

# THE SAAS CFO'S BLUEPRINT: ASC 606 COMPLIANCE FOR SALES COMMISSIONS

*“ Recognizing Revenue, Amortizing  
Commissions, and Ensuring  
Audit-Ready Reporting ”*





# Table of Contents

- 01. [Introduction](#)
- 02. [ASC 606 for SaaS](#)
- 03. [The Five Step Model Explained](#)
- 04. [Challenges in implementing ASC 606](#)
- 05. [ASC 606 for sales commissions accounting](#)
- 06. [Amortizing sales commissions for ASC 606](#)
- 07. [Commissions that should not be capitalized](#)
- 08. [Sales commission software for ASC 606 compliance](#)
- 09. [Visdum – Trusted Choice for ASC 606 and Sales Commission Accounting](#)

# Introduction

Revenue recognition, especially when it comes to sales commissions, is crucial for SaaS companies. Over time, as business models evolved, there was a clear need for updated guidelines on how to account for these commissions.

ASC 606 was designed to provide a consistent approach to revenue recognition, including the accounting of sales commissions. Before this standard, there were multiple guidelines, which often led to inconsistencies in financial reporting.

The introduction of ASC 606 by the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) aimed to address these inconsistencies and offer a clear path for businesses.

While ASC 606 applies to all businesses, its impact on SaaS companies is unique due to their specific business models and revenue streams.

This eBook focuses on helping SaaS leaders, particularly in understanding and managing sales commissions under ASC 606. It's a guide for founders, CFOs, CROs, FP&A professionals, and financial controllers to navigate the complexities of this standard and ensure their businesses remain compliant.



# ASC 606 For SaaS

---

At its core, ASC 606 directs entities to recognize revenue when the promised goods or services are transferred to the customer.

The amount of revenue recognized should equal the total consideration an entity expects to receive in return for the goods or services.

This standard is particularly important for SaaS companies due to their unique subscription-based business models, which often include upfront fees and multiple performance obligations.

Recognizing revenue accurately over the duration of a contract becomes crucial, and ASC 606 provides the guidelines to achieve this.



# ASC 606 For SaaS

---

However, while the standard offers a unified approach, SaaS companies face specific challenges:

- **Multi-Element Arrangements:** Many SaaS contracts bundle several products or services together. How to allocate the transaction price to each element becomes a key consideration.
- **Contract Modifications:** Any changes to the contract, like adding new services, can affect how revenue is recognized.
- **Renewals and Commissions:** How to account for commissions, especially upon renewals, is another area of focus.
- **Customer Incentives:** Offering discounts or free trials can impact the timing and amount of revenue recognized.
- **Contract Term and Cancellation Provisions:** The potential for customers to cancel or change their subscriptions can influence revenue recognition.
- **Implications for International SaaS Companies:** Operating in multiple countries brings in additional considerations like currency fluctuations and local tax regulations.

These challenges highlight the need for SaaS companies to have a deep understanding of ASC 606 to ensure accurate financial reporting and compliance.



# The Five-Step Model Explained

---

The Five-Step Model isn't just a regulatory requirement; it's a strategic tool that, when understood and applied effectively, can provide valuable insights into a company's financial health and customer relationships.

For SaaS companies, where revenue streams are often complex and intertwined with various customer contracts and obligations, mastering this model is not just beneficial – it's essential.

In this section, we will delve into each of the five steps, unraveling their intricacies and demonstrating their application

## **Step 1: Identify the Contract with a Customer**

Every revenue recognition journey begins with a contract. In the SaaS world, contracts often manifest as digital agreements, such as online subscription sign-ups or click-through agreements.

It's essential to recognize when an agreement with a customer truly constitutes a contract under ASC 606. This means there must be mutual understanding, clear terms, and an expectation of payment in exchange for goods or services.

### **What this means for SaaS Companies:**

- Ensure digital contracts are legally enforceable.
- Track and store customer consent for recurring billing agreements.
- Consider the "freemium" models and their implications.

### **Common contract types in SaaS:**

- Monthly or Annual Subscriptions
- Usage-Based Contracts
- Enterprise Agreements
- Freemium to Premium Upgrades
- Partner or Reseller Agreements

## **Step 2: Identify the Performance Obligations**

Performance obligations are the heart of a contract. They represent the promises a company makes to transfer goods or services to a customer. For SaaS companies, these obligations often extend beyond just providing software access.

It's crucial to identify each distinct promise made to the customer, as each of these could represent a separate performance obligation.

### **What this means for SaaS companies:**

- Define what constitutes a "distinct" service.
- Understand the implications of "lifetime access" promises.
- Consider additional services like custom integrations.

### **Common Performance Obligations in SaaS:**

- Software Access
- Maintenance and Support
- Data Storage
- Integration Services
- Training Services
- Onboarding and Implementation



## **Step 3: Determine the Transaction Price**

---

Determining the transaction price involves identifying the amount of consideration a company expects in exchange for fulfilling its performance obligations.

For SaaS companies, this can be a complex task due to variable pricing, tiered subscriptions, and potential refunds or concessions.

### **What this means for SaaS companies:**

- Account for free trials or discounted periods
- Estimate and recognize variable considerations
- Understand non-refundable setup fees

### **Discounts, Rebates, and Other Price Adjustments:**

- Early Payment Discounts
- Volume Rebates
- Referral Discounts
- Contract Renewal Discounts
- Loyalty Discounts

## Step 4: Allocate the Transaction Price to the Performance Obligations

---

Once the total transaction price is determined, it must be allocated to the identified performance obligations. This allocation is based on the standalone selling price of each obligation.

For SaaS companies, bundled services and products can make this allocation challenging.

### What this means for SaaS companies:

- Allocate prices for bundles with one-time and recurring charges.
- Consider significant financing components for upfront payments.
- Allocate discounts across multiple obligations.

### Allocation Methods and Challenges:

- Direct Pricing
- Estimated Cost Plus Margin
- Residual Approach
- Bundled Discounts
- Adjusted Market Assessment

## **Step 5: Recognize Revenue When (or as) the Entity Satisfies a Performance Obligation**

---

The final step involves recognizing the revenue as the company fulfills its promises to the customer.

For SaaS companies, this often means recognizing revenue over time as the service is provided, rather than at a single point in time.

### **What this means for SaaS companies:**

- Recognize revenue over time for long-term contracts.
- Understand milestones or deliverables' impact.
- Address customer churn or contract cancellations.

### **Milestones and deliverables in SaaS:**

- Feature Launch
- Service Level Achievements
- Data Migration Completion
- Integration Completion
- End of Trial Period



# Challenges in Implementing ASC 606

---

Implementing ASC 606, especially for SaaS companies, can be a complex endeavor. While the standard aims to bring clarity and consistency to revenue recognition, the transition to this new approach presents its own set of challenges.

Here's a deep dive into some of the primary hurdles SaaS companies might face:

## **Challenge 1: Identifying all Revenue Streams**

For SaaS companies, revenue streams can be diverse. From monthly subscriptions to one-time setup fees, usage-based charges, and even affiliate partnerships, each revenue stream has its own nuances.

### **What this means for SaaS companies:**

- Conduct a comprehensive audit of all revenue-generating activities.

# Challenges in Implementing ASC 606

---

- Understand the specific performance obligations associated with each revenue stream.
- Be wary of hybrid models that combine multiple revenue streams, as they can complicate recognition.

## Challenge 2: Assessing the Impact of Financial Statements

The shift to ASC 606 can significantly alter how revenue appears on financial statements, impacting metrics like monthly recurring revenue (MRR) or customer lifetime value (CLV).

### What this means for SaaS Companies:

- Re-evaluate key financial metrics in light of ASC 606.
- Communicate with stakeholders about potential shifts in reported revenue.
- Consider the implications for investor relations, especially if there are drastic changes in reported earnings.

## Challenge 3: Addressing Internal Controls

With new revenue recognition rules, internal controls around financial reporting must be reassessed and potentially revamped.



# Challenges in Implementing ASC 606

---

## What this means for SaaS companies:

- Review processes for contract approval, revenue recognition, and financial reporting.
- Ensure controls are in place to handle variable considerations, such as refunds or performance bonuses.
- Regularly audit internal controls to ensure compliance with ASC 606.

## Challenge 4: Educating Employees

The transition to ASC 606 isn't just a challenge for the finance team. Sales, customer support, and even product teams need to understand the implications of the new standard.

## What this means for SaaS companies:

- Conduct training sessions for teams involved in contract formation or execution.
- Ensure sales teams understand the implications of contract terms for revenue recognition.
- Foster cross-departmental communication to ensure everyone is aligned.

# Challenges in Implementing ASC 606

---

## Challenge 5: Ensuring System Readiness

Many SaaS companies rely on automated systems for billing and revenue recognition. These systems must be updated or replaced to handle the intricacies of ASC 606.

### What this means for SaaS companies:

- Assess current financial software for ASC 606 compliance.
- Consider investing in specialized revenue recognition software if current systems are inadequate.
- Regularly update systems to address changes or clarifications in the standard.

Adopting ASC 606 is a significant undertaking, but with careful planning and a thorough understanding of the standard's nuances, SaaS companies can navigate this transition successfully.



# Implementing ASC 606 for Sales Commissions Accounting

---

ASC 606 significantly changes revenue recognition, particularly affecting sales commissions in SaaS companies.

It's a strategic shift, not just a compliance issue, altering how sales commissions are accounted for and recognized.

## The Shift From Traditional Methods

Traditionally, sales commissions were recognized as expenses when paid. ASC 606 revises this, requiring some sales commission costs to be capitalized and recognized over the revenue period.

This aligns commission expenses more closely with the revenue they generate.

# Implementing ASC 606 for Sales Commissions Accounting

---

## Understanding Sales Commissions Expense with Sub-topic ASC 340-40

With ASC 606, ASC 340-40 was also introduced. It focuses on the accounting of commission expenses in customer contracts, part of the ASC 340 revenue recognition standard.

This sub-topic guides the amortization of capitalized commission costs over the contract's life.

## Estimation and Recognition of Commission Expense

Under ASC 606 and ASC 340-40, estimating and recognizing commission expenses is more detailed. SaaS companies must capitalize and amortize commissions over the contract term, a change from immediate expense recognition.

This applies to sales commissions, related bonuses, and fringe benefits. Implementing these standards ensures accurate, compliant financial reporting for SaaS companies.



# Amortizing SaaS Sales Commissions for ASC 606

---

For SaaS leaders, navigating the financial intricacies of sales commissions and their amortization is more than just numbers—it's about ensuring compliance, financial accuracy, and understanding the value delivered to customers.

## How Some Sales Commissions Might Be Treated:

Different roles in a SaaS company have varied commission structures:

### Customer Success Managers (CSMs)

Think of CSMs as the champions of customer retention and upselling. If their commission directly correlates with a contract's renewal or expansion, it's a prime candidate for capitalization.

But, if it's more about nurturing the customer relationship, it might not qualify.



# Amortizing SaaS Sales Commissions for ASC 606

---

Imagine a CSM securing a significant upsell halfway through a client's contract. This could lead to a higher commission, which, if directly tied to that upsell, might be capitalized and amortized over the remaining contract duration.

## Sales Development Representatives (SDRS)

SDRs are the gatekeepers, ushering in potential leads. If their commission is tied to a successful sale, it's up for capitalization.

But if it's for just setting the stage, it might not be.

An SDR might get a commission for every lead that converts into a sale. If 10 leads convert in a month, and each lead brings in a commission of \$50, that's a potential \$500 to consider for capitalization.

## Pre-Sales Consultants or Solution Architects

These are the tech wizards, ensuring the product fits the client's needs. If their commission is contingent on a sale, it's a strong contender for capitalization. However, post-sale involvement might change this.



# Determining commissions that should not be capitalized

---

The golden rule? Understand the "incremental costs of obtaining a contract." If incurring a cost is directly because of securing a contract, it's on the table for capitalization.

## Costs That Should Not Be Capitalized

It's essential to differentiate between costs that yield future benefits (capitalized) and those that benefit the current period (expensed). Here's a quick guide on the costs that should not be capitalized:

- Research during preliminary project stages.
- Routine software maintenance.
- Employee training on new software.
- General overheads not tied to software development.
- Marketing and promotional activities.
- Inefficiencies during software development.
- Bug fixes post initial development.
- Ongoing customer support.
- Costs after establishing a product's technological feasibility.
- Data conversion, unless essential for functionality.
- Recurring subscription and licensing fees.

# Role of Sales Commission Software in ASC 606 Compliance

---

The adoption of sales commission software plays a pivotal role in helping SaaS companies align with the ASC 606 revenue recognition standard.

## Benefits of Sales Commission Automation

- **Accuracy in Calculations:** Automated systems ensure precision in commission calculations, crucial for accurate financial reporting.
- **Streamlined Revenue Recognition:** Aligns the process of recognizing commissions with the revenue they help generate, as required by ASC 606.

# Role of Sales Commission Software in ASC 606 Compliance

---

## Key Features to Look for in Commission Software

- **Integration Capabilities:** Seamless integration with CRM and other financial systems to ensure data consistency and accuracy.
- **Customization Options:** Flexibility to tailor commission structures in line with company-specific needs and ASC 606 requirements.
- **Real-Time Reporting:** Capability to generate real-time reports, enhancing transparency and timely decision-making.

## Integration with Other Financial Systems

- **Data Synchronization:** Ensures that all financial systems work in harmony, providing a unified view of revenue and expenses.
- **Compliance Ease:** Simplifies the process of adhering to ASC 606 standards by integrating sales commission data into overall financial reporting.

# Visdum – Trusted Choice for ASC 606 Sales Commission Accounting

---

Visdum is your go-to tool for handling sales commission accounting the easy way. It's great for following ASC 606 rules and works well with other tools you already use.

## Here's How to Do It in Four Easy Steps:

1. **Pick Your Dates:** First, choose the dates you want to look at. This can be for a month, a quarter, or even a whole year.
2. **Sort Your Sales:** Group your sales the way you want. You can also leave out certain commissions, like those for your business development or customer success teams.
3. **Choose Your Amortization Method:** Decide if you want to spread out the commission costs over the contract length or the expected time you'll have the customer.
4. **Map and Report:** Finally, line up your data and create reports that show you're following ASC 606 rules.

**Ready to Make Commission Accounting Simpler?**



# Streamline your ASC 606 commission accounting today

Write to us at [jeetesh@visdum.com](mailto:jeetesh@visdum.com) for a personalised demo.

Want to see your comp plans live on Visdum? Sign up [here](#).

Still confused? Check us out on [G2](#).

Want to read more such content? Follow us on [LinkedIn](#).



[www.visdum.com](http://www.visdum.com)