- Content and timeline of upcoming IFRS / US GAAP accounting principles
- Microsoft new business models require new revenue recognition solutions
- Main impact of new revenue recognition accounting guidance for Microsoft
- Solution approach of SAP’s product vision
- How to influence SAP on product vision
Starting Point

A project for evaluating a new revenue recognition solution has been set up in Q2 2010

- Changes or upcoming changes in accounting standards, such as IFRS (draft), US GAAP SOP 97-02, EITF 08-01, EITF 09-03, and so on.
- Ongoing globalization
- Increasing demand for high-performance revenue recognition due to new business models (such as digital sales)
- Desire to increase flexibility and speed in sales

Development project is currently set up to work on new functionality
Changes in US GAAP & IFRS

**US GAAP**
Highly detailed, even industry-specific standards

- **SOP 97-02**: “Software Revenue Recognition”
- **EITF 08-1**: “Revenue Arrangements with Multiple Deliverables”
- **EITF 09-3**: “Certain Arrangements that Include Software Elements”

**US GAAP + IFRS**
General Standard for “Revenues from Contracts with Customers”

- **2016**
- **2015**
- **2014**
- **2013**
- **2012**
- **2011**
- **2010**
IFRS / US GAAP change

Objective

• The objective of the proposed new regulations is to improve financial reporting by clarifying the principles for recognizing revenue and creating a single joint revenue recognition standard for IFRS and US GAAP that companies can apply consistently across various industries and capital markets.

Timeline

June 2010

Q4 2011

H1 2012

Q4 2012?

Q1 2013?

Q1/1/2015?

Q1/2016?

Exposure Draft

Re-Exposure Draft

Comment Phase

Target Date IFRS

Effective Date

Scope

• The proposed standard would apply to all contracts with customers*

  * Except for lease contracts, insurance contracts, and financial instrument contracts
### Guidelines of current draft

**Identify the contract(s)**
- Combination of contracts
- Contract modification

**Identify the separate performance obligations**
- Determine distinct goods and services
- Sale of a product with the right of return (creation of a refund liability)
- Product warranties and liabilities
- Agent consideration
- Sale of additional goods and services (customer options)
- Non-refundable upfront fees

**Determine the transaction price**
- Variable consideration
- Time value of money
- Non-cash consideration
- Consideration payable to the customer

**Allocate the transaction price to the performance obligations**
- Such as consideration of multi-element arrangements
- Determination of stand-alone selling prices
- Allocating discounts to performance obligations
- Guidance on how to account for changes in the transaction price

**Recognize revenue when a performance obligation is satisfied**
- Implementation of “transfer of control” principle
- Performance obligation satisfied over time vs. at a point in time
- Recognize revenues towards the completeness of a performance obligation

**Additional guidance for cost recognition and disclosures**
- Disaggregation of revenue
- Reconciliation of contract balances
- Specific disclosure for performance obligations
Microsoft’s Business Evolution
The Changing Landscape

The global cloud computing market will grow from $40.7 billion in 2011 to more than $241 billion in 2020.

- Forrester Research, 2011

How does Microsoft’s Revenue Recognition systems and process scale to support the volume and complexity?
Microsoft’s Current Landscape

- Different Systems & Process today
  - Multiple Systems
    - SAP
    - Microsoft Developed Revenue Systems
      - MS Sales
      - Commerce Platform
      - Azure Insights
      - MS License
  - Complex Processes
    - Most processes are automated, but some manual adjustments are required.
Microsoft New Business Models

- Some cloud based services and products (e.g. Windows Azure) are priced based on consumption
  - The revenue recognition is based on consumption
    - Various plans and options available to customers require flexible solutions
    - Large number of customers (including consumers) require scalable solutions
Multiple-Element Arrangements

- Currently License & Software Assurance (L&SA) is recognized ratably over the agreement term
- It’s expected the L&SA needs to be recognized separately
  - Transaction price needs to be allocated to L&SA (separate performance obligations)
  - License – Up front (regardless of the billing pattern)
  - Software assurance – recognized over a different period of time than the license and may need to be further broken down into separate performance obligations (e.g. training, support, next versions, etc.)
Microsoft New Rev Rec Guidance Main Impacts

- Impacts expected based on current exposure draft (subject to change with final standard)
  - Retrospective Adoption
    - Current year P&L and 2 years of restated P&L applying the new guidance (along with the adjusted retained earnings)
  - Increased Disclosures
    - Disclosures are required quarterly instead of annually
    - Roll forward of contract assets & liabilities
    - Disaggregation of revenue
# SAP’s existing approaches to revenue recognition in the SAP Business Suite

<table>
<thead>
<tr>
<th>Revenue from...</th>
<th>Recognized with...</th>
</tr>
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<tbody>
<tr>
<td><strong>Sale of goods</strong></td>
<td><strong>SD revenue recognition</strong></td>
</tr>
<tr>
<td>- Event-based revenue recognition based on contract fulfillments</td>
<td>- Time-based revenue recognition</td>
</tr>
<tr>
<td>- Straight line method</td>
<td>- Revenue recognition at time of billing</td>
</tr>
</tbody>
</table>
| **Services** | | - Service-based revenue recognition based on events (goods issue, proof of delivery…)
| **Long-term projects** | **Result analysis** |
| - Percentage of completion | - Percentage of completion based on planned revenue per period |
|                          | - Cost-based percentage of completion |
|                          | - Percentage of completion based on project earned value |
|                          | - Completed contract |
Tightly integrated solution, customers requesting additional flexibility with respect to new business model adoption

Source: SAP
SAP product vision of a new revenue recognition solution for the SAP Business Suite

Decoupled sales and accounting views across all sales systems leading to increased business model flexibility and transparency.
Decoupling sales and accounting view provides increased flexibility and transparency

SAP’s product vision includes the ability to combine order line items across sales systems to perform revenue allocation as one multiple-element arrangement.
SAP’s product vision of a new revenue recognition solution would help companies adopt new FASB/IASB accounting guidelines within the current SAP architecture.

- **Multi-GAAP**
  - Integration of multi-ledger solution (new GL)
  - Account solution

- **Cost Recognition**
  - Material costs
  - WIP**

- **Revenue Recognition Processes**
  - Time-based
  - Event-based
  - Usage-based
  - Completion-driven (such as percentage of completion)
  - Bundle sales (multiple-element arrangements)
  - Intercompany sales

- **Analytical Scope**
  - Disclosures, reports, dashboards
  - Integration in costing-based and account-based CO-PA
  - Forecasting
  - What-if analysis

- **Migration**
  - Migration from SD Revenue Recognition
Actual plan for product vision

**First Phase (planned to be started)**
- Focus on main IFRS/US GAAP requirements (such as MEA); SD and C2C integration

**Second Phase**
- Further customer feedback; CRM and Make2Order integration; focus on TCO optimization

**Follow-Ups**
- Continuous innovations, such as further solution integration

Priorities are subject to change

Ongoing
An ongoing customer engagement initiative

A customer engagement initiative was launched in Q4 2011 to ensure close collaboration with customers in defining solution requirements.
Benefits for the customer in engaging with SAP during product development lifecycle

Primary benefits

- Gain early insights into SAP’s product visions / ideas / research projects
- Provide requirements and feedback directly to the product team
- Gain early insights into potential future products through evaluation of early prototypes before they are implemented
- Establish a direct line of communication to the product development organization
- Be among the first to take new functionality into production

Secondary benefits

- Opportunity to share ideas, solutions, and best practices within an ecosystem of similar SAP customers and partners
- Opportunity to expand your professional network by participating in a community of business experts and end-users who share similar interests
What we offer - levels of engagement

**Info**
- Open to everyone who would like to participate
- Activities:
  - Learn about status, provide feedback
  - Approx. 3 times during CEI

**Review**
- Up to eight customers
- Activities:
  - Calls
  - Review / test workshops in Walldorf
  - Interviews
  - Request for feedback

**In Detail**
- Up to 4 customers
- Activities:
  - SAP would like to visit you - on site workshops (and/or workshops in Walldorf)
  - Detailed discussions
  - Regular calls

**What we offer**
- Levels of engagement
  - Up to 4 customers
  - Activities:
    - SAP would like to visit you - on site workshops (and/or workshops in Walldorf)
    - Detailed discussions
    - Regular calls
  - Up to eight customers
  - Activities:
    - Calls
    - Review / test workshops in Walldorf
    - Interviews
    - Request for feedback
  - Open to everyone who would like to participate
  - Activities:
    - Learn about status, provide feedback
    - Approx. 3 times during CEI
In Detail

Activities
- Regular calls – once every two months, requiring preparation
- Willingness to be visited by us
- Willingness to invest time to prepare our visit, to give detailed feedback, and to comment on progress
- Willingness to travel to Walldorf (or an SAP location in the U.S.) for workshops (we cannot cover your travel costs) and to invest time for preparing the workshop and, if required, for follow-up discussions

Review

Activities
- Willingness to invest time for calls and their preparation approx. once every four months
- Willingness to travel to Walldorf (or an SAP location in the U.S.) for test workshops (we cannot cover your travel costs) and to invest time for preparing the workshop and, if required, for follow-up discussions

Info

Activities
- Willingness to invest time for calls and their preparation (three calls are planned)
Planned CEI Activities

CEI Revenue Recognition

<table>
<thead>
<tr>
<th>Year</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
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**Milestones IFRS**

- Re-Exposed Draft
- Finalized Standard
- Effective Date

**Detailed on-site workshops**

**Regular calls**

**Test workshops in Walldorf**

**Roll-in calls (incl. providing information)**

**Review calls**

**Info calls**

* 1:1 workshops - can also be held in Walldorf
** 1:1 calls
*** 1:n Test workshops
**** 1:1 Roll-in calls
***** 1:1 and/or 1:n Review calls

**Today**

**Prioritized requirements**

**Additional requirements**
Key Learnings

- Changes in accounting standards will drive changes in business processes and require new solutions
- Microsoft new business models require new rev rec solutions
- The main impacts of the new rev rec accounting guidance for Microsoft are multiple-element arrangements, retrospective adoption and increased disclosures
- SAP responds to the changes to the IFRS accounting principle with a product vision for revenue recognition:
  - Decoupled revenue recognition process will sustain flexibility in sales and increase efficiency in accounting
  - Flexible Rules Framework allows highly automated processes and will decrease TCO significantly
  - A separate but highly integrated Revenue Recognition Engine will increase transparency over revenues and thus improve customers’ ability to control their business
- You can influence SAP’s product vision directly by participating in the Customer Engagement Initiative
Thank you for participating.

Please remember to complete and return your evaluation form at the end of this session.

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