SK GLOBAL
SOFTWARE

REVENUE FROM CONTRACTS WITH CUSTOMERS ASC 606, IFRS 15

ESSENTIAL KNOWLEDGE AND CONSIDERATIONS FOR COMPANIES IMPLEMENTING MICROSOFT DYNAMICS AX

Focus Industries Coverage: High Tech, Software, Cloud or IP Based Industries

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Intended Audience and Disclaimer

DISCLAIMER: THIS WHITEPAPER IS NOT INTENDED TO BE A COMPREHENSIVE GUIDE FOR FINANCIAL COMPLIANCE OF EITHER THE LEGACY REVENUE ACCOUNTING STANDARDS (OF WHICH THERE ARE MANY) OR THE NEW CONVERGED RULES OF ASC 606 OR IFRS 15. ALL COMPANIES THAT HAVE ALREADY IMPLEMENTED OR WHO ARE CONSIDERING IMPLEMENTING MICROSOFT DYNAMICS AX SHOULD CONSULT WITH THEIR CERTIFIED PROFESSIONAL ACCOUNTANTS OR AUDITORS TO FULLY UNDERSTAND HOW THEIR BUSINESS WILL BE IMPACTED BY THE NEW REVENUE STANDARDS ASC 606, IFRS 15 AND WHAT FINANCIAL DISCLOSURES, IF ANY, ARE REQUIRED. THE AUTHOR MAKES NO IMPLIED OR EXPRESS WARRANTY TO THE INFORMATION OR APPLICATION OF THE INFORMATION IN THIS WHITEPAPER FOR ANY PURPOSE.

Intended Audience of Whitepaper:

- Controllers, CFO's, Chief Accounting Officers, Directors of Revenue Management
- AX Finance Consultants or Solution Architects
- CIO or PM's responsible for AX Implementations
- Companies in the High Tech, Software, IP, or Subscription model based Industry

Purpose of Whitepaper:

The primary purpose of the whitepaper is to raise awareness of the potential ERP implementation challenges facing customers and consultants who are implementing Microsoft Dynamics AX to handle the industry specific and business issues that fall under ASC 606 Revenue from Contracts with Customers.

The whitepaper provides background information related to the new revenue accounting standards and educational awareness of the new 5 Step Revenue Recognition Model provided by the standard Boards to implement ASC 606, IFRS 15.

From an implementation perspective, the whitepaper provides details of what drives complexity in implementing Dynamics AX related to contract, billing, and revenue recognition requirements and highlights possible solutions for your Microsoft Dynamics AX implementation.

Emerging Software Category: Enterprise Revenue Life-Cycle Management

Research groups like the IDC and revenue management software vendors have identified an emerging class of middleware that connects the business processes that happen after sales bookings all the way through final accounting as reported in financial statements as ERLM or Enterprise Revenue Lifecycle Management. Many of the topics and solutions discussed in this whitepaper fit within the definition of this new software categorization.

High Tech and Software Industries: Specific industry coverage is provided in the examples for high technology and software industry segments whose business practices fall under the IP guidelines of ASC 606, IFRS 15 Revenue from Contracts with Customers.

Background and ERP Impact of Revenue Standards

Revenue is perhaps one of the most important financial measurements for those responsible for accounting or users of a company's financial statements. Failure to accurately report revenue can prove disastrous to a company's financial valuation and could significantly impede a fast growing company from gaining access to capital from either public or private markets.

Historically, accounting for revenue has always been problematic for Companies and a leading cause of financial statement restatement in the US public markets. Needless to say, Investors and regulators alike pay close attention to how company's account for Revenue because of its importance in determining a Company's financial value both historically and prospectively.

Guiding force behind new revenue accounting standards:

Prior to the issuance of converged guidance (ASC 606 and IFRS 15) on Revenue from Contracts with Customers, one of the challenges of accurately reporting revenue was the lack of consistent regulatory guidance from US and international accounting standard boards ("Boards"), FASB and IASB respectively. Note: For purposes of this whitepaper, the term "legacy rules" refers to revenue recognition guidance that preceded the converged and/or superseded guidance from ASC 606, IFRS 15.

The new revenue accounting standards seek to harmonize accounting treatment for revenue recognition from companies that have similar business processes whether or not they are in the same industry and regardless if they are governed by US or International Boards.

Unfortunately, despite eliminating some regulations and harmonizing the principle based IFRS rules with the more prescriptive guidance driven GAAP rules, the new converged revenue standard rules are still a complex body of knowledge that require careful consideration for accountants and users of financial statements.

ERP Impact

For most companies, including those that followed industry specific guidance from US GAAP like software, construction, or real estate, they will need to carefully plan with their accountants and auditors how the new revenue accounting standards will impact the timing and pattern of revenue recognition in their financial statements.

Once you have consulted with your accountants, companies who have already implemented Dynamics AX or will be implementing Dynamics AX can determine your business requirements for contract management, billing, and revenue recognition under both the legacy and new revenue accounting standards which will be necessary in order to design and configure the Microsoft Dynamics AX software. You should determine what you need from a business requirements perspective before you evaluate any proposed modifications or add-on software to meet you your full requirements – see example list of ERP requirements for Revenue Automation in Appendix B of this whitepaper.

Until the new revenue accounting standards go into effect worldwide (2017-2019), Companies may need to evaluate and implement solutions that meet not only the legacy revenue accounting standards, which are still significant, and simultaneously get prepared to implement the new converged revenue accounting standards. For those Companies that must follow IFRS 15 (Europe), they can elect to adopt the new revenue accounting standards early by 2017. In most cases, Companies will be required to report on both the legacy and new revenue accounting standards during the financial reporting transition period of the new standards.

Scope of New Standards

Contract Types included under scope of ASC 606, IFRS 15:

Generally speaking, any entity, public, private, or non-profit that enters into a contract with a customer for the exchange of goods and services or non-financial assets unless those contracts are covered elsewhere is subject to ASC 606, IFRS 15.

The new ASC 606 standard supersedes the guidance from ASC 605-25, Multiple-Element Arrangements, and most of ASC 985-605, Software: Revenue Recognition. Software and cloud services arrangements should be accounted for under the new ASC 606 standard.

Contract Types excluded from ASC 606, IFRS 15:

- Leases
- Insurance Contracts
- Financial Instruments
- Guarantees (other than product or service warranties)
- Non-monetary exchanges between entities in same line of business seeking customers

Effective Dates

ASC 606 Effective Dates: Public Companies with Accounting Year Ends After December 15, 2017. Private Companies with Accounting Year Ends after December 15, 2018.

IFRS 15 Effective Dates: Public and Private Companies with Accounting Year Ends After December 15, 2016

Historical Readiness of Microsoft Dynamics AX

In order to properly track contracts, billing, and revenue recognition, Microsoft Dynamics AX incorporated key software capabilities into the Projects and Service modules of Microsoft Dynamics AX to handle common types of contract accounting that provided revenue recognition solutions for common time and materials or completed contract types of contracts. Microsoft Dynamics AX also provided basic support for simple standalone subscriptions and service arrangements.

However, if a business required complex subscription billing, support for multi-element arrangements, or VSOE pricing support under the legacy revenue accounting standards, they likely implemented customizations or add-on software to meet these requirements. In practice, companies with low transaction volume or a high tolerance level for inefficiency, may have implemented excel spreadsheets or manual workarounds to meet these more complex revenue recognition concepts.

In some cases, due to the complex nature of revenue accounting standards, some startup companies may not have implemented or complied with the rules at all because they didn't understand them or had a very low volume of transactions.

ASC 606, IFRS 15

Despite the goal of the standards boards to simplify revenue recognition, the new revenue accounting standards streamline certain aspects of revenue recognition but introduce new complexities which will likely still create gaps in your implementation of Microsoft Dynamics AX. Some of the most complex revenue recognition accounting requirements in the areas of IP driven industries like Software and High Technology are still significant in the new revenue accounting standards.

Current / Future State of ERP Revenue Automation Solutions

Although a few boutique add-ons and best-of-breed revenue automation solutions were developed over the past decade by independent software vendors to handle some of the complexities of the legacy rules, particularly VSOE, the new revenue accounting standards introduced additional implementation challenges from both a practical point of view and ERP implementation perspective that will need be dealt with for years to come as all Companies transition to the new rules globally.

Although many ERP products like Microsoft Dynamics AX are not likely ready to support all the new revenue accounting standard rules out-of-the box, they likely have accounted for them in product roadmaps and can direct customers who need solutions now to ISV solutions that may have already been developed to fill in the gaps. A source familiar with several large ERP publishers, recently shared with the author that one of the largest ERP vendors in the world has delayed the release of their latest ERP version to re-examine how they comply with ASC 606 and IFRS 15 requirements.

Trend: Subscription Models / Bundled Offers Increase Demand for Revenue Automation Solutions

The current trend toward worldwide connectivity through the handheld devices, internet of things, public or private cloud computing, media consumption, telecom, streaming media, communication, etc. continues to drive customers to buy packaged products and services either billed outright or on a subscription or consumption contract. Likewise, non-technology related industries like healthcare, marketing services, transportation services, buying clubs, etc… are attracted to subscription-based business models because of the higher valuations gained from recurring revenue and customer preference. Customers too are adopting subscription models in ever increasing numbers, perhaps because they prefer a lower entry price point and they reserve the right to switch service providers if they don't like their service provider once their contract term is expired.

As the trend toward subscription models continues to grow, so does the demand for Revenue Automation Solutions than can automate complex contract, billing, and revenue recognition requirements.

5 Steps to Evaluating the Complexity of your Microsoft Dynamics AX Implementation

Regardless of industry, when implementing Microsoft Dynamics AX as either a customer or partner/consultant, you should first pay attention to certain business processes or types of contracts that will give rise to special treatment under ASC 606, IFRS 15.

Step 0 Review the Company Revenue Recognition Policy

The first step in your due diligence should be to speak with the revenue accounting manager, auditor, or client/consultant subject matter expert that can confidently explain the company's current policies and financial disclosure requirements related to revenue recognition both under the legacy and the new revenue recognition rules.

In order to avoid making costly design choices in Microsoft Dynamics AX, you should not proceed any further than the Project Definition Phase of Microsoft Dynamics AX project until you have completed this step.

These findings should be documented and ultimately incorporated into your functional design documents and sign off prior to setup and configuration of Microsoft Dynamics AX.

Step 1 **Understand the Complexity of your Contracts with Customers**

Ok. Now that you have gathered some official guidance from your Company, a better understanding of your company's types of contracts with Customers is important. For example, if you deal in simple one-time sales orders,then contracting and revenue recognition requirements are likely simple and standard Microsoft Dynamics AX will likely meet your requirements.

If, on the other hand, you price and sell complex arrangements that involve multiple products and services bundled together that need to be accounted for separately for accounting and revenue recognition purposes, your requirements will be significantly greater. Subscription contracts can become very complicated, especially when you bundle product and services with them and / or customers frequently modify them.

Before you apply the new revenue accounting standards, you must first determine if you have a contract with a customer that meets the definition in the revenue accounting standards. Once you have determined you have a contract with a customer, then you can follow the 5 step conceptual revenue recognition guidelines provided by the "Boards" that are outlined later in this whitepaper to identify performance obligations, determine transaction price, allocate the transaction price, and recognize revenue either at a point-in-time or ever a period of time.

Step 2 **Identify your primary Industry is a leading indicator of the complexity of your contract, billing, and revenue accounting requirements**

- High Tech Manufacturing
- Software – Perpetual or Cloud
- Media and Publishing
- Pharmaceutical or Life Sciences
- Cloud or subscription based business models (tech or non-tech)
- Franchisors
- Service industries where contract accounting is complex
- Any business model that bundles or packages products and services

High Tech Manufacturing

The very nature of High Tech Manufacturing or Software companies almost certainly gives rise to compliance requirements under ASC 606, IFRS 15. Under the legacy GAAP guidance commonly referred to as VSOE, it was imperative that you split out or even carve out the distinct elements of an arrangement (a contract or contracts), allocate price, and recognize revenue for each element properly. Under the new guidance very similar requirements exist to separate out elements as distinct performance obligations.

For example, if a high tech manufacturer sells a piece of equipment, they typically bundle this with a service contract for extended warranty services, installation, and specialized cloud based software that is utilized to run or monitor the equipment. If the preceding fact pattern sounds familiar to you then your company will likely incur revenue accounting standards challenges during your implementation of Microsoft Dynamics AX.

Software, Media, Publishing, Pharma, Life Sciences, Cloud, Franchisor

For Companies that deal in IP that establishes customer's rights of intellectual property sold by the vendor, ASC 606 provides specific guidance. A key determining factor in the guidance on determining revenue recognition for IP is whether the customer was sold access to the IP at a point-in-time or granted access at any given period of time during the license period.

As with other contracting arrangements, companies need to determine if licensing is a distinct performance obligation from other goods and services that may have been bundled or sold separately. Performance obligations that cannot be separated are likely to be accounted for over the same contract term of the dominant IP contract term.

For example, a franchisor that sells the right to utilize its tradename and sell its products for a contract term of 5 years but continues to provide the franchisee access to product enhancements, marketing programs, and customer market analysis would recognize the franchise and related items over the contract term not a point-in-time.

In contrast, a software company that sells a software license on a perpetual software model and grants the customer the right to use said license with or without an ongoing maintenance contract could likely recognize revenue at the point-in-time the license was granted.

The guidance specifically indicates that if a vendor grants IP access to a customer and continues to be involved with its intellectual property then the vendor will recognize revenue for the license as the performance obligation is satisfied over time. The guidance provides specific criteria for determining whether a vendor stays involved with its intellectual property that should be reviewed with your accountants when making this determination.

Service Industries

Under new revenue accounting standards, service providers will need to identify what distinct performance obligations have been promised in the contact and price them according to the new rules. Complexities enter the picture when variable consideration or customer options are involved with the contract. An example might be a general contractor that builds buildings. If builder uncovers an asbestos problem and issues the customer an unpriced change order, then they have introduced variable consideration into their contract which will need to be dealt with under the new standards. A further explanation and example of variable consideration is provided under step 3 of the 5 Steps to Revenue Recognition section of this whitepaper.

Step 3 Recognize certain business models that will create complexities.

Channel Models

Special considerations will need to be given to both revenue recognition and the billing aspects of contracts that involve multi-tier or channel distribution models. Companies will need to deal with Issues like consignment, sell-through revenue recognition, and principal vs. agent (gross vs. net).

Warranty or Service Contracts – Implicit, Explicit, Assurance vs. Service

If you are a manufacturer, you will likely have implied service or explicitly stated warranty contracts that may need to be separated, priced, and recognized over a contract term unless it's deemed to be a distinct performance obligation that is of the type covered under ASC 460 - Guarantees. These types of warranty contracts, referred to as assurance contracts, are accounted for by accruing warranty costs and not covered under ASC 606.

Subscription based business models

As noted elsewhere in this whitepaper, subscriptions introduce both billing and revenue recognition complexities that will need to be handled. As noted in step 4 below, the number of subscription contracts and frequency of modification will introduce complexity.

Step 4   Assess Contract Volume and Contract Modifications Frequency

Assess Contract Volume and Contract Modifications Frequency - Consider the volume of contracts and how frequently they change. If you are tracking fewer than 100 projects that are all accounted for on a time and material basis then you aren't going to be nearly as concerned about revenue accounting as a Company that is tracking thousands, hundreds of thousands, or even millions of contracts that not only must be setup and tracked initially but then updated, changed, cancelled, and sometimes re-contracted with promotions, upsells or cross-sells.

Step 5   Consider your technical integration requirements.

Frequently Companies implementing Microsoft Dynamics AX are integrating multiple order systems into the ERP. For example, it is very common for Companies to implement a SalesForce.com, Microsoft CRM, ecommerce, or Custom Order System into Microsoft Dynamics AX. Not only do you have to consider the technical mapping of master data and moving order transactions into Microsoft Dynamics AX, you also need to fully understand how you intend to map these orders (typically at the line /SKU level) into your contract management system of record so you can accurately manage contract accounting, billing, and revenue recognition. You will probably find that you are missing data in order to create a valid contract and these issues must be addressed prior to mapping and building out the integration.

5 Steps to Revenue Recognition

The boards provided a 5-step conceptual model for recognizing revenue from contracts with customers.   The first step in the model, identifying a contract with a customer was discussed under point 1 above. As pointed out, the first step is to determine if you have a contract with a customer.   Once you have confirmed you have a contract with a customer, the next step is to identify performance obligations, determine the transaction price, allocate transaction price, and recognize revenue as depicted in the visual diagram below.

Five Step Model

STEP 1	STEP 2	STEP 3	STEP 4	STEP 5
Indentify Contract	Identify Performance Obligations	Determine Transaction Price	Allocate Transaction Price	Recognize Revenue
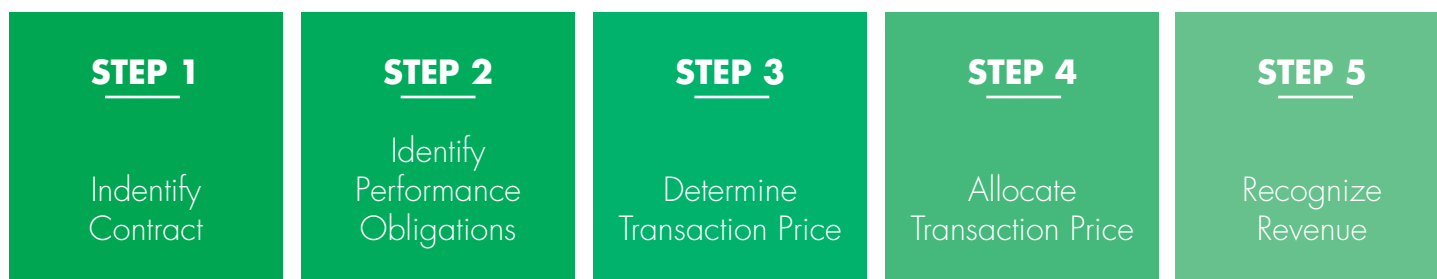
Step 1 Evidence of a Contract

Under the legacy rules, a written signed agreement was generally needed to provide evidence of a contract. Under the new rules, as long as your Company can demonstrate an agreement with enforceable rights and obligations, then a contract likely exists which could result in earlier revenue recognition than the legacy rules.

An example could be a commercial contractor that is renovating a building that uncovers an asbestos problem. Even though the contractor doesn't receive a written change order to remediate the asbestos, if it customary or if they received an oral commitment from their customer to proceed with the renovation, then this could be deemed enough to secure enforceable rights and obligations under the new standard resulting in application of the revenue recognition standard.

Collectability

Another issue that needs to be considered under the new revenue standard is collectability. If collectability from your customer from the contract is not probable (US GAAP) or not more than likely (IFRS), then you don't yet have a contract with a customer that should be accounted for under the new revenue recognition guidelines. This differs from legacy rules which indicate collectability should be evaluated at the point of revenue recognition.

Contract Aggregation

Under the legacy rules, judgement was allowed to evaluate whether contracts should be combined whereas, ASC 606 dictates that if one or more of the following criteria is met then contracts should be accounted for as a single combined contract.

Aggregate if one or more criteria applies:

- Contracts are negotiated as a package, with a single commercial objective
- Consideration to be paid in one contract depends on the price or performance of the other contract
- Goods and services promised in the contracts are a single performance obligation

Step 2 Performance Obligations

Performance obligations are promises in a contract that serve as the unit of accounting for purposes of applying the revenue recognition standards. At a high level, performance obligations are the transfer of distinct (or packaged) goods and services either at a point in time or over a period of time. Examples of distinct performance obligations include: sales of equipment, installation services, and an extended service warranty all sold and priced separately. Another example, might be a house that a general contractor is building for a homeowner. Although the contractor is transferring separate goods and services over a period of time in constructing the house, the context of the arrangement is the customer will not receive economic benefit until the house is complete and the title has transferred over therefore the contractor accounts for the contract as a single combined performance obligation – delivering the completed house.

Understanding which performance obligations should be accounted for separately or as a group requires judgement. Although the new revenue standards do provide some guidance in this area to help determine which approach more accurately represents the economic substance of the contract, it is still important to understand the company's business practices and policies, representations made during sales cycles and contract negotiations when determining what promises were made in the contract.

In Microsoft Dynamics AX, your contract will likely originate as a sales order, project, service order, service contract, e-commerce order, CRM order, or a custom order system(s). In some cases, your performance obligations will be represented by Item SKUs in the inventory module or project tasks or categories in the projects module. Regardless of your contracts origin, you will need to determine if you will need to account for distinct performance obligations either separately, which may require you to "unbundle" packaged items in your orders, or aggregate individual items or tasks back into a single performance obligation. Performance obligation is a key data entity that does not exist in a standard out-of-the box implementation of Microsoft Dynamics AX.

Step 3 Transaction Price

Transaction price is the amount of consideration an entity expects to receive from their customer when or as delivery against the performance obligation(s) which make up a contract occurs. At the core, this is very similar to contract value under legacy guidance.

ASC 606, IFRS 15 goes further to require that transaction price be evaluated periodically to take account of impairments to the contract's revenue stream present at contract initialization and which develop over the course of the contract term. Revenue impairments fall into one of four general categories:

- **Variable consideration** – Variable consideration will be included in the transaction price only to the extent that it is probable (highly probable in IFRS 15) that a significant reversal in the amount of revenue recognized to date will not occur when the uncertainty giving rise to the variability of the revenue stream is resolved. Once again the new standard calls for a high level of judgment to be exercised.

- **Significant financing component** – Time value of money must be taken into account to adjust the promised amount of consideration under terms of a contract to recognize revenue that reflects the cash-price a customer would have paid for goods or services when transferred to the customer. This impairment does not apply if the interval between payment and delivery of goods or services is not expected to exceed one year.

- **Non-cash consideration** – Entities will measure noncash consideration at fair value, when available, or apply the standalone selling price goods or services transferred to the customer in exchange for the consideration.

- **Consideration payable to a customer** – Includes cash, credit or other items provided to the customer which can be applied to amounts owed by the customer to the entity. An entity will account for these as a reduction of the contract price and, therefore, of revenue.

An exception from establishing transaction price at inception of a contract exists for sales and usage-based fees arising from licenses of intellectual property. Instead revenue from such fees is recognized at the later of the subsequent sale or usage or satisfaction or partial satisfaction of the related performance obligation.

An assumption that goods or services will be transferred to the customer as promised in the contract and that the contract will not be cancelled, renewed or modified must form the basis for determination of a contract's transaction price.

Example – Measuring variable consideration (taken from ASC-606) – An entity enters into a contract to sell 100 of Product A at a price of $100 each.

- Total consideration of $10,000 is received when control of the products transfers to the customer.
- The customer's normal business practice is to allow a customer to return any unused product within 30 days of sale for a full refund.
- Because of the return privilege, consideration received is considered variable. Based on its historical experience, the entity believes 3% of sales related to this product will be returned.
- The entity determines that the estimated amount of variable consideration should calculated at $9,700 to give effect to the estimated impairment of $300.
- The entity concludes that a significant reversal of the cumulative revenue recognized ($9,700) will not occur as the uncertainty is resolved (over the 30-day return period).

Step 4 **Price Allocation**

Transaction price is the amount of consideration an entity expects to receive from their customer when or as delivery against the performance obligation(s) which make up a contract occurs. At the core, this is very similar to contract value under legacy guidance.

A contract's transaction price (as arrived at by applying the requirements identified in the previous section) is allocated to each performance obligation in proportion to its standalone selling price.

Standalone selling price is similar to the concept of "relative selling price" in legacy guidance; however, where legacy guidance was very proscriptive when applying the hierarchy of VSOE/TPE/BESP, the new standard relies on judgement and the use of estimates to a much greater degree.

The best evidence of standalone selling price is an observable price of similar sales of a given product on a standalone basis. If unavailable, however, entities are required to estimate a price. The following approaches are recommended but not limited to in the standard:

- **Adjusted market assessment approach** – entity should evaluate the market in which they sell goods or services and estimate the price customers are willing to pay.
- **Expected cost plus margin approach**
- **Residual approach** – Applied in limited circumstances for a specific contract or standard contract type. Observable standalone selling prices of other goods or services in the contract from the total transaction price yields the standalone selling price for the remaining element.

Unless discounts and variable consideration may be allocated to one or more, but not all, performance obligations, the entity must allocate discounts or variable consideration proportionally to all performance obligations in the contract.

Step 5 Revenue Recognition

Transaction price is the amount of consideration an entity expects to receive from their customer when or as delivery against the performance obligation(s) which make up a contract occurs. At the core, this is very similar to contract value under legacy guidance.

An entity recognizes revenue when or as the entity satisfies a performance obligation by transferring control of promised goods or services to a customer. At contract inception, entities must determine whether performance obligations will be satisfied over time or at a point in time.

For those performance obligations satisfied over time, revenue must be recognized in a like manner. Three criteria are offered to assess whether control is transferred over time:

- The customer simultaneously receives and consumes benefits provided by the entity's performance against the contract.
- The entity's performance creates or enhances and asset that the customer controls as the asset is created or enhanced.
- The entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date.

If none of the three criteria for recognizing revenue over time are met, then revenue must be recognized at the point in time where transfer of the goods or service to the customer takes place.

Special application guidance is provided on assessing whether revenue from a distinct license of intellectual property is recognized at a point in time or over time:

- If the license grants a right to use the intellectual property as it exists at the time is the license is granted, revenue is recognized at a point in time.
- If the license grants a right to access the intellectual property as it exists throughout the license period, revenue is recognized over time.

Comprehensive Example

Big Electric Car Company, E-Zee sells high tech battery-operated cars directly to customers through a network of Corporate owned dealerships globally. Key Concept – E-Zee is the principal in the transactions with its customers and therefore should report revenue gross not net. E-Zee doesn't sell through dealerships on contingency so these issues can also be ignored for purposes of this example.

Performance Obligation Fact Pattern:

E-Zee sells the car on April 1, 2016 along with an embedded license of firmware software to power the cars onboard computer. E-Zee includes a bumper-to-bumper warranty for the first 36 months for a total combined fixed price of $ 85,000. The onboard computer and related firmware software are integrated by only E-Zee and are considered integral components of the car. E-Zee delivers and warranties the firmware to perform as it was originally designed at the point-in-time it was delivered.

Additionally, E-Zee sells an optional extended warranty for an additional 24 months for $12,000 that isn't due until the bumper-to-bumper warranty expires. An optional GPS and Satellite phone service is also included in the contract as a subscription for $60 per month beginning as soon as the customer takes delivery of the car. The subscription is renewable annually.

First, we need to make a few more assumptions in the fact pattern:

1. Is the bumper-to-bumper warranty a service-type warranty or simply an assurance-type warranty? If we assume that a 36-month bumper-to-bumper warranty is not required by law, then it's likely a combination of an assurance type warranty and a service type warranty. However, if we also assume that the facts and circumstances of this example don't allow E-Zee to reasonably account for them separately, then the combined assurance and service warranty would be treated as a single performance obligation and recognized as delivered over the 36-month bumper-to-bumper warranty term.

2. If we assume the firmware and onboard computer are components of a tangible good (the car) that is integral to the functionality to the tangible good, then they would be treated as part of the single performance obligation of delivering the car under 606.10.55.56.

3. Since the firmware is delivered as-designed at a point-of-time, this assurance type warranty for the firmware would not be handled as a service warranty but as a guarantee under ASC 460 which would require E-Zee to accrue an estimated warranty cost.

4. Assuming the extended warranty for two years is not refundable, is priced at its standalone selling price, and is transferrable as the vehicle is sold then this would be treated as a separate performance obligation and earned ratably over the 2-year extended warranty term.

5. The GPS and SAT phone service are variable consideration subscriptions. We assume that E-Zee, based on historical experience is 100% certain that customer will maintain the subscriptions for at least 3 years.

6. E-Zee decided not to provide an adjustment to the transaction price for financing given the very low rates currently available in the marketplace,

Given the fact set and assumptions above, the contract's combined transaction price is arrived at as follows:

Element	Performance Obligation	Start	End	Activation Date	Transaction Price
Vehicle	1			4/1/2016	$67,000.00
Firmware (License)	1			4/1/2016	
Onboard computer	1			4/1/2016	
					$67,000.00
Service warranty	2	4/1/2016	3/31/2019	4/1/2016	$18,000.00
Extended service warranty	3	4/1/2019	3/31/2021	4/1/2019	$12,000.00
GPS/SAT service ($60 per month)	4	4/1/2016	3/31/2019	4/1/2019	$ 2,160.00
					$99,160.00

Final Comment:

If E-Zee had determined the standalone selling price of the vehicle was greater than the selling price of the car ($ 85,000) less the bumper-bumper-to-warranty standalone selling price ($ 18,000) then the contract would be subject to revenue allocation across performance obligations based on relative standalone prices adjusted for any impairment to revenue.

Considerations beyond Revenue Automation

In addition to handling requirements that a very specific to revenue recognition, companies will also need to deal with other related sets of requirements that would be typical in their industry including but not limited to the following:

- Sales Tax
- Contract & Fulfillment Costs
- Warranty Costs
- Customer Portal
- Invoice Presentment and Online Payments

Additional Research

Additional research into the subject of ASC 606, IFRS 15, can be found directly from the publications themselves. The FASB (fasb.org) under accounting standards is a good place to start. Other good sources of information can be found on numerous websites from various large Accounting firms that have specialized practices in Revenue Recognition.

If you are interested in finding out more information about the Revenue Automation for Microsoft Dynamics AX available from SKG Global Software, please contact sales@sksoft.com

A detail example with screenshots of the Revenue Automation solution for Microsoft Dynamics AX can be found in Appendix B.

Appendix A – Revenue Automation Key Requirements Sample*

Requirement/Feature Needed

Contract Management

Provides Contract Master system of record

Company-defined contract types provide flexibility and ease of setup while ensuring conformity to guidance specified by management

Support for Multi-element/performance obligation contracts (products and services)

Support for Service Contracts (Warranty, Service, Entitlement, SAAS, Maintenance, Usage)

Manages Addendums and Changes

Support for Packages or Bundles

Support for Complex Subscriptions

Support for Sales line item mapping to Contract Elements

Support for automating high volume contracting and contract modifications

Automates managing and scheduling renewals

Support for auto-co-termination of multiple contracts

Support for contract modifications - scope, price, catch up adjustment or prospective

Expiration workbench identifies upcoming renewal opportunities and automates communications as well as management of renewals.

Numerous standard element types provide for compliance with latest revenue standards. Ability to add your own element types makes for richer analytics.

Powerful contract hierarchy assists to identify items under contract at contracting, billing and delivery customer levels and identifies booking value as well as revenue status

Pricing

Utilizes Dynamics AX powerful pricing agreement technology to establish pricing by customer relation, specific to a given contract and inclusive of different selling intervals.

Supports pricing for contractual escalation clauses

Discount Support

Support for VSOE, relative standalone pricing

Revenue Recognition, Automation and Compliance

Support for multiple revenue recognition methods (%, completed contract, usage)

Support for revenue schedule separate from billing based on period definitions

Supports pricing strategy by establishing evidence of fair value

Automates revenue allocations across individual items and recognize revenue as deliverables are met

Eases compliance with AICPA statements of position (SOP) 81-1, 97-2 and 98-9, SEC Accounting Bulletins (SAB) 101 and 104 and, FASB's Accounting Standard Update No 2009-13 (EITF 08-01) and 2009-14 (EITF09-03)

Supports new ASC 606 standard and migration requirements

 - Able to treat multiple contracts as one where warranted

 - Separation of elements into and management of performance obligations

 - Identification and management of transaction price

 - Allocation of transaction price to performance obligations

 - Recognize revenue on satisfaction of performance obligations

Builds a foundation for robust internal controls over revenue management processes with a comprehensive audit trail

Credit Hold Support - defer revenue for customers on credit hold

Defines revenue recognition accounting template rules for different products and services

Automatically generates revenue recognition amortization schedules and apply them across individual contract order line items

Automatically recalculate revenue schedules without manual workarounds

Supports Completion Percentage revenue recognition for services delivered over time. Inclusive of software licenses and other element types if conditions are met.

Support for Revenue Forecasting

Billing Automation

Bill customers using sales orders

Bill customers using project invoices

Supports milestone billing through free-text invoices

Supports collection and invoicing of metered activity (usage)

Supports application of base usage levels included with related subscriptions

Supports subscription billing for SaaS and traditional subscription contracts

Creates recurring invoices

Support for billing schedule separate from revenue based on contract billing terms

Handles stub periods, pro-rations, early terminations

Reporting, Integrations and Other

- Provides ACM Dashboard with KPI related to ACM functionality
- Eases integration to Quoting systems
- Streamlined assignment of financial reporting dimensions at element level
- Provides real-time summary of contract-to-date bookings, revenue, remaining revenue and gross margin at element, addendum and contract levels.
- Supports use of Microsoft Dynamics AX Data Import/Export Framework
- Leverages your existing investments in Microsoft technologies and ensures a seamless transition of data and functionality

Appendix B – Screenshots of Revenue Automation for Microsoft Dynamics AX from SK Global Software

Example: Entity enters into contract with customer to deliver specialized equipment to five locations worldwide. Equipment is being sold at one-third discount from standard pricing. In addition, entity will provide monitoring software for the equipment to allow customer to monitor each set of equipment remotely. Monitoring application will be sold as a perpetual license and be hosted by entity at its normal rates.

Customer also purchases a three-year service warranty at entity's full price of $30,000 per kit per year.

Last, Entity has agreed to provide installation as part of the purchase price for the equipment. Training will be provided at each location at normal rates. Installation and training services are readily available from other sources.

Each location will be billed separately for equipment, training and service warranties. The monitoring license and hosting services will be billed to customer at the corporate level.

Identify customers and contracts

The contract is created in a manner which creates six addendums: one at the corporate level for the monitoring application and hosting services and one each for the five locations for delivery of equipment, installation, training and warranty services. The advance contract management features included with Revenue Automation provide for the sophisticated contract structures required to handle today's complex deals. By providing for inclusion of unlimited addendums, each with its own schedule of elements, sophisticated breakdowns of elements for billing and delivery purposes is a snap. Enforcement of co-termination among the different addendums ensures that contract additions and renewals can be managed effortlessly. Activity roll-ups are always available by customer, contract and addendum. Customer activity may be analyzed based on the roles they've played, whether as contract executor, billing customer or delivery customer.

Offer packages may be created to group elements often sold as a group into one SKU to make order creation simpler and less time-consuming. An additional feature of offer packages is to provide for application of a package price different than the aggregate price of its components as called for in this fact case where the package is offered at two-thirds of the aggregate sales price.

Assign Elements to Performance Obligations

Performance obligations may include elements from several addendums. Elements are easily assigned to performance obligations as they are entered manually or as provided from upstream systems through an automated service.

Determine Transaction Price

Determination of transaction price must be done early and often. It's important that you have a solid base to work from and an effective tool to manage modifications to transaction price on a periodic basis.

Allocate Transaction Price

In order to allocate transaction prices to performance obligations effectively, you must be able to identify standalone pricing as well as document how you arrived at the value used.

Revenue Automation provides for establishment of standalone price based on observed selling price or an estimate in the event an observable price is not available. The system allows for unlimited estimation methods.

Revenue recognition

Now that you've taken the time and care to configure and manage the building blocks to an accurate and proper revenue stream, you must be able to schedule and forecast your revenue. Revenue Automation does so at the element level in order to provide ultimate control of revenue postings and management of deferred revenue.

Learn more at: sksoft.com/revenueautomation