Most software and software-as-a-service (SaaS) companies will see an impact from the adoption of ASC 606 on their revenue accounting. These changes will frequently be significant, particularly when implementation or upfront customization/setup services are offered. Highlights of step-by-step impacts for technology and SaaS entities include the following.

**STEP ONE: IDENTIFY THE CONTRACT**

- Not all Master Service Agreements (MSA) are contracts by themselves.
- If the MSA does not, by itself, establish an ASC 606 contract (for example, it does not create enforceable rights and obligations to provide services or transfer software licenses), an associated Statement of Work (SOW) is required to establish an ASC 606 contract.

**STEP TWO: IDENTIFY THE PERFORMANCE OBLIGATIONS**

- The identification of distinct performance obligations (DPO) is a significant change for companies in the software and technology industry. ASC 606 eliminates current software industry-specific guidance under US GAAP and thus, vendor specific objective evidence (VSOE) of fair value is no longer required to separately account for elements in a software licensing or SaaS arrangement.
- Not separating DPOs due to an absence of discernible, routinely priced standalone transactions will not be an option. In that situation, an entity will be required to estimate a standalone selling price (SSP) in Step 4.
- SaaS companies will need to assess whether up-front activities are a DPO (and thus revenue) or “set-up activities”. Under ASC 606, set-up activities (i.e. simply activating the customer and providing a login) do not provide an incremental benefit to the customer, and thus usually do not constitute a DPO.
- Installation services: consider whether the customer can benefit from those services on their own. If third-party vendors offer (or are capable of offering) installation services for the entity’s software, or if the customer could perform these services on its own, then the installation services provide a benefit to the customer on their own apart from the software purchased (and therefore constitute a DPO).

**EXAMPLES:** To the extent deemed material within the context of the contract: software licenses, professional services, specified upgrades, SaaS, or post-contract customer support (PCS).
STEP THREE: DETERMINE THE TRANSACTION PRICE

☐ Only high quality and probable estimates of variable consideration are included in the total transaction price. Examples of variable revenue elements include:

  ○ Price discounts or concessions
  ○ Rebates / refunds / credits
  ○ Extensions of scheduled payment obligations
  ○ Milestones
  ○ Performance bonuses

STEP FOUR: ALLOCATE THE TRANSACTION PRICE

This step only applies if there are more than one DPO. The total transaction price will be allocated to each DPO in proportion to the SSP of each. Specific considerations include:

☐ As software licenses [and hosted applications] are frequently bundled with other products and services, the SSP of the license may not be directly observable. ASC 606 permits good quality estimates of the SSP for each deliverable, including the license.

☐ If there is a lack of history of selling a DPO on a standalone basis in a contract with variable pricing on a bundled arrangement, the `residual approach` is usually the best method to determine and estimate the SSP.

☐ When evaluating whether or not the residual approach for estimating SSP is reasonable, the entity should bear in mind:

  ○ Consistency with the entity’s pricing strategy
  ○ Comparison to similar products or services offered by the entity (or its competitors)
  ○ Analyzing the cost to determine whether the estimated selling price yields an appropriate margin

☐ If an entity had previously established VSOE of fair value under the legacy revenue recognition guidance that VSOE is usually the SSP.

STEP FIVE: RECOGNIZE REVENUE

☐ For SaaS or technical support services [i.e. “help desk”), the customer contemporaneously obtains and consumes the benefits [i.e. access to the hosted software or platform for its intended use]. As such, control of the service transfers to the customer over time, and revenue is recognized ratably over time.

☐ Similarly, an entity may conclude that unspecified software updates provided on a when-and-if-available basis represent a ‘stand ready’ service that it makes available to the customer. Estimating the timing of deliverables under these types of engagements usually is not feasible. In these scenarios, the passage of time may be the best method that most suitably depicts the entity’s satisfaction of the performance obligation.

☐ Revenue previously deferred due to a lack of VSOE will likely be accelerated under ASC 606. For example, significant up-front integration or customization services that provide an incremental and identifiable benefit to the customer [i.e. upon achievement of a “go-live” date].

☐ These changes could also result in the need for significant modifications to the information systems currently used to record revenue.

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