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92% of Public Companies' Revenue Processes at Risk for Compliance Failures and Restatements

New study by RevenueRecognition.com and IDC reveals widespread reliance on spreadsheets, which greatly increases the likelihood of control weakness and accounting errors.

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A recent survey of 685 senior financial executives from a broad range of companies, revealed that revenue recognition and reporting activities are not automated within Financial/ERP systems. As a result, 92% of public companies are forced to rely on spreadsheets to fill vital gaps in their revenue reporting processes—despite the fact that spreadsheets are prone to errors, lack audit capabilities, and resist internal controls. This, and other findings, is from a new report by www.RevenueRecognition.com and IDC, "Enterprise Systems and Revenue Recognition: The Missing Link".

Revenue Spreadsheets: The Compliance Killers

These results should be alarming for corporate finance departments, executives, and investors alike, because:

1. The risks introduced by spreadsheets violate basic compliance principles.
2. Revenue accounting problems are the leading cause of financial restatements.
3. The number of restatements is on the rise.

As a result, compliance managers should be addressing the issue of having spreadsheets in the revenue reporting process. Executives should be extremely cautious about the integrity of the numbers they are attesting to under Sarbanes-Oxley requirements. Investors have to be wary of the risks of restatement which can hurt stock prices.

The Functionality Gap

Financials/ERP systems manage operational data flows throughout an enterprise, but they may not automate critical tasks in the revenue recognition and reporting workflow. This causes a break down in the financial reporting infrastructure. As the table below illustrates, it is very common for companies to use spreadsheets for one or more of the key revenue recognition and reporting tasks listed. More than half of all companies are using spreadsheets to create their accounting entries for revenue. Surprisingly, public companies with more than $200 million in revenue are substantially more reliant than the overall sample (61% vs. 52%) on spreadsheets for basic accounting entries.

Table 1
Spreadsheet-based revenue recognition and reporting tasks.
(Multiple responses accepted, n=685)

1. Creating accounting entries	52%
2. Creating revenue recognition schedules for future periods	47%
3. Reporting on future revenue streams	47%
4. Applying revenue allocation rules	43%
5. Performing revenue contribution analysis	42%
6. Redistributing revenue (e.g. SOP 97-2, EITF 00-21)	35%
7. Reviewing sales orders for deferred revenue	27%
8. Do not use spreadsheets for any of these activities	8%

Source: www.RevenueRecognition.com and IDC, 2006

Internal Controls

Respondents were presented with a list of eleven accounting activities and asked to identify for which areas it is most difficult to establish internal controls. As the table below shows, contract management and revenue recognition accounting were the top two most challenging areas for companies with more than $20 million in revenue. No other process rated higher than 10%.

Table 2
In your opinion, for which area is it most difficult
to establish internal controls? (Rev=$20M+, n=492)

1. Contract administration and management	34%
2. Revenue recognition accounting	32%
3. Purchasing and payables	8%
4. Billing and accounts receivable	8%
5. Order processing	5%
6. All others combined	13%

Source: www.RevenueRecognition.com and IDC, 2006

Improving the Revenue Recognition Process

When asked to identify the single most important change they would make to improve their revenue accounting processes, the top three issues related to the integrity and visibility of revenue data, as shown in Table 3.

Table 3
If you could improve your revenue recognition process,
what would be the most important change you would make? (n=685)

1. Enhance revenue recognition functionality in financial systems	22%
2. Establish single source of "clean" revenue data	19%
3. Implement business intelligence solution for analyzing revenue	18%
4. Integrate sales, contract, service and support activities	14%
5. Improve internal controls for revenue	10%
6. Eliminate spreadsheets	10%
7. Standardize consolidation and reporting procedures	6%
8. Other	2%

Source: www.RevenueRecognition.com and IDC, 2006

For companies with more than $1 billion in revenues, establishing a clean source of revenue data was number one (26%), followed by BI tools (19%) and enhancing revenue functionality in financial systems (16%).

Productivity vs. Performance

One thing was clear — companies want to spend less time manipulating data and more time on business performance analysis. When asked what they need to spend less time on, 56% said "data aggregation, manipulation, and validation." The next highest response was "generating custom reports" at 21%, no other category garnered more than 10%. When asked what they need to spend more time on, the answer was equally decisive: 50% said "business performance analysis," followed by forecasting future performance at 24%.

The real message behind the results is that there are significant obstacles to improving revenue reporting processes. "Revenue recognition processes are dependent upon information from multiple sources and typically cannot be executed in existing enterprise systems," said Kathleen Wilhide, Director of Compliance and Business Performance Management (BPM) Research at IDC. "What is required is automation across this function which will yield a host of benefits, including: more accurate results, better internal controls, less reliance on uncontrolled spreadsheets, and freeing up time for performance analysis."

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