REVENUE RECOGNITION OF UPFRONT FEES UNDER ASU NO. 2014-09

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INTRODUCTION

Historically, revenue recognition was based on the revenue recognition principle. Under this principle, revenue would be recognized when the earnings process was complete and the party providing the good or service had a reasonable assurance of collection. Due to significant complexity with multi-year contracts and transactions that involved the transfer of several different products or differing services, a new approach has been developed as presented in accounting standard update No. 2014-09. As of December 2016 this new standard applies to all public companies who issue reports under US GAAP and is expected to be tested on the Uniform CPA exam as of 2017. This standard update significantly changes how revenue recognition is to be taught within an Intermediate Accounting course. This compact case provides an example that can be utilized in class to demonstrate recognition when a business receives up front fees from a customer with multiple performance obligations. The case also provides opportunity for class discussion of the specific criteria of 'performance obligations' required to recognize revenue under standard update No. 2014-09. This case can be utilized within the Intermediate Accounting classroom, or part of continuing professional education seminars for CPA's.

FACTS

On January 15, 2016, Frank Furman and Harvey Walters, recent graduates of the Gamma University School of Business made the decision to enter a business together which fulfilled their dreams of owning a business and having a life of playing golf. Frank and Harvey purchased a golf course together as 50/50 partners located in their hometown. As the purchase closed, Frank and Harvey had a meeting with Leo Kramer, CPA to review previous financial records from the prior owner and establish an accounting system for golf course operations. Leo noted that moving forward, even though not a public entity, for consistent financial reporting purposes Frank and Harvey need to be aware of new revenue recognition criteria taking effect the following year. Leo suggested that an accounting system be established to recognize revenue using the new criteria. Having a solid accounting system from the start of operations will allow Frank and Harvey to more effectively generate financial statements that can be easily audited for banks or future investors to fund long-term expansion and upgrade needs of club-house facilities and the course.

The golf course generates all of its revenue from two sources, membership fees to play golf, as well as private lessons taught by Frank and Harvey. There are no other revenue sources to be considered, as Frank and Harvey have arrangements with private vendors to manage food concessions and retail golf supply sales (i.e. golf shoes, clothing, clubs etc…). Any income from these sources is allocated and paid directly to Frank and Harvey personally and not recorded through the golf course.

The golf course offers a package where for a membership fee of $900 a member has unlimited use of the golf course and a voucher that provides a 20% discount on golf lessons for the first year of membership. This voucher is a coupon and does not state the member name on it, and as a result could be fully transferable. The private lessons are offered to club members at the discounted price as well as the general public. A new membership not part of the special package will sell for $950, and one year of private lessons (one lesson per week maximum) is an additional $600 for the year. Frank and Harvey feel that 30% of the package members will utilize the golf lessons available. As part of a marketing strategy, for those who purchase lessons separately, they typically offer a 5% standard discount on lessons.

1. Under ASU No. 2014-09, for purposes of recognition, for those members who utilize the new member package, how many performance obligations would need to be included to recognize revenue?
2. How would the total contract price be allocated to each performance obligation? Explain your answer.
3. Prepare the necessary journal entry to recognize sale of a new club membership.

TEACHING NOTES

Prior to discussion of this case, it is expected that students have completed reading from an appropriate textbook on the specific steps for revenue recognition as defined in the updated standards and/or appropriate class lecture on the basic standards. Once the student is comfortable with the updated standards, this case specifically illustrates the process when proceeds from a customer are received before revenue is recognized, known as an upfront payment.

The learning objectives of this compact case are:

- Define and identify a performance obligation.
- Allocate revenue for upfront fees received by performance obligations.
- Prepare the necessary journal entries and explain financial statement impact when revenue is earned across multiple performance obligations.

The first task in the case is to assure the student understands that revenue is recognized based on performance obligation. Before addressing the answer to the first question of the case, the instructor should have a discussion with the class on the principle of revenue recognition and the meaning of a performance obligation. It is important the student understands that a performance obligation is a promise to transfer a good or provide a service. Other examples can be used to illustrate a performance obligation such as how many obligations exist when a customer dines at a restaurant or makes a purchase at a retail store.

In the specific case herein, there are 2 separate performance allocations to recognize revenue. The voucher for the discounted golf lessons provides a right to a customer that the customer would not receive otherwise. This right is the larger discount of 20% over the 5% to non-members. As this there is nothing to prevent this discount voucher of being sold or transferred, it is not related to the obligation of providing access to the golf course, and as a result would be considered a separate performance obligation.

To allocate the contract price to each performance obligation, it is first important to demonstrate to the students that the golf course would typically offer a 5% discount on all lessons, so the membership discount of 20% really provides a value of 15% (20%-5%). As a result, the selling price of the vouchers is (selling price of the lessons x true discount value x probability that the discount voucher will be exercised). This is \$600 x 15% x 30% = \$27.

Selling price of the discount voucher: $27
Stand-alone price of membership: $950
Total value of stand-alone prices: $977

Under the rules of ASU 2014-19, the golf course must allocate the share based on the stand-alone prices of each service or product delivered.

Lessons are $27 of the $977 total, so 2.76% of the total value

The stand-alone membership price is $950 of the total of $977, so 97.24% of the value.

The total selling price of the membership is now to be allocated by the respective percentages of the stand-alone services as if they were not bundled. In this specific case:

Bundled member price: $900
Membership: $900 x .9724 = $875.16
Lessons: $900 x .0276 = $24.84

When the membership fee is received, to record the membership, as it is received upfront and allocated over the year of membership, it is necessary to allocate the deferred revenue to each separate performance obligation. The journal entry to record the receipt of membership is:

Cash	$900	
Deferred revenue- golf membership		$875.16
Deferred revenue- lesson coupon		$24.84

To record cash received for annual membership fees and membership lesson vouchers

Though most likely covered earlier in the course, this also makes a good opportunity for the instructor to clarify that deferred revenue replaces 'unearned revenue' and reasons for the terminology change.

CONCLUSION

This compact case illustrates how performance obligations are determined and utilized to establish a transaction price when payment is received in advance. This transaction is common in other businesses such as fitness memberships, ski memberships or any membership where an upfront fee is paid for a future time period. The prepayment itself is not considered a performance obligation, because the payment itself is not a promise to provide a service or transfer a product. The upfront fee in situations such as this are treated as an advance payment to receive a product or service in the future. The price paid needs to be proportionately allocated to all performance obligations required in the future as a result of the payment. When the payment is received it is deferred revenue, and as time passes over the term of the membership, the deferred revenue would be adjusted to revenue. This case does not specifically ask the student to make the adjustments to the deferred revenue accounts to recognize revenue at the end of an accounting period, but instructors may wish to demonstrate this. As the memberships are for one year (12 months), if monthly adjustments are made, the monthly adjusting entry to recognize the revenue would be:

Deferred revenue-golf membership	$ 72.93	
Deferred revenue- lesson coupon	$ 2.07	
Revenue- golf membership		$72.93
Revenue- lesson coupon		$2.07

To adjust deferred revenue accounts to recognize revenue earned for month ended.