

ASC 606 REVENUE RECOGNITION MEMORANDUM

TO: Chief Accounting Officer **FROM:** Technical Accounting Team - AI **DATE:** August 22, 2025 **RE:** Contract Analysis - ASC 606 Revenue Recognition Analysis

BACKGROUND

We have reviewed the contract documents provided by Customer to determine the appropriate revenue recognition treatment under ASC 606. This memorandum presents our analysis following the five-step ASC 606 methodology and provides recommendations for implementation.

ASC 606 ANALYSIS

Identify the Contract

Analysis:

To determine if a valid contract exists under ASC 606-10-25-1, we must evaluate the contract between InnovateTech Solutions Inc. ("InnovateTech") and Global Dynamics Corp. ("Customer") against the criteria outlined in the guidance.

- Approval and Commitment (ASC 606-10-25-1(a)):** The Statement of Work (SOW) is entered into as of October 26, 2023, under the terms of a pre-existing Master Services Agreement (MSA) dated January 15, 2022. This indicates that both parties have approved the contract in writing and are committed to performing their respective obligations. The presence of a signed SOW and reference to an MSA supports this conclusion.
- Identification of Rights (ASC 606-10-25-1(b)):** The contract clearly identifies each party's rights regarding the goods and services to be transferred. InnovateTech is obligated to provide the Logi-AI Suite SaaS license, hardware (OptiScan-7 scanners), and professional services for integration and training. The Customer's rights include receiving these deliverables and providing written acceptance for the professional services.
- Payment Terms (ASC 606-10-25-1(c)):** The payment terms are explicitly stated in the contract. The Logi-AI Suite SaaS license is priced at 240,000 per year, with the first year's fee due Net 30 from the Effective Date. The hardware is priced at a one-time fee of 50,000, and the professional services at 75,000, both due Net 30 from the Effective Date. Additionally, a performance bonus of 30,000 is contingent upon achieving a 15% reduction in shipping costs. These terms are clear and provide a basis for recognizing revenue.
- Commercial Substance (ASC 606-10-25-1(d)):** The contract has commercial substance because it is expected to change the risk, timing, or amount of InnovateTech's future cash flows. The provision of the Logi-

AI Suite, hardware, and professional services will result in cash inflows from the Customer, and the performance bonus provides an incentive for InnovateTech to enhance the Customer's operational efficiency.

5. **Probability of Collection (ASC 606-10-25-1(e)):** It is probable that InnovateTech will collect substantially all of the consideration. The Customer is a corporation with an existing relationship under the MSA, suggesting a history of payment reliability. The contract terms do not indicate any significant credit risk, and the structured payment schedule supports the likelihood of collection.

Conclusion: The contract between InnovateTech and Global Dynamics meets all the criteria under ASC 606-10-25-1 for a valid contract. The parties have approved and committed to the contract, rights and payment terms are clearly identified, the contract has commercial substance, and it is probable that InnovateTech will collect the consideration.

Issues or Uncertainties: None identified.

Identify Performance Obligations

Analysis:

The contract between InnovateTech Solutions Inc. and Global Dynamics Corp. includes several promised goods and services. These are: (1) a 3-year subscription license to the Logi-AI Suite, (2) provision of 200 OptiScan-7 handheld scanners, and (3) professional services for implementation, system integration, and on-site user training. Additionally, there is a performance bonus contingent on achieving a 15% reduction in shipping costs.

According to ASC 606-10-25-14, each promise to transfer a good or service to the customer must be assessed to determine if it is a distinct performance obligation. A good or service is distinct if the customer can benefit from it on its own or with other readily available resources, and if it is separately identifiable from other promises in the contract (ASC 606-10-25-19).

1. **Logi-AI Suite SaaS License:** The SaaS license is capable of being distinct because the customer can benefit from the software on its own, as it provides access to the Logi-AI Suite's functionalities. It is regularly sold separately, as evidenced by its standalone pricing. Therefore, it meets the criteria of ASC 606-10-25-20 and ASC 606-10-25-21.
2. **OptiScan-7 Handheld Scanners:** The scanners are also capable of being distinct. The customer can benefit from them as they are necessary for the optimal use of the Logi-AI Suite's inventory tracking features. The title and risk of loss transfer upon delivery, indicating they are a separate deliverable. They are not highly interdependent with the SaaS license, as the software can function without them, albeit less optimally. Thus, they meet the criteria of ASC 606-10-25-20 and ASC 606-10-25-21.
3. **Professional Services:** These services are capable of being distinct because they enhance the functionality of the Logi-AI Suite by integrating it with the customer's ERP system. While the software can be used without these services, the integration provides significant additional value. The services are not highly interdependent with the SaaS license or the scanners, as they are a one-time engagement and are completed upon acceptance by the customer. Therefore, they meet the criteria of ASC 606-10-25-20 and ASC 606-10-25-21.

The performance bonus is contingent and does not represent a separate performance obligation at contract inception, as it is dependent on the customer's achievement of specific cost reductions.

Conclusion: The contract contains three distinct performance obligations: (1) the Logi-AI Suite SaaS license, (2) the OptiScan-7 handheld scanners, and (3) the professional services for implementation and integration. Each of these is capable of being distinct and is separately identifiable within the context of the contract.

Issues or Uncertainties: None identified.

Determine the Transaction Price

Analysis:

To determine the transaction price under ASC 606, we must consider both fixed and variable consideration, as well as any significant financing components or noncash consideration.

Fixed Consideration: The contract with Global Dynamics includes several fixed consideration components. The Logi-AI Suite SaaS License is priced at 240,000 *per year for three years, totaling 720,000*. The hardware component, consisting of 200 OptiScan-7 scanners, is priced at a one-time fee of 50,000. *Additionally, the professional services for implementation and training are priced at a one-time fee of 75,000*. These amounts are fixed because they are specified in the contract and not subject to change based on future events.

Variable Consideration: The contract includes a performance bonus of \$30,000, contingent upon Global Dynamics achieving a 15% reduction in shipping costs within the first 12 months. According to ASC 606-10-32-5 to 32-10, variable consideration should be estimated using either the expected value or the most likely amount method. Given InnovateTech's history of achieving this metric with 80% of similar customers, the most likely amount method may be appropriate. However, per ASC 606-10-32-11 to 32-14, this variable consideration must be constrained to avoid significant revenue reversal. Given the 80% success rate, it is reasonable to include the performance bonus in the transaction price, but management must evaluate the likelihood of achieving the target.

Constraints on Variable Consideration: The performance bonus is subject to constraint because it depends on the customer's internal reporting and achievement of specific cost reductions. Management must assess the likelihood of achieving these reductions and the reliability of the customer's reporting systems.

Significant Financing Components: According to ASC 606-10-32-15, a significant financing component exists if the timing of payments provides a significant benefit of financing. In this contract, payments for the SaaS license are due annually, and other fees are due within 30 days of the effective date. The timing does not indicate a significant financing component because the payment terms align closely with the delivery of goods and services.

Noncash Consideration and Consideration Paid to a Customer: There is no indication of noncash consideration or consideration paid to the customer in this contract.

Conclusion: The total transaction price for the contract with Global Dynamics is 875,000, *consisting of 720,000 for the SaaS license, 50,000 for hardware, and 75,000 for professional services*. The \$30,000 performance bonus is included as variable consideration, subject to constraint evaluation. No significant financing components or noncash considerations are present.

Issues or Uncertainties: The primary uncertainty involves the constraint on the variable consideration related to the performance bonus. Management must evaluate the likelihood of achieving the 15% cost reduction and the reliability of the customer's reporting systems.

Allocate the Transaction Price

Analysis:

In accordance with ASC 606, the allocation of the transaction price to performance obligations is a critical step in revenue recognition. Based on the contract with Global Dynamics, the performance obligations identified in Step 2 include: (1) the Logi-AI Suite SaaS License, (2) the provision of OptiScan-7 hardware, and (3) professional services for implementation and training. Each of these deliverables represents a distinct performance obligation as they are capable of being distinct and separately identifiable within the context of the contract.

Per ASC 606-10-32-31 to 32-34, standalone selling prices (SSPs) should be determined separately for each performance obligation based on observable data. This involves assessing market conditions, entity-specific factors, and other relevant inputs to estimate the price at which the entity would sell the promised goods or services separately to a customer.

The allocation methodology to be used is the relative standalone selling price method, as outlined in ASC 606-10-32-31. This method requires the transaction price to be allocated to each performance obligation in proportion to its SSP. The contract specifies a total transaction price of 365,000, *which includes 240,000 for the SaaS*

license, 50,000 for the hardware, and 75,000 for professional services. Additionally, there is a potential performance bonus of \$30,000, contingent upon achieving a 15% reduction in shipping costs.

The contract includes a 10% bundle discount on the hardware and services, which must be considered in the allocation process. According to ASC 606-10-32-37, if a discount is applicable to only one or more, but not all, performance obligations, it should be allocated proportionately to those obligations. In this case, the discount applies to the hardware and professional services, and thus, should be allocated proportionately to these obligations based on their SSPs.

Conclusion:

The transaction price for the contract with Global Dynamics should be allocated to the identified performance obligations using the relative standalone selling price method. The 10% discount should be proportionately allocated to the hardware and professional services, as these are the obligations to which the discount applies. The final allocation will be subject to the determination of the SSPs for each performance obligation.

Issues or Uncertainties:

None identified.

Recognize Revenue

Analysis:

The contract between InnovateTech Solutions Inc. and Global Dynamics Corp. involves multiple performance obligations, each requiring distinct revenue recognition considerations under ASC 606.

- Logi-AI Suite SaaS License:** The SaaS license is a subscription service provided over a 3-year period. According to ASC 606-10-25-27, revenue for services provided over time should be recognized over the period the service is delivered. The customer receives and consumes the benefits of the SaaS license simultaneously as InnovateTech performs, satisfying the criteria for over-time recognition. Therefore, revenue from the \$240,000 annual SaaS license fee should be recognized ratably over each year of the subscription term.
- Hardware Provisioning (OptiScan-7 Scanners):** The transfer of control for the hardware occurs upon delivery, as indicated by the contract's stipulation that title and risk of loss transfer to the customer at that point. Per ASC 606-10-25-23, revenue is recognized when control of the asset is transferred to the customer. Thus, the \$50,000 fee for the scanners should be recognized at a point in time, specifically upon delivery within 14 days of the effective date.
- Professional Services:** These services are a one-time engagement for implementation, system integration, and training. The contract specifies completion upon written acceptance by the customer, indicating a point-in-time recognition. According to ASC 606-10-25-23, revenue is recognized when the customer obtains control of the service, which occurs upon acceptance. Therefore, the \$75,000 fee should be recognized at the point of customer acceptance.
- Performance Bonus:** The performance bonus is contingent upon achieving a 15% reduction in shipping costs within the first 12 months. ASC 606-10-32-28 through 32-41 requires that variable consideration be included in the transaction price only to the extent that it is probable that a significant reversal will not occur. Given InnovateTech's history of achieving this metric with 80% of similar customers, it may be reasonable to include this bonus in the transaction price, subject to reassessment as the performance period progresses.

Conclusion: Revenue recognition for the contract with Global Dynamics involves a combination of over-time and point-in-time recognition. The SaaS license revenue is recognized over time, the hardware and professional services are recognized at a point in time upon delivery and acceptance, respectively, and the performance bonus is recognized based on the likelihood of achieving the specified cost reduction.

Issues or Uncertainties: None identified.

PREPARED BY: [Analyst Name] | [Title] | [Date] **REVIEWED BY:** [Reviewer Name] | [Title] | [Date]

This memorandum represents our preliminary analysis based on the contract documents provided. Final implementation should be reviewed with external auditors and may require additional documentation or analysis of specific implementation details.