

## **U.S. MATH RECOVERY COUNCIL® - REVENUE RECOGNITION AND OTHER ISSUES**

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*After a meeting with her supervisor, Maggie (a staff auditor in a small public accounting firm) learned that she would be completing her next assignment nearly entirely on her own. Although she knew very little about her new non-profit client, U.S. Math Recovery Council®, the client file contained all the information she would need for the project. After reviewing the file, Maggie knew that her GAAP research skills would be valuable, as the organization had potential financial reporting issues related to revenue recognition, contributed services, and inventory. Using these skills, Maggie began researching each of the issues in preparation for her follow-up meeting with her supervisor.*

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### **INTRODUCTION**

As Maggie left her supervisor's office, she was eager to get started on her new project. She was only in her first year in public accounting, but her supervisor, Carol, had been giving her increasingly difficult projects, each of which she had completed with high praise. As a staff auditor in a small firm, this would be her first project that she completed nearly entirely on her own.

After meeting with Carol, she believed she had everything she needed to start the project. The client, U.S. Math Recovery Council® ("USMRC®"), was a non-profit that had seen significant revenue growth over the past several years. With this growth came several financial accounting issues that Maggie would need to research for the audit.

As Maggie reviewed the information in the file, she thought about Carol's final words from the meeting:

*Make sure you review all the details carefully, so you can provide answers to each of the issues, along with support for your*

*conclusions. Let's meet later this week to go through each of the audit issues and your conclusions.*

Maggie was excited to get started but was nervous at the same time. *Would she have all the information she needed to research each of the issues? Would she be able to find answers to all the issues? Would she be able to complete everything in time for her meeting with Carol?* After a deep breath, she went to work.

## **COMPANY BACKGROUND**

U.S. Math Recovery Council® was a 501(c)(3) not-for-profit organization, formed in 2003, with the following mission:

*The mission of the US Math Recovery Council® is to transform numeracy education, to connect research with practice, and to empower educators to advance student mathematical thinking and success...through Math Recovery® principles (U.S. Math Recovery®, 2017).*

USMRC® provided resources, training, and support services that helped improve math skills in elementary school children (most in Kindergarten through 5<sup>th</sup> grade) across the nation. One of the ways they did this is by using the Math Recovery® system, which had been designed by educators with many years of experience and success stories. In addition, they trained teachers on the effective use of the materials to improve numeracy education.

In most cases, school districts contracted with USMRC® to provide instruction to children using the Math Recovery system. This instruction was either provided by highly skilled USMRC® instructors, or by teachers in the school district who had been trained to use the Math Recovery system.

The primary sources of revenue for USMRC® were the sales of Math Recovery Kits® and the sale of professional services. In addition, the organization received some revenue from membership fees, contributions, and the production of an annual conference.

Although USMRC® had been operating since 2003, the last several years had been especially successful for the organization. More school districts and teachers had become champions for the Math Recovery® system, and the reputation of USMRC® as a leader in promoting numeracy education in elementary school children had grown. The organization's cash had been growing steadily and had now reached a

point where discussions had started regarding whether USMRC® should be investing it in ways that might provide more value to the organization. Currently, the company invested excess cash in FDIC-insured certificates of deposit, with interest rates that were generally less than 1% per annum. Although USMRC® created and tried to follow an annual budget, management had mentioned that it felt as though it could be a more robust and meaningful process, as most of the budget simply used the previous year's information to create a new budget.

## **POTENTIAL AUDIT ISSUES**

During field work and conversations with USMRC®, Maggie encountered the following potential issues with the 2017 audit:

### **Recognition of Program Revenues**

The majority of USMRC®'s program revenues came from two different types of situations, as described below:

#### *Situation #1 – Kits only*

In this situation, customers (i.e. school districts or teachers) who had completed at least four USMRC® training courses could purchase kits for use in the classroom. The kits included a textbook, handouts, and other materials that could be used during the course. USMRC® charged \$395 per kit. Included in the price of the kit were additional support services, such as access to additional website materials and access to other instructors who have used the materials in class. These support services, although valuable, would not be of great benefit to the customer without the kit. Customers could access these resources by setting up an account on the company's website as soon as they had paid for the kits.

During discussions with Maggie, USMRC® management mentioned that they had heard about new revenue recognition rules that might require them to separate the cost of the kit from the additional support services. Since, in most cases, there was a timing difference between when the product was delivered and the additional support services were used, USMRC® was concerned about the impact this change might have on revenue (and deferred revenue). The current financial statements did not reflect any separation of these two items.

*Situation #2 – Kits and professional services*

In this situation, customers purchased both the kits and professional services. This would occur most often when a school district wanted to use the Math Recovery<sup>®</sup> system, but did not have teachers trained in the system available to teach the course. For these circumstances, USMRC<sup>®</sup> would provide a professional to teach the course. USMRC<sup>®</sup> charged \$995 per student for this situation, which included a \$395 kit. The school district placed the order and a contract was signed with USMRC<sup>®</sup>. USMRC<sup>®</sup> required all amounts to be paid before the start of the course, and the professional fees charges were non-refundable once the course had begun. Most school districts paid the full invoice amount in advance when they placed the order.

Currently USMRC<sup>®</sup> accounted for this by invoicing the customer for the entire \$995 per student up front, but then tracked recognized revenue for each item (the kit and the professional services) separately. For kits, USMRC<sup>®</sup> recognized the revenue once the kits are shipped. For the professional services, USMRC<sup>®</sup> recognized the full amount on the first day of the class session since the amounts were non-refundable at that point.

**Membership Dues**

USMRC<sup>®</sup> charged annual membership fees, which allowed members to gain access to additional support services, track training certifications, and to take discounts on certain products and registrations. For 2017, the annual membership fee was \$50 per member. USMRC<sup>®</sup> collected membership fees up front and recorded them as deferred revenues. Annual adjusting entries were made to account for the portion of fees collected that had been earned but not yet recognized. The amounts not yet recognized were included in deferred revenues at year end.

Although only one level of membership fee currently existed (an annual fee of \$50), several members had asked about the potential of a lifetime membership fee, which would allow members to pay one fee up front and have lifetime membership benefits. While discussing the 2017 audit, USMRC<sup>®</sup> asked Maggie about the potential accounting consequences of adding an up-front lifetime membership fee that would be sufficient to cover lifetime membership costs.

**Contributed Services**

The USMRC<sup>®</sup> board of directors has traditionally been a “working board,” meaning that board members were strategically chosen based on the individual skill sets that

might be valuable to the organization, and were expected to use those skills to help advance the mission of the organization. For example, some board members were well versed in USMRC® products and had used them for years. Some board members had a research background, and others had a financial background. Choosing board members from different industries and backgrounds allowed the organization to assemble a panel of experts in different areas who could help guide the organization.

Because of this arrangement, many board members devoted a significant amount of time and expertise to USMRC® activities. The following situations occurred in 2017 and were brought to Maggie's attention. Neither of these items had been recorded in the financial statements.

#### *Situation #1*

Board Member A ("BM-A") has a PhD in Educational Psychology and was considered an expert in her field of research, which aligned very closely with USMRC®'s products and process. During 2017, USMRC® worked diligently to create a whitepaper regarding the research-based benefits of the Math Recovery system. BM-A was a major contributor to the whitepaper, as she used her research expertise to provide research-based evidence for success. If BM-A had not contributed to the whitepaper, USMRC® would have had to hire an outside consulting firm to help complete the project at an estimated cost of \$10,000.

#### *Situation #2*

Board Member B ("BM-B") also has a PhD in Educational Psychology and was considered an expert in his field of research, which also aligned very closely with USMRC®'s products and processes. During 2017, BM-B was heavily involved with the annual conference that was hosted by USMRC®. BM-B estimated that he spent approximately 200 hours helping schedule speakers, set up appointments, contact vendors, and set up displays. No specialized skills were required to complete the tasks. USMRC® estimated that it would have cost approximately \$4,000 to hire another individual to complete the duties.

#### **Inventory**

Inventory was currently calculated using the lower of average cost or market method. The organization's accounting software automatically computed the average cost of inventory. Because most inventory consisted of textbooks and related materials, there was no issue with spoilage. In years in which a new textbook

version was published, the old textbook versions became less valuable (and the sales price was reduced), and in some cases, obsolete. During 2017, inventory included some items that were outdated or obsolete. Table 1 provides an inventory listing by group of the course kits, along with information necessary for computing market value, as follows:

**TABLE 1**  
**SELECTED INVENTORY INFORMATION**

<b>Inventory Group</b>	<b>Average Cost</b>	<b>Sales Price</b>	<b>Completion and Disposal Costs</b>	<b>Normal Profit Margin</b>
Course Kits – Current Version	210 @ \$182.16 = \$38,253.60	\$395.00 each	\$20.00 each	\$110 each
Course Kits – Old Version	182 @ \$174.28 = \$31,718.96	\$179.00 each	\$20.00 each	\$110 each

As Maggie reviewed these issues, she knew she would be asked to provide clear, concise answers for each of them to her supervisor, Carol. To do so, she wanted to make sure that she understood all the facts, researched each question thoroughly, and provided succinct answers with citations to the standards for each.