CaptivateIQ

The Hefty Impact of ASC 606 on Sales Commissions

Table of contents

01 What the heck is ASC 606?

In 2018, Adobe performed accounting acrobatics by adopting new rules that capitalized $413 million of commissions that they had previously expensed.

This change was the result of a new set of accounting standards introduced in 2014 that impacted how revenue and some related costs are recognized by all companies.

So what changed?

Introducing ASC 606

A set of new standards called ASC 606 completely changed the way companies account for revenue and related sales commissions. Some consider ASC 606 to be the biggest change in accounting standards in the last 100 years. (Exciting! But we still recommend you read the following post with coffee in-hand!)

Under ASC 606 (also including related changes to ASC 340), companies not only have to modify how they recognize revenue, they must now include certain costs related to capturing that recognized revenue. For many businesses, those costs include sales commissions and now, business must capitalize certain commission costs and amortize those costs over time to match the timing of the revenue recognized. For some companies (like SaaS companies), the accounting changes for sales commissions are a bigger impact than the changes for revenues.

Companies are required to adopt these rules at different times (but can elect to do so earlier):

- US public companies for fiscal years starting after 12/15/2017
- US private companies for fiscal years starting after 12/15/2021 *
- International companies that report under IFRS for fiscal years starting on or after 1/1/2018

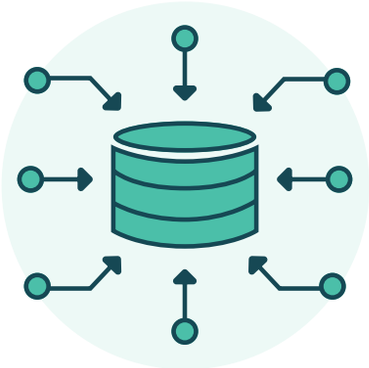
Be sure to check with your accounting department to ensure that you are meeting appropriate deadlines. If you're a private company, your accounting department should have recently completed or is in-process of completing its initial assessment with these new rules.

Notes:
** On May 20, 2020, the FASB voted to extend the deadline by one year from 12/15/2020 to 12/15/2021.*

02 How does this affect my business?

Detailed Data Needs

In order to meet the new ASC 606 requirements and amortize commissions, companies will be forced to disaggregate much of their data. The explosive growth in data volume will make manual management of commissions extremely challenging, if not nearly impossible.



For example, let's say a company used to maintain aggregated sales data based on ARR for the month and would calculate sales commissions based on that aggregated data. Under ASC 606, that company may now need to disaggregate its data to show multiple products with differing revenue patterns (such as up-front revenues for on-premises software and over time revenues for post-contract support). This may require breaking down commissions calculations to the contract or product level, or a reasonable estimation method to disaggregate the commission amounts.

Changing Amortization Considerations

In order to determine how to treat specific types of commissions costs, your team needs to assess three factors:

1. Can this cost be capitalized?
2. If capitalized, what is the life: contract term or expected customer benefit period?
3. If capitalized, what is the pattern of revenue we are trying to match?

Here are some common types of commissions and how they are treated:

Commission Type	Capitalizable	Asset Life
AE 10% commission on new logo	Yes	Customer benefit period ("CBP"), non-commensurate with CSM renewal commission rate
CSM 2% commission on contract renewals	Yes	Contract term, commensurate with the rate for next renewal
Management bonus paid on target attainment of Net New ARR	Yes	CBP, non-commensurate because no commission paid on the subsequent contract's renewal since paid only on new ARR
Management bonus paid on target attainment of renewal rate	Yes	Contract term, commensurate with bonus paid in future years if the plan doesn't change
Fringe benefits	Yes/No	Follows the accounting treatment for the related commission

After you identify the life of the commission cost, you then consider the pattern that you need to match. Here are some common examples:

Product Type	Revenue Pattern
SaaS platform access	Straight-line / ratable
Hardware / physical goods	Upon delivery
On-premise software, perpetual license	Upon delivery
On-premise software, term license	Upon delivery for the portion of the initial contract, then upon renewal for anticipated renewals
Software support	Straight-line / ratable
Professional services: installation, implementation, customization, etc	Most commonly over time as delivered or upon completion.

After you have mapped your costs to their commission requirements, then comes the fun part! Lots of math! You simply calculate an amortization table for each commissionable amount (or portfolio of amounts) that requires capitalization.

A new logo sale with a SaaS platform product amortizes ratably over the estimated customer benefit period. The implementation services on that same contract would be recognized as delivered.

The renewal of the SaaS platform a year later amortizes ratably over the contract term.

03 Where CaptivateIQ can help

You may be an excel wizard, or perhaps you like mixing cake batter by hand rather than by electric mixer because you love a good challenge. In this case, you may feel that managing ASC 606 calculations is a piece of cake (that you just made with hand-mixed batter). After all, if you have 4 commission plans that require a benefit period of 3 years, that's only 144 overlapping amortization tables that you need to build.

However, for those of you who would like to save yourself the hassle of creating hundreds of amortization tables, CaptivateIQ has built a CPA-designed solution to help you adopt ASC 606 for both revenue and commission calculations. And we know that our solution works because we were the ones calculating those hundreds of amortization tables before building CaptivateIQ!

Why CaptivateIQ?

Built by CPAs

Produce ASC 606 ready reports directly from our platform built by accounting experts.

Super Flexible

Take either the Asset approach or Portfolio approach, and make calculations in multiple currencies.

Fully Automated

Save hundreds of hours with automated asset roll-forward reconciliations and journal entry support.

Ready to take on ASC 606 with a modern commission platform?

Schedule a demo with us

04 Helpful buzz words to keep in mind

Performance obligation (POB)

Sales contracts contain the promised goods or services that your company agrees to provide a customer in exchange for consideration (i.e., cash!). Promised goods or services in a contract that require accounting are performance obligations or POB.

Directly incremental

Costs that are directly incremental to obtaining a contract are required to be capitalized and matched to sales revenues. This includes sales commissions, but can also include fringe benefits, management bonuses or anything else that's paid because of closed deals.

Want to know if something is "incremental to obtaining a contract?" Ask yourself, "Was this cost incurred directly as a result of a customer signing a contract?" Travel to a customer for sales? No. Commissions for qualified leads instead of closed won contract? No. Fringe benefits incurred because of a closed won contract (like a 401k match)? Yes.

Capitalized (or deferred) costs

A capitalized (or deferred) cost is not expensed immediately. Thus, the $1,200 commission in the above example would be capitalized and shown as a deferred cost (an asset) until the expense is matched with your sales revenue.

The adoption of ASC 606 means you'll be recording a lot of commission costs as deferred costs.

Commensurate and non-commensurate

The period of time that your capitalized commission costs need to be amortized is determined by whether the related commission is commensurate with costs that would be paid to renew the contract. If you pay a 10% commission on new logo deals (first contract) and a 2% commission on the renewal (second contract), then these commissions are non-commensurate. However, the 2% renewal commission (second contract) is commensurate with the next 2% renewal commission (third contract).

A commensurate commission is recognized over the contract term associated with the related sales revenue. A non-commensurate commission is amortized over an estimated customer benefit period.

Amortization table / waterfall

Amortization is the process of expensing a capitalized cost over time. A list of all of the expenses (in the amount and period) is an amortization table or a waterfall.

Pattern of recognition, revenue pattern, etc.

POBs trigger revenue recognition according to a specific pattern of recognition that varies depending on the type of good or service provided. SaaS platform access or support typically has a pattern of recognition that is ratable over the term of the contract. Physical goods or on-premise software is typically recognized upon delivery. Professional services such as installation, implementation, custom development can vary significantly, but are most commonly either recognized proportionately while the services are performed or deferred until completed.

Portfolio approach

Rather than track these capitalized costs for every commissionable amount, companies can group similar costs with similar recognition requirements into portfolios.

The matching principle

Costs should be recognized in the same period as their related revenues. For example, for a $12,000 annual contract for which you pay a $1,200 sales commission, during each month you will have $1,000 of revenue and $100 of expense for the commission to match the revenue's timing.

Customer benefit period

The estimated customer benefit period is intended to estimate how long a customer benefits from the initial sale. In practice, this number is highly subjective. For example, SaaS and software industry companies commonly will use 3-5 years, but can vary depending on customer churn rates and other factors.

Anticipated renewals

So how do we match a capitalized cost with a customer benefit period of three years when our initial contract has a one year term? We consider the anticipated renewals of the contract. We match the revenue pattern anticipated over a three year life assuming that the customer were to renew his or her contract.