

A PRACTICAL GUIDE FOR REVENUE RECOGNITION
AT HIGHER EDUCATION INSTITUTIONS

Applying Topic 606 Using Various Contract Examples



In May 2014, the Financial Accounting Standards Board (FASB) issued new accounting standards (Topic 606) that overhauled accounting for revenue recognition.

The objective of these new rules is to develop a single, principle-based revenue standard. Topic 606 aims to improve accounting for contracts with customers by providing a robust framework for addressing revenue issues as they arise, increasing comparability across industries, and requiring better disclosure.

The scope of the new standards includes all contracts with customers (except lease contracts, insurance contracts, financial instruments, guarantees, and non-monetary exchanges in the same line of business to facilitate sales to customers). It should also be noted that contributions are not within the scope of Topic 606, so you will continue to account for contributions under the current standards (ASC 958-605).

Achieving the core principle in five steps

New model includes a five-step process

The core principle of the new standards is to recognize revenue to depict the transfer of promised goods or services in amounts that reflect the consideration to which your entity expects to be entitled in exchange for those goods or services

FASB included five steps to achieve this core principle. These steps will help your institution determine how to recognize revenue from contracts with customers:

Step 1: Identify the contract(s) with the customer.

Step 2: Identify the performance obligations.

Step 3: Determine the transaction price.

Step 4: Allocate the transaction price

Step 5: Recognize revenue when (or as) a performance obligation is satisfied.

There is significant guidance contained in Topic 606 further defining and showing examples of the five-step process. For those institutions with conduit debt, the new standards are effective for fiscal years beginning after December 15, 2017; all other institutions are required to implement the new standards for fiscal years beginning after December 15, 2018.

Practical steps for implementing ASC 606

For many accountants, principle-based standards can be the hardest to implement. We tend to feel more comfortable with the rules-based standards and their black-and-white decision points. To add to the discomfort, Topic 606 is long

and cumbersome. But implementing the following practical steps can make what appears to be a monumental task much more manageable:

- Review commentary from accounting firms and other resource groups and, when possible, attend live training courses. Once you get a baseline understanding, read the standard while thinking about your institution's revenue streams and questions you may have in interpreting Topic 606. The AICPA's Revenue Recognition Task Force has published helpful information on [specific revenue stream implementation](#) issues.
- Take inventory of all your institution's significant revenue streams. Have a team member create an Excel spreadsheet that lists all of the current revenue sources. This is an important starting point for implementing Topic 606 and can guide later implementation steps.
- Using your inventory, assign team members to be responsible for adopting Topic 606 for assigned revenue streams or categories. Consider utilizing legal or operational personnel.
- Task each champion with determining an initial position on Topic 606's effect on their assigned categories. Start by documenting the current revenue recognition process, and then identify the relevant sections in Topic 606. When options or judgements are required, be specific as to why a certain decision was made. Support this decision with facts, and review your conclusions with other team members, external auditors, and peers within the higher education industry.
- Finalize and approve the new revenue recognition policy. Consider the need to train staff on new policies and procedures.
- Ensure significant changes are communicated to the president and governing board. Other team members to notify may include internal auditors, any individual responsible for executing external contracts, and vice presidents with budget responsibilities who may be affected.

Keep in mind while reviewing specific revenue contracts or accounts that any potential change to revenue recognition may be immaterial your current practices. If a change is deemed insignificant, there may not be a need to alter your current revenue recognition policy. Any decisions to that effect should be discussed with your external auditor; there could be a need for annual passed audit adjustments.

Application examples

Once you have an implementation plan in place, it's helpful to take a look at some common higher education revenue stream scenarios and how they might be analyzed within the five-step process. Common revenue stream examples include:

- Tuition and housing
- Naming rights
- License and royalty
- Intellectual property
- Exclusive food service
- Research grant
- Sponsorship
- Membership revenue

These scenarios are hypothetical, and analysis and application could significantly change depending on your unique circumstances.

Tuition and housing

Scenario — A university's charges for tuition and housing are published on its website. Upon acceptance to the university, a student must pay a non-refundable deposit to hold a spot. The university sends a bill for the remaining balance due a month prior to the start of the semester. There is an add/drop period (first two weeks of the semester) when the student may receive a partial refund of the gross amount of tuition and housing charged.

Using the AICPA Financial Reporting Executive Committee (FinREC)'s [working draft for recognizing revenue from tuition and housing](#), the university could apply the five-step process in the following way:

Step 1: Identify the contract(s) with the customer

A contract exists as a student is exchanging consideration for education and housing services to be provided by the university. However, the contract's timing will vary among institutions based on individual policies and procedures. This would include a review of registration and admission practices.

The university requires a student to pay a non-refundable deposit to hold a spot for the upcoming semester. This in essence is a prepayment for the educational and housing services to be provided at a later date. As a result, when the university receives the deposit, it will record a contract liability (deferred revenue). When the student begins taking class and moves into the dorm, this contract liability will be included in the transaction price (see step 3 below).

In this step in the revenue recognition process, the university should determine if applying the revenue recognition criteria

would be materially different between a portfolio approach (e.g., all students enrolled for the fall semester) and recording each individual student separately. In this case, the university determined that there is not a material difference and used the portfolio approach to recognize revenue from tuition, room, and board services.

Step 2: Identify the performance obligations

The university has the obligation to provide classroom instruction and a room in a residence hall. Are these services distinct? If so, they need to be accounted for separately. The university concluded that tuition and housing are distinct services, as a student can benefit from educational services without the need for housing. As a result, tuition and housing are considered separate performance obligations.

Step 3: Determine the transaction price

The university has published fees for different educational levels and programs offered, so the transaction price is different based on different class of students. The university receives payments from its students, or from others on behalf of its students. The transaction price includes payments from all sources.

The university offers aid packages to students in various forms, including scholarships and discounts. If a student is doing nothing in return for a particular scholarship, the amount of that scholarship is recorded as a reduction to revenue when revenue is recognized. If a student performs a service in exchange for a reduction of tuition, that amount would be recorded as an expense.

The university has an add/drop period in which the student can receive a refund. Based on historical experience, the university estimates the percentage of students who will be due a refund. This percentage will then be used to reduce revenue recognition. If a student paid the bill prior to the start of the semester, this amount will be reclassified from contract liability (deferred revenue) to refund liability. After the two-week add/drop period ends, the university makes adjustments to this estimate based on actual results.

Step 4: Allocate the transaction price

The university had concluded (in step 2) that tuition and housing are separate performance obligations. As a result, the price is allocated to these separate contracts based on their respective published rates. The university also concluded that financial aid applies both to tuition and housing and so reduced the transaction prices accordingly.

Step 5: Recognize revenue

Revenue for tuition and housing would be recognized ratably over the course of the semester as the related services are performed.

Practical considerations

According to a typical academic calendar and related billing cycle, the journal entries would be made as follows:

- Nonrefundable deposit received prior to the start of the semester — debit cash, credit contract liability (entire amount of deposit)
- A bill is sent for the remaining balance due prior to the start of the semester — no entry, an unconditional right to consideration does not exist
- Student pays entire bill prior to the start of the semester — debit cash, credit contract liability (the entire amount received)
- Debit contract liability, credit refund liability (estimated refunds due based on historical analysis during the add/drop period)
- First day of class — Debit contract liability, credit revenue. Amount is calculated by taking the total fee divided by the number of days in the semester; less the refund estimate calculated by taking net fees (total fees less un-refundable deposit) divided by the number of days in the semester times the percentage estimate of refunds. Assume total charges are \$10,000, the refund estimate is 10 percent, the semester is 100 days, and the non-refundable deposit is \$1,000. Amount recorded would be \$91 $(\$10,000)/100 - (\$9,000/100 * 10 \text{ percent})$
- End of add/drop period assuming student dropped 10% of classes — Debit refund liability, credit cash (This entry assumes the refund liability was estimated 100 percent correct. If the refund liability needed adjustment, an entry would be made to update the refund estimate to actual.)
- Throughout the remainder of the semester — Debit contract liability, credit revenue (ratably over the semester term)

Analysis under the new revenue recognition model may not be necessary for semesters that begin and end within the fiscal year, assuming interim GAAP reporting is not utilized.

The above example may seem complicated. But for traditional academic calendars and semesters, Topic 606 may not have a significant impact. If you have a summer semester that spans fiscal years, you would need to implement procedures to track and calculate refund estimates. Journal entries will need to be prepared to record contract liabilities and or refund liabilities.

If your institution historically recorded a receivable and deferred revenue as bills were rendered and mailed, that practice is not acceptable under Topic 606, as an unconditional right to consideration does not exist.

Naming rights (first example)

Scenario — A university receives \$13,000,000 from a corporation. In exchange, the university agrees to name its new basketball stadium in the corporation's name. That name must be prominently displayed on the front of the stadium to certain specifications contained within an agreement between the university and the corporation. The stadium is located next to a heavily traveled road in the heart of the city where the university is located. The term of the agreement is 15 years.

Step 1: Identify the contract

This is considered to be a reciprocal contract. The university and the corporation have approved the agreement and are committed to satisfy the terms. The university has the obligation to name the stadium in the corporation's name and display that name per specification in the contract. The payment terms are identified. The contract is deemed to have commercial substance as the corporation is receiving value (advertising). The university determines that collectability of the consideration is probable.

Step 2: Identify the performance obligations

The university must exclusively name the stadium after the corporation and maintain signage in accordance with the terms of the contract.

Step 3: Determine the transaction price

The transaction price is \$13,000,000.

Step 4: Allocate the transaction price

There is one performance obligation; therefore the entire transaction price is allocated as such.

Step 5: Recognize revenue

Revenue is recognized when a performance obligation is satisfied. In this case, the naming right for the stadium lasts 15 years. It is deemed reasonable to conclude that the corporation simultaneously receives and consumes the benefits over the term of the contract. Therefore, revenue would be recognized pro ratably over the term of the contract.



Naming rights (second example)

Scenario — A university receives \$200,000 from an alumnus. In exchange, the university agrees to name a residence hall in the alumnus' name. That name is to last into perpetuity so long as the residence hall stands.

Step 1: Identify the contract

The revenue recognition standards note that if there are other sections of the FASB Accounting Standards Codification that specify how to separate and/or initially measure one or more parts of a contract, then those provisions should be applied first. We need to consider guidance contained in FASB ASC 958 to determine if this particular example meets the definition of a contribution, an exchange transaction, or both. To be considered an exchange transaction, each party to a contract receives and sacrifices commensurate value. The university analyzed the above contract and determined that the alumnus did not receive commensurate value for the consideration paid. Therefore, the above transaction would be accounted for as a contribution and further analysis under the new revenue recognition standards would not be required.

License and royalty (similar to that contained in ASC 606-55-395)

Scenario — A university participates in significant NCAA Division I sporting events. A commercial company obtains the license to use the university's name and logos. The commercial company manufactures various items such as clothing, hats, and memorabilia on which it plans to affix the university's name and logos. For these rights, the university receives \$500,000 at the execution of a contract. The university will also receive a royalty of 1 percent of the sales price of any products using its name and logos. The term of the contract is four years.

Step 1: Identify the contract

There is a contract between the university and the commercial company wherein the university receives commensurate compensation for allowing the commercial company to access its name and logos.

Step 2: Identify the performance obligations

The university has analyzed the provisions of Topic 606 related to if there is one or more distinct goods or services contained within the contract. The university will continue to participate in athletics and maintain excellence in educational services. These activities do not directly transfer a good or service to the commercial company, so only one performance obligation is identified: the granting of a license to the commercial company.

Step 3: Determine the transaction price

The transaction price includes both fixed and variable consideration. The fixed component is the upfront payment of \$500,000 upon the execution of the contract. The variable consideration is the royalty of 1 percent of future sales on items containing the university's name or logo.

Step 4: Allocate the transaction price

As noted in step 3, there is only one performance obligation. Therefore, the entire transaction price is allocated to that performance obligation.

Step 5: Recognize revenue

The university analyzed if the nature of the license being provided was a functional license or symbolic license as defined by Topic 606. Generally, a functional license equates to point-in-time recognition, where a symbolic license equates to over-time revenue recognition. Functional intellectual property has the characteristics of standalone functionality. Symbolic intellectual property does not have standalone functionality. The value of symbolic intellectual property is derived from the university's past and ongoing activities. The university concludes that the commercial company has obtained the rights to symbolic intellectual property, as the value of the university's name and logos comes from a rich history of quality education services and competitive sports teams. Absent these activities, the logos would have little value or standalone functionality. As a result, the single performance obligation identified is satisfied over time.

The consideration for this contract has a fixed piece (upfront payment of \$500,000) and a sales-based component (royalty). As it relates to the fixed consideration, the university analyzed FASB 606-10-25-31 through 25-37, which covers measuring progress toward complete satisfaction of a performance obligation. This section further defines output and input methods for measuring progress. After careful consideration, the university decided it would utilize an input method as resources are consumed as time elapses. The university expects that inputs are expended evenly throughout the performance period and, therefore, will recognize revenue on a straight-line basis over the term on the contract, starting on the commencement date.

As it relates to the sales-based royalty, FASB ASC 606-10-55-65 applies. Revenue should be recognized only when or as the latter of 1) sale occurs or 2) the performance obligation to which some of the sales-based usage has been partially satisfied. As a result, the university will recognize revenue as the subsequent sales occur.

Intellectual property

Scenario — A university has a world-renowned marching band that recently completed a recording of marches by famous composers. The university enters into a contract with a vendor who wishes to use the recordings in advertisements. Significant terms of the contract include: the term is two years, the vendor receives a license to use the recordings in advertisements for that period, and the university receives a payment of \$40,000 at the start of the two-year term.

Step 1: Identify the contract

A contract exists; in exchange for a license to use university-owned intellectual property, the vendor pays \$40,000.

Step 2: Identify the performance obligations

The university's performance obligation is to provide the vendor a license for a two-year period.

Step 3: Determine the transaction price

The transaction price is \$40,000.

Step 4: Allocate the transaction price

As there is only one performance obligation, the entire transaction price is allocated to the license of intellectual property.

Step 5: Recognize revenue

Topic 606 notes that a license to functional intellectual property grants the use of that property as it exists at a point in time, unless the functionality is expected to change because of activities performed by the owner of the property and the customer is required to use the updated intellectual property. The university concludes that the recordings have standalone functionality which will not be changed. Revenue is recognized at the start of the two-year contract term.

Practical considerations

If the payment for the license to the intellectual property was made over the term of the contract, the university would have to consider if there is a significant financing component to the contract.

Exclusive food service

Scenario — A university enters into a contract with a food service provider. The university grants the food service provider the exclusive right to operate all dining facilities and charge students for these services. In exchange for this right, the food service provider agrees to update the food service facilities by installing new equipment. Ownership of these capital improvements reverts to the university when

completed. The university will also receive an agreed-upon percentage of food sales to students, to be remitted by the food service company to the university on a monthly basis. The agreement term is 10 years.

Step 1: Identify the contract

A contract exists; the university grants the food service company exclusive access to provide services to its students in exchange for consideration in the form of capital improvements and a specified percentage of monthly sales.

Step 2: Identify the performance obligations

The university's has one performance obligation: to grant the exclusive right to provide all food services on campus to the food service company.

Step 3: Determine the transaction price

The transaction price includes both noncash and variable consideration.

The capital improvements represent noncash consideration, as the university obtains control of the capital items. As a result, the university measures the estimated fair value of the capital improvements at contract inception.

Variable consideration is the percentage of monthly sales to be remitted to the university. This amount will depend on monthly sales to students.

Step 4: Allocate the transaction price

As there is only one performance obligation, the entire transaction price is allocated to the exclusive right to provide food services.

Step 5: Recognize revenue

The university is transferring control of the exclusive right over time and therefore will satisfy the performance obligation over the term of the contract. The food service provider simultaneously receives and consumes the benefits provided by the university's performance. As a result, revenue is recognized over the term of the contract. In assessing the methods for measuring progress, the university concluded that the passage of time is the most appropriate measure; therefore, revenue will be recognized over the term of the contract based on the passage of time.

Practical considerations

- At inception of the contract, the university will record a capital asset in the amount of the estimated fair value of the capital assets provided by the food service company. The other side to this initial entry will be contract liability, which will be recognized into revenue over the term of the contract.
- The variable consideration can be measured on a monthly basis as the related sales occur.

Research grant

Scenario — A university enters into an agreement with the National Science Foundation (NSF). The university will receive milestone payments upon specific research performed. The output of this research becomes the property of NSF. Based on similar research grants from various organizations, the University determines that it is 95 percent probable it will receive the milestone payments defined in the agreement.

Step 1: Identify the contract

It is determined that both the university and NSF receive something of value, so a contract is determined to exist.

Step 2: Identify the performance obligations

There is one performance obligation: the research activity as defined in the agreement.

Step 3: Determine the transaction price

The agreement contains terms that state the university will be paid a specified amount when defined milestones are achieved. It cannot be determined at the inception of the agreement that 100 percent of the milestones will be reached. Therefore, each milestone payment is deemed a variable consideration. The variable consideration should be estimated using the likely amount to be received.

Step 4: Allocate the transaction price

There is only one performance obligation, so no allocation is required.

Step 5: Recognize revenue

Revenue would be recognized as the research output defined in the agreement is delivered to NSF.

Practical considerations

Identifying the contract (step 1) calls for close analysis. In this example, it was determined that each party to the contract received equal value (cash consideration in exchange for defined research output). If the agreement was not reciprocal, Topic 606 would not apply.

Sponsorship

Scenario — A university gives local employers the opportunity to sponsor a career fair. The sponsors receive placement of their logo in the event brochure and signage at the event.

Step 1: Identify the contract

In analyzing the advertising the employers are receiving for their sponsorship, the university concludes the value is de minimis. As a result, there is not a contract with a customer, and the university applies contribution accounting standards.

Membership revenue

Scenario — A university has a related alumni association that is a separate nonprofit. The purpose of the alumni association is to keep connected with graduates and raise funds on behalf of the university. Annual membership dues are \$100. Members receive quarterly newsletters but no further benefits.

Step 1: Identify the contract

The amount paid for the newsletter is deemed to be a contract with a customer, as each party is receiving reciprocal benefits. Fair market value for the newsletter was determined to be \$25. The remaining \$75 is considered to be a contribution, as no further benefits are provided to the members.

Step 2: Identify the performance obligations

There is one performance obligation: providing quarterly newsletters to members.

Step 3: Determine the transaction price

Fair market value for the newsletter was determined to be \$25.

Step 4: Allocate the transaction price

There is only one performance obligation, so no allocation is required.

Step 5: Recognize revenue

The transaction price is recognized over four quarters, as the quarterly newsletters are provided. Outside of the scope of Topic 606, the contribution revenue would be recognized when received.

Practical considerations

If the alumni association provided benefits to its members in addition to the quarterly newsletter, additional performance obligations would exist. In that case, the transaction price would be allocated to those additional performance obligations.

Applying the new revenue recognition standard at your institution

As you can see from these examples and scenarios, every revenue situation is unique. Once you determine that a contract exists (which can take a good deal of analysis in and of itself), accurately analyzing the conditions that lead to compliant revenue recognition takes time and thought. With practice and experience, however, the process will become less challenging over time.

Tuition and housing are the primary revenue sources for higher education institutions and will account for the bulk of your revenue recognition activities. As the industry adjusts to the new standard, we'll have more practical information to share among our organizations.

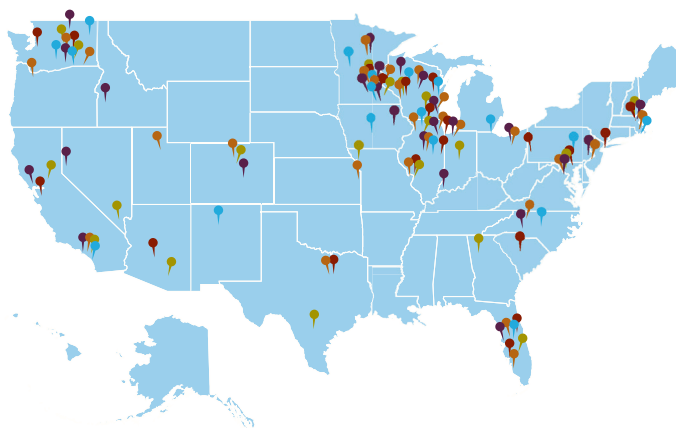
The new standard is complex. Start preparations now so you can implement the updated procedures as smoothly as possible.

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