Complying with SOP 97-2: Utilizing Daily Revenue Recognition in Oracle EBS 11.5.10 and Beyond

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Introduction

Revenue reporting is a challenge for all companies, however for software companies revenue recognition can be a daunting task. The evaluation of when revenue can be recognized is complicated by the nature of the deal. Selling Software and hardware in conjunction with Services and Training requires compliance with SOP 97-2.

Complying with 97-2 is difficult on a deal by deal basis even for a trained individual, but requiring a system to apply this logic is even more difficult. The major challenge for most companies revolves around Fair Market Value(FMV) and warranty carveout(PCS) when product and services are bundled. Unfortunately for many companies a deal is not defined by a sales order, thus accurate revenue recognition may require evaluating many orders to determine when revenue can be earned.

For many companies shipment is not the basis for revenue recognition acceptance or delivery is the criteria. This presents its own issues for an ERP system. This along with reseverves for penalities and poor credit risks leave the typical Oracle customer with a compliance nightmare.

Traditionally Oracle has performed poorly in accounting for revenue recognition. However with new features created for the R12 release Oracle has made major strides in handling many of these issues. Features such as Daily Revenue Recognition, Acceptance based recognition and a feature for credit worthiness have come a long way towards helping customers comply. Unfortunately every customer is different, and what allows them to be in compliance is different.

Last fall prior to presenting at Open World I met with the head of the R&D group responsible for Revenue Recognition. Oracle plans on continuing to enhance the revenue recognition process, however he did acknowledge that they are a long way from dealing with 97-2.

Other challenges that arise from the deferred revenue process in Oracle revolve around Revenue Forecasting, not only for items that have been invoiced, but also for items that are currently in the backlog or have a deferred accounting rule assigned to them. Many customer today are asking for the ability to do revenue projections and what if scenarios on orders that remain in their backlog. This poses and interesting challenge, that we are currently working through with one of our clients.

What is new in Oracle

As part of the Oracle release 12, a variety of new features have been introduced that will allow companies to more accurately deal with revenue recognition.   A portion of the daily revenue recognition was also backported into release 11.5.10 in December of 2006.

The first and most significant of these is the new daily Accounting rules. These rules come in two flavors, the first type is truly daily revenue recognition, it will take the number of days between the rule start and end date and simply do the math. If a period has 28 days it will recognize 28/(duration) * amount for that period. It will also recognize the appropriate pro-rated amount in the first and last periods.   The second flavor equally spreads the revenue across all periods except the first and last and pro-rates those periods based on the number of days in the two partial periods. In December of 2006 the Oracle receivables group back ported the calculation portion of Daily Revenue Recognition, however the Inventory, OM and Service contracts did not participate in the backporting process.   Although this does not by itself help the customer, it does allow with a simple customization for customers to take advantage of the new functionality.

The other changes to revenue recognition address the following issues. Acceptance based accounting, allows for revenue to be deferred until the customer accepts the item. Credit worthiness can also be defined to prevent revenue recognition until the customer is in compliance.

But What about SOP-97-2?

Although the functionality helps many customers with Revenue Recognition, it in no ways deals with a majority of what is required by 97-2. Just by the nature of 97-2 it will be very difficult for Oracle to ever provide an out of the box solution. Having spent a many hours with a number of customers that fall under 97-2, it became very obvious that every company has different requirements based on what they do as a business. The major challenges for clients around 97-2 are the Warranty and Fair Market Value each of which present a variety of challenges. Each of which by themselves would be difficult, but when combined with the other causes exponential challenges

Warranty carve-out can be very simple or quite complex depending on the method that a company has adopted. If the company uses a bell shaped curve model and can identify the minimum and maximum value associated with warranty, the calculation by itself is simple. However, using the residual value method for product valuation quickly complicates the situation. Requirements under this method require that first year maintenance must equal the amount carved out for the annualize warranty.

Fair Market Value(FMV) presents a multitude of challenges. Issues such as product and services being sold on different orders requires a method for identifying what is the scope of a particular deal. This possibility requires that the deal be evaluated and that

acceptance has been obtained before the calculations of FMV can be performed. This prevents companies from ignoring the impact that bundling had on the value of services.

Additional challenges are presented by contractual penalties and customer credit worthiness.   Which require revenue to be deferred or a portion of it until the penalty period has expired or the customer has paid their bill(or some portion of it).   These challenges just add to the complexities of trying to standardize a solution that meets all requirements for all customers.

So what can be done

There are a variety of ways to approach SOP 97-2 compliance within Oracle if you choose to customize. These customizations can be very non-intrusive if designed correctly. Designing the solution poses many challenges first and foremost is defining what the rules are and how they are to be applied. Once you establish the design, then the challenge turns to getting creative with what Oracle provides for functionality. Although Oracle does not address 97-2 many of the standard features and functionality will allow you to address the requirements.

Some Examples of this include:

1. In the case study for this presentation, we utilized the product configurator to add placeholders for the carve-outs. These place holders were utilized in conjunction with small workflow change to perform the calculation every time the order was changed prior to shipping.

2. In other cases we have designed solutions around the auto-invoice interface tables. In this solution, the rules would be applied prior to information being sent to receivables. This along with creatively using the accounting rules can provide a variety of options for the user.

3. Projects provides an additional avenue that can be utilized to address these issues. Many of the standard projects features align nicely with the end goal of complying with 97-2.

Our Case Studies?

The case studies presented in this presentation represent two customers one in the networking industry and the second one is in telecom.

In the first case study the client was migrating to Oracle from Great Plains with Softrax providing the revenue recognition. There desire was to perform Revenue recognition within Oracle. The challenges that they faced were that the auditors were currently receiving daily revenue recognition with carve-outs for fair market value and warranty. Thus the customer wanted Oracle to provide the same type of information as they were currently receiving. Our predecessor on this project had implemented daily revenue recognition with the revenue schedule have 730 postings for each year/line combination. This was causing the Revenue Recognition Job to hang for hours trying to write these records. After removing most of what they had done, we were able to design and configure a system with only minor modifications that provided the daily revenue recognition with monthly buckets along with the desired carve-outs. The net result of this project was that they continued to have the same functionality as they had in Softrax but integrated into the EBS system.

In the second case study the client was an existing EBS customer that was using EBS to do billing only. The rest of the transactions were occurring in a legacy system. They needed to be able to perform acceptance based transactions in release 11.5.10 and to assign trigger the acceptance event for the whole order. We created a custom form for this customer to allow them to see all orders that were deferred revenue. They could then select items to be released, as well as to change the accounting rules as required. This was feasible based on the low volume high dollar nature of this account.