



Technology Highlights

Challenges Associated With Applying the New Revenue Standard: Accounting for Cloud-Based or Hosted Software Arrangements With Variable Consideration

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For public entities, the new revenue standard (ASC 606¹) became effective for annual reporting periods beginning after December 15, 2017. The standard is effective for all other entities for annual reporting periods beginning after December 15, 2018. Early adoption is permitted for annual reporting periods beginning after December 15, 2016.

While ASC 606 will affect organizations differently depending on their facts and circumstances, we have identified certain aspects of its application that are especially challenging for technology companies. This *Technology Alert* is part of a [series](#) intended to help technology entities better understand the new guidance, particularly private organizations that are currently adopting the standard's requirements.

Executive Summary

Entities that sell cloud-based or hosted software solutions (e.g., software-as-a-service (SaaS) arrangements)² often require the customer to pay them a variable amount, usually based on the underlying usage of the SaaS technology. ASC 606 generally requires entities to estimate variable consideration subject to a constraint,³ but it also provides a practical expedient and a variable consideration allocation exception. In addition, while ASC 606 includes an exception to the

¹ For titles of FASB Accounting Standards Codification (ASC) references, see Deloitte's "[Titles of Topics and Subtopics in the FASB Accounting Standards Codification.](#)"

² In this publication, it is assumed that a SaaS arrangement is accounted for as a service contract because the customer does not have the ability to take possession of the underlying software license on an on-premise basis.

³ In accordance with ASC 606-10-32-11, variable consideration can only be included in the transaction price "to the extent that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved."

general model for variable consideration in the form of a sales- or usage-based royalty related to licenses of intellectual property (IP),⁴ SaaS arrangements often do not qualify for the exception because a license is typically not transferred to the customer in such cases (i.e., the contracts are often hosting arrangements that do not meet the criteria in ASC 985-20-15-5 to be considered a license and are therefore accounted for as a service).

The accounting methods for variable consideration in SaaS arrangements may present a challenge to entities that were not required or able to estimate this type of variable consideration under legacy U.S. GAAP. The legacy guidance required such variable consideration to be recognized when it became fixed and determinable, which was generally when the uncertainty associated with the consideration was resolved.

The questions and answers (Q&As) below provide interpretive guidance intended to help entities address certain challenges associated with applying the revenue model in ASC 606 to SaaS arrangements that include variable consideration. All of the Q&As and related examples assume that (1) SaaS is the only promise in the contract and (2) the SaaS performance obligation meets the requirements to be recognized over time because the customer “simultaneously receives and consumes the benefits provided by the entity’s performance as the entity performs,” in accordance with ASC 606-10-25-27(a).

Interpretive Guidance



Q&A 1 Determining Whether a SaaS Arrangement Represents a Stand-Ready Obligation or an Obligation to Provide a Specified Amount of Services

To determine the appropriate revenue recognition model to apply to its SaaS arrangements, an entity must first determine the nature of its promise to provide services. In some arrangements, the entity may price a SaaS arrangement on the basis of the expected volume of usage, but it may not always be clear whether the nature of the promise is (1) an obligation to provide a specified amount of services (e.g., a promise to process 5,000 transactions) or (2) a stand-ready obligation to provide services if and when the customer needs them (e.g., a promise to make the SaaS available throughout a specified term to process all transactions remitted during the period).

Question

What factors should an entity consider when determining the nature of its promise in a SaaS arrangement?

Answer

An entity will need to carefully consider the rights and obligations in the contract to identify the nature of the promise and to determine an appropriate measure of the progress toward complete satisfaction of the performance obligation.

The following factors may indicate that the nature of the entity’s promise is an obligation to provide a specified amount of services:

- The customer has the right to “roll over” unused volume into a future period.
- The customer’s right to use the SaaS terminates upon reaching the specified volume.
- Upon reaching the specified volume, the customer must make a separate purchasing decision with respect to additional services and the entity is not obligated to provide those services before the customer exercises its rights (e.g., the customer and entity need to enter into a contract modification to continue service).

The following factors may indicate that the nature of the entity’s promise is to stand ready to provide the service:

- The contract does not include any specified volumes of usage (i.e., the customer has “unlimited access” to the SaaS).

⁴ When a sales- or usage-based royalty is related only to a license of IP or a license of IP that is the predominant item in an arrangement, the royalty is recognized at the later of the date on which (1) the subsequent sale or usage occurs or (2) the performance obligation associated with the royalty is satisfied (or partially satisfied).

- The specified volume is set as the maximum amount the customer can use, but it is not substantive (e.g., the limit is set as a protective measure and, in reality, is substantially higher than is actually expected to be used by the customer).
- The entity is required to stand ready to provide the service over the entire contractual period regardless of whether the customer exceeds the specified volume (i.e., the customer can continue use of the SaaS without requesting such ability from the entity, even if it has to pay an incremental fee for the excess).

If the nature of the entity's promise is to provide a specific amount of services, revenue is typically recognized when (or as) those services are provided. Breakage may be considered if a customer is not expected to use all the specified volume.

If the nature of the entity's promise is to stand ready to provide the SaaS, there are additional considerations related to applying the series guidance, determining an appropriate measure of progress, and determining how variable consideration is recognized. Those considerations are discussed further below.



Q&A 2 Applying the Series Guidance to SaaS Arrangements That Are Stand-Ready Obligations

Under ASC 606-10-25-14(b), a performance obligation is considered a series of distinct goods or services if such goods or services “are substantially the same and . . . have the same pattern of transfer to the customer.” To help entities make that determination, ASC 606-10-25-15 states:

A series of distinct goods or services has the same pattern of transfer to the customer if both of the following criteria are met:

- a. Each distinct good or service in the series that the entity promises to transfer to the customer would meet the criteria in paragraph 606-10-25-27 to be a performance obligation satisfied over time.
- b. In accordance with paragraphs 606-10-25-31 through 25-32, the same method would be used to measure the entity's progress toward complete satisfaction of the performance obligation to transfer each distinct good or service in the series to the customer.

Question

Does a SaaS performance obligation that is a stand-ready obligation represent a series of distinct goods or services?

Answer

Generally, yes. SaaS arrangements that represent stand-ready obligations typically meet the criteria to be considered a series since (1) each increment of service (e.g., each day of service) is distinct and would require recognition over time and (2) an entity would use the same method to measure its progress toward satisfaction of the obligation. Accordingly, the guidance on a series of distinct goods or services would typically apply.



Q&A 3 Measuring the Progress Toward Complete Satisfaction of Stand-Ready SaaS Arrangements

As explained in [Q&A 1](#), sometimes the nature of an entity's promise in a SaaS arrangement is to “stand ready” for a period rather than to provide a specified amount of services (e.g., processing a discrete number of transactions through the SaaS). In the case of a stand-ready obligation, the customer obtains (i.e., receives and consumes) a benefit from the assurance that the SaaS is available for a specified period when and if needed or desired (irrespective of actual usage). For a stand-ready obligation that is satisfied over time, an entity may measure its progress toward complete satisfaction of the performance obligation by using either an input or output method.

Although the guidance in ASC 606-10-55-16 through 55-21 indicates when an entity would use an output or input method to measure the progress toward satisfaction of the obligation, it does not prescribe the use of either method. However, an entity does not have a “free choice.” The actual method selected should be

consistent with the clearly stated objective of depicting the entity's performance (i.e., the entity's satisfaction of its performance obligation in transferring control of goods or services to the customer).⁵

Question

How should an entity measure the progress toward the complete satisfaction of a stand-ready SaaS arrangement that is satisfied over time?

Answer

To select an appropriate measure of progress, an entity needs to use judgment on the basis of the arrangement's particular facts and circumstances. In a typical stand-ready SaaS arrangement, the entity promises to make the SaaS available to its customer throughout the contractual period. In many of these arrangements, the entity may reasonably conclude that it is providing the customer with assurance that the SaaS will be made available when and if the customer needs it, and the customer therefore benefits from that guarantee evenly throughout the contract period. As a result, it would generally be appropriate to apply a time-based measure of progress over the period during which the customer has rights to use the SaaS.



Q&A 4 Applying the Practical Expedient to Stand-Ready SaaS Arrangements With Usage-Based Variable Consideration

ASC 606-10-55-18 provides the following practical expedient, which can be applied to performance obligations that are satisfied over time:

As a practical expedient, if an entity has a right to consideration from a customer in an amount that corresponds directly with the value to the customer of the entity's performance completed to date (for example, a service contract in which an entity bills a fixed amount for each hour of service provided), the entity may recognize revenue in the amount to which the entity has a right to invoice.

Commonly referred to as the "invoice practical expedient," this option allows an entity to recognize revenue in the amount of consideration to which the entity has the right to invoice if such amount corresponds directly to the value transferred to the customer. That is, the invoice practical expedient cannot be applied in all circumstances because the amount that an entity has the right to invoice does not always correspond to the value of the entity's performance to date. Therefore, an entity should demonstrate its ability to apply the invoice practical expedient to performance obligations satisfied over time. In addition, because the use of the invoice practical expedient must faithfully depict the entity's measure of progress toward completion, the expedient can only be applied to performance obligations satisfied over time (not at a point in time).

Question

Can an entity apply the invoice practical expedient to a stand-ready SaaS arrangement with a variable pricing structure based on the customer's usage?

Answer

Generally, yes. We believe that if a stand-ready SaaS arrangement (1) has a pricing structure that is solely variable on the basis of the customer's SaaS usage, (2) is priced at a fixed rate per usage, and (3) gives the entity the right to invoice the customer for its usage as it occurs, the invoice practical expedient may be applied. In such cases, the amount of revenue for which the entity has the right to invoice may reflect the value the customer has obtained from the SaaS during the period because it is a fixed rate based on the volume of the customer's SaaS usage. Accordingly, an entity with this type of arrangement is not required to estimate the amount of variable consideration to which it would be entitled at contract inception and instead can recognize revenue as the customer's usage occurs (provided that it also has the right to invoice).

The conclusion above may not be appropriate when (1) there are fixed fees (in addition to the usage-based fees), (2) there are substantive minimum usage requirements, (3) the usage price or rate varies during the contract period, or (4) up-front or back-end fees are charged. In those circumstances, it may be challenging to

⁵ See ASC 606-10-25-31.

demonstrate that the amount the entity has the right to invoice corresponds to the value the customer has received to date. However, the invoice practical expedient may not necessarily be precluded in the following scenarios (not all-inclusive):

- The amount of fixed consideration the entity has a right to invoice does not change from period to period and the customer's usage is expected to be consistent from period to period.
- The customer is expected to significantly exceed any minimum usage requirements.
- The usage rate changes solely on the basis of the Consumer Price Index or another metric that reflects an increase or decrease in value and directly correlates to the benefits received by the customer.
- The up-front or back-end fees are insignificant relative to the other consideration in the arrangement so that the amount the entity has the right to invoice is commensurate with the value the customer has received to date.



Q&A 5 Applying the Variable Consideration Allocation Exception to Stand-Ready SaaS Arrangements With Usage-Based Variable Consideration

Generally, ASC 606 requires an entity to allocate the transaction price to each performance obligation on a relative stand-alone selling price basis. However, the guidance provides an exception to the general allocation principle that applies specifically to variable consideration (the “variable consideration allocation exception”). Specifically, ASC 606-10-32-39(b) states that variable consideration may be attributable to “[o]ne or more, but not all, distinct goods or services promised in a series of distinct goods or services that forms part of a single performance obligation.” In addition, ASC 606-10-32-40 states the following:

An entity shall allocate a variable amount (and subsequent changes to that amount) entirely to a performance obligation or to a distinct good or service that forms part of a single performance obligation in accordance with paragraph 606-10-25-14(b) if both of the following criteria are met:

- a. 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).
- b. Allocating the variable amount of consideration entirely to the performance obligation or the distinct good or service is consistent with the allocation objective in paragraph 606-10-32-28 when considering all of the performance obligations and payment terms in the contract.

Question

If an entity elects to not apply the invoice practical expedient or is precluded from applying such expedient to its stand-ready SaaS arrangements, may it apply the variable consideration allocation exception to usage-based fees?

Answer

It depends. Because a SaaS arrangement would typically be a series of distinct services that represent a single performance obligation, an entity that does not apply the invoice practical expedient would apply the variable consideration allocation exception if the conditions in ASC 606-10-32-40 are met. An entity that receives variable consideration based on usage would typically meet the first condition in ASC 606-10-32-40(a) because the usage is usually associated with a specific outcome (e.g., the transaction is processed, or storage capacity is used). However, an entity must carefully evaluate its pricing structure to determine whether allocating variable consideration to a distinct service (e.g., each day that SaaS is provided) is consistent with the allocation objective.

Example 5-1

Application of the Variable Consideration Allocation Exception to Stand-Ready SaaS Arrangements With Variable Consideration That Is Solely Usage-Based

Entity A sells a SaaS platform that is a stand-ready performance obligation. The pricing structure for its SaaS is based solely on usage (e.g., \$1 for each transaction processed). We believe that if a stand-ready SaaS arrangement has a variable pricing structure based on the customer's SaaS usage and the SaaS is priced at a fixed rate per usage, the variable consideration allocation exception may be applied.⁶ This is because (1) the usage-based fees are related to a specific outcome and (2) allocation of the variable consideration to each distinct service period (e.g., each day) would meet the allocation objective (i.e., the usage-based pricing represents the amount of consideration to which the entity expects to be entitled upon the transfer of each and every distinct service, which is based on each increment of time within the series). Accordingly, A is not required to estimate the amount of variable consideration to which it would be entitled at contract inception and instead can recognize revenue as the customer's usage occurs.

However, the conclusion above may not be appropriate if the usage price or rate varies during the contract period, and an entity should give careful consideration to variable fees that increase or decrease on the basis of usage (e.g., tiered pricing). If the usage-based fees that would be allocated to each distinct service would not represent the amount of consideration to which the entity expects to be entitled upon the transfer of each distinct service (i.e., the increase or decrease in the fee is not commensurate with the efforts required by the entity to satisfy each distinct service or does not reflect the value of the specific outcome associated with usage), it may not be appropriate to conclude that the requirements to use the variable consideration allocation exception are met.

Example 5-2

Application of the Variable Consideration Allocation Exception to Stand-Ready SaaS Arrangements With Both Fixed Consideration and Usage-Based Variable Consideration

Entity B sells a SaaS platform that is a stand-ready performance obligation. The pricing structure for its SaaS includes a fixed component that is charged regardless of usage (e.g., a flat fee of \$100,000 for an annual subscription) and a variable component based on usage (e.g., \$1 for each transaction processed). If B uses a ratable (i.e., time-based) measure of progress for its stand-ready SaaS arrangements, the fixed consideration (e.g., \$100,000) would be recognized ratably over the contractual period. In addition, as discussed in Example 5-1 above, we believe that if a stand-ready SaaS arrangement has a variable pricing structure based on the customer's SaaS usage and the SaaS is priced at a fixed rate per usage, the variable consideration allocation exception may be applied. This is because (1) the usage-based fees are related to a specific outcome and (2) allocation of the variable consideration to each distinct service period (e.g., each day) would meet the allocation objective (i.e., the usage-based pricing would represent the amount of consideration to which the entity expects to be entitled upon the transfer of each and every distinct service, which is based on each increment of time within the series). Accordingly, B is not required to estimate the amount of variable consideration to which it would be entitled at contract inception and instead can recognize the variable consideration as the customer's usage occurs (with the fixed consideration recognized ratably).

As in Example 5-1, the conclusion above may not be appropriate if the usage price or rate varies during the contract period.

⁶ This assumes that the invoice practical expedient is not used. However, as discussed in [Q&A 4](#), the invoice practical expedient could be used when a stand-ready SaaS arrangement (1) has a pricing structure that is solely variable on the basis of the customer's SaaS usage, (2) is priced at a fixed rate per usage, and (3) gives the entity the right to invoice the customer for its usage as it occurs.

Example 5-3

Application of the Variable Consideration Allocation Exception to Stand-Ready SaaS Arrangements With Overage Fees and Minimums That Reset Monthly

Entity C sells a SaaS platform that is a stand-ready performance obligation and uses a ratable measure of progress for the performance obligation. The pricing structure for its SaaS includes a fixed component that is based on a predetermined amount of usage (i.e., a minimum usage requirement) and a variable component that is charged if the customer exceeds the predetermined amount (i.e., "overage fees"). In one of its arrangements, C sells a one-year subscription that has a minimum usage requirement of 100,000 transactions every month. The subscription is priced at \$100,000 per month (\$1 for each transaction processed); if the number of transactions exceeds 100,000, additional transactions processed are also priced at \$1 each. If the customer has fewer than 100,000 transactions in any month, the shortfall is not carried forward (e.g., if the customer only has 90,000 transactions in a particular month, it must still pay \$100,000 that month and the next month's minimum is still 100,000 transactions). Therefore, the total fixed consideration is \$1.2 million ($\$100,000 \times 12$ months), which is recognized ratably over the contractual term.

An entity's ability to apply the variable consideration allocation exception when there is a fixed component and overage fees depends on whether the minimum usage requirements are the same in each period, whether the overage fees are a fixed rate per usage, and how often the minimum usage requirements are "reset." If the minimum usage requirements are the same in each period, overage fees are a fixed rate per usage, and minimum usage requirements are reset frequently throughout the entity's reporting period (e.g., monthly), the overage fees incurred in such periods typically qualify for the variable consideration allocation exception. This is because (1) the usage-based fees are related to a specific outcome and (2) allocation of the variable consideration to each distinct service period (e.g., each month) would meet the allocation objective (i.e., the usage-based pricing represents the amount of consideration to which the entity expects to be entitled upon the transfer of each and every distinct service, which is based on each increment of time within the series).

In assessing the allocation objective, C determines that any overage fees for a particular month are solely associated with that month and reflect the value of the specific outcome associated with the overage. Accordingly, C is not required to estimate the amount of variable consideration to which it would be entitled at contract inception and instead can recognize the variable consideration as the customer's usage occurs (with the fixed consideration recognized ratably).

Example 5-4

Application of the Variable Consideration Allocation Exception to Stand-Ready SaaS Arrangements With Overage Fees and a Minimum That Does Not Reset

Assume the same facts as in [Example 5-3](#) except that in one of its arrangements, Entity C sells a one-year subscription that has an annual minimum usage requirement of 1.2 million transactions. The subscription is priced at a fixed fee of \$1.2 million (\$1 for each transaction processed); if the number of transactions exceeds 1.2 million, additional transactions processed are also priced at \$1 each. Therefore, the total fixed consideration is \$1.2 million, which is recognized ratably over the contractual term (\$100,000 each month).

Because the minimum usage requirements do not reset, the overage fees incurred in the latter part of the year would not qualify for the variable consideration allocation exception. While the usage-based fees are related to a specific outcome, allocation of the variable consideration to each distinct service period (e.g., the latter month or months of the year) would not meet the allocation objective (i.e., the usage-based pricing does not represent the amount of consideration to which the entity expects to be entitled upon the transfer of each and every distinct service, which is based on each increment of time within the series). In assessing the allocation objective, C determines that any overage fees for a particular month (1) would not be solely associated with that month and (2) would not reflect the value of the specific outcome associated with the overage. For example, if the customer has 110,000 transactions in each month, total consideration would be \$1.32 million ($110,000 \times \1×12 months) and \$100,000 of fixed consideration would be recognized in each month. The overage fees would be \$120,000 (\$1.32 million – \$1.2 million). However, if the overage fees were recognized in the specific month they related to, they would be recognized in the last two months of the year (\$10,000 in month 11 and \$110,000 in month 12). Therefore, even though the number of transactions would be the same in each month (i.e., the benefits received in the last two months are similar to those received in the first ten months because the usage is the same), more revenue would be recognized in the last two months (\$100,000 recognized in months 1–10, \$110,000 recognized in month 11, and \$210,000 recognized in month 12).

Accordingly, C would generally be required to estimate the amount of variable consideration to which it would be entitled at contract inception and to recognize both fixed and variable consideration ratably over the contract term, subject to the variable consideration constraint.⁷

⁷ However, as discussed in [Q&A 4](#), the invoice practical expedient could be used when a stand-ready SaaS arrangement (1) has a pricing structure that is solely variable on the basis of the customer's SaaS usage, (2) is priced at a fixed rate per usage, and (3) gives the entity the right to invoice the customer for its usage as it occurs. While, in this example, the fees are not solely variable, if (1) the customer is expected to significantly exceed the minimum usage requirements, (2) the minimum usage is priced at the same rate as any overages, and (3) C has the right to invoice the customer for its usage as it occurs, C may be able to use the invoice practical expedient (which would result in the recognition of both the fixed and variable fees as usage occurs rather than ratable recognition).

Example 5-5

Application of the Variable Consideration Allocation Exception to Stand-Ready SaaS Arrangements With Overage Fees and Minimums That Reset Annually

Assume the same facts as in [Example 5-3](#) except that in one of its arrangements, Entity C sells a three-year subscription that has an annual minimum usage requirement of 1.2 million transactions. The subscription is priced at \$1.2 million per year (\$1 for each transaction processed); if the number of transactions exceeds 1.2 million, the additional transactions are also priced at \$1 each. If the customer has fewer than 1.2 million transactions in any year, the shortfall is not carried forward (e.g., if the customer only has 1 million transactions in a particular year, it must still pay \$1.2 million and the next year's minimum is still 1.2 million transactions). Therefore, the total fixed consideration is \$3.6 million (\$1.2 million × 3 years), which is recognized ratably over the contractual term (\$100,000 in each month).

Since the minimum usage requirements are the same for each year, overage fees are a fixed rate per usage, and minimum usage requirements are reset each year, the overage fees incurred for a particular annual period typically qualify for the variable consideration allocation exception and can therefore be allocated to that year's service. This is because (1) the usage-based fees are related to a specific outcome and (2) the allocation of variable consideration to each distinct service period (e.g., each year) meets the allocation objective (i.e., the usage-based pricing represents the amount of consideration to which the entity expects to be entitled upon the transfer of each and every distinct service, which is based on each annual increment of time within the series). In assessing the allocation objective, C determines that any overage fees for a particular year are solely associated with that year and reflect the value of the specific outcome associated with the overage.

However, as in [Example 5-4](#), because the minimum usage requirements do not reset frequently (e.g., monthly), the overage fees incurred in the latter part of each year would not qualify for the variable consideration allocation exception for the periods within each year (e.g., each month within the year). While the usage-based fees are related to a specific outcome, the allocation of variable consideration to each distinct service period (e.g., the latter month or months of the year) would not meet the allocation objective (i.e., the usage-based pricing does not represent the amount of consideration to which the entity expects to be entitled upon the transfer of each and every distinct service, which is based on each increment of time within the series). In assessing the allocation objective, C determines that any overage fees for a particular month (1) are not solely associated with that month and (2) do not reflect the value of the specific outcome associated with the overage.

Accordingly, C would generally be required to estimate the amount of variable consideration to which it would be entitled in each year and to recognize both fixed and variable consideration ratably over each annual period, subject to the variable consideration constraint. However, because the allocation objective is met on an annual basis (i.e., the overage fees for each year (1) are solely associated with that year and (2) reflect the value of the specific outcome associated with the overage for that year), the overages for a particular year can be recognized that year. For example, if C expects \$100,000 in overage fees in the first year, \$120,000 in overage fees in the second year, and \$150,000 in overage fees in the third year, it may recognize \$1.3 million⁸ ratably in the first year, \$1.32 million⁹ ratably in the second year, and \$1.35 million¹⁰ ratably in the third year, subject to the variable consideration constraint.¹¹

⁸ \$1.2 million fixed consideration plus \$100,000 estimated variable consideration.

⁹ \$1.2 million fixed consideration plus \$120,000 estimated variable consideration.

¹⁰ \$1.2 million fixed consideration plus \$150,000 estimated variable consideration.

¹¹ To determine whether the invoice practice expedient can be used, see [footnote 7](#).

Example 5-6

Application of the Variable Consideration Allocation Exception to Stand-Ready SaaS Arrangements With Overage Fees and Minimums That Increase Monthly

Assume the same facts as in [Example 5-3](#) except that in one of its arrangements, Entity C sells a one-year subscription that has an increasing minimum usage requirement in every month, which is priced at \$1 for each transaction processed. If the number of transactions exceeds the minimum requirement, the additional transactions processed are also priced at \$1 each. The minimum usage starts at 100,000 transactions in the first month and increases by 10,000 in each month of the year (210,000¹² in the last month). Therefore, the total fixed consideration is \$1.86 million,¹³ which is recognized ratably over the contractual term.

Because the minimum usage requirements change in each month, C must carefully evaluate whether it would qualify for the variable consideration allocation exception. While the usage-based fees are related to a specific outcome, allocation of the variable consideration to each distinct service period (e.g., each month) would not be likely to meet the allocation objective (i.e., the usage-based pricing is not likely to represent the amount of consideration to which the entity expects to be entitled upon the transfer of each and every distinct service, which is based on each increment of time within the series). In assessing the allocation objective, C determines that any overage fees for a particular month are not likely to (1) be solely associated with that month or (2) reflect the value of the specific outcome associated with the overage. For example, fixed consideration of \$155,000 would be recognized in each month (\$1.86 million ÷ 12 months). However, if the customer had 200,000 transactions in each month, the amount of overage fees would be greater in the earlier months (\$100,000¹⁴ in the first month, \$90,000¹⁵ in the second month, and so on). Therefore, even though the number of transactions would be the same in each month, more consideration would be recognized in the earlier months (for a total of \$255,000¹⁶ recognized in the first month, \$245,000¹⁷ recognized in the second month, and so on).

Accordingly, C would generally be required to estimate the amount of variable consideration to which it would be entitled at contract inception and to recognize both fixed and variable consideration ratably over the contract term, subject to the variable consideration constraint.¹⁸

¹² \$100,000 plus (\$10,000 × 11 months).

¹³ \$100,000 + \$110,000 + \$120,000 + \$130,000 + \$140,000 + \$150,000 + \$160,000 + \$170,000 + \$180,000 + \$190,000 + \$200,000 + \$210,000.

¹⁴ \$200,000 total fees (200,000 transactions × \$1 per transaction) less \$100,000 minimum in month 1.

¹⁵ \$200,000 total fees (200,000 transactions × \$1 per transaction) less \$110,000 minimum in month 2.

¹⁶ \$155,000 fixed consideration plus \$100,000 overage fees (see footnote 14).

¹⁷ \$155,000 fixed consideration plus \$90,000 overage fees (see footnote 15).

¹⁸ We believe that for these types of arrangements, the allocation objective would only be met in limited circumstances. For example, if the number of overages was expected to be the same in each month (in line with the increase in minimums), an entity may be able to apply the variable consideration allocation exception. However, the entity must have sufficient historical data to substantiate that the number of overages will be the same in each month. In addition, to determine whether the invoice practice expedient can be used, see [footnote 7](#).

Example 5-7

Application of the Variable Consideration Allocation Exception to Stand-Ready SaaS Arrangements With Overage Fees and Minimums That Carry Over

Assume the same facts as in [Example 5-3](#) except that in one of its arrangements, Entity C sells a one-year subscription that specifies a minimum usage requirement of 100,000 transactions in every month. The subscription is priced at \$100,000 per month (\$1 for each transaction processed); if the number of transactions exceeds 100,000, the additional transactions processed are also priced at \$1 each. However, if the customer has fewer than 100,000 transactions in any month, the shortfall is carried over to the following month (e.g., if the customer only has 90,000 transactions in the first month, it must still pay \$100,000 for that month but the next month's minimum becomes 110,000 transactions; and if in the second month the customer only has 95,000 transactions, it must still pay \$100,000 for that month but the next month's minimum becomes 115,000. However, if in the third month the customer has 120,000 transactions, it will pay \$100,000 for that month and pay \$5,000 for the overage). In addition, any shortfall at the end of the year is not carried forward upon renewal. Therefore, the total fixed consideration is \$1.2 million ($\$100,000 \times 12$ months), which is recognized ratably over the contractual term.

Because the minimum usage requirements could change in each month, C must carefully evaluate whether it would qualify for the variable consideration allocation exception. As in [Example 5-6](#), while the usage-based fees are related to a specific outcome, allocation of the variable consideration to each distinct service period (e.g., each month) may not meet the allocation objective (i.e., the usage-based pricing may not represent the amount of consideration to which the entity expects to be entitled upon the transfer of each and every distinct service, which is based on each increment of time within the series). Therefore, if the minimum usage requirements change monthly, any overage fees for a particular month may not (1) be solely associated with that month or (2) reflect the value of the specific outcome associated with the overage. Accordingly, C may be required to estimate the amount of variable consideration to which it would be entitled at contract inception and to recognize both fixed and variable consideration ratably over the contract term, subject to the variable consideration constraint.

However, if C expects the customer to exceed 100,000 transactions in every month (i.e., there is no shortfall carried over), the arrangement may be similar to that in [Example 5-3](#), and any overage fees for a particular month would (1) be solely associated with that month and (2) reflect the value of the specific outcome associated with the overage. In that case, C would not be required to estimate the amount of variable consideration to which it would be entitled at contract inception and instead could recognize the variable consideration as the customer's usage occurs (with the fixed consideration recognized ratably).¹⁹

¹⁹ To determine whether the invoice practice expedient can be used, see [footnote 7](#).

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