Arkansas State University
Sponsored Programs Accounting
Revenue Recognition Procedure

Purpose

The purpose of this procedure is to define revenue recognition for Sponsored Programs and to provide guidelines for recognizing such revenue in accordance with generally accepted accounting principles (GAAP).

Revenue Recognition Overview

For purposes of this procedure, Sponsored Programs are externally-funded activities in which a formal written agreement, i.e., a grant, contract, or cooperative agreement, is entered into by the University and by the sponsor.

a. **Revenue recognition** – Revenue recognition should be based on accrual accounting in accordance with GAAP. Revenue should be recognized when earned, and expenses should be recognized when incurred. Revenue is considered earned when the University has substantially met its obligation to be entitled to the benefits represented by the revenue. Revenue should be recorded when earned, regardless of the timing of cash receipts. In the event a project stipulates performance measures, revenue is considered earned when the performance measures have been completed.

b. **Unearned revenue** – Unearned revenue results when cash is received in advance of revenue being earned. Unearned revenue is recorded as a liability until it is earned. Once earned, the liability is reduced and revenue is recorded. When recording cash receipts, it is important to determine whether the cash represents earned revenue or unearned revenue.

c. **Percentage of completion** – Many projects funded by grants and contracts are long-term, meaning that the projects will continue for one year or more. For long-term contracts, GAAP allows revenue to be recognized on a percentage-of-completion basis if "circumstances are such that total profit can be estimated with reasonable accuracy and ultimate realization is reasonably assured."

   Current income recognized under the percentage-of-completion method is based upon (a) the total income projected for the contract at the time of completion and (b) the expenses incurred to date. The percentage-of-completion can be measured using the proportion of costs incurred versus the total estimated cost to complete the contract.

Sponsored Project Award Types

a. **Cost reimbursement agreements** – Under these programs, sponsors reimburse expenses that have been incurred. Sponsored terms and conditions determine the University's reimbursement for costs.

b. **Fixed fee agreements** – This type of agreement sets a fixed price for the delivery of the work stipulated in the agreement, regardless of actual expenses incurred by the University on the contract.

c. **Service rate agreements**– This type of agreement is paid based on agreed amounts per unit of service

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Revenue Recognition Guidelines by Sponsored Project Award Type

a. **Cost Reimbursement Agreements –**

   - **Revenue recognition:** Revenue is directly related to the costs incurred on cost-reimbursement contracts. Revenue should be recognized as expenses are incurred. Expenditure adjustments may create an adjustment to revenue.
   - **Unearned revenue:** While cost reimbursement, by definition, implies that payments are made after costs are incurred, this is not always the case. When payments are received in advance, or exceed expenditures to date, the liability, Unearned Revenue, should be recorded. Once the advance payment or excess payment is earned, the liability is reduced and revenue is recorded.

b. **Fixed Fee Agreements –**

   - **Revenue recognition:** Revenue should be recognized on a percentage of completion basis. The percentage of completion basis records revenue as a percent of cost incurred to date, divided by the total estimated expenses. (Total estimated expense is the fixed price award.) Expenses are monitored against the award amount to ensure that expenses do not exceed the award amount. At the end of the project, if the total award received exceeds the cumulative project expenses, the excess should be recorded as revenue.
   - **Unearned revenue:** If payments are received in advance or in excess of the percentage completed, Unearned Revenue should be recorded. Once the advance or excess payment is earned, the liability is reduced and revenue is recorded.

c. **Service Rate Agreements-**

- **Revenue recognition:** Revenue should be recognized when each service unit is performed or served. Expenses are monitored against the award amount to ensure that expenses do not exceed the award amount. At the end of the project, if the total award received exceeds the cumulative project expenses, the excess should be recorded as revenue.
- **Unearned revenue:** If payments are received in advance, Unearned Revenue should be recorded. Once the advance or excess payment is earned, the liability is reduced and revenue is recorded.

Invoicing and Cash Receipt

Revenue recognition, invoice processing and cash receipts may or may not occur at the same time. Revenue should be recognized when earned, while invoicing and cash receipt may occur independently of the earning process. For example, cash may be received at the start of the project, prior to the University incurring any expense or performing any work. When cash is received in advance, cash and an unearned revenue liability are recorded, but revenue is not recognized.