



Financial Reporting Insights

# REVENUE RECOGNITION CONSIDERATIONS FOR NOT-FOR-PROFIT ORGANIZATIONS

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## 1. Introduction and Background

In 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers (Topic 606)* to provide a robust framework and comprehensive principles for addressing revenue recognition issues. Additionally, the guidance on accounting for certain costs related to a contract with a customer in the scope of Topic 606 was codified in ASC 340-40, *Other Assets and Deferred Costs – Contracts with Customers*.

The guidance in ASC 606 applies to contracts with customers. As such, it only affects the accounting for exchange transactions entered into by not-for-profit organizations. In some cases, determining whether a transaction entered into by a not-for-profit organization represents a contribution or exchange transaction can be complex. As a result, in 2018, the FASB issued ASU 2018-08, *Not-for-Profit Entities (Topic 958): Clarifying the Scope and Accounting Guidance for Contributions Received and Contributions Made*, which is discussed in more detail in the next section of this white paper.

For a detailed discussion of the guidance in ASC 606, refer to [our guide to revenue recognition](#).

Additionally, the American Institute of Certified Public Accountants (AICPA) has published a comprehensive nonauthoritative revenue recognition guide (the Revenue Recognition AAG) that provides helpful discussion and illustrative examples on how to apply the guidance in ASC 606. The guide includes discussion of the following topics that a not-for-profit organization may encounter in its application of the guidance in ASC 606:

- Scope
- Subscriptions and membership dues
- Tuition and housing fees
- Assets and liabilities recognized under ASC 606
- Disclosure requirements

## 2. Scope

### 2.1 Exchange transaction or contribution?

As previously mentioned, ASC 606 applies to all contracts with customers. Therefore, to the extent a not-for-profit organization enters into arrangements that are considered exchange transactions, it is required to apply the guidance in ASC 606. However, the FASB staff and Transition Resource Group (TRG) did discuss whether contributions are within the scope of ASC 606. A summary of these discussions is provided in Question 6 of FASB's [Revenue Recognition Implementation Q&As](#). The FASB staff and TRG concluded that contributions are not within the scope of ASC 606 because they are nonreciprocal transfers. As a result, contributions should continue to be accounted for in accordance with ASC 958-605.

In some cases, determining whether a transaction entered into by a not-for-profit entity represents a contribution or exchange transaction can be complex. An exchange transaction is defined as a reciprocal transfer in which each party receives and sacrifices approximately commensurate value. ASU 2018-08 provides implementation guidance related to determining whether a resource provider (e.g., government entity) receives commensurate value from the recipient entity (e.g., not-for-profit entity). For example:

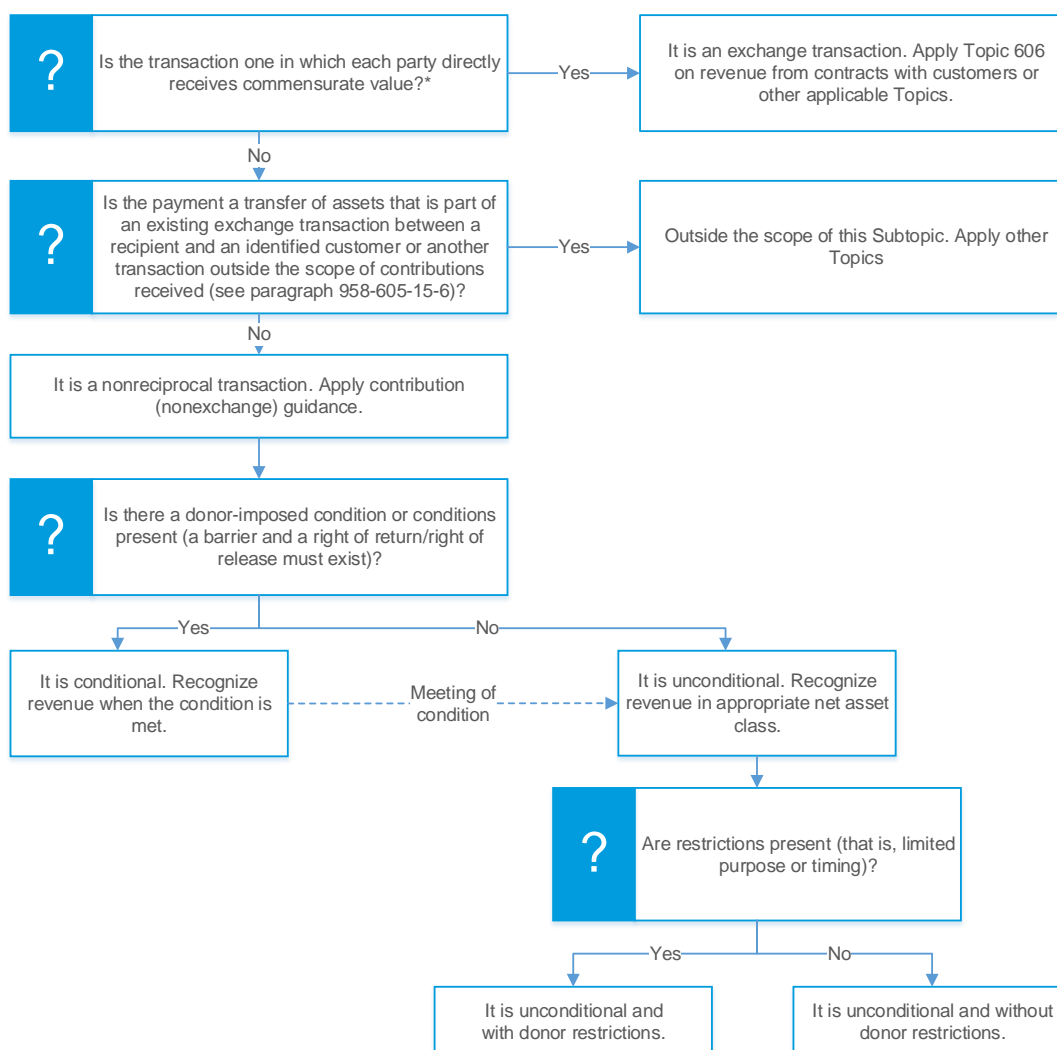
- The value considered in determining whether commensurate value was received by the resource provider would be the direct value it receives, not the indirect value it receives in the form of an overall potential public benefit.
- An expressed intent by both parties for the grant or contract to represent an exchange of commensurate value would be indicative of an exchange transaction. Conversely, solicitation of

assets by the recipient without the intent of transferring goods or services of commensurate value would be indicative of a contribution.

- The resource provider having sole discretion in determining the amount of the transferred assets would be indicative of a contribution.

Transfers between a resource provider (e.g., Medicare reimbursements, state tuition assistance) and a recipient (e.g., hospital, university) in connection with an existing exchange transaction between the recipient and an identified customer (e.g., hospital and patient, university and student) would not be contributions and would be accounted for in accordance with other applicable guidance (e.g., ASC 606).

The flow chart in ASC 958-605-55-1A illustrates the framework for assessing transactions, showing the thought process for determining whether a transfer of assets to a recipient is a contribution, an exchange transaction or an agency transaction wherein there is no revenue but only balance sheet recognition; and whether a contribution is conditional or unconditional.



\*See paragraph 958-605-55-6 for guidance about transactions that are in part an exchange and in part a contribution.

For additional information on applying ASU 2018-08, see our white paper, [Changes to accounting for grants and contributions made and received](#).

## 2.2 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 55-12 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.

## 3. 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 addresses the exchange transaction component of subscriptions and membership dues.

The AICPA Not-for-profit Revenue Recognition (NFPRR) Task Force discussed the application of the five steps in the revenue recognition model to subscriptions and membership fees, the results of which are included in Section 8.6 of the Revenue Recognition AAG. The sections that follow summarize these discussions and highlight other aspects of applying the guidance to subscriptions and membership fees.

### 3.1 Step 1: Identify the contract with a customer

The not-for-profit organization must determine whether the membership or subscription agreement meets: the definition of a contract and the contract existence criteria, including whether enforceable rights and obligations exist for both parties and 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 guidance in ASC 606 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 for evaluating whether there is a material difference.

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

The not-for-profit organization must identify the promised goods or services that are expected to be provided in accordance with the contract. In doing so, consideration should be given to those promised goods or services explicitly identified in the contract, 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.

One promised good or service that may need to be identified under ASC 606 is a membership renewal option. Under ASC 606, 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. A material right is an incremental discount that the customer 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 an option to purchase multiple renewal periods at once for a discount should be evaluated under ASC 606 to determine whether it represents a material right that the member would not have received without entering into the membership agreement. Other common examples of material rights include access to member pricing on publications, future educational opportunities and other products or services.

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 should determine whether there is one unit of account or multiple units of account. To do so, each of the promised goods or services should be evaluated to determine whether it is distinct. In general, a promised good or service is considered distinct and is accounted for separately as a performance obligation if both of the following criteria in ASC 606-10-25-19 are met:

- Capable of being distinct. Can the customer benefit from the promised good or service, either on its own or together with other resources that are readily available to the customer?
- Distinct within the context of the contract. Is the promise to transfer the good or service separately identifiable from other promises in the contract?

For example, if the university sweatshirt and one ticket to three 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 each of the goods or services otherwise being considered satisfied over time (see [Section 3.5](#)) and 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 [Section 3.5](#)). 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.

### 3.3 Step 3: Determine the transaction price

The transaction price is the amount of consideration to which the not-for-profit organization expects to be entitled 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.

### 3.4 Step 4: Allocate the transaction price to the performance obligations

If there is more than one performance obligation in the contract (e.g., tickets to multiple sporting events), the transaction price generally should 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). If a standalone selling price is not observable, the not-for-profit organization should estimate it using one of the methods, or a combination of methods, described in ASC 606-10-32-34.

Exceptions to the relative selling price model are provided for certain situations involving discounts 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 32-41 provides 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.

### 3.5 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 by evaluating whether the performance obligation meets one or more of certain criteria focused on when and how the member obtains control of the promised goods or services. If a performance obligation meets one or more of the following criteria, it is considered satisfied over time:

- Customer simultaneously receives and consumes benefits as industrial entity performs.
- Customer controls the asset as the industrial entity creates or enhances the asset.
- No alternative use and an enforceable right to payment for performance to date.

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 transfers to the customer.

As noted in paragraph 8.6.96 of the Revenue Recognition AAG, any revenue allocated to an option, such as a discount on future educational opportunities, is recognized when the educational opportunity is provided (if exercised) or the option expires. If the member exercises the option to participate in the educational opportunity, paragraph 8.6.97 notes that, based on the discussions of the TRG, the exercise might be accounted for either as a contract modification or a continuation of the existing contract (i.e., a change in the transaction price for the contract).

A not-for-profit organization that offers lifetime memberships or subscriptions in return for an upfront nonrefundable fee likely will 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 also must 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.

## 4. 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. The NFPRR Task Force discussed the application of the five steps in the ASC 606 revenue recognition model to tuition and housing fees, the results of which are included in Section 8.6 of the Revenue Recognition AAG. The following sections summarize these discussions and highlight other aspects of applying ASC 606 to tuition and housing fees.

### 4.1 Step 1: Identify the contract with a customer

#### 4.1.1 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 ASC 606 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 obligates the institution to stand ready to provide instruction and housing and provides the student with the rights to receive instruction and 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 [Section 4.5](#).

- *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. 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 [Section 4.3](#)) 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 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 to which the educational institution expects to be entitled for the instruction and housing that *will be transferred* to the customer, which may not be all of the instruction and 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.

#### 4.1.1.1 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 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 [Section 4.2](#), 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 ASC 606 revenue recognition model.

At a July 2019 meeting, the FASB discussed a technical inquiry related to the combination of education and residential service contracts. The National Association of College and University Business Officers (NACUBO) submitted a common scenario in which universities charge students for tuition and housing and noted that such contracts typically are executed as separate contracts, and the pricing is not interrelated. The FASB agreed with NACUBO's application of the guidance in ASC 606 and noted that it generally does not expect to see contracts for tuition and housing combined for accounting purposes; however, the FASB could not rule out the possibility that there could be some situations in which the contract combination criteria are met. Refer to NACUBO Advisory 19-02, [Revenue Recognition \(Topic 606\): Education and Residential Contracts](#), for additional information.

#### 4.1.2 Portfolio approach

The guidance in ASC 606 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 for evaluating whether there is a material difference. One of the benefits of electing the portfolio approach would be the ability to assess collectibility 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.

### 4.2 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 should determine 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. In general, a promised good or service is considered distinct and is accounted for separately as a performance obligation if both of the following criteria in ASC 606-10-25-19 are met:

- Capable of being distinct. Can the customer benefit from the promised good or service, either on its own or together with other resources that are readily available to the customer?
- Distinct within the context of the contract. Is the promise to transfer the good or service separately identifiable from other promises in the contract?

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 [Section 4.1.1.1](#)), 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 [Section 4.1.1.1](#)), 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.

### 4.3 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 [Section 4.1.1.1](#)), 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 [Section 4.4](#). The amounts allocated in that step to each performance obligation may not be the same as the consideration earmarked in the contracts for tuition and housing.

The transaction price is the amount of consideration (e.g., tuition, housing fees, meal fees) to which the educational institution expects to be entitled as a result of transferring the instruction, housing 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 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 withdrawal rights. Each of these factors is discussed further in the remainder of this section.

#### 4.3.1. 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., a 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.
- *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.
- *Student provides distinct goods or services, and their fair value is not known.* When the fair value of the distinct goods or services provided by the student is 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 when the revenue for the related goods or services is recognized or 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 (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 parenthetically disclose the amount of those fee reductions on the statement of activities or disclose the amount of those fee reductions in the financial statement footnotes.

#### 4.3.2. 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 to which the educational institution ultimately expects to be entitled is reduced as a result of the students exercising their withdrawal rights (e.g., if students who withdraw from a class within the first two weeks of a semester 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 to which it expects to be entitled (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 to which the educational institution ultimately expects to be entitled. 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 typically would 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 to which the educational institution expects to be entitled, 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 guidance in ASC 606 on a portfolio basis (discussed in more detail in [Section 4.1.2](#)), provided doing so is not reasonably expected to result in a materially different outcome compared to applying ASC 606 on a contract-by-contract basis. If the educational institution does not elect to apply ASC 606 on a portfolio basis, it must still take into consideration its general experience with students 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 in [Section 5](#). The recognition of nonrefundable deposits the student forfeits as a result of exercising its right to withdraw is discussed in [Section 4.5](#).

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

In most cases, we expect that an educational institution’s tuition and housing contracts will be separate and should not be combined for accounting purposes (based on the related discussion in [Section 4.1.1.1](#)), meaning that there are two transaction prices, one for each contract based on the elements of consideration in each individual contract. In other words, if there is only one performance obligation in the contract, no allocation is necessary. In the rare situation in which 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 [Section 4.1.1.1](#)), the transaction price generally should 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 likely could be identified using the tuition charged to 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 of the housing it provides to its students.

Exceptions to the relative selling price model are provided for certain situations involving discounts or variable consideration that can be shown to be related to one or more (but fewer than all) performance obligations. ASC 606-10-32-36 to 32-41 provides 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.

#### 4.5 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 by evaluating whether the performance obligation meets one or more of certain criteria focused on when and how the student obtains control of the promised goods or service (e.g., educational instruction, housing). If a performance obligation meets one or more of the following criteria, it is considered satisfied over time:

- Customer simultaneously receives and consumes benefits as industrial entity performs
- Customer controls the asset as the industrial entity creates or enhances the asset
- No alternative use and an enforceable right to payment for performance to date

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 generally should 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 generally are provided to the student ratably over the academic period.

As discussed in [Section 4.1.1](#), payment of a nonrefundable deposit may provide the student with rights to receive educational instruction and 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 ASC 606, 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 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).

## 5. Assets and Liabilities Recognized Under ASC 606 and ASC 340-40

Applying the five steps in the ASC 606 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 only should 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 [Section 4.3.2](#) of this white paper). 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 also should be recognized.
- *Refund liability.* As discussed in [Section 4.3.2](#), 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. Typically, 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 liability and asset in the balance sheet. However, if a descriptor other than contract asset is used, it should be clear that the asset represents something other than a receivable.

Once recognized, a receivable is accounted for in accordance with the guidance in ASC 326, "Financial Instruments—Credit Losses." That same guidance also is 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 refund liabilities for contracts between an educational institution and student.

## 6. Disclosure Requirements

Many qualitative and quantitative disclosure requirements are included in ASC 606-10-50 and ASC 340-40-50. ASC 606-10-50-1 states the following as the overall disclosure objective of ASC 606 (which is also the overall disclosure objective of ASC 340-40): “The objective of the disclosure requirements in this Topic is for an entity to disclose sufficient information to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers.”

The disclosures required to achieve this objective 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. However, there is also a significant amount of detailed information that must be disclosed annually related to customer contracts, including information about:

- Disaggregated revenue
- Contract assets, contract liabilities and receivables
- Performance obligations
- Transaction price allocated to remaining performance obligations at the end of the reporting period (disclosures required for public entities and elective for nonpublic entities)
- Significant judgments about the timing of satisfying performance obligations
- Significant judgments about the transaction price and the amounts allocated to performance obligations
- Practical expedients (disclosures required for public entities and elective for nonpublic entities)
- Capitalized costs related to obtaining or fulfilling a customer contract (disclosures required for public entities and elective for nonpublic entities)

The nature and extent of the required disclosures in each of the preceding categories depends on whether the not-for-profit organization is a public entity (more required disclosures) or nonpublic entity (fewer required disclosures). In addition, while more disclosures are required for annual periods, some disclosures also are required for interim periods. However, when a not-for-profit organizations applies ASC 606 and 340-40 in its interim financial statements for one or more interim periods before it applies ASC 606 and 340-40 in its annual financial statements, the not-for-profit organizations must provide all the required annual disclosures in those interim financial statements.

Detailed discussion and illustrations of the disclosure requirements for both public and nonpublic entities are included in Chapter 15 of [our revenue recognition guide](#).

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