

Demystifying Vendor Specific Objective Evidence

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Answers to Remaining Questions from Seminar

1. Is VSOE an industry term or your term?
It is an industry term.
2. How about SLA's?
If the SLA includes a monthly service component or prepaid service component then the vendor can only recognize the revenue in the month that it was delivered.
3. VSOE hasn't been defined yet...
Vendor Specific Objective Evidence (VSOE) requires the vendor to provide objective evidence of each element pricing in order to establish how much revenue they can recognize. Often, one element is delivered yet other parts have not. e.g. Software was delivered, yet it has not been customized for the customer.
4. The maintenance or the license or both?
Only when an element has met all four prong revenue recognition rules.
5. Could the situation with a single customer be unique enough to establish VSOE at that level?
Yes, if the customer is out of their current "band" e.g. 75,000 users and they never licensed the software for 75,000 users.
6. How does VSOE effects pricing of a deal done prior to VSOE being effective?
Management will arbitrarily set a VSOE price before any deal is done. They can go back and change or adjust the VSOE to account for any market conditions.
7. What did you mean by "hell or high water"
Regardless of what happens in the deal, you must pay. These are most common in telecommunication deals with "Minimum Annual Revenue Commitments" (MARC) and occasional maintenance deals.
8. Why are more suppliers asking for pre-payment for multi year contract?
Cash flow, reduce billing cost, and cash today is worth more than cash tomorrow (interest earned)
9. What is the impact from waiving acceptance in lieu of a longer warranty period?
If the warranty clause permits refund or any monetary return, it will delay the recognition of revenue until the expiration of the warranty period.

10. We've had vendors say that they could not discount the fees to calculate maintenance because of revenue recognition rules. Does this have anything to do with revenue recognition?

Actually, it really doesn't. Go back to the "4 prong" test in order to recognize revenue and discount does not effect it...as long as the discount is not out of their normal and customary discount. This will be very difficult for us, the customer, to find out what is their normal discount range.

11. Any special provisions for Govt. entities?

None that I know of.

12. If you sign up for a 3 year support agreement and you pay in advance does the supplier "recognize" all of that revenue up front?

No, the supplier recognizes the revenue 1/36 at a time at the end of the month in which the support was delivered.

13. Can you explain further how liquidated damages impact VSOE and rev rec?

Instead of negotiating a refund in warranties, you can negotiate liquidated damages in the event of breach of performance in the sum equal or better yet greater than fees paid.

14. OK, so if I am purchasing a software license and maintenance separately but both on the same PO or contract, they can still book the entire SW license charge right?

No, the maintenance has yet to be delivered, therefore, it must be prorated as in question 12 above. Only the software license portion of the entire PO can be recognized and that sum must be subject to VSOE based on the pricing if it were a single element deal.

15. If you were to pick one item to remember would it be "not my problem"? (IE it is not that revenue will not be recognized... it is "when" revenue will be recognized)

After careful thought, I really don't see preference between the two. I think they are equally important. If we know when they can recognize the revenue, we can substantiate the claim that it is not our problem. It really isn't a customer problem for the most part. A convenient ploy for the vendor, yes. Again, we can always leverage their need to recognize the revenue for leverage on other negotiation objectives.

16. Frequently we sense that VSOE is used as FUD: Fear uncertainty and Doubt. Other times, I just think they don't understand it.

I agree, I doubt most account reps really understand VSOE...all they know is it is in their "play book for objections" and a convenient ploy too.

17. Do vendors have to publish their VSOE rules or how can you validate what they are saying is true?

To the best of my knowledge, there is no public repository or mechanism for them to publish VSOE. I believe it is an external audit compliance issue.

18. Do software suppliers generally place more weight on the revenue from licensing vs. revenue from maintenance/support or does it matter?
My experience tells me that they are placing more emphasis on the maintenance. Maintenance is generally more profitable over time. One a manufacturer breaks even on their software development the rest...is pure profit. The maintenance is added frosting on the cake and does not require the initial investment of resources.
19. Over what period of time is the VSOE 80% 15% range pertinent - quarterly annually etc? To further clarify my submitted question, if 80% of the sales transactions are within 15% of the median price, over what period of time does this apply - quarterly annually etc. before VSOE is no longer established.
To the best of my knowledge, it is annual along with all other accounting practices and requires justification to change the timing.
20. If you sign up for a 3 year support agreement and you pay in advance does the supplier "recognize" all of that revenue up front?
No, please refer to question 12 above.
21. Can you go over liquidated damages?
In addition to the answer in question 13 above, liquidated damages are damages whose amount the parties designate during the formation of a contract for the injured party to collect as compensation upon a specific breach (e.g., late performance).
22. How much financial benefit does the supplier receive if we deem software accepted upon delivery in exchange for a longer warranty (zero-cost maintenance and support) period?
Assuming the warranty period does not provide for any refund or prorated refund...the supplier receives a considerable financial benefit by not only getting the money sooner rather than later, they can recognize the revenue upon delivery.
23. Regarding the long term warranty issue with a refund, wouldn't the test of vendor's probability of having to actually pay the refund be applicable as based on their own history?
No, although a logical assumption, not all deals are priced the same and no two contracts are the same. Hence, it is a "white wash" rule.
24. Do you have a sense of the effort required on the vendor side to establish VSOE or change VSOE?
To establish the vendor needs to make a best guess as to the market price of the element being sold. To change VSOE, they must make an accounting note and the justification for making the change.
25. Vendor claims can't reduce Maintenance % of fee paid due to VSOE. Is this a ploy? Also told Vendor VSOE policy allows contractual maintenance fee to have some of those fees applied as revenue

The answer to the first question is it depends...if you are asking for a discount beyond their normal range than no it is not a ploy. You need to ask specific questions in this regard to obtain additional information on their range and VSOE policies.

The second question – the vendor can only recognize a prorated portion of the maintenance that has been delivered.

26. If you have a 3rd party IP infringement indemnity clause that compensates in the future with a refund does that preclude revenue recognition?

Actually it really shouldn't have any impact. Assuming that the refund is prorated based on the amount of time and use the customer has derived from the software. It would be recorded as the same as maintenance. The vendor will not be that friendly to this idea. The other argument is how many 3rd party IP infringement cases have been brought against them? The obvious answer should be well none or very few. That being said, the likelihood of a refund is slim and none. The vendor can take the risk...recognize all the revenue upfront and then if there is an infringement settlement, make a notation or restate earnings. Final note, if they have an infringement case...they have bigger alligators in their swamp than revenue recognition.

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