Accounting for Sales Compensation becomes even more challenging under ASC 606 / IFRS 15

Finance and sales leaders need to review the significant changes to the way revenue and expenses are recognized; specifically, sales compensation expenses

Overview

Sales leaders leverage incentive compensation to motivate and drive the right sales behaviors with the intent of achieving corporate objectives and increasing revenue. It seems like a relatively easy process, but those responsible for the design, implementation, and management of incentive plans, know that it's challenging and complex.

And now, the accounting of sales commission expenses has become more challenging and complex for finance leaders with the new ASC 606 and IFRS 15 accounting standards introduced for both public and non-public organizations reporting financial statements under generally accepted accounting principles (GAAP). Alignment between sales and finance leaders is critical for organizations to maintain GAAP-compliance.

Reporting revenue is at the core of every organization's financial statement. This reporting is the cornerstone of many financial measures used to compare one organization's performance to another and to analyze a single organization's performance over an extended time period.

The *Financial Accounting Standards Board* (FASB) and the *International Accounting Standards Board* (IASB) recognized that existing revenue recognition methods differed between their authorities and that both systems needed to change and improve. Through collaboration, these two organizations introduced the *Accounting Standards Codification (ASC) Topic 606: Revenue from Contracts with Customers*, otherwise known as the *ASC 606/IFRS 15 accounting standard.*

The need for compliance for recognizing revenue

In the past, there have been significant differences between the way revenue has been financially reported by organizations in the U.S. and internationally with different accounting standards and processes throughout the globe.

In the U.S., the Financial Accounting Standards Board (FASB) supported GAAP rules that did not provide an accurate comparison with the International Accounting Standards Board (IASB) and the IFRS 15 accounting standards. By FASB changing the GAAP rules to support the IASB and IFRS 15 accounting standards, a baseline compliance has been created at an international level.

With one common standard at an international level, sales and finance leaders can compare one organization's performance to another and analyze a single organization's performance over time; globally.

What are the ASC 606 and IFRS 15 Accounting Standards?

ASC 606 and IFRS 15 accounting standards bring international alignment on how organizations will recognize revenue from contracts with customers including the process of contracts, pricing, quotes, orders, and finally revenue recognition – a complete end-to-end process.

ASC 606: Revenue from Contracts with Customers is a U.S. based rule that was issued by the Financial Accounting Standards Board (FASB) and is responsible for maintaining the U.S. standard accounting, Generally Accepted Accounting Principles (GAAP). Whether you are a public or private organization, it's typically best practice to follow GAAP standards however; only public organizations are required to adhere to GAAP standards.

The IFRS 15 was introduced by an organization entitled the International Accounting Standards Board (IASB) which works to standardize accounting rules across dozens of other countries outside the U.S.

The FASB and IASB work together. The IASB is issuing IFRS 15, which is essentially the same rule as ASC 606, given that these changes in accounting standards will have global implications.

What is changing and why is it adding complexity for sales and finance leaders?

ASC 606 has significant changes to the way revenue and expenses are recognized by sales and finance leaders. When recognizing revenue, there are multiple considerations and factors that may have an impact to the financial reporting of revenue.

For example, throughout the lifecycle of a sale – the sale may be based on a transactional or subscription model (i.e. monthly payments versus an up-front expense), bundling of products and/or services, termination clauses and fees, discounts and rebates, product warranties, shipping expenses, etc.

If an organization processes millions of transactions each month, resulting in billions of dollars in revenue, it quickly becomes obvious how the countless arrangements will impact revenue recognition and add complexity for financial reporting.

In the end, the rules on revenue recognition both in the U.S. and internationally have not been consistent and resilient in the past. With the FASB and the IASB coming together, the ASC 606/IFRS 15 will bring global standardization for revenue recognition for organizations financial and revenue reporting.

Accounting for Sales Compensation: The incremental cost of obtaining a contract

As part of the ASC 606, there is a section that outlines a principle that requires companies to match expenses to revenue; subtopic 340-40. Subtopic 340-40 is also referred to as, "*the incremental cost of obtaining a contract*".

Sales and finance leaders will want to review subtopic 340-40 together as it will change how they account for incremental cost of obtaining a contract including sales compensation and other related expenses.

ASC 606: Subtopic 340-40 or the Incremental Costs of Obtaining a Contract, includes the following:

340-40-25-1: An entity shall recognize as an asset the incremental costs of obtaining a contract with a customer if the entity expects to recover those costs.

340-40-25-2: The incremental costs of obtaining a contract are those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract not been obtained (for example, a sales commission).

340-40-25-3: Costs to obtain a contract that would have been incurred regardless of what the contract was obtained shall be recognized as an expense when incurred, unless those costs are explicitly chargeable to the customer regardless of whether the contract is obtained.

340-40-25-4: As a practical expedient, an entity many recognize the incremental costs of obtaining a contract as an expense when incurred if the amortization period of the asset the entity otherwise would have recognized is one year or less.

ASC 606: Subtopic 340-40 describes how organizations will be required to handle the financial reporting of the incentive compensation expenses from the sales team.

Are organizations prepared for accounting for sales compensation under ASC 606?

Unfortunately, the majority of organizations have not sufficiently prepared for the accounting of sales compensation under the ASC 606 accounting standards.

Most organizations are underestimating the effort and necessary analysis of their sales compensation plans and sales data and are unable to claim readiness.

They consider the ASC 606: Subtopic 340-40 or Incremental Costs of Obtaining a Contract to be a small consideration of the new revenue recognition standard overall however; it is imperative to consider the implications related to paying compensation and accounting for compensation expenses.

The ASC 606 Compliance will take effect on December 15, 2017

The new revenue recognition standards will take effect on December 15, 2017 and organizations must implement and adopt these accounting standards and financial reporting for the 2018/2019 fiscal period.

In addition, organizations are expected to provide financial reporting statements to compare retroactively against the prior two years using the new accounting standards. This will be a significant challenge for some organizations that will require many sales and finance leaders to revisit their incentive compensation plans and payouts for 2016 and 2017.

IBM Sales Performance Management (SPM) helps organizations stay compliant with the ASC 606 accounting standards

Ensuring that the organization is adopting the ASC 606 accounting standards introduces a challenge for finance leaders, and sales and compensation leaders have an opportunity to rise to this challenge and become 'heroes' to finance.

Sales and compensation leaders are the individuals who will need to calculate and provide accurate compensation information to finance who in turn will be responsible for the financial reports and statements that show the organization is in GAAP-compliance.

IBM Sales Performance Management (SPM) can automate the end-to-end process from consuming the correct data, calculating and segmenting the compensation results, to publishing accurate and trusted financial reports and dashboards.

Consuming the correct data: To calculate accurate and trusted compensation and report compensation expenses in alignment with the new ASC 606 accounting standards, you will be required to consider additional data in your compensation calculations.

For example, you may need to consider the booking date, invoice date, length of the contract, contract effective date, contract termination date, revenue period, transaction type, sales role, customer type, expected customer life-cycle, product/SKU – and more.

This additional data will be required to create the supporting calculations to meet the ASC 606 accounting standards and financial reports requirements to demonstrate GAAP-compliance.

IBM Sales Performance Management includes an extendable data model that allows organizations to create additional data fields in their model, import data through an easy to use wizard, automate/schedule the data feeds, and transparently consume the correct data that is needed to calculate and publish the financial reports necessary to meet the ASC 606 accounting standards and GAAP-compliance.

Calculating and segmenting the compensation results: Although the design of the sales incentive compensation plans will not necessarily change, the calculations will need to include additional data in order to segment the calculations at the appropriate level of detail to meet the financial reporting requirements for ASC 606 and GAAP-compliance.

For example, the calculations may need to be able to produce results that are segmented by the customer contract date, the contract length, the amount of commission expense at the time of booking, the amount of commission expense each month or quarter. This level of detail in calculating compensation will be required by finance to allow for financial reporting and auditability.

IBM Sales Performance Management includes a calculation engine that allows the flexibility to create calculations that produce detailed results by any desired data segmentation.

The Excel-like formulas makes it easy to construct calculations quickly using familiar syntax. Calculations in the model produce accurate and trusted results that can be used to build the necessary financial reports and dashboards.

Publishing accurate and trusted financial reports and dashboards: Accurate and trusted calculation results are the foundation of publishing the appropriate reporting and dashboards related to commission expense that finance will depend upon to produce any financial reports and statements.

IBM Sales Performance Management includes reporting and dashboard capabilities that allow you to design custom, branded, and well-formatted reports that are specific to your organization design guidelines.

Reports can be configured and personalized for each user across the enterprise including sales and finance. Finance leaders simply sign into the IBM SPM portal to access the information they need for reporting incentive compensation expenses in alignment with the ASC 606 accounting standards while ensuring GAAP-compliance.

Contact IBM to learn more

To learn more about IBM Sales Performance Management solutions and how IBM can help you meet the new ASC 606 accounting standards, contact your IBM sales representative or visit ibm.com\spm.

For more information: To learn more about IBM Sales Performance Management (SPM) solutions, contact your IBM sales representative or visit: www.ibm.com/spm

© Copyright IBM Corporation 2017

IBM Corporation
Software Group Route
100
Somers, NY 10589

Produced in the United States of America September
2017

IBM, the IBM logo and ibm.com are trademarks of International Business Machines Corp., registered in many jurisdictions worldwide. Other product and service names might be trademarks of IBM or other companies. A current list of IBM trademarks is available on the web at "Copyright and trademark information" at www.ibm.com/legal/copytrade.shtml

The content in this document (including currency OR pricing references which exclude applicable taxes) is current as of the initial date of publication and may be changed by IBM at any time. Not all offerings are available in every country in which IBM operates.

THE INFORMATION IN THIS DOCUMENT IS PROVIDED "AS IS" WITHOUT ANY WARRANTY, EXPRESS OR IMPLIED, INCLUDING WITHOUT ANY WARRANTIES OF MERCHANT- ABILITY, FITNESS FOR A PARTICULAR PURPOSE AND ANY WARRANTY OR CONDITION OF NON-INFRINGEMENT. IBM products are warranted according to the terms and conditions of the agreements under which they are provided.

Please Recycle