

TRENDS AND BEST PRACTICES:

Independent School Revenue Recognition for Tuition Under FASB ASC 606





Implementation of the Financial Accounting Standards Board's (FASB) revenue recognition standard, Accounting Standards Codification (ASC 606): *Revenue from Contracts with Customers*, is raising questions and creating challenges in the financial departments of independent schools. One topic of discussion is how and when to recognize revenue from one significant source: tuition and fees.

Tuition and fees — a significant revenue source for independent schools — present special challenges under FASB ASC 606. Your school has the opportunity now to document how this revenue should be recognized. While there may be variations by school, the key driver is your conclusion and documentation regarding your performance obligation.

This white paper uses examples to illustrate the steps that CFOs and finance professionals in independent schools will need to take to comply with the FASB guidance.

Five steps to the core principle

The core principle of ASC 606 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. More simply, revenue

from a contract may not be recognized evenly over the life of the contract. The amount of revenue recognized would be determined based on the price, or cost, to the specific performance obligation, as they are delivered and fulfilled. To achieve this core principle, an entity should apply the following steps:

- Step 1:** Identify the contract(s) with a customer.
- Step 2:** Identify the performance obligations in the contract.
- Step 3:** Determine the transaction price.
- Step 4:** Allocate the transaction price to the performance obligations in the contract.
- Step 5:** Recognize revenue when (or as) the entity satisfies a performance obligation.

Contributions, investment return, and lease contracts are excluded from coverage under this standard; other accounting guidance governs their recording principals.

It is common for independent schools to have entered into contracts before the end of the fiscal year that apply to the subsequent and upcoming fiscal year. We will go through the five step process noted above for each of these contracts. The key driver in each of these examples is how each school identifies its performance obligation and how it documents and supports this conclusion. This may vary by school depending on the language in the contracts, how the school communicates the performance obligations to families, and ultimately, the school's documentation of what it considers the performance obligations to be. The examples below are meant to guide a school through the five step process to understand where the key decisions will be made.



Example 1: Registration/Deposit Fee

Assumptions

School A's fiscal year ends on June 30, 2021. A \$1,500 nonrefundable registration fee for the 2020 – 2021 school year is due by February 15, 2020 (during fiscal year ended June 30, 2020). The total amount of the contract for the full 2020 – 2021 school year is \$25,000 (inclusive of the \$1,500 nonrefundable registration fee).

Analysis

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

The contract is the fiscal year tuition contract.

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

School A considers its performance obligation providing education to the student for the 2020 – 2021 school year. School A sees this registration fee as a component of tuition (as stated in the contract) in which the obligation is met upon the start of the upcoming school year in August 2020.

Step 3: *Determine the transaction price.*

The transaction price is \$25,000 (full amount of the contract).

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

\$1,500 is allocated, with the overall tuition noted in the contract to the education provided to the student.

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

\$1,500 is recognized as revenue with the remainder of tuition costs, upon education being provided to the student. The registration fee is added to the rest of the tuition charges and is allocated over the days education is provided to the student.

If there are two performance obligations

What if School A considers there to be two performance obligations: 1) the registering of a student for the next school year, and essentially holding a space for that student, and 2) providing of educational services for the 2020 – 2021 school year? How would the above example change? The school would need to recognize the deposit as revenue upon meeting this obligation, which would occur in the year that obligation is met (regardless of collection of the deposit). The amount of revenue recognized would be dependent on the relative standalone selling prices, which requires further analysis and calculations (see FASB ASC 606-10-32-28 for additional information).

Example 2: Tuition

Assumptions

School A's fiscal year ends on June 30, 2021. Tuition of \$25,000 is communicated to a family via a signed contract for a student. The contract states that the family can void the contract (withdraw the student) prior to June 15 of the upcoming school year. Cancellation requests must be received on or before June 15 or the tuition becomes nonrefundable.

Analysis

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

The contract is the fiscal year tuition contract.

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

School A considers its performance obligation to be providing education for the nine-month school year covered by the contract (2020 – 2021 school year).

Step 3: *Determine the transaction price.*

The transaction price is \$25,000.

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

\$25,000 is allocated to the education provided over the school year.

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

\$25,000 is recognized as revenue over the school year. If the school has documented that the only obligation in a contract for an upcoming school year is the actual education services it will provide, then the revenue will be recognized over those months.

Questions to consider

Q: What if the contract is nonrefundable?

A: This actually has no impact on the revenue recognition steps that the school will go through. The obligation being performed by the school is the key driver on recognizing revenue.

Q: When a family notifies the school that a student will be withdrawing, what is the impact on revenue recognition?

A: As noted in the examples above, if the performance obligation relates to providing education, a family withdrawing a student removes the need for the school to perform that obligation. The revenue recognition analysis will

then follow the language of the contract. If the contract is nonrefundable and the school intends to pursue collection of the tuition (if not yet received), then revenue would be recognized at the time of withdrawal (breakage point, as defined in FASB ASC 606-10-55-48). If the school has a practice of allowing families to exit the contract or providing a refund of any advance payments received (such as a registration fee), then revenue would not be recognized related to the contract (FASB ASC 606-10-32-10).

Q: Can revenue recognition cross the school's fiscal year?

A: Yes, the key driver to revenue recognition is the school's determination and documentation of its performance obligation. In Example 1 above, it is possible that a school determines the \$1,500 registration fee should be allocated between two performance obligations, both providing education (tuition related) and the registration of a student (holding a space). If the registration of a student occurs before the end of a current fiscal year and the education occurs in a subsequent fiscal year, then the revenue recognition of the contract would be within two fiscal years.

With both of these examples it is possible for two schools with similar registration fees and tuition contracts to record the revenue in two different ways. The key driver under both examples, and with the new standard overall, is that the school has documented what the performance obligations are under each contract with the customer.

Presentation of contracts in the financial statements

Statement of financial position

When the school has met a portion of its performance obligation, it should present the contract as a contract asset (receivable if the payment has not been received or cash if the payment has been collected) in the statement of financial position. A contract asset is an entity's right to consideration in exchange for goods or services that the entity has transferred to a customer.

If a payment is made for a contract before the school has provided its obligation to the student, the school would present the consideration received as a contract liability when the payment is made. A contract liability is an entity's obligation to transfer goods or services to a customer for which the entity has received consideration (or an amount of consideration is due) from the customer.

Statement of activities

Because FASB ASC 606 prescribes that revenue is recognized based on the transaction price (net of any reductions or consideration payable to customer), presenting the gross amount as revenue is not allowed. However, ASC 606 neither

prescribes nor prohibits presentation of the reductions (for example, financial aid or scholarships) in the financial statements. It is acceptable for schools to disclose the amount of reductions incorporated in the revenue line either parenthetically on the face of the statement of activities or in the notes to the financial statements.

Disclosures

Schools will see an increase in disclosures surrounding transactions. For each year presented, a school must provide qualitative and quantitative information on contracts, the significant judgments (and changes in those judgments) made in applying the standard, and any assets or liabilities recognized related to costs to obtain or fulfill the contract.

Under the revenue recognition standard, nonpublic entities are not required to provide specific disclosures related to the following:

Final U.S. GAAP Model — Disclosure (for public entities only)

Disaggregation of revenue

- Qualitative and quantitative disaggregation of revenue into categories that depict how revenue and cash flows are affected by economic factors

Information about contract balances

- Opening and closing balances
- Amount of revenue recognized from contract liabilities
- Explanation of significant changes in contract balances*

Remaining performance obligations

- Transaction price allocated to remaining performance obligations
- Quantitative or qualitative explanation of when amounts will be recognized as revenue

Interim requirements

- Quantitative disclosures

Effective dates

For a public entity, ASC 606 is effective for annual reporting periods beginning after December 15, 2017 (e.g., as of and for the year ending June 30, 2019). Note that schools that have issued, or are a conduit bond obligor for, securities traded, listed, or quoted on an exchange or an over-the-

counter market are considered public entities. For all other nonpublic entities, the standard is effective for annual reporting periods beginning after December 15, 2018 (e.g., as of and for the year ending June 30, 2020).

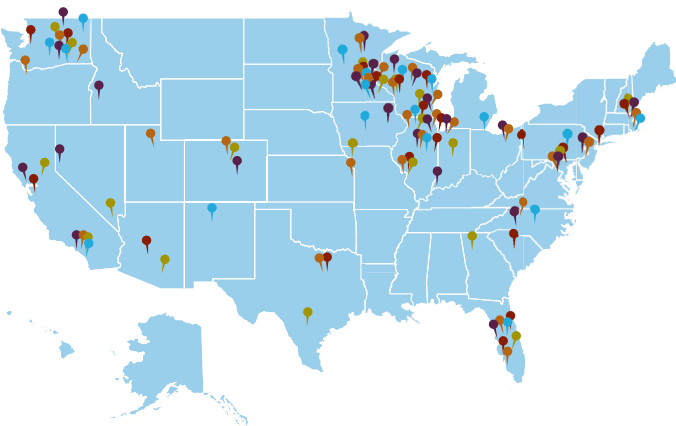
Evaluate all revenue streams

Schools will need to evaluate each of their revenue streams by following the five-step process required by ASC 606. The evaluation should result in formal documentation of management's analysis and conclusion. However, unless a school has a more-than-inconsequential history of collection issues or issuing student refunds, for most schools, the conclusion will not change the amount of revenue recognized in a fiscal year. Schools will continue to recognize tuition revenue evenly over the academic year.

The more significant effects of ASC 606 are enhanced disclosures that prohibit schools from presenting the gross amount as revenue in the statement of activities (other than parenthetically, as noted above).

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