Revenue Recognition Changes Coming Sooner Than You Think:

Five Key Considerations for Adopting ASU 2014-09

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The new Revenue Recognition Standard (ASU 2014-09) scheduled to go into effect in 2017 promises to simplify and create uniformity around the way companies book their revenue, but the new rules also bring the threat of chaos for companies that don't properly ready themselves for the changes.

Fortunately, finance organizations have plenty of time to prepare for the new revenue recognition standard, a collaboration between the Financial Accounting Standards Board, which sets accounting rules for the U.S., and the

International Accounting Standards Board. Public companies are required to adopt the rules in 2017 and private companies in 2018, though they can elect to adopt the rules early in 2017.

So, how can organizations prepare?

The impact of the new standard on your business will greatly depend upon which rules your company has been using to determine your company's revenue recognition. For instance, manufacturers that include warrantees with their products, software companies that sell upgrades and wireless phone companies that include discounts on new phones are all certain to be impacted by the new rules. However, regardless of industry, company size or whether the entity is public or private, there will be a great deal of work involved in making the transition. In fact, the clear trend toward more "solution" selling where companies find themselves spanning products as diverse as hardware, software, implementation services, consulting, subscriptions and more is only going to further complicate the challenges of recognizing revenue.

Many companies are being asked by their board members and investors to estimate the impact of the new standard. Our experience working with companies during the adoption of previous revenue reporting guidelines, and unique ability to combine the power of integrated Order Management, Billing, Revenue Recognition and Multi-Book Accounting capabilities provides NetSuite with deep insights into how businesses can make the transition to the new standard.

What's Old Is New Again

The new Revenue Recognition Standard (ASU 2014-09) returns to a single principle-based approach vs. the industry-specific rules-based framework under current U.S. GAAP. The result is one set of rules for all industries and a convergence with IFRS.

The core principle of the new standard is companies should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

Compared to current GAAP, finance teams will need to prepare for:

- Additional management judgment in estimating fair market value, segregating performance obligations, determining collectability, and many more areas.
- Increased granularity in determining the performance obligations, which will—in some cases—accelerate revenue recognition versus current GAAP.
- More disclosure requirements including transition from existing revenue recognition standards.

Public companies are required to adopt the new revenue recognition standard in 2017. Private companies have until 2018 to make the change, but can elect to adopt early in 2017.

Five Key Considerations for ASU 2014-09 Preparation

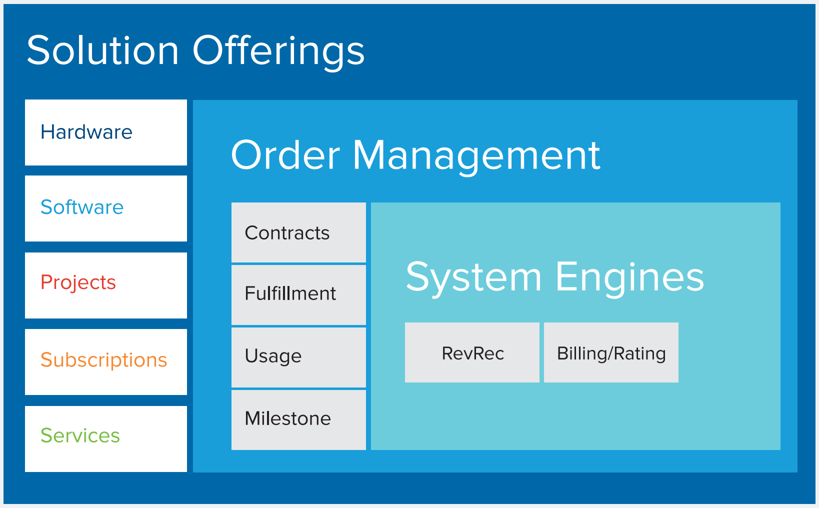
The new revenue recognition standard will place a significant burden on finance teams for many years as companies make the transition, adjust to auditor interpretations of the new standard, and increase the level of rigor to support the greater use of management judgment in recognizing revenue. Some key transition considerations include the following:

1. Selling Solutions vs. Products

Challenge: More and more companies are selling solutions vs. products by bundling products and services over time and in different economic models (e.g., subscriptions). These multiple-element arrangements increase the complexity of revenue recognition, and the proliferation of such arrangements place an increased burden on finance teams with respect to audit evidence and management judgment.

Solution: Companies offering complex solutions will need an integrated financial management system that at its core has flexible calculation engines for complex revenue recognition and billing which support different delivery models and a multitude of solutions/offerings. The integrated system allows for the creation of arrangements that more easily facilitate the interaction between the "front" office or sales team with the "back" office or finance team. The integrated system can then deliver revenue recognition based upon the events that satisfy the new regulations and trigger revenue recognition.

As multi-element arrangements increase, it is critical for finance teams to support complex and granular treatment of these components. Now is the time to evaluate core business systems and ensure they are up to the task.



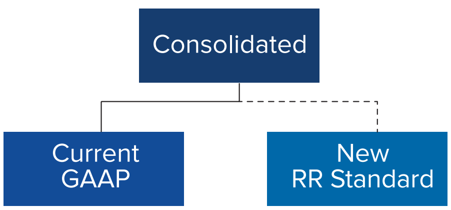
2. Financial Statement Transition Presentation

Challenge: Companies have two choices in how they make and report the transition to the new standard:

- Restatement of prior three years as well as prospectively (for public companies, also providing any five-year table disclosures).
- Cumulative transition journal entry to book the difference in Balance Sheet accounts and significant disclosures.

Either election requires the ability to simultaneously calculate revenue under existing GAAP as well as the new standard.

An ERP system with multi-book capabilities can ease the transition.



Solution: It's been proven time and time again that spreadsheets don't work for calculating revenue recognition in a scalable and error-free way. So calculating revenue for all current and historical orders will require the use of an ERP system. But how can a company calculate revenue recognition under two completely different sets of rules in one ERP system? The answer is your ERP system must have the combination of powerful built-in/core revenue recognition functionality as well as multi-book (also called parallel books).

If you don't have an ERP system that combines complex revenue recognition and multi-book functionality, your transition to the new standard will be more risky, time-consuming and expensive. Companies without an ERP system that can handle both will be forced to rely on manual process and spreadsheets.:

3. Sales Compensation

Challenge: Sales compensation is clearly a very complex area. Companies that have built sales compensation around revenue recognition are going to have to reevaluate those plans in the wake of the new rules or face the prospect of an angry, confused and likely unmotivated sales force.

Solution: In order to properly incentivize the sales organization while adapting to the new rules, companies will need to know how the new standard will impact their revenue recognition. To do this, finance teams will need to evaluate current contract language, working with their auditors to see if changes can be made to achieve consistent revenue recognition. If the underlying economics and the application of the new standard will materially change revenue recognition, companies will need to evaluate the impact and then potentially restructure existing compensation to ensure that the sales teams stay focused.

In addition to preparing the financial organization, businesses should prepare the sales force. Identifying early on how much revenue recognition will change compensation and modifying plans to incentivize the behavior that drives the most revenue is an important step in the process. So is clearly articulating these changes to the sales organization. Again, the benefit of an integrated financial system that includes commissions capability will provide the tools necessary to determine the impact on individual positions as well as the sales organization overall.

4. Expense Matching

Challenge: Companies that expect to see significant changes in the way revenue is recognized will need to match expenses with that revised timing. In addition, the new standard requires that all material Customer Acquisition Costs (CAC) are capitalized as a Prepaid Asset and matched to the associated revenue as it's recognized. Specifically, ASU 2014-09 states that the following costs must be capitalized and amortized over the life of the contract: 1.) incremental costs of obtaining a contract that would have an amortization period of greater than one year and 2.) specific fulfillment costs that directly relate to a contract. However, as product offerings become more complex and performance obligations become bundles themselves, the ability to track and recognize more complex cost bundles will require more complex costing methods. In addition, CAC pools will need to be tracked, maintained on the Balance Sheet and expensed when appropriate.

Solution: Current systems and processes are good at matching cost with revenue when the use cases are simple. Current standard costing methods work well for many physical goods companies. However, new processes must be developed to track and allocate costs in complex multi-element arrangements, working closely with auditors to establish the reporting of additional reporting dimensions, charge methods and automated reconciliations to comply with 2014-09 and ensure minimal overhead impact on the business.

Businesses will need to form cross-functional teams to develop methods to track costs for deals with special circumstances that drive incremental costs. Systems will need to be tuned to identify and automate the costs pools that need to be tracked. Standalone solutions built only for revenue recognition will not have enough information to allow for the tracking of these costs and associated them with specific contracts. Companies will need an integrated financial system that tracks labor, vouchers and other costs and links those costs to particular customer contracts. Modern and sophisticated financial systems that utilize built-in allocations will aid in spreading costs as appropriate.

Think your outdated on-premise ERP or a standalone system for revenue recognition is the answer? Think again.

Table 1: System Checklist for ASU 2014-09

SYSTEM CAPABILITIES CRITICAL TO ADOPTING ASU 2014-09	NETSUITE	REV REC POINT SOLUTION	LEGACY ERP[1]
Integrated Price Book, Revenue Recognition and Billing	✔		
Built In Complex Revenue Recognition	✔	✔	
Multi-Book Functionality/ Dual Reporting	✔		✔
Easily Customizable Complex Workflows[2]	✔		
Comprehensive Reporting Across The Order To Revenue Cycle	✔		

5. Investor, Board and Tax Communications

Challenge: If the new standard has a material impact on your business, the CFO will need to translate the revised policies and trends, comparing those to previously-reported figures as well as to a comparable set of companies or competitors.

If the transition is not handled well, uncertainty created by changes in revenue resulting from the new standard can affect company valuations, impact resource allocation, cash flow and investment decisions and reduce visibility. Management will need to plan for the transition, stay on top of any changes that impact their business and communicate well with all stakeholders. Finally, any change in revenue recognition may impact tax compliance activities and existing tax strategies.

[1] Examples of Legacy ERP include SAP, Microsoft Dynamics, Oracle, Sage, Epicor, etc.
[2] To provide greater flexibility in audit trails associated with increased used of estimates

Solution: Systems alone cannot ensure great communication and planning. However, with the right tools in place to provide the proper information such as trends, accurate forecasts, and the financial impact of the change in standard, the CFO will be well-positioned to manage the transition successfully. In turn, the CFO will likely increase outsiders' confidence in management to successfully manage through such a difficult change in accounting rules and their associated impact.

Plan Ahead to Ensure a Smooth Transition

Regardless of their size, complexity, geographic reach and industry, companies should begin planning soon for transition to the new standard. Obviously, larger organizations will generally require much more time to prepare for the cutover. However, depending on the industry, the new standard will have a larger or smaller impact on how much time is needed. Table 2 below summarizes some key areas and their impact on a few select industries. Companies should also consult with their auditors and advisors about their specific facts and circumstances.

Table 2: Key Areas of Impact on Select Industries

FACT/CIRCUMSTANCE	SOFTWARE	MFG	SERVICES	RETAIL
Additional Footnote Disclosures	✔	✔	✔	✔
New "Performance Obligations" For Future Obligations	✔	✔		
Combining Multiple Contracts At Or Near The Same Time	✔	✔	✔	✔
Tracking And Capitalizing Costs of Obtaining A Contract	✔	✔	✔	✔
New Element: Distinct Licensing Of Intellectual Property	✔	✔		
Multi-Tier Distribution Models Allowing Revenue Recognition Upon Shipment Vs. Sell-Thru	✔	✔	✔	✔

It is equally critical for organizations to evaluate their existing financial systems and identify any gaps that could impact the ability to transition effectively. Legacy, on-premise applications are both difficult and costly to reconfigure and customize. Organizations who have adopted modern, cloud-based systems with deep capabilities for customized workflows and automation to enable key business processes and change management will have a distinct advantage during the transition period.

Five Steps to Prepare for Transition[3]

1. Establish a project team and governance.
2. Estimate the impact on policies and disclosures.
3. Gather incremental information requirements.
4. Consider the impact to internal controls.
5. Involve Tax resources.

Conclusions and Recommendations

With the new standard, financial management systems face increasing demands to provide consolidated revenue recognition evidence and ensure compliance is maintained in a scalable and consistent way. While current revenue recognition rules certainly require rigor, the five key considerations outlined in this document will require important, new functionality from core financial systems.

NetSuite provides the only solution to truly support the complexities of migrating to the new standard. NetSuite integrates order management, billing and complex revenue recognition capabilities with proven core financials. Delivered via the cloud, NetSuite's solution further reduces the burden on finance teams with built-in flexibility designed to increase agility; automatic upgrades that eliminate version-lock; and mobile-enabled visibility designed for modern businesses.

While systems will play a crucial rode, what lies next for the revenue task forces of FASB and IASB (combined to form the Transition Resource Group) is to identify convergence issues that will be critical to adoption of the new standard. At least as critical will be the interpretation of the new standard by the FASB and the audit firms. Lack of consistent application of the new standard will result in varying financial results reported for similar underlying revenue transactions—which would conflict directly with a key purpose of the new standard.

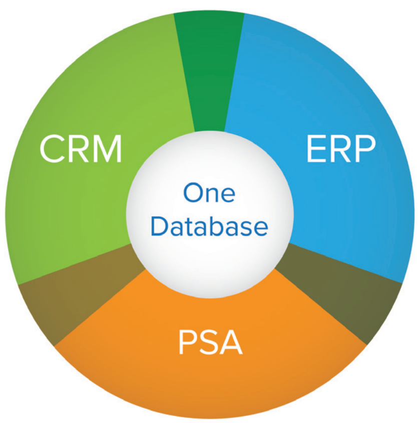
Over the next two years, companies will need to keep a close eye on the developments in the revenue recognition area, implement systems that can support the requirements of the new standard, and remain flexible as the general principles prescribed in the new standard are interpreted.

[3] KPMG Executive Share Forum, June 2014

NetSuite Solution Summary

From the start, NetSuite's product vision has emphasized the value of the "suite"—CRM, ERP, PSA and ecommerce—all in the cloud. The benefits of the single data model greatly improve visibility within your business—in particular, the order to revenue recognition process.

As companies transition to the new revenue recognition standard, finance professionals will require much more audit evidence regarding management judgment. NetSuite provides the only cloud-based solution to meet the needs of companies migrating to the new revenue recognition standard.



About NetSuite

NetSuite Financials

NetSuite Financials provides award-winning financial/ERP capabilities that integrate with broader back-office, sales and project delivery processes. NetSuite Financials takes the business beyond traditional accounting software by providing the real-time visibility needed to make better, faster and more accurate decisions. Key capabilities include:

- Comprehensive financial management accelerates financial close and ensures accountability and compliance.
- Integrated quote-to-order-to-cash accelerates cash flow, drives sales and improves customer satisfaction.
- Advanced revenue recognition automates processes and supports revenue recognition standards.
- Flexible bid-to-bill and recurring billing management automates billing, invoicing and complex recurring, time and project-based billing.
- Automated contract renewal reduces cost, revenue leakage and customer churn.
- Powerful reporting, budgeting and planning delivers real-time visibility with drill-down to detail.

NetSuite PSA

NetSuite PSA provides comprehensive project management, resource management, project costing and accounting, and timesheet and expense management. NetSuite PSA has been proven to generate tangible results by driving down bench time, increasing resource utilization, enhancing on-time project delivery, improving invoicing accuracy, streamlining revenue recognition, reducing overhead, expediting billing cycles and increasing visibility. Key PSA functionality includes:

- Advanced resource management and forecasting.
- Project costing, accounting, budgeting and profitability reporting.
- Powerful billing rules engine to support complex client billing.
- Collaborative project management to proactively identify and resolve issues.
- Easy-to-use timesheet management, integrated with project management and billing.
- Flexible expense management to maximize accuracy and timeliness.
- Powerful, intuitive, configurable dashboards and reporting for personalized views of key metrics.

NetSuite CRM

NetSuite CRM capabilities include sales force automation (SFA), marketing automation, customer support and service, and flexible customization, all in a web-based solution. Unlike typical CRM solutions, NetSuite CRM includes powerful sales performance, order management and marketing capabilities as standard.

NetSuite CRM is the only CRM solution that is completely integrated with the back office and project delivery, reducing manual entry and risk of error by synchronizing front- and back-office processes and information. This integration ensures the business is operating on the same customer and project data, and has real-time visibility into the entire client lifecycle from lead to close to fulfillment. Key CRM features include:

- Advanced SFA to improve sales performance and customer service.
- Marketing automation to drive lead generation, nurturing and management.
- CRM analytics and reporting for a single, pervasive view of customer information.