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The *Experts* in Oracle Projects ℠

Revenue Accounting for Combined Product/Services Projects

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About Project Partners, LLC

- Founded in 1997 by former chief architect of Oracle Projects
- Former Oracle developers, consultants, support technicians and marketing personnel
- ORACLE CERTIFIED PARTNER PRIMAVERA TECHNOLOGY PARTNER Microsoft Partner @task Gold Partner Safran
- ~300 successful customers
- Expert services
- Products to extend Oracle and Primavera solutions

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Our Services

- Implementation
  - Full Projects Suite
  - Financials & Projects
- Extensions
  - Library of proven successes for E&C, Govt Contractors, Prof Services industries
- Conversions
- Upgrades
- Training
- Premium Support

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Our Products

- User Interface Applications
  - User Interface Apps: MS-Excel based UI
  - Reporting: Custom Dashboards and Reporting
  - Used by AECOM, Fair Isaac, Iberdrola and more….
- Invoicing Applications
  - Invoice Consolidation and Printing
  - Used by PBS&J, Carlson, ASRC, USEC and more…
- OP3
  - Pre-packaged bi-directional integration between Primavera and Oracle Projects
  - Used by USACE, Iraq PCO, Enbridge and more….

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Combined Product/Services Projects

- **Contract with client includes**
  - Products Licensed
  - Services to install/implement
  - Maintenance/Support Licenses (Optional)
  - Classic Example – Software products
- **Revenue Accounting Issues**
  - **VSOE**
  - **Reserve Revenue Accounting**

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VSOE

- **Vendor Specific Objective Evidence**
  - **A requirement for public companies to report revenues from different lines of business separately**
  - **Specifies that each LOB should get it's fair share of revenue – cannot lump revenue from one to the other**
  - **Examples:**
    - **Services given away free/at a discount with Product**
    - **Services bundled with product**
  - **Required that although Contract with Customer is as described above, Revenue recognition must be divided fairly between 2 LOBs – so as not to overstate revenue for 1 at the expense of the other**

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VSOE - Products

- Issue is how to perform a fair market evaluation of all the components in the contract – Product, Services and Maintenance
  - Product – List price or comparable competitive product pricing is the bench mark for this.
    - Complications based on Geography, Time of year, Promotional pricing,etc
    - Additional Complications for Software products – every product is deemed unique and hence comparable competitive products pricing cannot be considered
- Best bet is to review historical sales records for the geography and time period in question and use an average price from this history
- For New Products – an internal estimate for fair market value may be used but should be adjusted as soon as good history is available

VSOE – Services/Maintenance

- The Services should be valued at UCR – Usual and Customary Rate
  - Good estimate of effort * UCR based on potential job levels of people delivering the services
- The Maintenance Contract should be valued at the UCR percentage of the product license value
- Once again – the key here is historical data based on Geography of the sale and the Time period in question
- For new markets – an internal estimate of the UCR should be good but it should be revised as soon as adequate history is available

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VSOE – Final Determination

- VSOE Values for each component are now determined for the contract as follows:
- Funding Allocation for Products:
  - (Product Value / Product + Services + Maintenance) * Contract Value
- Funding Allocation for Services:
  - (Services Value / Product + Services + Maintenance) * Contract Value
- Funding Allocation for Maintenance:
  - (Maintenance Value / Product + Services + Maintenance) * Contract Value
- Any Change Orders also need to go through this process for funding allocation

VSOE – Example

- Contract Values after all negotiations
  - Product: 1M, Services: 0.8M, Maintenance: 0.2M
- Fair Evaluation based on Historical/UCR data
  - Product: 2.5M, Services: 1.5M, Maintenance: 0.5M
- Funding Allocation for Products:
  - (2.5/ 2.5 + 1.5 + 0.5) * 2 = **1.11**
- Funding Allocation for Services:
  - (1.5/ 2.5 + 1.5 + 0.5) * 2 = **0.67**
- Funding Allocation for Maintenance:
  - 2 – (1.11 + 0.67) = **0.22**

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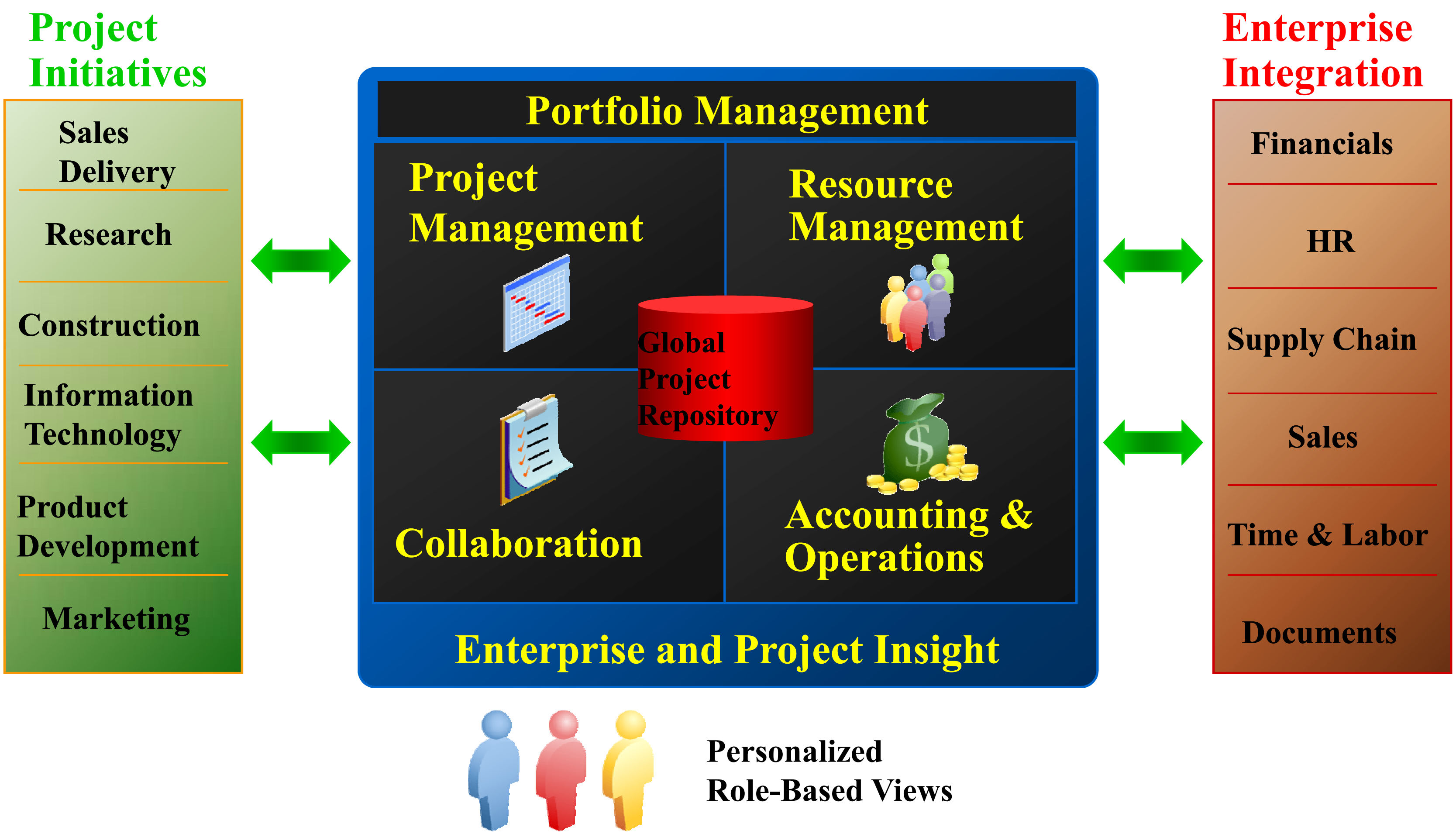
VSOE – Tools

- Currently no Enterprise tools exist that will automate this revaluation process for VSOE
- Can be easily achieved using a modelling spreadsheet with data from Oracle Projects – Agreements/Funding
- Data will need to build up over time to be useful
- In the meantime we will need to maintain empirical data based on experience and history (typically offline) or from legacy systems
- KEY IS STANDARDIZATION

Oracle Enterprise Project Management



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VSOE – Setup in Oracle

- Financial Structure for Project should include a Top Task for each component of the contract
  - Product License, Services, Maintenance
- Funding allocation will be at the task level based on the VSOE calculations shown earlier
- Based on Contract (FP, T&M, etc), the revenue hard limit is set. Invoicing limit set to “Soft”
- Actual Contract breakdown amounts should be captured via DFFs or UDAs on the Financial Tasks to drive invoicing
- Billing Extension should be used to manage invoicing limits based on contract type (for Fixed Price)

Revenue Recognition & Accounting

- Now that we know how the contract is broken out (allocated), we now need to look at how this revenue is recognized
- On face value it is simple enough
  - Product Revenue – on Delivery
  - Services – T&M or Milestone or POC (% Spent – Cost/Effort or Physical Completion)
  - Maintenance – Straight line thru life of maintenance contract
- BUT….

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Revenue Recognition & Accounting

- Product Revenue
  - Typically product is not useable by the client until all services are delivered and hence the license revenue should be prorated based on services revenue
  - Further product revenue should be prorated over life of license granted
  - If license is for indefinite use, then revenue should be prorated over product useful life
    - Typically for as long as the product is not fully depreciated – using typical depreciation rules dictated by tax laws

Revenue Recognition & Accounting

- Product Revenue - How is this achieved?
  - First step is to tie-in the product revenue recognition to the services
    - To do this, you will need a billing extension that will apply the ratio of product to services funding to the recognized services revenue in order to determine the product revenue to be recognized
  - Next step is to determine the time period over which this revenue is to be prorated
    - Based on length of product license or useful life of the product

Revenue Recognition & Accounting

- Product Revenue - How is this achieved?
  - Now we introduce the concept of Reserve Revenue
    - The revenue recognized is then prorated from the point of recognition to the end of the license/life of product
    - This is achieved using a pair of event types specifically designated for this purpose
      - Net Zero impact on Project Revenue and Billing WIP
      - Event type to Reduce Revenue
      - Event type to Increase Reserve
      - Net – Dr. Revenue, Cr. Reserve
    - Another extension will be needed to effect this

Revenue Recognition & Accounting

- Product Revenue - Example
  - VSOE Funding values: Prod-1.11, Serv-.67, Maint-.22
  - Services Revenue based on Milestone completion
  - Product License is for 24 months & follows services
  - 1st milestone worth 0.2 M achieved in 3rd month
  - Product Revenue will be (1.11/0.67)*0.2 = **0.33M**
  - This amount now prorated over remaining 21 mths
    - 0.33/21 = ~16K – to be recognized every month till next milestone
    - Event 1 (Dr. Revenue) = -317K
    - Event 2 (Cr. Reserve) = +317K

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Revenue Recognition & Accounting

- ## Product Revenue – Example continued..
  - VSOE Funding values: Prod-1.11, Serv-.67, Maint-.22
  - Services Revenue based on Milestone completion
  - Product License is for 24 months & follows services
  - 2^{nd} milestone worth 0.2 M achieved in 7^{th} month
  - 4 monthly installments of 16K (total of 64K) from 1^{st} milestone have been recognized for product revenue

  - Product Revenue will be (1.11/0.67)*0.2 = 0.33M
  - This amount now prorated over remaining 17 months
    - 330K(from 2^{nd} MS) + 266K(330K – 64K from 1^{st} ms)/17 = 35K – to be recognized every month till next milestone
    - Event 1 (Dr. Revenue) = -295K
    - Event 2 (Cr. Reserve) = +295K

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Revenue Recognition & Accounting

- Services Revenue - How is this achieved?
  - Ideally Services Revenue is also prorated and reserved like the product revenue
- Maintenance Revenue – How is this achieved?
  - Maintenance Revenue is prorated over the life of the maintenance contract and recognized each month starting with the delivery of the product
  - Assuming Product is delivered in month 10
  - 0.22M will be prorated over 14 months – **16K/month**
  - Can get anal here and prorate by days…

In conclusion

- Revenue Recognition for product/services combination projects is tricky business
  - Various Governance and GAAP rules apply
  - Conservative is the name of the game
- Flexibility built into Oracle Projects allows for the implementation of these complex requirements

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For More Information

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