ASC 606 Recap
Capitilization of Sales Commissions

Introduction

You may have heard about the upcoming impacts of the new FASB accounting regulation ASC 606, scheduled to take effect for all year-end financial reporting regarding the fiscal year 2020. Company accountants are working hard at applying the ASC 606 standard, but the new guidelines' most significant effect on sales organizations is the ASC 606, Subtopic 340-40. **This compliance substantially re-writes the accounting rules for handling sales organizations' most considerable expense: commission.** There has been a lot of attention on the ASC 606 new revenue recognition standard for contracts with customers; however, Subtopic, ASC 340-40, stipulates how companies should account for and recognize the costs associated with those contracts, including the capitalization of sales commissions.

Sales Expenses That Are Affected

Subtopic 340-40 specifies that the new accounting guidance applies to any "incremental costs of obtaining a contract with a customer," defined more specifically as any cost of the contract that would not have been incurred if the contract had not been won. Commission—including the commission for managers—is a prime example of such a cost: if the firm does not win the contract, then the firm will not pay commission to its sales staff. If a firm provides 401(k) matching on earned commission amounts and/or pays taxes on earned commission, these are further examples of expenses that can be capitalized.

A counterexample is rent for the sales team's office space because the firm has to pay these costs regardless of whether any given contract is won or not. Another significant counterexample is any bonus paid to sales leaders or reps that are not dependent on sales performance; perhaps some sales team members are entitled to bonuses for good performance reviews or overall company profitability, not specifically tied to any particular contract won or lost.

Example: Two Significant (but limited exceptions) of the New Requirements

First, incremental contract costs are exempted from the new treatment if the firm does not expect to recoup the contract revenue expenses. In most cases, companies naturally expect the revenue from their contracts to cover their sales commission expenses. Still, there may be exceptional cases in which the firm sells a special deal below cost and does not expect to earn back its sales commission expense in that instance. In these situations, the new accounting requirements do not need to be followed.

Second, there is a "practical expedient" that allows incremental costs to obtain a contract when the expected amortization period is one year or less to be expensed. Be mindful that the amortization period could be longer than the initial contract period when determining whether the expedient is available. Companies need to factor in anticipated renewals when evaluating the amortization period.

Contact SalesVista to learn more about how the capitalization of sales commissions will impact your organization. We provide sales compensation management solutions to businesses of all sizes. Visit us at salesvista.com to learn about our products and services, or email us directly at sales@salesvista.com.