Revenue recognition: A Q & A guide for software and SaaS entities

Revenue recognition: A Q&A guide for software and SaaS entities

At a glance

Although the revenue recognition guidance applies the same accounting model across all industries, there are a number of unique considerations when accounting for software and software-as-a-service (SaaS) arrangements. We've developed a series of Q&As to help you navigate common issues that arise in these arrangements.

Glossary of key terms

EITF	Emerging Issues Task Force
IP	Intellectual Property
PCS	Post-Contract Customer Support
PwC FSP guide	PwC's Financial statement presentation guide
PwC Revenue guide	PwC's Revenue from contracts with customers guide
SaaS	Software-as-a-Service
SLA	Service Level Agreement
SSP	Standalone Selling Price

The eight issue areas addressed in this Q&A guide

Easy reference Q&A index

Q&A guide for software and SaaS entities

Ref #	Question	Response
Identifying the contract		
1	How do customer termination rights impact the accounting for a software license?	Customer termination rights could result in a contract term for purposes of applying ASC 606 that is shorter than the stated term. The contract term for purposes of applying ASC 606 is the period during which the parties have present and enforceable rights and obligations. Therefore, it is important to identify any termination rights in a contract, as well as any refunds received or penalties due upon termination. Consider an example in which a customer is granted a four-year software license but is able to cancel at the end of each year and receive a pro-rata refund of the license fee. In that scenario, there are enforceable rights and obligations for one year only. The customer effectively has the option to “renew,” or enter into a new license, after one year. Revenue allocated to the one-year license is typically recognized at the beginning of the license term and amounts allocated to the option to enter into additional one-year licenses in the future is deferred until the customer renews the license by choosing not to exercise the termination right. The likelihood of the customer exercising the termination right is not considered in the determination of the contract term. In this example, even if the customer is not expected to cancel the license at the end of one year, enforceable rights and obligations do not extend beyond the first year. On the other hand, termination rights that are non-substantive, similar to other non-substantive contract terms, do not impact the accounting for the contract. Consider an example in which a customer is granted a four-year software license that can be cancelled at the end of one year, but the customer is not entitled to any refund upon cancellation (that is, the customer is still obligated to pay the entire license fee). In that scenario, the termination right likely lacks substance; thus, there are enforceable rights and obligations for the duration of the four-year contract. Similarly, if the customer is required to pay a substantive penalty to cancel the contract, the termination right is generally disregarded for purposes of determining the contract term. Determining the contract term for a software license when the customer has termination rights can require significant judgment. The objective is to determine the period over which the parties have enforceable rights and obligations. For a software license, a key consideration is whether the customer is making a decision to renew the license by choosing not to exercise a termination right. If so, the enforceable rights and obligations are limited to the noncancellable license period. **PwC Revenue guide reference:** Section 2.7 (Determining the contract term)
2	How do customer termination rights impact the accounting for a SaaS arrangement?	Customer termination rights could result in a contract term for purposes of applying ASC 606 that is shorter than the stated term. See Q&A 1 for further discussion of the contract term and consideration of refunds received or penalties paid upon termination. Because revenue from a SaaS arrangement is generally recognized over the contract term, the recognition of revenue may not be impacted by a termination right. For example, consider an arrangement in which the vendor provides a customer with access to its SaaS platform for three years, for a total fee of $90,000; however, the customer can terminate the contract for convenience with 30 days notice and is only required to pay for the period over which the customer received services. In this scenario, the contract is treated as a month-to-month service contract despite the three-year stated term. For revenue recognition, if the vendor determines that straight-line recognition is appropriate, it recognizes $2,500 ($90,000/36) per month regardless of whether the contract term is one month or three years. There are certain scenarios when the contract term determination could impact revenue recognition for a SaaS arrangement. For example, if the contract has other performance obligations in addition to the SaaS, only the noncancellable SaaS term and related fee ($2,500 for one month of SaaS in the above example) is included when allocating transaction price to the performance obligations. Additionally, if the price of the SaaS increases over the stated term, the transaction price is limited to the fee for the noncancellable SaaS term (see Q&A 1). In contrast, if the price of the SaaS decreases over the stated term, the vendor assesses whether the future discounts provide the customer with a material right. Additionally, customer termination rights may impact a software vendor’s required disclosures. ASC 606-10-50-13 requires disclosure of information about the transaction price allocated to remaining performance obligations (RPO disclosure). This disclosure only includes the noncancellable term of the SaaS. In the above example, amounts related to periods beyond the 30-day notice period are not included in the RPO disclosure for the SaaS arrangement because it is a month-to-month

Ref #	Question	Response
		contract, even though the stated term is three years. **PwC Revenue guide reference**: Section 2.7 (Determining the contract term) **PwC FSP guide reference**: Section 33.4.3.2 (Remaining performance obligations)
3	How should extended payment terms be considered in software arrangements?	Extended payment terms are those that are outside the software vendor's customary payment terms. Extended payment terms could impact the software vendor's assessment of collectability as well as the determination of the transaction price. A software vendor considers collectability in assessing whether a contract exists in step 1 of the revenue recognition model. Extended payment terms could impact a software vendor's assessment of the customer's ability and intent to pay when payments become due. Extended payment terms on their own are not determinative in the collectability assessment and management needs to consider all relevant facts and circumstances. However, if the software vendor concludes that collection of substantially all of the transaction price is not probable, it further concludes the criteria are not met to account for the contract under the revenue standard. Extended payment terms may also increase the likelihood that a software vendor will forgive payments or provide price concessions to customers. If a contract includes an implied price concession, this is considered variable consideration and the transaction price is reduced by the amount of the expected concession. Additionally, extended payment terms could indicate the contract includes a significant financing component. ASC 606-10-32-16 provides factors to consider to determine whether a significant financing component exists, which may require judgment. Vendors can elect a practical expedient to disregard the effects of a financing component if the period between the transfer of the good or service and receipt of payment is one year or less. If the software vendor concludes that the contract includes a significant financing component, a portion of the consideration in the contract with the customer represents interest income. In this scenario, the amount of revenue ultimately recognized is less than the cash received since the difference represents interest income. **PwC Revenue guide references**: Section 2.6.1.5 (Collection of the consideration is probable), Section 4.3.2 (Constraint on variable consideration), and Section 4.4 (Existence of a significant financing component)
Identifying the performance obligations		
4	Is a software license always considered a license of functional IP?	Yes. Software is considered functional IP because it has standalone functionality and the customer can use the IP as it exists at a point in time. This is consistent with BC56 of ASU 2016-10, which cites software as an example of functional IP. Therefore, revenue for a distinct software license is recognized at the point in time that control is transferred to the customer. This is typically the beginning of the license term, regardless of whether the software license has a stated term or is perpetual. A software vendor also needs to assess whether a software license provided with other goods or services is distinct. If the software license is not distinct, it is combined with other goods and services and the timing of revenue recognition is based on the combined performance obligation (which could be over time). For example, if a software vendor promises to deliver a software license and one year of PCS, the software vendor needs to determine whether the software license and PCS are distinct, or whether they are to be accounted for as a single performance obligation (see Q&A 7). As discussed in ASC 606-10-55-56, a software license is also not distinct if (1) it is embedded in a tangible good and is integral to the functionality of that good or (2) it can only be used in conjunction with a related service (e.g., a license that solely enables a customer to access an online service). **PwC Revenue guide references:** Chapter 9 (Licenses) and Section 3.4 (Assessing whether a good or service is "distinct")
5	How should a software vendor account for a license arrangement in which the number of seats or users increases each year?	Some software arrangements are structured so that the customer obtains the rights to an increasing number of seats or users over the contract period. The parties may negotiate these terms because the customer expects it will utilize more seats or users in future periods due to forecasted growth. Consider an example in which a software vendor enters into a noncancellable three-year contract with a customer that provides the customer with rights to 100 users in 20x1, 200 users in 20x2, and 300 users in 20x3. In this situation, the software vendor has promised to provide additional rights to use the software each year of the contract. Therefore, it may be appropriate to account for the arrangement as three distinct licenses (and separate performance obligations): (1) a three-year license for 100 users commencing January 1, 20x1, (2) a two-year license for 100 users commencing January 1, 20x2, and (3) a one-year license for 100 users commencing January 1, 20x3.

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		It is not appropriate to account for the additional seats or users as separate performance obligations if the increasing number over the contract period does not have substance (e.g., the customer could not practically utilize more than 100 users in the above example) and the number of users is only a mechanism to achieve deferred payment terms for the customer. Further, it may require judgment to differentiate between contract terms that indicate that the software vendor has promised to transfer multiple distinct licenses (i.e., additional rights to use the software) to the customer and contract terms that represent attributes of a single license (i.e., terms that define the scope of the customer's rights to use the software). A contract that provides a customer the option to purchase additional seats or users in the future may include a customer option that is assessed to determine whether it provides a material right (see Q&A 17). **PwC Revenue guide reference**: Section 9.6 (Restrictions of time, geography or use)
6	Are the components of PCS distinct from each other?	PCS arrangements often include multiple promises that are distinct from one another. For example, PCS may include both when-and-if available updates and upgrades and phone support. These two components are likely each capable of being distinct and separately identifiable. However, in many instances, the components of PCS are stand-ready obligations that are delivered to the customer concurrently (see Q&A 24). Consistent with the concept discussed in BC116 of ASU 2014-09, if the PCS components are delivered concurrently and have the same pattern of transfer, a software vendor may account for PCS as a single performance obligation. In this case, the outcome is the same as accounting for the PCS components as separate performance obligations. **PwC Revenue guide reference**: Section 3.3.2 (Promise to transfer a series of distinct goods or services)
7	What factors should be considered in determining whether a software license and promise to provide updates to the software should be combined into a single performance obligation?	A software license is combined with a promise to provide updates if the updates significantly modify the software or if the software and updates are determined to be highly interdependent or highly interrelated. A key consideration is whether the updates are critical to maintaining the utility of the software. This assessment will often require significant judgment. Some factors that may indicate that the software license and promise to provide updates is combined into a single performance obligation include: • Providing updates is essential to fulfilling the promise in the contract and the intended purpose of the software. • The updates relate to the core functionality of the software; utility of the software declines quickly and significantly (relative to the contract term) without the updates. • The updates are related to changes caused by external factors outside the software vendor's control that impact the software's ability to function as intended. • The software vendor has more than insignificant resources dedicated to monitoring external factors, identifying the need for updates, and developing and releasing the necessary updates. • The updates are expected to be frequent relative to the contract term. There is not a minimum number of updates needed to qualify as "frequent"; however, updates should be frequent enough that the utility of the software would decline quickly without the updates. Only critical updates are included when assessing frequency of updates. • Evidence supports that customers download/accept updates when they are made available. • The customer cannot practically obtain the updates from another source. None of the above factors are individually determinative and there may be other relevant facts and circumstances to consider. If a license and a promise to provide updates are combined, the outcome is generally a performance obligation for which control transfers over time. ASC 606 Example 10C and Example 55 illustrate fact patterns in which a software license is combined with a promise to provide updates. **PwC Revenue guide reference**: Section 9.3 (Determining whether a license is distinct)

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8	What factors should be considered in determining whether a software license and cloud-based services should be combined into a single performance obligation?	An arrangement that includes both a license to on-premises software and cloud-based services (such as SaaS) is sometimes referred to as a "hybrid cloud" offering. If a customer can only benefit from a license in conjunction with a related service (e.g., the software is used solely to access an online service), the license is not distinct in accordance with ASC 606-10-55-56. If the on-premises software has standalone functionality (i.e., capable of being distinct), the software and cloud-based services are generally only combined if the vendor can demonstrate that the components are highly interdependent or highly interrelated. This assessment requires a thorough understanding of the functionality provided by each of the components and how they interact with each other. Significant judgment is often required to determine whether the on-premises software is distinct from the cloud-based services. Some factors that may indicate that the software license and cloud-based services are highly interdependent or highly interrelated and therefore, are combined into a single performance obligation include: • There is significant and regular two-way interaction between the on-premises software and SaaS, as opposed to a one-way hand-off between the elements. • The interaction between the elements is critical for the user to obtain the intended benefit from the arrangement. • The two elements together provide new or different functionality; in other words, the SaaS functionality is transformative rather than additive. Note that obtaining increased efficiencies by using the two elements together is generally not considered transformative on its own. The value of the SaaS to the customer and its influence on the customer's decision to purchase the offering does not dictate whether the functionality is "additive" or "transformative." • The customer cannot practically obtain similar benefits provided via the SaaS from other sources. • Contracts, marketing materials, and other customer communications describe the offering on a combined basis rather than as two separate elements. This factor is not conclusive on its own and it is only used as supporting evidence. None of the above factors are individually determinative and there may be other relevant facts and circumstances to consider. If a license and cloud-based services are combined, the outcome is generally a performance obligation for which control transfers over time. **PwC Revenue guide reference**: Section 9.3 (Determining whether a license is distinct)
9	When does a hosting arrangement (in connection with licensing software products) include a software license?	In a hosting arrangement, the end user does not take possession of the software being licensed by the vendor; instead, the hosted software resides on the vendor's or a third party's hardware with the customer accessing the software remotely. In accordance with ASC 985-20, *Costs of Software to be Sold, Leased, or Marketed*, a hosting arrangement includes a software license only if both of two criteria are met: 1. the customer has the contractual right to take possession of the software at any time during the hosting period without significant penalty, and 2. it is feasible for the customer to run the software on its own or by contracting with an unrelated third party. The phrase "without significant penalty" refers to the ability to take delivery of the software without incurring significant cost and use the software separately without a significant diminution in utility or value. Significant costs could include penalties that the customer would incur for terminating the hosting arrangement (including forfeiting a nonrefundable upfront payment for services), as well as costs the customer would incur for the necessary infrastructure to host the software itself. "Significant diminution in utility or value" generally refers to a reduction in features, functions, processing speed, or computing power of the software, including losing the right to receive upgrades or updates that are integral to the functionality of the software. If the hosting arrangement meets both of the criteria in ASC 985-20, it includes a software license and a hosting service, which will typically be two separate performance obligations. A hosting arrangement not meeting both of these criteria is accounted for solely as a service contract. **PwC Revenue guide reference:** Section 9.3 (Determining whether a license is distinct)

Ref #	Question	Response
10	What is the accounting treatment for a right in a software arrangement to convert an on-premises software license to a SaaS arrangement?	A continuing trend in the software industry is the desire to transition customers from on-premises software to a SaaS arrangement. A software vendor may enter into a software license agreement with a customer that includes the contractual right, at the customer's option, to convert the on-premises software license to a SaaS arrangement. The customer often receives a "credit" towards the purchase of the SaaS equal to the "unused" portion of the license term at the time the option is exercised. If the customer does not have to forfeit the license to obtain the SaaS, then the SaaS is an additional service that the customer has the option to purchase. The software vendor assesses whether the option provides a material right based on whether pricing in the contract provides a discount incremental to the range of discounts typically given to that class of customer. The revenue standard does not directly address the accounting model in scenarios when the customer must forfeit the license to obtain the SaaS. • If the customer must pay an incremental fee equal to the SaaS SSP when it purchases the SaaS (that is, the customer pays SSP for the SaaS in addition to paying in full the original license fee), the customer has purchased the SaaS in addition to the license. The contract does not contain a material right and the purchase of the SaaS is accounted for when it occurs. • If the customer pays an incremental amount that is less than the SaaS SSP when it exercises the option (generally, as a result of receiving a "credit" for the "unused" license), we believe there are two primary views: ○ Alternative A – The right represents a future discount on a SaaS purchase (i.e., a material right). The software vendor determines the SSP of the material right and allocate a portion of the total transaction price to the material right. The allocated revenue is recognized as the right is used (i.e., the customer converts to SaaS) or expires. Under this accounting alternative, the credit is treated as an incentive to purchase the SaaS, not compensation for "returning" the license. ○ Alternative B – The right represents a right of return for the license (i.e., variable consideration). The software vendor estimates a refund liability in accordance with ASC 606-10-55-25 and updates the estimate each period until the license is "returned" or the right expires. Under this accounting alternative, the credit is treated as compensation for "returning" the license. A software vendor assesses its specific facts and circumstances, including the substance of each transaction, to determine the most appropriate accounting approach. In certain fact patterns, either of these alternatives may be acceptable. See Q&A 29 for discussion of the accounting for the modification of an on-premises software license to convert to a SaaS arrangement.
11	Is a SaaS arrangement a series of distinct services?	A SaaS arrangement that is a promise to provide access to SaaS (e.g., a "platform") typically meets the criteria to be accounted for as a series of distinct goods or services and therefore, be considered a single performance obligation. To meet the criteria to be accounted for as a series pursuant to ASC 606-10-25-14(b), the distinct goods or services provided must both (1) be substantially the same and (2) have the same pattern of transfer to the customer. These criteria are often met with a SaaS arrangement because each period of service (e.g., each day of service) is distinct and the services provided each period are substantially the same (i.e., access to SaaS). Further, the services meet the requirements for over-time recognition, and a software vendor uses the same measure of progress for the services in each period (e.g., time-based recognition). See Q&A 25 for discussion of assessing whether a SaaS arrangement is (1) a promise to provide access to SaaS or (2) a promise to provide a specified amount of services. **PwC Revenue guide reference**: Section 3.3.2 (Promise to transfer a series of distinct goods or services)
12	Are rights to "updates" included in a SaaS arrangement (that is solely a service) a separate performance obligation?	Generally, no. SaaS arrangements may refer to rights to when-and-if available updates and upgrades, similar to PCS in a software license arrangement. If the promise is to update or maintain the software vendor's own software that multiple customers access as part of the SaaS service, this likely is not considered a performance obligation to the customer that is separate from the ongoing SaaS service. However, if the SaaS arrangement includes a promise to deliver an additional service to the customer in the future as result of a software update (e.g., incremental functionality), the SaaS vendor assesses whether the additional service is distinct and therefore a separate performance obligation.

Ref #	Question	Response
		PwC Revenue guide reference: Section 3.4 (Assessing whether a good or service is "distinct")
13	Are set-up or implementation activities performed by a vendor in a software or SaaS arrangement considered a separate performance obligation?	The conclusion will depend on whether the set-up or implementation activities transfer a good or service to the customer, and if so, whether the good or service transferred is distinct from the software or SaaS arrangement, as illustrated in Figure 13-1. The first evaluation is whether the set-up or implementation activities transfer a good or service to the customer, either as an explicit or implicit promise to the customer. This will depend on the nature of the activities performed. Set-up or implementation activities that modify the vendor's own infrastructure or assets (e.g., systems or platforms) or involve training the vendor's own personnel in preparation to provide services to the customer represent activities the vendor undertakes to fulfil a contract with a customer. These activities do not transfer goods or services to the customer and therefore, are not performance obligations. The vendor considers, however, whether the costs are capitalized under the cost to fulfil guidance in ASC 340-40. In contrast, set-up or implementation activities that modify the customer's infrastructure or assets or involve providing training or consulting services to the customer's personnel likely are promises to transfer a good or service to the customer. If the activities transfer a good or service to the customer, the next evaluation is whether those goods or services are distinct from the software or SaaS arrangement based on the guidance in ASC 606-10-25-19. Factors indicating that the set-up or implementation is distinct, and therefore a separate performance obligation, could include: • The customer's own employees or another vendor could perform the activities (e.g., there is a bidding process for the set-up/implementation phase). • The customer receives a benefit from the goods or services separate from the software/SaaS (e.g., an improved business process or hardware/software asset that can be used for other purposes). • The customer's purchase of the goods or services is optional (e.g., optional training or consulting services). • The vendor has historically offered the SaaS without set-up or implementation services to other customers. • The set-up or implementation services do not significantly alter any functionality of the SaaS and are not significantly integrated, or highly interdependent, or highly interrelated with the SaaS. • Providing the set-up or implementation services does not require a highly specialized or complex skill set. None of these factors are individually determinative and there may be other relevant facts and circumstances to consider. **Figure 13-1** Whether set-up or implementation activities represent a separate performance obligation

Ref #	Question	Response
		Question 1: Do the set-up or implementation activities transfer a good or service to the customer? No → The set-up or implementation activities are not a separate promise to the customer. Account for them as costs to fulfill the contract. Yes → Question 2: Is the promised good or service (1) capable of being distinct and (2) separately identifiable from the software or SaaS arrangement? No → Set-up or implementation service are bundled with the software or SaaS arrangement into a single performance obligation. Yes → Account for the set-up or implementation services as a separate performance obligation. **PwC Revenue guide references**: Section 3.3 (Identifying performance obligations) and Chapter 11 (Contract costs)
14	If a contract includes optional services free of charge (e.g., up to a specified number of training or consulting hours), does this represent a material right?	Yes, a customer option to obtain services free of charge provides a material right unless the value of the services is determined not to rise to the level of "material" in the context of the arrangement. The 100% discount is incremental to that typically offered to customers purchasing the services and the customer would not otherwise receive the free services without entering into the current arrangement. Therefore, the transaction price is allocated to the option to obtain the services based on relative SSP, which incorporates the likelihood of the customer opting to obtain the services. For example, a software vendor sells a two-year software license for $100,000 and provides the customer up to 150 free consulting hours upon request, which is determined to be a material right. The contract includes two performance obligations: (1) a software license and (2) an option to obtain 150 free consulting hours. The software vendor determines that the license has a SSP of $100,000 and the consulting services have a SSP of $200 per hour. The software vendor expects the customer to utilize 125 of the 150 offered consulting hours and thus, determines the SSP of the option to be $25,000 ($200 x 125). The vendor allocates the $100,000 transaction price as follows: License: $100,000 x ($100,000/$125,000) = $80,000 Option to obtain services: $100,000 x ($25,000/$125,000) = $20,000 The transaction price allocated to the software license is recognized when the software vendor transfers control of the license. The transaction price allocated to the option to obtain consulting services is recognized as the software vendor provides the services (upon request by the customer), or when the option expires. **PwC Revenue guide references**: Section 3.5 (Options to purchase additional goods or services) and Chapter 7 (Options to acquire additional goods or services)
15	What are the performance obligations in an arrangement with "remix rights"?	An arrangement may include rights (sometimes referred to as "remix rights") that allow a customer to change or alternate its use of multiple products, which may include on-premises software licenses and/or access to SaaS. The arrangement may also include limitations or restrictions, such as a cap on the number of copies or concurrent users of a specific product or in total for all products; however, the customer retains rights to all of the products throughout the contract term. Typically, the performance obligations in the arrangement are the distinct license rights or SaaS that have been made available to or transferred to the customer. An option to obtain additional software or services in the future (that have not yet been made available to or transferred to the customer) for no additional fee or at a discount may provide a material right. The "remix right" itself is not a separate performance obligation. In other words, the vendor has promised to provide the license rights and SaaS, and it is the customer's determination as to how it utilizes those rights and services. The transaction price is allocated to each of the distinct promised license rights and SaaS and this allocation generally is not subsequently adjusted based on the actual mix of products utilized by the customer. Revenue allocated to

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		distinct software license(s) is recognized once the software is provided (or made available) to the customer and the license term commences. Revenue allocated to SaaS is recognized as the services are provided. It is generally not appropriate to apply the guidance on exchanges or return rights to these arrangements because the customer is not returning anything to the vendor or forfeiting any rights. For example, a limit on the number of concurrent users of a software product is likely viewed as an attribute of the license that defines the scope of the customer's right to use the software, which could impact SSP but does not impact the timing of transfer of control of the license rights. The term "remix rights" might be used to describe various types of arrangements; the accounting conclusion will depend on the specific facts and circumstances of the contract. Judgment may be required to identify the performance obligations, estimate SSP, and determine when control of the rights to software or SaaS is transferred to the customer in arrangements with remix rights. Note: The arrangement discussed in this Q&A differs from the arrangement in Q&A 29 in which a right to convert an on-premises software license arrangement to a SaaS arrangement (on a one-time basis) requires the customer to forfeit its rights to the on-premises software, and as a result, the customer does not have the rights to both the software license and SaaS throughout the contract term.
Determining the transaction price		
16	How does an SLA in a SaaS arrangement impact transaction price?	An SLA is a form of guarantee frequently found in SaaS arrangements. SLA is a generic description that is often used to describe promises by a vendor that could include a guarantee of a product's or service's performance or a guarantee of warranty service response rates. SLAs are commonly used by companies that sell products or services that are critical to the customer's operations in which the customer cannot afford to have product failures, service outages, or service interruptions. For example, a software vendor might guarantee a certain level of "uptime" for a SaaS platform (e.g., 99.99% within a defined time limit). An SLA might also include a penalty clause triggered by breach of the guarantee. An SLA is typically not in the scope of ASC 460, *Guarantees*, because the SLA is a guarantee of the vendor's own future performance as described in ASC 460-10-15-7(i). Therefore, a potential refund to the customer pursuant to the SLA is accounted for as variable consideration. For example, a software vendor guarantees the availability of its SaaS platform with a penalty in the form of a credit for failure to achieve the guaranteed availability. A portion of the transaction price is variable because of the potential credit (refund) to the customer. The vendor estimates the expected credit using either the expected value or most likely amount approach. The vendor also considers whether the transaction price is constrained; that is, amounts are only included in the transaction price to the extent that it is probable that a significant reversal of the revenue recognized will not occur once the uncertainty is resolved. In some fact patterns, the uncertainty will be resolved within the reporting period; that is, it will be known by the end of the reporting period whether the vendor has satisfied the SLA for the period or whether a credit is due to the customer. **PwC Revenue guide reference**: Section 4.3.3.9 (Guarantees (including service level agreements))
17	When does a variable fee in a software arrangement with an end user represent (1) an option to purchase additional software rights versus (2) a usage-based royalty?	Many software license arrangements include a variable fee linked to usage of the software. It might not be clear whether this fee is a usage-based royalty or a fee received in exchange for the purchase of additional rights by the customer. If a software vendor is entitled to additional consideration based on the usage of software to which the customer already has rights, without providing any additional or incremental rights, the fee is generally a usage-based royalty. In contrast, if a software vendor provides additional or incremental rights that the customer did not previously control for an incremental fee, the customer is likely exercising an option to acquire additional rights. Judgment might be required to distinguish between a usage-based royalty (a form of variable consideration) and an option to acquire additional rights. A usage-based royalty is recognized when the usage occurs or the performance obligation is satisfied, whichever is later. Fees received when an option to acquire additional rights is exercised are recognized when the additional rights are transferred; however, at contract inception, the software vendor needs to assess whether the option provides a material right. Factors indicating that a variable fee is an option to purchase additional rights could include:

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The customer is making a separate purchasing decision (within its control) to obtain additional rights.
The customer is either obtaining (1) additional and incremental rights to use the same software (e.g., additional seats or users) or (2) incremental functionality.
The customer benefits from the additional rights concurrently with existing rights; that is, in exchange for the variable fee the customer receives an incremental benefit as opposed to replacing usage that has been consumed.

Factors indicating that a variable fee is a usage-based fee could include:

The fee is incurred as a result of usage of the software that is not solely within the customer’s control (e.g., processing of transactions initiated by end users).
The fee is incurred as a result of the customer’s use of the software to perform a function or obtain an output.
The usage is “consumed” within a specific period such that the customer must pay for additional usage in the following period to continue to benefit from the arrangement.

None of these factors are individually determinative and there may be other relevant facts and circumstances to consider. See AICPA Revenue Recognition Guide (9.2.16-9.2.29) for further discussion of this topic.
PwC Revenue guide reference: Section 9.8.4 (Distinguishing usage-based royalties from additional rights)
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<tr><td colspan="3">Allocating the transaction price</td></tr>
<tr><td>18</td><td>How should a SaaS vendor assess whether it is appropriate to allocate variable consideration received in a SaaS contract to distinct services within a series?</td><td>
A SaaS arrangement that is a promise to provide access to SaaS generally meets the criteria to be accounted for as a series of distinct goods or services (see Q&A 11 and Q&A 25). When the SaaS is being provided in exchange for variable consideration (e.g., a usage-based fee), the SaaS vendor applies the guidance in ASC 606-10-32-40 to determine whether the variable consideration is allocated entirely to a distinct good or service within the series. Typically, the distinct good or service within the series for a SaaS arrangement is a unit of time, such as a day or month of access to SaaS.
The guidance in ASC 606-10-32-40 includes two criteria:

The terms of a variable payment relate specifically to the entity's efforts to satisfy the performance obligation or transfer the distinct good or service (or to a specific outcome from satisfying the performance obligation or transferring the distinct good or service) and
Allocating the variable amount of consideration entirely to the performance obligation or the distinct good or service is consistent with the allocation objective.

A common example is a SaaS arrangement with a variable fee based on daily usage of the SaaS platform. The criteria in ASC 606-10-32-40 are used to determine whether the daily fee (variable consideration) is allocated to the day to which it relates (a distinct good or service within the series).

If the criteria are met, the daily fee is recognized each day as the usage occurs.
If the criteria are not met, the variable consideration is estimated and included in the total transaction price, which is recognized using the measure of progress determined for the SaaS arrangement (e.g., ratably over the SaaS contract term if a time-based measure of progress is utilized).

The first requirement in ASC 606-10-32-40 is often met for usage-based fees that relate solely to the SaaS because the terms of the variable fee relate to the period the customer is receiving benefit from the SaaS. More judgment may be required to assess whether allocation of the fee to the period of usage is consistent with the allocation objective. The allocation objective is likely met if (1) the usage-based fee is consistent throughout the contract period (e.g., a per-usage fee for each transaction processed) and (2) a usage-based fee is incurred each reporting period. This is because the amount of revenue recognized each period is consistently calculated based on usage of the SaaS and therefore, it reasonably reflects the vendor’s performance and value to the customer each period.
If the usage-based fee is not consistent throughout the contract term (e.g., the per-usage fee ranges significantly from period to period), allocating the fee to the period of usage may not be consistent with the allocation objective, depending on the reasons for the varying fee. That is, differences in revenue recognized each period may not correspond to differences in the vendor’s level of effort or value to the customer.
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		Further, the vendor assesses whether the allocation objective is met for the contract in its entirety, including consideration of amounts being allocated to other performance obligations in the contract, if any. See Q&A 19 for discussion of applying the guidance on allocating variable consideration to an arrangement with a fixed fee for a minimum amount of usage and a variable fee for overages. **PwC Revenue guide references**: Section 3.3.2 (Promise to transfer a series of distinct goods or services), Section 5.5.1 (Allocating variable consideration), Section 5.5.1.1 (Allocating variable consideration to a series)
19	How do you apply the guidance on allocating variable consideration when a SaaS arrangement includes a fixed fee for a minimum amount of usage and a variable fee for overages?	As discussed in Q&A 18, a SaaS vendor applies the guidance in ASC 606-10-32-40 to determine whether variable consideration in a SaaS arrangement that is a series of services (access to SaaS) is allocated entirely to a distinct good or service within the series. The guidance in ASC 606-10-32-40 includes two criteria: 1. The terms of a variable payment relate specifically to the entity's efforts to satisfy the performance obligation or transfer the distinct good or service (or to a specific outcome from satisfying the performance obligation or transferring the distinct good or service) and 2. Allocating the variable amount of consideration entirely to the performance obligation or the distinct good or service is consistent with the allocation objective. Some SaaS arrangements include a fixed fee that represents a minimum amount of usage and a variable fee that is only incurred once the fixed minimum is depleted (e.g., an “overage” fee). In this situation, the analysis of whether the criteria in ASC 606-10-32-40 are met will depend on whether the fixed minimum “resets” each reporting period. Consider the following two fact patterns: • Case A - The fixed minimum resets each month and a variable fee is charged for usage in excess of the monthly minimum. • Case B - The fixed minimum applies to the entire annual contract and customers typically incur variable fees in the last few months of the contract period. In Case A, a SaaS vendor might conclude that the allocation objective is met by (1) recognizing the fixed minimum over the contract term and (2) allocating the monthly usage fee (when incurred) to the month to which it relates. In contrast, in Case B, it is likely not consistent with the allocation objective to (1) recognize the fixed minimum over the contract term and (2) allocate the usage fee only to the last few months of the contract period when it is incurred. This is because more revenue would be recognized in the later months of the contract (both a portion of the fixed minimum and the usage fee) without a corresponding increase in usage of the SaaS or effort by the SaaS vendor. Therefore, if the promise in the SaaS arrangement is to provide access to SaaS, the SaaS vendor likely has to estimate the variable fee and recognize the total transaction price (fixed minimum and estimated variable fee) over the contract term. A SaaS vendor also considers whether the arrangement is a promise to provide access to SaaS or to provide a specified amount of services (see Q&A 25). If the arrangement is a promise to provide a specified amount of services, it is appropriate to recognize revenue as services are provided (i.e., as the customer uses or consumes the services). Thus, in Case B, it may be appropriate to recognize the fixed minimum as it is utilized/consumed by the customer and the overage fee as it is incurred. Judgment may be required to determine the promise in a SaaS arrangement and the most appropriate method of recognition. **PwC Revenue guide references**: Section 3.3.2 (Promise to transfer a series of distinct goods or services), Section 5.5.1 (Allocating variable consideration), Section 5.5.1.1 (Allocating variable consideration to a series)
20	When can the residual approach be used to estimate SSP for a software license?	Software vendors often sell software licenses bundled with other goods or services, such as PCS. The revenue standard requires a software vendor to allocate the transaction price to the performance obligations based on their relative SSPs. SSP is the price at which a software vendor would sell a promised good or service separately. The best evidence of SSP is an observable price when the good or service is sold on a standalone basis. There may be observable prices for PCS based on standalone renewal transactions. However, a software vendor often has limited, if any, standalone sales of a software license. A software vendor may estimate the SSP of a good or service using the “residual approach” when the SSP of a promised good or service is highly variable or uncertain. The residual approach is only used when the software vendor sells the same good or service to different customers for a broad range of prices, making them highly variable, or when the software vendor has not yet established a price for a good or service because it has not been previously sold. Before concluding that SSP for a

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		software license will be estimated using the residual approach, the software vendor first considers whether another method can be used to estimate SSP by maximizing the use of observable inputs, if any. For example, the software vendor considers whether there is a value relationship between the software license and PCS that can be used to estimate SSP of the software license as further discussed in Q&A 21. To determine whether the criteria are met for using the residual approach, a software vendor that does not license software separately considers whether the pricing of its bundled arrangements (e.g., software licenses and PCS) is highly variable. There are no bright lines for assessing whether pricing is highly variable; therefore, this analysis requires judgment and could include both qualitative and quantitative data. A software vendor should document its methodology for evaluating pricing variability and apply that methodology consistently. In applying the residual approach, a software vendor calculates the estimated SSP of the software license by subtracting the sum of observable SSPs of other goods or services in the arrangement (e.g., PCS). The software vendor then uses the estimated SSP of the software license in the relative SSP allocation. When the residual approach is used, management still needs to compare the results obtained to all reasonably available observable evidence to ensure the method meets the objective of allocating the transaction price based on SSP. Allocating little or no consideration to a performance obligation suggests the method used might not be appropriate, because a good or service that is distinct is presumed to have value to the purchaser. Reasonable evidence for a software arrangement could include the software vendor's pricing policies and strategy, pricing for similar products sold by the vendor, pricing for competitor's products, or an assessment of whether the estimated SSP yields a reasonable margin. See AICPA Revenue Recognition Guide (3.4.15) for further discussion of this topic. **PwC Revenue guide reference**: Section 5.3.3 (Residual approach)
21	Can you use a percentage relationship to establish SSP for a software license bundled with PCS?	The revenue standard does not prescribe or prohibit any particular method for estimating SSP as long as the method results in an estimate that faithfully represents the price a software vendor would charge for the goods or services if they were sold separately. A software vendor that bundles software licenses with PCS and does not sell software licenses on a standalone basis will have to apply judgment to estimate SSP. The vendor considers its pricing policies and practices, as well as data used in making the pricing decisions, maximizing the use of observable inputs. It may be reasonable for a vendor to conclude that there is a value relationship between the license and PCS that could be used to establish SSP if the vendor has historically and consistently priced PCS as a percentage of the license fee for both the initial purchase and renewals. For example, a vendor may determine that PCS is historically and consistently priced at 20% of the license fee. See AICPA Revenue Recognition Guide (9.4.34, 9.4.44, and 9.4.45) for further discussion of this topic.
Recognizing revenue		
22	Is the timing of revenue recognition different for a distinct perpetual software license and a term software license?	No. As discussed in Q&A 4, software is an example of functional IP and accordingly, revenue allocated to a distinct software license is recognized at the point in time that control is transferred to the customer. This is typically at the beginning of the license term, regardless of whether the software license has a stated term or is perpetual. The term of the license could however impact the estimate of SSP, which may impact the allocation of transaction price to the license and other performance obligations in the contract. For licenses that are not distinct and are bundled with other goods or services, management will apply judgment to assess the nature of the combined item and determine whether the combined performance obligation is satisfied at a point in time or over time (see Q&A 7 and Q&A 8). **PwC Revenue guide reference**: Section 9.4 (Accounting for a license bundled with other goods or services)
23	Does a software vendor have to deliver a software key or access code to conclude control has transferred to the customer in a software arrangement?	It depends. ASC 606-10-55-58C states that revenue cannot be recognized from a license of IP before "an entity provides (or otherwise makes available) a copy of the intellectual property to the customer" and "the beginning of the period during which the customer is able to use and benefit from its right to access or its right to use the intellectual property." A software vendor may need to apply judgment to determine when it "makes available" a copy of the software. This assessment considers all of the indicators to determine the point in time control transfers in ASC 606-10-25-30.

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		If delivery of a software key or access code is not substantive, it does not impact the assessment of control transfer. For example, delivery of a software key or access code is likely not substantive when (1) the customer already has access to the software (such as through a hosting arrangement or from a prior license period or use of a temporary key) or (2) the vendor has made the software available for access by the customer upon demand and there is minimal to no effort required by the vendor to transfer the software (i.e., providing a key or access code is an administrative task). However, in other circumstances, the delivery of a software key or access code could be substantive, such as a situation when payment terms or acceptance clauses (that are not a formality) are tied to delivery. **PwC Revenue guide reference**: Section 6.2 (Control)
24	Should revenue allocated to a promise to provide PCS be recognized using a time-based measure of progress (i.e., ratably) over the contract period?	For PCS arrangements that are a promise to stand ready to provide unspecified when-and-if available updates and upgrades once developed by the vendor, revenue is typically recognized using a time-based measure (i.e., ratably) over the contract term. This is because the customer benefits evenly throughout the contract period from the guarantee that any updates or upgrades developed by the software vendor during the period will be made available. However, judgment could be required to determine an appropriate measure of progress in less common circumstances when the customer does not benefit evenly throughout the contract period. In contrast, a promise to provide a specified update or upgrade is not a stand-ready obligation. For example, if the software vendor has provided a development roadmap to the customer, the vendor may have implicitly promised to provide the specified updates or upgrades on the roadmap. An implied promise exists if, at the time of entering into the contract, the customer has a valid expectation that the vendor will transfer a specified update or upgrade. Specified updates or upgrades are likely distinct from unspecified when-and-if available updates and upgrades even if both are provided pursuant to the same PCS arrangement. Revenue allocated to a specified update or upgrade will typically be recognized when the update or upgrade is delivered. See Revenue TRG Memo No. 16 and the related minutes in No. 25 for further discussion of stand-ready obligations. **PwC Revenue guide reference**: Section 6.4.3 (Time-based methods)
25	What is the appropriate measure of progress for a SaaS arrangement?	To determine the appropriate measure of progress for a SaaS arrangement, the SaaS provider assesses whether the arrangement is (1) a promise to provide access to SaaS or (2) a promise to provide a specified amount of services. This assessment may require judgment. Factors indicating that the promise is to provide access to SaaS could include: • The SaaS provider offers unlimited access to (or usage on) the SaaS platform during the contract term, or the contract includes a usage maximum that the customer is not expected to exceed (i.e., a nonsubstantive “cap”). • The customer primarily benefits from access to the SaaS platform over a contract term, rather than specific usage or outputs such as processing transactions or data. • The SaaS provider provides support services related to access to the SaaS platform throughout the contract term. • The SaaS provider does not separately sell services on a usage-only basis (i.e., pay-as-you-go). Factors indicating that the promise is to provide a specified amount of services could include: • The contract with the customer specifies a fixed amount of usage/transactions and the customer needs to purchase more once the fixed amount is depleted. • The customer can rollover unused pre-purchased amounts to subsequent periods. • The customer does not benefit significantly from access to the SaaS platform alone without specific usage or outputs such as processing transactions or data. • The SaaS provider separately sells services on a usage-only basis (i.e., pay-as-you-go). None of these factors are individually determinative and there may be other relevant facts and circumstances to consider. For SaaS arrangements that are a promise to provide access to SaaS platform for a period of time, the appropriate measure of progress is often a time-based measure. For SaaS arrangements that are a promise to provide a specified amount of services, revenue is typically recognized as the services are provided (i.e., as the customer

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		uses or consumes the services). For variable fees, the SaaS provider needs to determine whether the variable consideration allocation exception in ASC 606-10-32-40 applies. See Q&A 18 and Q&A 19. **PwC Revenue guide references**: Section 3.3.2 (Promise to transfer a series of distinct goods or services), Section 6.4 (Measures of progress), and Section 5.5.1 (Allocating variable consideration)
26	How should revenue be recognized for a SaaS arrangement when the contract includes scheduled increases in the fee on an annual basis?	It depends. As discussed in Q&A 25, a SaaS vendor first assesses whether the promise in the SaaS arrangement is (1) a promise to provide access to SaaS or (2) a promise to provide a specified amount of services. If the arrangement is a promise to provide access to SaaS, the appropriate measure of progress is often a time-based measure because the arrangement is a series of distinct goods or services (see Q&A 11). Accordingly, a scheduled increase in the annual fee that is only a mechanism to achieve deferred payment terms for the customer vendor is recognized ratably over the noncancellable term. The SaaS vendor also assesses whether the payment terms indicate that the arrangement includes a significant financing component. Increases in the fee indexed to inflation or similar terms are generally recognized ratably over the contract term. Further, if the SaaS term is cancellable (e.g., the customer can terminate for convenience after the first year), the SaaS vendor only accounts for the noncancellable term (see Q&A 2). In contrast, if the increase in the annual fee is as a result of the SaaS vendor providing the customer with additional services each year (such as increased functionality or increased user access), straight-line recognition may not be appropriate. Instead, the SaaS vendor assesses whether the customer is receiving multiple distinct services that commence on different dates.
Contract modifications		
27	How should a software vendor account for a contract modification that extends the contract term for existing license rights and adds new rights?	For renewals of existing license rights, ASC 606-10-55-58C(b) states "an entity would recognize revenue from a license renewal no earlier than the beginning of the renewal period." Accordingly, if a license is renewed in advance of the expiration of the original contract term, revenue is deferred until the renewal period begins. This is sometimes referred to as the "renewals guidance." The accounting for a modification that includes a renewal of existing rights along with other changes, such as adding new rights, can require judgment. A software vendor first considers whether the existing rights are solely being renewed or being substantively changed. If the existing license rights are being changed (e.g., attributes are being modified other than extension of time or the functionality of the underlying IP has changed), a software vendor might conclude the modification does not include a renewal of existing rights and therefore, the renewals guidance is not applicable. If a modification includes the renewal of existing rights, the software vendor generally applies the renewals guidance to that element of the contract. As a result, consideration allocated to the renewed license rights is deferred until the renewal period begins. However, if the modification is considered the termination of an existing contract and creation of a new contract in accordance with ASC 606-10-25-13(a) (e.g., because the pricing of additional goods or services is not at SSP), an acceptable alternative may be to account for the license rights in the modified contract as a "new" license as opposed to a renewal of existing rights. Under this alternative, a software vendor may conclude it is appropriate to recognize revenue immediately for new licenses granted as a result of the modification. A modification can be structured as either (1) an amendment to the original agreement or (2) a cancellation of the original agreement and execution of a new agreement. As discussed, the accounting is not based solely on the form of the modification and is based on the substance of the arrangement. **PwC Revenue guide reference**: Section 9.7.1 (License renewals)
28	How should a SaaS vendor account for the modification of an arrangement before the end of the initial contract term to renew the contract and revise the	The parties in a SaaS arrangement may agree to modify a contract prior to the end of the initial contract term to extend the contract term and revise the contract pricing for the remaining term (i.e., a "blend-and-extend" modification). Generally, in a "blend-and-extend" modification, the customer immediately takes advantage of a lower price. Because a promise to provide access to SaaS is typically a series of distinct goods or services (see Q&A 11), the modification of a SaaS arrangement is generally accounted for as either (1) a separate contract in accordance with ASC 606-10-25-12 or (2) as if it were the termination of the existing contract and the creation of a new contract in accordance with ASC 606-10-25-13(a). Thus, the accounting for the modification depends on whether the additional consideration reflects the SSP of

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	pricing on a "blended" basis for the remaining term?	the additional services added to the contract. Consider an example in which a SaaS vendor enters into a three-year noncancelable SaaS contract for $900,000 per year. At the end of the second year, the parties agree to modify the contract to: (1) extend the service contract for an additional year and (2) lower the price to a "blended" rate of $850,000 per year for the remaining two years. In this fact pattern, the parties agreed to add distinct services for additional consideration that reflects $800,000 per year ($850,000 for the extension term, less $50,000 decrease in price for the original remaining term). • If $800,000 for the additional year of services reflects the current SSP, the SaaS vendor accounts for the modification as a separate contract. Under this approach, the SaaS vendor continues to recognize revenue of $900,000 in the third year of the original contract and recognize $800,000 in the following year. • If $800,000 for the additional year of services does not reflect the current SSP, the modification is accounted for as the termination of the existing contract and creation of a new contract, and revenue is recognized based on the blended price ($850,000 per year). Management should consider all of the relevant facts and circumstances to determine whether the additional consideration reflects SSP, which may require judgment. For example, the additional consideration may not reflect SSP in situations when quantities are variable (e.g., "usage-based" fees), prices are expected to change significantly in the future (such that the SSP for future years is expected to differ from the contract price), or the arrangement contains a significant financing component (to provide the benefit of advanced cash flow). **PwC Revenue guide reference**: Section 2.9 (Contract modifications)
29	How should a software vendor account for the modification of an on-premises software license to convert the license to a SaaS arrangement?	A continuing trend in the software industry is the desire to transition customers from on-premises software to a SaaS solution. This may be achieved by modifying an existing software agreement to revoke the rights to the on-premises license and convert the arrangement to a SaaS arrangement. As revenue from a software license is typically recognized at a point in time (i.e., at contract inception), while revenue from a SaaS arrangement is typically recognized over time. Questions have arisen on accounting for the conversion of a point-in-time license to a service provided over time. Often, as part of the conversion, the customer receives a "credit" towards the purchase of the SaaS equal to the "unused" portion of the license term. For example, a software vendor enters into a software license arrangement with no explicit or implicit right to cancel or convert the license. Part way through the license term, the parties agree to modify the agreement to revoke the customer's rights to the on-premises software in exchange for a "credit" toward the purchase price of a hosted software solution (SaaS) for the remaining term. The revenue standard does not directly address the accounting in this scenario. We believe there are two primary views: • Alternative A: The "credit" received upon the cancelation of the on-premises license is a discount on the SaaS purchase. There is no further accounting for the license cancellation (i.e., no revenue reversal for the "unused" license term). Any remaining unrecognized consideration (e.g., amounts allocated to future PCS) or incremental consideration paid for the SaaS is allocated to the SaaS to be provided over the remaining term, consistent with the modification guidance in ASC 606-10-25-13(a). Under this accounting alternative, the credit is treated as an incentive to the customer to purchase the SaaS, not compensation for "returning" the license. • Alternative B: The "credit" received upon cancelation of the on-premises license is a refund for the return of the license and is accounted for under the sale-with-a-right-of-return guidance (i.e., as variable consideration). The customer is giving up something of substance (i.e., possession or control of the on-premises software license) in exchange for another good or service, as contemplated in the right-of-return guidance. Revenue is therefore adjusted to reflect the return of the license (i.e., an adjustment of variable consideration), prior to applying the modification guidance. The credit provided to the customer is recognized as revenue as the SaaS is provided over the remaining term. Under this accounting alternative, the credit is treated as compensation for "returning" the license. A software vendor assesses its specific facts and circumstances, including the substance of the transaction, to determine the most appropriate accounting approach. In certain fact patterns, either of these alternatives may be acceptable. Alternative B (application of the sale-with-a-right-of-return guidance) is not appropriate if (1) the software vendor does not enforce the revocation of the on-premises license, (2) the cancellation of the license does not have substance, or (3) the customer does not receive a discount on the SaaS (i.e., the customer pays incremental consideration consistent with the SSP of the SaaS offering). Further, a software vendor applying Alternative B considers whether there is an implicit right to convert the

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		software license based on past business practices, which requires establishing a returns reserve under the sale-with-a-right-of-return guidance. See Q&A 10 for discussion of the accounting for a contractual right to convert an on-premises software license to a SaaS.
Principal versus agent considerations		
30	How should a vendor that distributes its software through a reseller (or digital marketplace) determine whether the reseller or the end consumer is the vendor's customer?	When another party (i.e., an intermediary) is involved in transferring goods or services to an end consumer, a vendor needs to assess whether the intermediary or the end consumer is the vendor's customer: • If the intermediary is the vendor's customer, the vendor recognizes as revenue the amount it receives from the intermediary ("net" revenue). • If the end consumer is the vendor's customer, the vendor recognizes the price paid by the end consumer (if known) as revenue, with an expense recognized for the amount retained by the intermediary ("gross" revenue). Note: See PwC Revenue guide, Section 10.3 (Determining a vendor's customers in a three-party arrangement), for discussion of the accounting implications when the price paid by the end consumer is not known. The principal versus agent framework is also relevant in assessing which party is the software vendor's customer. The principal versus agent assessment is a two-step process that consists of: (1) identifying the specified good or service to be provided to the end consumer and (2) assessing whether the intermediary controls the specified good or service before it is transferred to the end consumer. The intermediary (e.g., a reseller or digital marketplace) is the principal in the arrangement with the end consumer (and therefore, the vendor's customer) if it controls the software before it is transferred to the end consumer. The principal versus agent assessment is performed separately for each specified (distinct) good and service in a contract. The assessment of whether the intermediary takes control of software is based on the definition of control in ASC 606-10-25-25 and the explanation of how an intermediary obtains control outlined in ASC 606-10-55-37A. If additional evidence is needed to reach a conclusion, the intermediary evaluates the three indicators in ASC 606-10-55-39. Examples of evidence that the intermediary controls the software could include:

Indicator	Evidence that the intermediary controls the software
Primary responsibility for fulfilment	• Contractual terms and other communications (e.g., marketing materials, website FAQs) indicate that the intermediary is responsible for providing the software. • The vendor does not have the right to refuse an arrangement with an end consumer (or the right is only protective in nature). • The vendor does not have a contractual relationship with the end consumer and/or has little to no interaction with the end consumer. • The intermediary (1) has the ability to redirect the vendor to fulfil a different end consumer contract and/or (2) can prevent the vendor from providing software to a specific end consumer. • The intermediary is the sole or primary contact for customer service issues, including resolving complaints. • The intermediary provides a warranty or other guarantees (e.g., SLA) directly to the end consumer. • The intermediary is significantly involved with the end consumer in identifying the software products that meet the end consumer's needs and determines which vendors to contract with to fulfil end consumer orders.
Inventory risk	• The intermediary purchases software licenses that the intermediary could use itself or resell to other parties in advance of contracting with end consumers. • Note: Economic risk (e.g., collection risk, credit risk, nonrefundable or guaranteed minimum values) is not equivalent to inventory risk and is not sufficient on its own to demonstrate control of the software.

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Pricing discretion	• The intermediary determines the price paid by end consumers for the software. • Note: Pricing discretion on its own is generally not sufficient to establish control over the software.

These indicators are not to be viewed as a checklist and there may be other facts and circumstances that are relevant to the assessment. Additional judgment may be required as the vendor may not have access to all the applicable contractual relationships between the intermediary and the end consumer.

PwC Revenue guide reference: Chapter 10 (Principal versus agent considerations)

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How should a vendor that distributes its SaaS offering through a reseller (or digital marketplace) determine whether the reseller or the end consumer is the vendor's customer?

As discussed in Q&A 30, when another party (i.e., an intermediary) is involved in transferring goods or services to an end consumer, a vendor needs to assess whether the intermediary or the end consumer is the vendor's customer.

In a SaaS arrangement involving an intermediary (e.g. a reseller), the specified good or service transferred to the end consumer is typically the vendor's SaaS. However, if the reseller sells the vendor's SaaS packaged with other equipment, software, or services (e.g., as a "value-added reseller" or "managed service provider") and integrates the SaaS with other goods or services into a combined output sold to the end consumer, the specified good or service transferred to the customer is the integrated offering. In this case, the reseller typically controls the SaaS to perform the significant service of integrating goods and/or services to create the combined output sold to the end consumer. Sufficient evidence is needed to support that the reseller is performing a significant integration service beyond simply packaging multiple products from different vendors into a single contract / purchase order. Providing "implementation services" such as system setup, data migration, and connecting the SaaS platform to the end consumer's systems typically does not represent an integration of the SaaS with the reseller's services.

Assuming the reseller is not integrating the SaaS with other goods or services to create a combined output, a reseller could control a vendor's SaaS by directing the SaaS vendor to provide services to the end consumer on the reseller's behalf (i.e., where the substance of the arrangement is that the reseller engages the SaaS vendor to fulfil the reseller's obligation to the end consumer in a subcontractor capacity and, therefore, acting as the party that is primarily responsible to the end consumer). In performing this assessment, key considerations specific to SaaS offerings include:

Indicator	Evidence that the intermediary controls the software
Primary responsibility for fulfilment	• Contractual terms indicate the intermediary is providing the SaaS. The mere existence of a contract between the reseller and the end consumer is not determinative. Terms of all of the relevant contracts between the vendor and the reseller and the reseller and the end consumer need to be assessed to identify terms that would indicate which party is responsible for providing the SaaS to the end consumer. • The intermediary provides support to the end consumer (e.g., requests for support must go through the reseller). Often, both the SaaS vendor and the intermediary provide some level of support to the end consumer, which may not clearly support either conclusion. In that case, other factors are considered to support the overall conclusion that the reseller is primarily responsible. • The intermediary provides a warranty or other guarantees (e.g., SLA) directly to the end consumer. • In the end consumer's user interface, the SaaS application is branded as a reseller product. • The intermediary is the sole or primary customer-facing party for interactions with end consumer. • The intermediary has relevant expertise and is significantly involved in selecting the SaaS vendor's product to meet end consumer needs. • The intermediary is responsible for the end consumer's overall satisfaction with the SaaS product and is either responsible for finding a replacement or is at risk for providing refunds without ability to recoup from the SaaS vendor.
Inventory risk	• We expect it will be uncommon for intermediaries to take inventory risk for a typical SaaS offering, as an intermediary is generally not pre-purchasing specific "seats" or "accounts" of the SaaS (i.e., it is not comparable to an advance purchasing of a right to a service - e.g., an airline ticket - which is finite and expiring).

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		• Note: Economic risk (e.g., collection risk, credit risk, nonrefundable or guaranteed minimum values) is not equivalent to inventory risk and is not sufficient on its own to demonstrate control of the SaaS. Pricing discretion • The intermediary determines the price paid by end consumers for the SaaS. • Note: Pricing discretion on its own is generally not sufficient to establish control over the SaaS offering. These indicators are not to be viewed as a checklist and there may be other facts and circumstances that are relevant to the assessment. Additionally, judgment may be required as the vendor may not have access to all the applicable contractual relationships between the intermediary and the end consumer. Note: See PwC Revenue guide, Section 10.3 (Determining a vendor's customers in a three-party arrangement), for discussion of the accounting implications when the price paid by the end consumer is not known. **PwC Revenue guide reference**: Chapter 10 (Principal versus agent considerations)
32	When software is sold through a reseller, but the software vendor has an obligation to the end consumer to provide PCS, is the end consumer the software vendor's customer for PCS?	As discussed in Q&A 30 and Q&A 31, when an intermediary (e.g., a reseller) is involved in transferring goods or services to an end consumer, a vendor will need to assess whether the intermediary or the end consumer is the vendor's customer. Each distinct good or service in the arrangement is assessed separately. Accordingly, if the software and PCS are distinct, the vendor determines which party is its customer separately for the promises to license software and provide PCS. The analysis for PCS is similar to that discussed in Q&A 30 and Q&A 31. It is possible that a vendor could conclude the reseller is the vendor's customer for the software license, but the end consumer is the vendor's customer for PCS. However, the conclusion will depend on the specific facts and circumstances of the arrangement. **PwC Revenue guide reference**: Chapter 10 (Principal versus agent considerations)
Costs to obtain a contract		
33	How should a SaaS vendor account for commission payments that are contingent upon receipt of contract consideration from the customer (i.e., the commission is not paid if the customer defaults on payment of contract consideration)?	Commission payments that are an incremental cost to obtain a contract are capitalized as an asset in accordance with the guidance in ASC 340-40 (unless the practical expedient can be applied). The fact that the payments are contingent upon receipt of contract consideration from the customer does not impact the accounting for the commission if (1) collection is probable (which is one of the requirements for accounting for a contract under ASC 606) and (2) there are no other contingencies associated with the payment (e.g., there is not a substantive future employee service requirement, as discussed below). Assuming these facts, the full amount of the commission is capitalized as an asset at contract inception with a corresponding liability. The asset is amortized in accordance with the guidance in ASC 340-40. The same accounting applies if the commission is paid upfront, but there is a "clawback" if the customer defaults on payment of the contract consideration. The accounting may differ if the commission is paid to an employee and the employee must be an active employee at the time of payment to receive the commission. If the commission will be paid in the future or in instalments (e.g., because it mirrors receipt of contract consideration from the customer over time), the SaaS vendor assesses whether the payment is contingent upon future employee service and as a result, the payment is not solely a cost to obtain a new contract. Payments that are determined to be in exchange for future employee service are not accounted for under ASC 340-40; instead, they are recognized over the service period in accordance with ASC 710, *Compensation*. Assessing whether a payment has a substantive future service requirement may require judgment. For example, a SaaS vendor might conclude there is not a substantive future service requirement if an employee must remain an active employee only for a short period of time for administrative reasons, such as until the commission payment is processed at the end of the month the customer contract is obtained. See Revenue TRG Memo No. 23 and the related minutes in No. 25 for further discussion of accounting for commission arrangements. **PwC Revenue guide reference**: Section 11.2 (Incremental costs of obtaining a contract)
34	How should a software vendor amortize an asset recorded for costs to obtain a contract (e.g.,	ASC 340-40 requires that an asset recorded for costs to obtain a contract be amortized on a systematic basis consistent with the transfer of goods or services to the customer. In an arrangement that is a license of functional IP (e.g., software), the license is transferred at a point in time. Therefore, the asset recorded for costs to obtain a contract (e.g., commissions) related to the license is recognized as expense at the point in time the license is transferred. The timing of amortization of the

Ref #	Question	Response
	commissions) that is related to a license of functional IP for which revenue from sales-based royalties is recognized over time?	asset is not impacted by the recognition of royalty revenue over time under the sales- and usage-based royalty exception. **PwC Revenue guide reference:** Section 11.4.1 (Amortization of contract cost assets)

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