ANNUAL MEETING

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EXPLORE. EMPOWER. ENRICH.

Change has come!
What the new revenue recognition standard means for your institution

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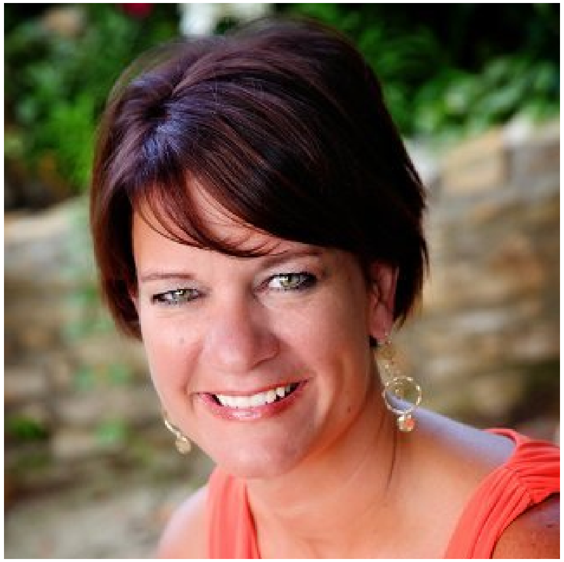

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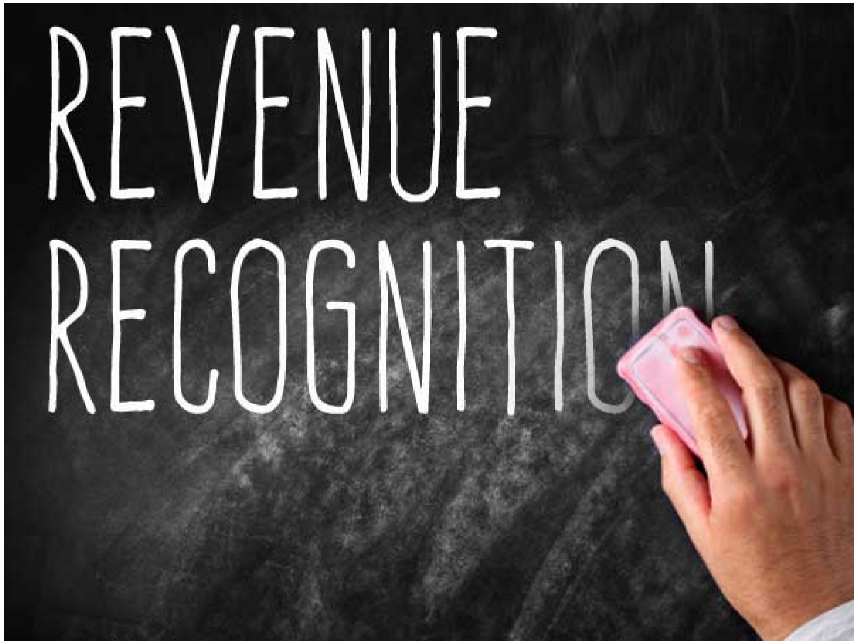
Financial Accounting Standard Board (FASB) issued Accounting Standard Update (ASU) 2014-09, *Revenue from contracts with customers*, (Topic 606)



Why change?

Why change?

- Diversity in practice by industry groups
  - Software, Construction-Type, Production-Type, Multiple Element Arrangements, etc.
- Current GAAP disclosure lacks cohesion
- Enhance comparability
- Principles-based framework can be applied regardless of industry-specific or transaction-specific fact patterns
- Reduces number of requirements to consider

Key takeaways

1. Principle-Based Focus which Converges with International Accounting Standards
2. Effective Dates
3. Not All Revenue Sources are Impacted
4. Follows a Five Step Recognition Process

Effective date

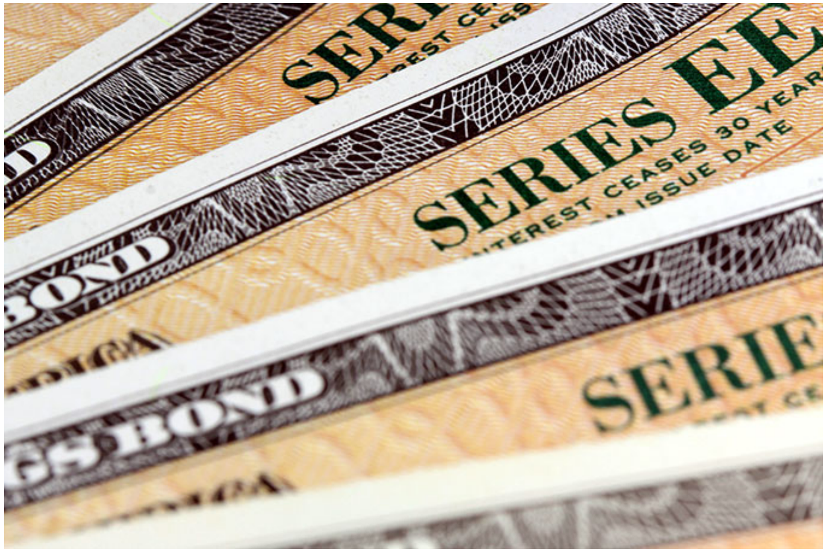
- Retrospective application
  - Single year presentation
- Effective for periods beginning after December 15, 2017 (FY 2019)
- Conduit debt – effective for periods beginning after December 15, 2016 (FY 2018)

Conduit debt

- An entity that has issued, or is a conduit debt obligor for, securities that are traded, listed, or quoted on an exchange or an over-the counter market is considered a public entity.
  - FY 2018 implementation required
  - Additional disclosures for public entities must be provided

Conduit debt

- Check with your bond trustee or bond counsel to determine whether your bonds are publicly traded, listed, or quoted on an exchange or over-the-counter market (as opposed to being privately placed bonds)



Revenue streams – Potential Impact

- This could impact the following:
  - Tuition and housing
  - Federal and state grants and contracts
  - Conferences and seminars
  - Sponsorships
  - Royalty agreements
  - Licensing
  - Advertising
  - Products and services
  - Subscriptions
  - Memberships

Not all revenues are impacted

- The following revenues are scoped out:
  - Contributions
  - Investment return
  - Grants that are nonreciprocal

Example #1 Tuition

Example #1: Student Pays Tuition Bill After Classes Start

- Fact pattern:
  - Institution has a fiscal year end that occurs during the semester (Summer semester)
  - Student pays $1,000 nonrefundable deposit upon acceptance of offer to enroll
  - Institution generates $9,000 for remaining balance which is due two weeks prior to start of classes
  - Student pays bill after classes have started and semester spans 100 days
  - Withdrawal period is the first 2 weeks of classes
  - Student withdraws from 1 class ($900) during withdrawal period
  - Institution estimates 10% refund rate and uses the portfolio approach

Handout

- Please refer to the Example #1 handout as we walk through the next few slides

Example #1: Student Pays Tuition Bill After Classes Start

A. Student pays nonrefundable enrollment deposit of $1,000 prior to enrollment

	DR	CR
Cash	$1,000	
Contract Liability (Deferred Revenue)		$1,000

Example #1: Student Pays Tuition Bill After Classes Start

B. Student enrolls in classes and bill is sent to student for remaining $9,000 balance of tuition

- No journal entry is recorded at this time as revenue recognition has not yet commenced.
- Institution does not have unconditional right to consideration given the 2 week withdrawal period.

Example #1: Student Pays Tuition Bill After Classes Start

C. Institution provides the first day of class and the student has made no payment other than the enrollment deposit

	DR	CR
Contract Liability (Deferred Revenue)	$91	
Revenue		$91

- Institution estimates a 10% refund rate based on historical experience ($9,000/100 days)*10% = $9
- Institution recognizes revenue ratably over the 100-day semester ($10,000/100 days = $100 less $9 of estimated refund rate)
- This journal entry is repeated for each of the 10 days of the withdrawal period

Example #1: Student Pays Tuition Bill After Classes Start

- At the end of day 1, student partially withdraws by dropping a class, and tuition is reduced by $900 and the tuition bill is reduced to $8,100

  D. Fiscal year end occurs during week 1 of classes

  E. After the end of week 2, withdrawal period has ended

	DR	CR
Accounts Receivable	$8,100	
Contract Liability (Deferred Revenue)		$8,100

- The receivable is recorded for the student for the unpaid tuition balance (net of $900 withdrawal) with an offsetting liability as the contract is now non-cancellable.

Example #1: Student Pays Tuition Bill After Classes Start

F. Institution records remaining revenue ratably over the remaining 90 days in the semester

	DR	CR
Contract Liability (Deferred Revenue)	$8,190	
Revenue		$8,190

- Institution records revenue ratably over the semester to reduce contract liability. Revenue is recorded at $91 per day.

Example #1: Takeaways

- Consider when your withdrawal period ends and how this will impact your financial statements
  - If withdrawal period ends before year end
- Consider if refunds are significant to your financial statements
- Gross up of balance sheet – if withdrawal period ends before fiscal year end
- Data needed – need to identify AR by term

Example #2 Tuition

Example #2: Student Pays Tuition Bill before Classes Start

- Fact pattern:
  - Assume the same fact pattern from Example #1, except that the student pays the tuition bill prior to the start of classes.

Example #2: Student Pays Tuition Bill before Classes Start

A. Student pays nonrefundable enrollment deposit of $1,000 prior to enrollment

	DR	CR
Cash	$1,000	
Contract Liability (Deferred Revenue)		$1,000

B. Student pays tuition bill

	DR	CR
Cash	$9,000	
Contract Liability (Deferred Revenue)		$9,000

Example #2: Student Pays Tuition Bill before Classes Start

C- 1. Institution recognizes refund liability

	DR	CR
Contract Liability (Deferred Revenue)	$900	
Refund Liability		$900

- Refund liability is estimated at 10% based on historical experience. $900 represents the applicable refund estimate per student.

Example #2: Student Pays Tuition Bill before Classes Start

C – 2. Institution provides the first day of class

	DR	CR
Contract Liability (Deferred Revenue)	$91	
Revenue		$91

C – 3. At the end of day 1, student partially withdraws by dropping a class, and tuition is reduced by $900

	DR	CR
Refund Liability	$900	
Cash		$900

Example #2: Student Pays Tuition Bill <u>before</u> Classes Start

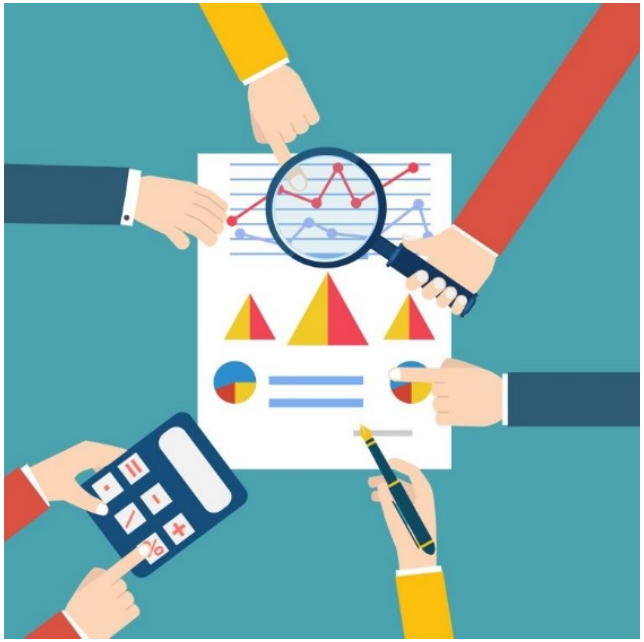
- Institution records remaining revenue ratably over the remaining 90 days in the semester

	DR	CR
Contract Liability (Deferred Revenue)	$8,190	
Revenue		$8,190

- Institution records revenue ratably over the semester to reduce contract liability. Revenue is recorded at $91 per day.

Example #2: Takeaways

- Will need data to estimate refund liability percentage
- Will need a report to show cash received by term



5 STEP REVENUE RECOGNITION MODEL

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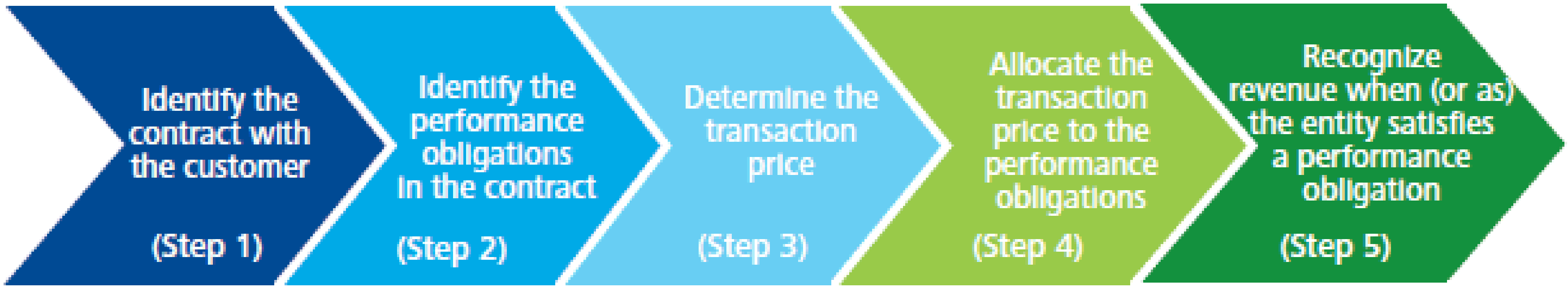


STEP 1: IDENTIFY THE CONTRACT

- ALL must be met to determine whether a contract exists:

1. Parties to the contract have approved the contract.
   - Writing, verbally or implied by customary business practices
2. The Entity can identify each party's rights regarding goods or services to be transferred.
3. The Entity can identify the payment terms for goods and services to be transferred.
4. The contract has commercial substance (risk, timing, amount of Entity's future cash flows is expected to change as a result of the contract.)
5. It is probable that the Entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer.

Wholly Unperformed

- A contract does NOT exist if each party to the contract has the unilateral enforceable right to terminate a wholly unperformed contract without compensating the other party.

- A contract is considered *wholly unperformed* if both of the following criteria are met:
  1. The entity has not yet transferred any promised goods or services to the customer
  2. The entity has not yet received, and is not yet entitled to receive, any consideration in exchange for the promised goods or services

Nonrefundable deposits

- Institutions will recognize a contract liability in the amount of the prepayment.

- If Institution expects to be entitled to a *breakage* amount then they should recognize the expected breakage amount as revenue.

Step 2: Identify the Performance Obligations

- Determine if tuition and housing are distinct services promises by the Institution

- In most cases tuition and housing should be considered distinct performance obligations
  - Distinct performance obligations

Step 3: Determine the Transaction Price

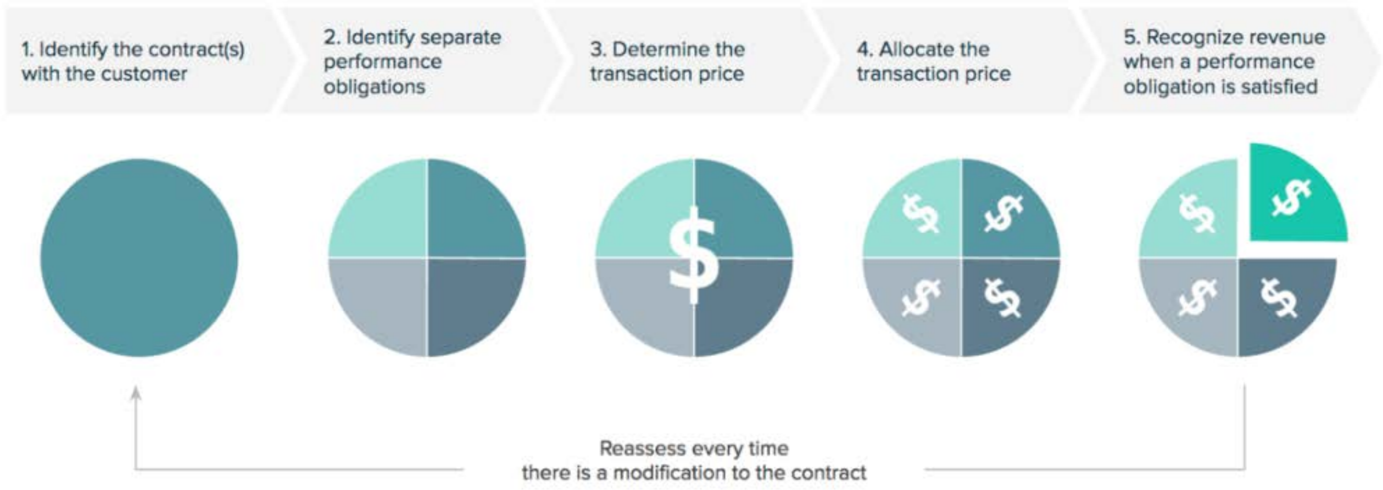
- Amount of consideration to which the institution expects to be entitled in exchange for transferring goods or services
- Discounts and financial aid are often provided to students and should be considered when determining the transaction price
- Varying types of discounts:
  - Work study programs (shown as an expense)
  - General scholarships (reduction in revenue)
- Refund liability should be considered for refunds expected to be issued by the institution's withdrawal deadline

Right to Withdraw

- Some consideration is considered to be variable
  - If institution expects to refund some or all of the consideration paid by a student, then this would be considered variable
- Institution should evaluate ways to determine if such refunds are material to their financial statements

Step 4: Allocate the transaction price to the performance obligations in the contract

- Allocate the transaction price to tuition and housing separately as these are considered to be separate performance obligations
  - Allocated to each performance obligation identified in a contract on a relative standalone selling price basis
- Consider discounts when allocating



Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation

- For each performance obligation identified, the institution needs to determine whether it satisfies the performance obligation over time or at a point in time
  - Over time – Customer simultaneously receives and consumes the benefits provided by the institutions performance
- Over time method appropriate for institutions (ratably)
- Summer tuition

Key Takeaways – New concepts

- Breakage
- Refund liability
- A/R not booked until withdrawal period ends
- Gross up of balance sheet
- Additional data needed to evaluate and implement new standard

Summary of revenue recognition

Current	New

Current

- Numerous requirements for recognizing revenue
- Limited disclosures
- Many goods or services not considered distinct
- Accounting for variable consideration differs greatly across industries

New

- Consistent principles for recognizing revenue regardless of industry
- Cohesive set of disclosures
- Identify each performance obligation and recognize revenue as each is satisfied
- Single model for variable consideration including rebates, discounts, bonuses, right of return

Presentation of financial statements

Presentation of Financial statements

- Contract asset - right to consideration in exchange for goods or services that the entity has transferred to a customer when that right is conditioned on <u>something other than the passage of time</u> (for example, the entity's future performance)
- Receivable – unconditional right to consideration if only the passage of time is required before that consideration is due
- Contract liability
  - Does not prohibit institutions from using different terms

Presentation of Financial statements

- Refund liability – amount of consideration received for which the institution does not expect to be entitled
- Revenue – presented on a net basis

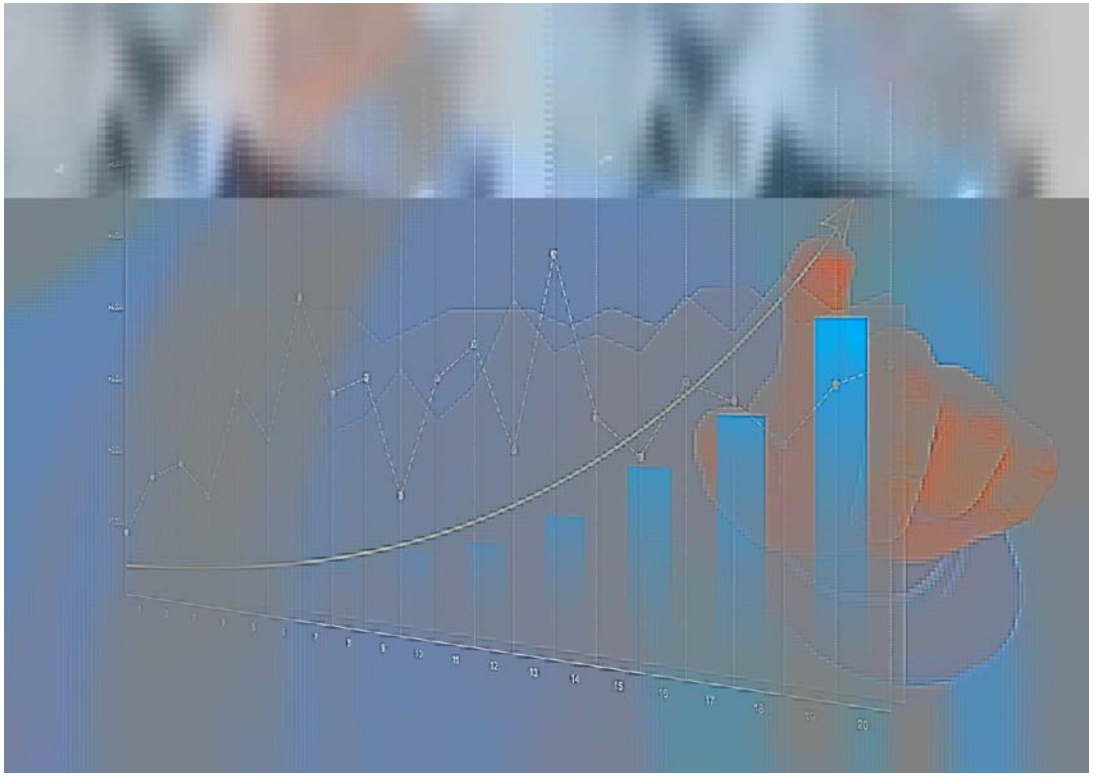
DISCLOSURES

- Qualitative information to address how economic factors affect revenue and cash flows
  - Type of customer, geographical location of customers and type of contract

- Institutions that have conduit debt subject to additional disclosures
  - Disaggregation of revenues

DISCLOSURES

- Performance Obligations
  - When institutions typically satisfy their performance obligations
  - Significant payment terms
  - Nature of the goods or services the institution has promised
  - Any obligations for returns or refunds



Ways to prepare for and implement the new revenue recognition standard

Prepare for and implement the new revenue recognition standard

1. Become familiar with the new standard and discuss the standard with your accounting advisors to evaluate impact

2. Take an inventory of all current revenue streams and evaluate if there are differences between current practice and the new standard

3. Reconsider if revenue should be recognized over time or at a point in time for multi-year contracts

Prepare for and implement the new revenue recognition standard

4. Consider the update of processes and internal controls as a result of any changes in the timing of revenue recognition

5. Identify any potential data gaps between what is presently available and what will be needed for the required disclosures in the new standard

QUESTIONS?