Changes to revenue recognition for not-for-profit organizations

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Introduction and background

In May 2014, the Financial Accounting Standards Board (FASB) and International Accounting Standards Board issued substantially converged final standards on revenue recognition. These final standards are the culmination of a joint project between the Boards that spanned many years. The FASB’s Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers (Topic 606), provides a robust framework for addressing revenue recognition issues and, upon its effective date, will replace almost all pre-existing revenue recognition guidance, including industry-specific guidance, in current U.S. generally accepted accounting principles (GAAP) (i.e., legacy GAAP). In addition, we expect the Securities and Exchange Commission (SEC) staff to remove, or make significant changes to, Staff Accounting Bulletin Topic 13, Revenue Recognition (also part...
of legacy GAAP for SEC registrants). Implementation of the robust framework provided by ASU 2014-09 should result in improved comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets. Implementation must occur no later than the quarter and year beginning January 1, 2018, for public entities with a calendar year end. Public entities include: (a) public business entities, (b) not-for-profit entities that have issued, or are conduit bond obligors for, securities that are traded, listed or quoted on an exchange or an over-the-counter market and (c) certain employee benefit plans. For all other entities with a calendar year end, implementation must occur no later than the year ending December 31, 2019. For additional information about the effective date of the new guidance, refer to our article, Are you sure you know when the revenue guidance in ASC 606 is effective?

The new guidance applies to contracts with customers. As such, it only affects the accounting for exchange transactions entered into by not-for-profit organizations that are otherwise within the scope of the new guidance. The legacy GAAP related to accounting for contributions received, which is included in Subtopic 958-605, "Not-for-Profit Entities – Revenue Recognition," of the FASB’s Accounting Standards Codification (ASC), remains in place along with the guidance related to distinguishing between exchange transactions and contributions. While only the exchange transactions of not-for-profit organizations will be affected by the new guidance, such organizations should not delay their implementation activities given that the effects of the new guidance could still be significant. For additional implementation information, refer to our article, Getting ready: Revenue recognition and not-for-profit entities.

The FASB has changed the new guidance originally included in ASU 2014-09 several times since its issuance and additional limited changes to that guidance are in process. One of those changes is focused on improving and clarifying the existing guidance on revenue recognition of grants and contracts by not-for-profit organizations, which is discussed in more detail in the next section of this white paper. For the status of this and all other final and in-process changes to the new guidance, refer to our summary, Revenue recognition: In motion. For a detailed discussion of the new guidance (as amended), refer to our white paper, Revenue recognition: A whole new world.

The American Institute of Certified Public Accountants (AICPA) has organized several industry-specific task forces, including one focused on not-for-profit organizations, which meet regularly to identify and provide guidance on implementation issues. The AICPA’s ultimate objective is to develop a comprehensive nonauthoritative revenue recognition guide that provides helpful discussion and illustrative examples on how to apply the new guidance to contracts in various industries. The AICPA decided to publish content for the guide as it is completed, instead of waiting until all of the content is completed. As a result, the AICPA Audit and Accounting Guide, Revenue Recognition (the Revenue Recognition AAG), has been published and currently includes discussion of: (a) the general accounting and auditing considerations related to the new guidance and (b) various implementation issues in several industries, including the not-for-profit industry. The AICPA will be updating the guide with additional industry-specific implementation issues as they are completed. For those implementation issues identified by the Not-for-Profit Entities Revenue Recognition (NFPRR) Task Force, which includes those implementation issues that are included in the Revenue Recognition AAG and those still in process, click here.

This white paper includes discussion of the following topics that a not-for-profit organization may encounter in its application of the new guidance, including those issues identified and discussed by the NFPRR Task Force:

- Scope: Exchange transaction or contribution?
- Scope: Contracts that include exchange transaction and contribution components
- Subscriptions and membership dues
• Tuition and housing fees
• Assets and liabilities recognized under ASC 606
• Disclosure requirements

Scope: Exchange transaction or contribution?

As mentioned earlier, the new guidance (which includes ASC 606) applies to contracts with customers. As such, it only affects the accounting for exchange transactions entered into by not-for-profit organizations that are otherwise within the scope of ASC 606. The following excerpt from the definition of a contribution in the Master Glossary of the ASC not only includes the definition of a contribution, but also includes the definition of exchange transaction, both of which are critical to understanding whether a contract entered into by a not-for-profit organization is within the scope of ASC 606 or ASC 958-605:

An unconditional transfer of cash or other assets to an entity or a settlement or cancellation of its liabilities in a voluntary nonreciprocal transfer by another entity acting other than as an owner. Those characteristics distinguish contributions from exchange transactions, which are reciprocal transfers in which each party receives and sacrifices approximately equal value; from investments by owners and distributions to owners, which are nonreciprocal transfers between an entity and its owners; and from other nonreciprocal transfers, such as impositions of taxes or legal judgments, fines, and thefts, which are not voluntary transfers.

In addition, ASC 958-605-55-3 to 8 provides implementation guidance on how to distinguish between contributions and exchange transactions. The guidance that should be applied when a transaction includes both exchange transaction and contribution components is discussed in the next section of this white paper.

One question that arises in determining whether a contract represents an exchange transaction or contribution involves government grants. As mentioned earlier, the FASB currently has a project on its agenda, Revenue Recognition of Grants and Contracts by Not-for-Profit Entities, the objective of which is to “improve and clarify existing guidance on revenue recognition of grants and contracts by not-for-profit entities.” The two issues being addressed in the project deal with: (1) characterizing grants and contracts as reciprocal (i.e., exchanges) or nonreciprocal transactions (i.e., contributions) and (2) distinguishing between conditional and unconditional contributions. With respect the first issue, the FASB has decided to propose clarifying the scope of ASC 958-605 and adding examples to demonstrate the difference between reciprocal and nonreciprocal transactions. With respect to the second issue, the FASB has decided to propose improving the existing guidance for distinguishing between conditional and unconditional contributions and providing additional examples. The FASB is nearing completion of its initial deliberations and is expected to issue a proposed ASU in the near term. For additional information about this project, its status and the decisions reached, refer to the related FASB project page.

Scope: Contracts that include exchange transaction and contribution components

A not-for-profit organization’s contract with a third party may include an exchange transaction component within the scope of ASC 606 and a contribution component within the scope of ASC 958-605. The difference between a contribution and an exchange transaction is addressed in ASC 958-605-55 and is summarized in the preceding section of this white paper. In addition, ASC 958-605-55-9 to 12 provides guidance specific to membership dues and addresses separating and measuring the portion of a membership arrangement within its scope (i.e., the portion of the membership that represents an inherent contribution within the scope of ASC 958-605) from the portion of a membership arrangement not within its scope (i.e., the portion of the membership that represents an exchange transaction within the scope of ASC 606). While this guidance is specific to
memberships, paragraph 8.7.05 of the Revenue Recognition AAG indicates that the same guidance should be applied by analogy to other transactions (e.g., grants, awards, naming opportunities, gifts in kind). In addition, paragraph 8.7.06 of the Revenue Recognition AAG indicates that whenever a contract includes an exchange transaction component and a contribution component, those components should be separated and measured using the same approach used to separate and measure the exchange transaction and contribution components of a membership. In other words, the exchange transaction and contribution components should be separated, measured and accounted for as follows:

- **Exchange component:** Measure the fair value of the exchange transaction, allocate the lesser of that amount and the resources received from the counterparty (consideration due under the contract, such as membership dues) to the exchange transaction and account for the amount allocated to the exchange transaction in accordance with ASC 606 (Note that if the resources received from the counterparty are less than the fair value of the exchange transaction, there is no contribution component.)

- **Contribution component:** Measure the contribution as the excess of the resources received from the counterparty (consideration due under the contract, such as membership dues) over the fair value of the exchange transaction and account for that amount in accordance with ASC 958-605

### Subscriptions and membership dues

Not-for-profit organizations may sell various types of subscriptions or memberships to third parties. For example, a not-for-profit organization that has workout facilities may sell gym memberships to third parties or a not-for-profit educational institution may sell subscriptions to its alumni newsletter. In some cases, the subscriptions or membership dues may include an inherent contribution that should be accounted for separately as discussed in detail in the previous section of this white paper. The remaining discussion of subscriptions and membership dues in this section of the white paper addresses the exchange transaction component of subscriptions and membership dues.

To determine when subscriptions and membership dues should be recognized as revenue under legacy GAAP, not-for-profit organizations should first follow any applicable guidance in ASC 958-605. For example, ASC 958-605-25-1 indicates that nonrefundable initiation and life membership fees are recognized over the period to which they relate, which is based on whether any ongoing periodic fees are expected to cover the costs of the related future services expected to be provided to the members:

- If so, the nonrefundable upfront initiation and life membership fee is recognized in the period it becomes receivable.
- If not, the nonrefundable upfront initiation and life membership fee is recognized over the average period of time the membership is sustained (which may be based on any number of factors, including the life expectancy of members).

To the extent there is not any applicable guidance in ASC 958-605, the not-for-profit organization should follow the general revenue recognition guidance in legacy GAAP (e.g., determining when revenue has been earned and realized or realizable). In addition, the not-for-profit organization should consider the guidance in a nonauthoritative source used widely in practice to account for service transactions, the FASB Invitation to Comment (ITC), *Accounting for Certain Service Transactions*, which was issued in 1978, but never finalized.

While the NFPRR has discussed application of the five steps in the new revenue recognition model to subscriptions and membership fees, an issue paper has not yet been exposed for comment. For an update on the status of the issue paper, [click here](#) and refer to Issue #5.
An overview of some of the considerations involved in applying the five steps in the new revenue recognition model to subscriptions and membership fees is included in the table that follows.

**Step 1: Identify the contract with a customer**

The not-for-profit organization must determine whether the membership or subscription agreement meets: (a) the definition of a contract and (b) the contract existence criteria, including (i) whether enforceable rights and obligations exist for both parties and (ii) whether collection of substantially all of the amounts to which the organization will be entitled in exchange for the goods or services that will be transferred to the customer is probable (i.e., likely to occur). If the definition and criteria are not met, subscriptions and membership fees may not be recognized as revenue for some time, even when nonrefundable cash has been received.

If the membership or subscription agreement provides the unilateral, enforceable right to each party to terminate the agreement with no compensation to the other party if it is wholly unperformed, a contract does not exist for accounting purposes. Consider a situation in which a not-for-profit organization bills a member or subscriber prior to when the membership or subscription period starts. If both parties have the unilateral, enforceable right to terminate the membership or subscription agreement with no compensation to the other party, a contract does not exist for accounting purposes because the agreement is wholly unperformed. When that is the case, no entry should be recorded by the not-for-profit organization prior to the start of the membership or subscription period. In addition, as discussed later in this white paper, a receivable only exists when the not-for-profit organization has an unconditional and noncancellable right to consideration from the member or subscriber. When that right does not exist before the start of the membership or subscription period, a receivable also does not exist for accounting purposes before the start of that period. In other words, the act of billing the member or subscriber is not a basis for recognizing a receivable and a contract liability.

The not-for-profit organization may choose to apply the new guidance to a portfolio of similar contracts if doing so is not reasonably expected to result in materially different outcomes compared to individually accounting for the contracts. In other words, the not-for-profit organization may choose to either separately account for each of its contracts or account for similar contracts on a portfolio basis provided doing so does not result in a materially different outcome. While not required to calculate revenue both ways (i.e., as if each contract were separately accounted for and as if similar contracts were accounted for as a portfolio) for this purpose, the not-for-profit organization would be required to develop a reasonable approach to evaluating whether there is a material difference. Ultimately, each not-for-profit organization will need to reach a conclusion with respect to electing the portfolio approach based on its own facts and circumstances. If the portfolio approach is elected, the not-for-profit organization should review this election with its auditor early in the implementation process.

**Step 2: Identify the performance obligations in the contract**

First, the not-for-profit organization must identify the promised goods or services that are expected to be provided in accordance with the contracts. In doing so, consideration should be given to those promised goods or services explicitly identified in the contracts, as well as implicit promised goods or services that arise out of the not-for-profit organization’s customary practices, published policies or specific statements. For example, if membership in a university alumni association entitles the member to a university sweatshirt and one ticket to three specific sporting events, there are four promised goods and services in the membership.

A promised good or service that may need to be identified under the new guidance is a membership renewal option. Under the new guidance, an option for additional goods or
services is treated as a performance obligation (and some of the transaction price is allocated to it) if it provides a material right to the customer that it would not have received without entering into the contract with the entity. For example, an option to renew a membership at potentially favorable rates once the initial membership term expires or to offer an option to purchase multiple renewal periods at once for a discount should be evaluated under the new guidance to determine whether it represents a material right that the member would not have received without entering into the membership agreement.

A not-for-profit organization that offers lifetime subscriptions to a publication in return for an upfront nonrefundable fee will likely need to estimate the average life expectancy of its subscribers to determine the number of publications that are expected to be transferred to the subscriber under the subscription agreement.

Second, the not-for-profit organization must determine whether the identified promised goods or services should be accounted for as one performance obligation or separate performance obligations. In other words, the not-for-profit organization is determining whether there is one unit of account or multiple units of account. To do so, each of the promised goods or services is evaluated to determine whether it is distinct, using two specific criteria. In general, if a promised good or service meets both criteria and is considered distinct, it is accounted for separately as a performance obligation. For example, if the university sweatshirt and three tickets to specific sporting events are distinct (which they likely would be), the membership would include four performance obligations. Promised goods or services that are not distinct are combined until the group of promised goods or services is considered distinct, at which point that group is considered a performance obligation and accounted for separately.

Third, the not-for-profit organization must determine whether the subscription or membership includes a series of distinct promised goods or services that should be accounted for as a single performance obligation. Distinct promised goods or services are accounted for as a single performance obligation when they are substantially the same and have the same pattern of transfer to the customer as a result of: (a) each of the goods or services otherwise being considered satisfied over time (see Step 5) and (b) the not-for-profit organization otherwise having to use the same method of measuring progress toward completion for each of the goods or services (see Step 5). Depending on the nature of the promised goods or services that will be provided in accordance with a subscription or membership, the series exception may apply, which could result in accounting for the subscription or membership as a single performance obligation.

**Step 3: Determine the transaction price**

The transaction price is the amount of consideration the not-for-profit organization expects to be entitled to as a result of transferring the promised goods or services to the customer. It is also the amount ultimately recognized as revenue by the not-for-profit organization. In general, the customer's credit risk is not taken into consideration when estimating the transaction price except, for example, when the customer contract includes a significant financing component (which requires use of a discount rate that reflects the customer's credit risk when estimating the transaction price). Instead, credit risk is considered in Step 1. The transaction price includes or takes into consideration fixed cash consideration, noncash consideration, variable consideration, significant financing components and consideration payable to the customer.

A not-for-profit organization that offers lifetime memberships or subscriptions in return for an upfront nonrefundable fee must consider whether there is a significant financing component that should be reflected in the transaction price. Whether a significant financing component exists requires the consideration of many factors. If a significant financing component must be reflected in the transaction price for a lifetime membership
or subscription that is paid up front, interest expense would be recognized over the same period the fee is recognized as revenue.

**Step 4: Allocate the transaction price to the performance obligations**

If there is more than one performance obligation in the contract(s) (e.g., tickets to multiple sporting events), the transaction price should generally be allocated to each performance obligation based on the standalone selling prices of each performance obligation in relation to the total of those standalone selling prices (i.e., relative selling price model).

Exceptions to the relative selling price model are provided for certain situations involving discounts and (or) variable consideration that can be shown to be related to one or more (but less than all) performance obligations. ASC 606-10-32-36 to 41 provide guidance on the circumstances under which a discount and variable consideration should be attributed to one performance obligation instead of being allocated to all performance obligations.

**Step 5: Recognize revenue when (or as) each performance obligation is satisfied**

First, the not-for-profit organization determines whether revenue should be recognized for each performance obligation over time or at a point in time using specific criteria focused on when and how the member obtains control of the promised goods or services. If revenue should be recognized over time, the not-for-profit organization next determines the method that should be used to recognize revenue over time as control of the promised goods or services transfers to the customer. If revenue should be recognized at a point in time, the not-for-profit organization recognizes revenue at the point in time control of the promised goods or services transfer to the customer.

A not-for-profit organization that offers lifetime memberships or subscriptions in return for an upfront nonrefundable fee will likely conclude that at least some of the transaction price should be recognized as revenue over time. In addition to determining the method that should be used to recognize that revenue over time, the not-for-profit organization must also determine the period of time over which that revenue should be recognized. Doing so likely requires the not-for-profit organization to estimate the average life expectancy of its members and subscribers.

Discussion of the assets and liabilities that may be recognized as a result of applying ASC 606 are discussed later in this white paper.

**Tuition and housing fees**

Not-for-profit educational institutions enter into contracts with students (which are their customers) to provide the students with educational instruction and, in many cases, housing. In return, the student is obligated to pay tuition and housing fees. To determine when the tuition and housing fees should be recognized as revenue under legacy GAAP, educational institutions should apply the general revenue recognition guidance in legacy GAAP (e.g., determining when revenue has been earned and realized or realizable). In addition, these institutions should also consider the guidance in the ITC for service transactions discussed in the preceding section of this white paper. Applying the guidance in legacy GAAP and the ITC typically results in recognizing: (a) tuition ratably as instruction is provided to the student (because the individual acts involved in providing the student with educational instruction cannot be accounted for separately) and (b) housing fees ratably as housing is provided to the student, which typically correlates to the period over which instruction is provided.

The NFPRR Task Force discussed the application of the five steps in the new revenue recognition model to tuition and housing fees, the results of which are included in Section
8.6 of the Revenue Recognition AAG. The table that follows summarizes these discussions and highlights other aspects of applying the new guidance to tuition and housing fees.

**Step 1: Identify the contract with a customer**

**Combining contracts for tuition and housing**

If one or more of the following criteria are met, separate contracts for tuition and housing with the same student (or parties related to the student) that are entered into at or near the same time are combined for accounting purposes:

- The contracts were negotiated as a package and share the same commercial objective.
- The consideration to be paid under one contract is tied to the other contract’s price or performance.
- The contracts include goods and (or) services that represent a single performance obligation (see Step 2).

While meeting one or more of these criteria results in combining the tuition and housing contracts for accounting purposes, it does not automatically result in concluding that there is only one performance obligation (i.e., unit of account). As discussed in Step 2, the identification of performance obligations considers other factors. If none of the contract combination criteria are met, the tuition contract and the housing contract (and the consideration included in each) should be separately evaluated under the five steps in the new revenue recognition model.

When determining whether any of the contract combination criteria are met, consideration should be given to whether any fee reductions provided to the student (which are discussed further in Step 3) are indicative of the tuition and housing contracts sharing the same commercial objective or the consideration under each contract being tied to the other.

When a contract is referred to in the remainder of the discussion focused on tuition and housing, unless otherwise noted, it could mean: (a) one contract that includes either tuition or housing or both tuition and housing or (b) one contract for tuition and one contract for housing combined for accounting purposes based on the preceding guidance.

**Definition of a contract and the contract existence criteria**

Specific issues that may arise in evaluating whether an agreement meets the definition of a contract and the contract existence criteria in the new guidance include the following:

- **When do enforceable rights and obligations exist for both the educational institution and the student?** A contract does not exist for accounting purposes unless enforceable rights and obligations exist for each party. The educational institution should evaluate its practices and processes to determine which actions and agreements create enforceable rights and obligations for both it and the student. Both the admissions and registration processes could affect whether and when enforceable rights and obligations are established for both parties.

- **Does the contract provide the unilateral, enforceable right to each party to terminate the agreement with no compensation to the other party if it is wholly unperformed?** If so, a contract does not exist for accounting purposes (the implications of which are addressed later in this step). Determining whether a contract is wholly unperformed requires consideration of many factors, including whether the educational institution has received consideration from the student or from another party on the student’s behalf, and whether the educational institution has started to provide educational instruction or housing to the student. While each educational institution should make this determination based on its own facts and circumstances, paragraph 8.6.05 of the Revenue Recognition AAG indicates that the receipt of a nonrefundable deposit...
from a student generally: (a) obligates the institution to stand ready to provide instruction and (or) housing and (b) provides the student with the rights to receive instruction and (or) housing. As such, to the extent the educational institution receives a nonrefundable deposit from the student (or from another party on the student’s behalf), the contract is not wholly unperformed. The recognition of nonrefundable deposits for which students do not exercise their rights is discussed in Step 5.

- **Is collection of substantially all of the amounts to which the educational institution will be entitled in exchange for providing the student with instruction and housing probable (i.e., likely to occur)?** If not, a contract does not exist for accounting purposes (the implications of which are addressed later in this step). Before evaluating the likelihood of collection, the amount that should be evaluated for collectibility must be determined. Based on Paragraph 8.6.06 of the Revenue Recognition AAG, consideration expected to be paid by other parties on the student’s behalf should be included in the amount evaluated for collectibility and the overall collectibility assessment. For example, if the student has a financial aid package, consideration expected to be paid by the party providing the financial aid should be included in the amount evaluated for collectibility and the creditworthiness of the financial aid provider should be considered in determining whether collection of that consideration is probable. In addition, the following are two additional key considerations in determining the amount that should be evaluated for collectibility:
  
  - **Transaction price.** In general, the transaction price (as discussed further in Step 3) should not consider credit risk, but should consider factors such as fee reductions (e.g., scholarships, work-study programs) and withdrawal rights.
  
  - **Ability to mitigate credit risk.** An educational institution may be able to mitigate its credit risk through its ability to stop providing instructional credit and (or) housing to the student upon nonpayment (and its practice of doing so). Taking into consideration the educational institution’s ability to mitigate its credit risk could, depending on the facts and circumstances, result in the amount evaluated for collectibility being an amount less than the transaction price. This is consistent with the focus of the collectibility criterion on the amount the educational institution expects to be entitled to for the instruction and (or) housing that will be transferred to the customer, which may not be all of the instruction and (or) housing promised in the contract.

It is important to note that the amount evaluated for collectibility is used only for that purpose. In other words, if the educational institution arrives at the amount evaluated for collectibility by concluding that the instruction and housing that will be provided to the student is less than all of the instruction and housing promised in the contract because it can mitigate its credit risk by ceasing to provide such services upon nonpayment, that conclusion does not affect the requirement to consider all of the instruction and housing promised in the contract when applying other aspects of Step 1 and the remaining steps in the revenue recognition model. For example, determining the amount evaluated for collectibility generally has no effect on determining the transaction price.

If a contract does not exist for accounting purposes, tuition and housing fees may not be recognized as revenue for some time, even when nonrefundable cash has been received.

**Portfolio approach**

The new guidance may be applied to a portfolio of similar contracts if doing so is not reasonably expected to result in materially different outcomes compared to individually accounting for the contracts. In other words, an educational institution may choose to either separately account for each of its contracts or account for similar contracts on a portfolio basis provided doing so does not result in a materially different outcome.
Whether an educational institution should elect the portfolio approach depends on the costs it will incur and the benefits it will receive from doing so. One of the costs of electing the portfolio approach would be performing the necessary analysis to determine whether applying the portfolio approach results in a materially different outcome. While not required to calculate revenue both ways (i.e., as if each contract were separately accounted for and as if similar contracts were accounted for as a portfolio) for this purpose, the educational institution would be required to develop and implement a reasonable approach to evaluating whether there is a material difference. One of the benefits of electing the portfolio approach would be the ability to assess collectibility and (or) estimate the effects of fee reductions on a portfolio basis, which would likely be less time consuming than doing so on a contract-by-contract basis. Ultimately, each educational institution will need to reach a conclusion with respect to electing the portfolio approach based on its own facts and circumstances. If the portfolio approach is elected, the educational institution should review this election with its auditor early in the implementation process.

**Step 2: Identify the performance obligations in the contract**

First, the educational institution must identify the promised goods or services (e.g., instruction, housing, meals) that are expected to be provided in accordance with the tuition and housing contracts. In doing so, consideration should be given to those promised goods or services explicitly identified in the contracts, as well as implicit promised goods or services that arise out of the educational institution’s customary practices, published policies or specific statements.

Second, the educational institution must determine whether the identified promised goods or services should be accounted for as one performance obligation or separate performance obligations. In other words, the educational institution is determining whether there is one unit of account or multiple units of account. To do so, each of the promised goods or services is evaluated to determine whether it is distinct, using two specific criteria. In general, if a promised good or service meets both criteria and is considered distinct, it is accounted for separately as a performance obligation. Promised goods or services that are not distinct are combined until the group of promised goods or services is considered distinct, at which point that group is considered a performance obligation and accounted for separately.

If the tuition and housing contracts are separate and should not be combined for accounting purposes (based on the related discussion in Step 1), there is no question that educational instruction and housing should be accounted for separate from one another. However, if there is one contract for both tuition and housing or two contracts that should be combined for accounting purposes (based on the related discussion in Step 1), the educational institution must determine whether the instruction and housing are distinct. While each educational institution should make this determination based on its own facts and circumstances, paragraph 8.6.19 of the Revenue Recognition AAG indicates that, in most cases, educational instruction and housing are distinct.

**Step 3: Determine the transaction price**

The transaction price is the amount ultimately recognized as revenue by an entity. In general, the customer’s credit risk is not taken into consideration when estimating the transaction price except, for example, when the customer contract includes a significant financing component (which requires use of a discount rate that reflects the customer’s credit risk when estimating the transaction price). Instead, credit risk is considered in Step 1.

If an educational institution’s tuition and housing contracts are separate and should not be combined for accounting purposes (based on the related discussion in Step 1), there are two transaction prices, one for each contract based on the elements of consideration in each individual contract. If there is one contract for both tuition and housing, or two
contracts that should be combined for accounting purposes (based on the related discussion in Step 1), there is one transaction price based on the elements of consideration from both contracts. Allocation of that transaction price when there is more than one performance obligation (e.g., educational instruction and tuition) is addressed in Step 4. The amounts allocated in that step to each performance obligation may not be the same as the consideration earmarked in the contract(s) for tuition and housing.

The transaction price is the amount of consideration (e.g., tuition, housing fees, meal fees) the educational institution expects to be entitled to as a result of transferring the instruction, housing and (or) meals to the student. The consideration included in the transaction price may be payable by the student or by other parties on the student’s behalf. The transaction price includes or takes into consideration fixed cash consideration, noncash consideration, variable consideration, significant financing components and consideration payable to the customer. Specific factors that may affect the transaction price for educational instruction and housing include the following: (a) fee reductions (including those the educational institution intends to offer the student or that the student has a valid expectation of receiving based on the institution’s customary business practices, published policies or specific statements) and (b) withdrawal rights. Each of these factors is discussed further in the remainder of this section.

Fee reductions

How fee reductions affect the transaction price depends on whether the student provides the educational institution with distinct goods or services in return for the fee reduction (e.g., work-study program), and if so, whether the known fair value of those goods or services is less than the fee reduction:

- **Student does not provide distinct goods or services in return for fee reduction (e.g., scholarships, general discounts).** These fee reductions should reduce the transaction price.

- **Student provides distinct goods or services and their known fair value is less than the fee reduction.** When this is the case, the distinct goods or services are provided only partially in return for the fee reduction. As a result, the known fair value of the distinct goods or services is treated as an expense in accordance with ASC 958-720-25-7. Essentially, such expenses are treated and presented in the same manner as if the distinct goods or services were provided by a nonstudent. In addition, paragraphs 8.6.30 and .31 of the Revenue Recognition AAG indicate that the excess of the fee reduction over the known fair value of the distinct goods or services provided by the student should reduce the transaction price. When the fair value of the distinct goods or services provided by the student are not known, all of the fee reduction should reduce the transaction price.

- **Student provides distinct goods or services (e.g., work-study program) and their known fair value is not less than (i.e., equals or exceeds) the fee reduction.** When this is the case, the distinct goods or services are provided fully in return for the fee reduction. As a result, the amount of the fee reduction is treated as an expense in accordance with ASC 958-720-25-7. Essentially, such expenses are treated and presented in the same manner as if the distinct goods or services were provided by a nonstudent. When the fair value of the distinct goods or services provided by the student are not known, all of the fee reduction should reduce the transaction price.

Fee reductions are a form of consideration payable to the customer. When consideration payable by an entity to its customers or customers’ customers is not variable and should be treated as a reduction in the transaction price, that reduction should be reflected upon the later of: (a) when the revenue for the related goods or services is recognized and (b) when consideration is paid or promised (which includes payments made only upon the occurrence of a future event). While each educational institution should make this determination based on its own facts and circumstances, paragraph 8.6.29 of the Revenue Recognition AAG indicates that tuition and housing fee reductions that should
be reflected in the transaction price (as otherwise required by the previously discussed guidance) should be recognized as reductions to revenue when the related tuition and housing fees are recognized as revenue (which is discussed in Step 5).

While the revenue line item in an educational institution’s statement of activities should be net of fee reductions that are required to be reflected in the transaction price based on the previously discussed guidance, paragraph 8.6.67 of the Revenue Recognition AAG indicates that it would be acceptable for the institution to either: (a) parenthetically disclose the amount of those fee reductions on the statement of activities itself or (b) disclose the amount of those fee reductions in the footnotes.

Withdrawal rights

An educational institution may provide its students with rights to withdraw from receiving instruction for which the students previously registered. If the amount of consideration the educational institution ultimately expects to be entitled to is reduced as a result of the students exercising their withdrawal rights (e.g., when students withdraw from a class within the first two weeks of a semester they are not obligated to pay for the class), those rights represent a form of variable consideration.

In accounting for withdrawal rights as variable consideration, the educational institution:

- **Estimates the amount of the consideration that it expects to be entitled to (which would reflect the effects of expected withdrawals).** To do so, the educational institution uses either the expected value method or the most likely amount method, depending on which one better predicts the effects of the withdrawal rights on the amount of consideration the educational institution ultimately expects to be entitled to. In general, one method should be used consistently when accounting for the effects of withdrawal rights.

- **Limits the amount of consideration to which it expects to be entitled to the amount for which it is probable that a significant reversal of cumulative revenue recognized will not occur.** In assessing the probability of a significant reversal in cumulative revenue recognized, the educational institution should take many factors into consideration, including its history with the same or similar withdrawal rights in the same timeframe (e.g., actual number of withdrawals in the same quarter or semester of the previous academic year). While each educational institution should make this determination based on its own facts and circumstances, paragraph 8.6.37 of the Revenue Recognition AAG essentially indicates that a significant reversal of cumulative revenue recognized would typically not be expected when both of the following circumstances exist:
  - The educational institution’s history with its withdrawal policies provides it with significant predictive experience.
  - The period over which the withdrawal rights may be exercised is short.

When a significant reversal of cumulative revenue recognized is not expected because both of these circumstances exist, the transaction price is the amount of consideration the educational institution expects to be entitled to, which would be the amount that was estimated using either the expected value method or most likely amount method.

While predicting whether a particular student will exercise its withdrawal rights may prove difficult for an educational institution, predicting how many students in a portfolio of similar students will exercise their withdrawal rights may prove to be much less difficult. As a result, the educational institution may elect to apply the new guidance on a portfolio basis (which is discussed in more detail in Step 1), provided doing so is not reasonably expected to result in a materially different outcome compared to applying the new guidance on a contract-by-contract basis. If the educational institution does not elect to apply the new guidance on a portfolio basis, it must still take into consideration its
experience with students in general exercising their withdrawal rights when accounting for the withdrawal rights on a contract-by-contract basis.

Accounting for withdrawal rights likely results in the recognition of a refund liability. Additional discussion related to the assets and liabilities recognized under ASC 606 is provided later in this white paper. The recognition of nonrefundable deposits the student forfeits as a result of exercising its right to withdraw is discussed in Step 5.

**Step 4: Allocate the transaction price to the performance obligations**

If there is more than one performance obligation in the contract (e.g., one performance obligation for educational instruction and one performance obligation for housing), the transaction price should generally be allocated to each performance obligation based on the standalone selling prices of each performance obligation in relation to the total of those standalone selling prices (i.e., a relative selling price model).

Observable standalone selling prices for educational instruction likely exist when the institution does not provide housing to every enrolled student. In other words, observable standalone selling prices for educational instruction could likely be identified using the tuition charged commuter students or students that obtain their own housing with unrelated third parties. Conversely, observable standalone selling prices likely do not exist for housing because the educational institution typically does not provide housing on its own (i.e., without also providing educational instruction). As a result, the educational institution may need to consider market information for similar housing to estimate the standalone selling price(s) of the housing it provides to its students.

Exceptions to the relative selling price model are provided for certain situations involving discounts and (or) variable consideration that can be shown to be related to one or more (but less than all) performance obligations. ASC 606-10-32-36 to 41 provide guidance on the circumstances under which a discount and variable consideration should be attributed to one performance obligation instead of being allocated to all performance obligations.

**Step 5: Recognize revenue when (or as) each performance obligation is satisfied**

First, the educational institution determines whether revenue should be recognized for each performance obligation over time or at a point in time using specific criteria focused on when and how the student obtains control of the promised goods or service (e.g., educational instruction, housing). While each educational institution should make this determination based on its own facts and circumstances, paragraph 8.6.49 of the Revenue Recognition AAG indicates that revenue related to educational instruction and housing should generally be recognized over time because students typically simultaneously receive and consume the benefits of educational instruction and housing, which satisfies one of the specific criteria that results in recognizing revenue over time for a performance obligation.

If revenue should be recognized over time, the educational institution next determines the method that should be used to recognize revenue over time, which should mirror how control of the promised goods or services (e.g., educational instruction, housing) transfers to the student. While each educational institution should make this determination based on its own facts and circumstances, paragraph 8.6.56 of the Revenue Recognition AAG indicates that ratable recognition of revenue over the academic period (i.e., straight-line recognition over the academic period) is typically appropriate because such services are generally provided to the student ratably over the academic period.

As discussed in Step 1, payment of a nonrefundable deposit may provide the student with rights to receive educational instruction and (or) housing. When these rights go unexercised by the student (i.e., the student forfeits his or her rights to educational instruction), the question arises with respect to when the nonrefundable deposit related
to those unexercised rights (which is often referred to as breakage) should be recognized as revenue. Under the new guidance, to the extent an entity expects to be entitled to an amount of breakage, that amount should be recognized as revenue as the other performance obligations in the contract (i.e., those contractual rights expected to be exercised by the customer) are satisfied. Because the performance obligations for educational instruction and (or) housing are either wholly satisfied (rights are exercised) or unsatisfied (rights are not exercised), paragraphs 8.6.05 and 8.6.51 in the Revenue Recognition AAG indicate that the breakage related to any unexercised rights should only be recognized as revenue when those rights expire (i.e., when the rights are forfeited).

Discussion of the assets and liabilities that may be recognized as a result of applying ASC 606 are discussed in the next section of this white paper.

**Assets and liabilities recognized under ASC 606**

Applying the five steps in the new revenue recognition model will result in the recognition of one or more of the following assets and liabilities:

- **Receivable.** A not-for-profit organization should only recognize a receivable from the customer (or other parties on behalf of the customer) when it has an unconditional and noncancellable right to consideration from the customer (or other parties on behalf of the customer). For example, consider a situation in which an educational institution bills a student for tuition and housing fees on the first day of the academic period, but the student may withdraw within the first two weeks of that period and owe nothing to the institution. In this situation, the educational institution should not recognize a receivable for the billed amount because it does not have an unconditional and noncancellable right to the tuition and housing fees. The receivable should only be recognized when the two-week withdrawal period expires without the student exercising its withdrawal right. Also, see the contract asset discussion later in this list.

- **Contract liability.** A contract liability arises if the customer’s performance is greater than that of the not-for-profit organization. For example, consider a situation in which a customer pays upfront for an annual membership in a not-for-profit association. In this situation, the not-for-profit association recognizes a contract liability for the amount paid upfront by the customer because the customer’s performance (i.e., upfront payment of the membership fee) is greater than the association’s performance at the point in time the payment is made (i.e., the association is obligated to perform over the entire annual membership period). This liability represents the not-for-profit association’s obligation to perform under the contract with its member. The contract liability is derecognized as revenue is recognized.

- **Contract asset.** A contract asset arises if the not-for-profit organization’s performance is greater than that of the customer. This asset represents the not-for-profit organization’s conditional right to consideration for its performance. For example, consider the situation introduced earlier when discussing receivables in which the educational institution bills the student for tuition and housing fees on the first day of the academic period, but the student may withdraw within the first two weeks of that period and owe nothing to the institution. In this situation, the educational institution starts recognizing revenue for providing instruction and housing during the first two weeks of the academic period. The amount of revenue recognized is based on the transaction price, which should consider the effects of the withdrawal rights (as discussed in Step 3 of the new revenue recognition model in the earlier section of this white paper focused on tuition and housing fees). As the educational institution recognizes revenue during the two-week withdrawal period, it recognizes a corresponding contract asset (which is consistent with the discussion in paragraph 8.6.64 of the Revenue Recognition AAG). If the two-week withdrawal period expires without the student exercising its withdrawal
right, the contract asset is derecognized, and a receivable is recognized for the amount due from the student (which is likely much more than the amount previously recognized as a contract asset). In addition, at this point in time, because the educational institution’s performance goes from being more than the student’s performance to less than the student’s performance, a contract liability should also be recognized.

- **Refund liability.** As discussed in Step 3 of the new revenue recognition model in the earlier section of this white paper focused on tuition and housing fees, the accounting for return and refund rights (e.g., withdrawal rights) likely results in the recognition of a refund liability for amounts received from customers that are expected to be refunded. A refund liability should not be included with the contract liability for presentation purposes.

Contract liability and contract asset are not prescribed descriptors for the related asset or liability in the balance sheet. However, if a descriptor other than contract asset is used, it needs to clearly indicate that the asset represents something other than a receivable.

Once recognized, a receivable is accounted for in accordance with the guidance in ASC 310, “Receivables” (or ASC 326, “Financial Instruments—Credit Losses,” once it is adopted). That same guidance is also used to evaluate a contract asset for impairment.

Numerical examples are provided in paragraph 8.6.69 of the Revenue Recognition AAG to illustrate the recognition of revenue, receivables, contract liabilities, contract assets and (or) refund liabilities for contracts between an educational institution and student.

**Disclosure requirements**

The new guidance includes many new qualitative and quantitative disclosure requirements. The objective of the disclosure requirements is to help financial statement users understand the nature, amount, timing and uncertainty of revenue and related cash flows. In general, entities are required to disclose a variety of information about the contracts they have with customers and significant judgments used in the application of the new guidance.

While the most disclosures are required of public entities (which includes certain not-for-profit organizations), many disclosures are also required of nonpublic entities. In addition, more disclosures are required of public entities on an annual basis than an interim basis, with many of the disclosures required on an interim basis being quantitative in nature.

The disclosure requirements themselves focus on providing a variety of revenue-related information. Some of the information that must be disclosed is high level, such as the amount of revenue recognized from customer contracts and the amount of any impairment (or credit) losses recognized on receivables or contract assets related to customer contracts. But, there is also a significant amount of detailed information that must be disclosed related to customer contracts, such as disaggregated revenue and the significant judgments involved in estimating the transaction price.

A not-for-profit organization should review its systems, processes, procedures and controls to determine whether it is capable of providing the information necessary to satisfy the new disclosure requirements and, if not, what changes it must make to enable it to provide the necessary information.

**Conclusion**

This white paper discusses those aspects of the new guidance that are likely to have the most significant effects on how not-for-profit organizations account for exchange transactions. For comprehensive discussion about the new guidance, including its scope, core principle and key steps, implementation guidance, presentation and disclosure requirements and effective date and transition provisions, refer to our white paper, Revenue recognition: A whole new world.
All not-for-profit organizations with exchange transactions whose financial statements are prepared in accordance with U.S. GAAP will be affected by the new guidance. The degree to which a particular not-for-profit organization’s revenue will be affected depends on its own facts and circumstances. However, every not-for-profit organization will be significantly affected by the disclosure requirements in the new guidance because they substantially increase the volume of revenue-related information disclosed in the financial statements, particularly for public entities. The new guidance will require not-for-profit organizations to evaluate whether any changes are needed to their current revenue and financial reporting processes and systems to comply with the new guidance. This will undoubtedly require substantive involvement by more than just those involved in the accounting function.

While the FASB provided delayed effective dates for the new guidance, it was with the understanding its implementation would be a significant undertaking for many (if not most) entities. With over three years having passed since initial issuance of the new guidance, entities in the not-for-profit industry should be well on their way to assessing how it will affect their accounting for exchange transactions and developing an implementation plan. This is particularly true for those not-for-profit organizations that are public entities (i.e., those that have issued, or are conduit bond obligors for, securities that are traded, listed or quoted on an exchange or an over-the-counter market), those that plan on electing the full retrospective transition method and those that have multi-year contract terms with their customers. To discuss the impacts of the new guidance on your organization and its financial statements, please contact your RSM representative, Susan Davis (+1 515 281 9275) or Susan Stewart (+1 804 281 6816).