



## Expense Recognition

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### Policy Statement

This policy establishes when operational expenses must be recorded at the University. The University reports its expenses on the accrual basis, meaning when the expenses are incurred, not necessarily when they are paid. Expenses are generally incurred when Harvard receives goods or services.

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### Reason for Policy

This policy exists to ensure adherence with Generally Accepted Accounting Principles (GAAP) and other regulatory requirements, to promote consistent accounting treatment across the University, and to ensure the operating results of University units are not misstated as a result of expenses unrecorded or recorded improperly.

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### Who Must Comply

All Harvard University schools, tubs, local units, Affiliate Institutions, Allied Institutions and University-wide Initiatives must comply.

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### Procedures

#### 1. Understand accrual rules for expense recognition.

- A. Accrual accounting rules require Harvard to record expenses when they are incurred, meaning when the goods are received or the services are provided, whether or not an invoice has been received or payment has been made.
- B. Balance sheet entries: if Harvard doesn't pay for goods/services in the same quarter as it receives them, then Harvard needs to record an entry on its balance sheet. The type of balance sheet entry depends on when Harvard receives the goods/services relative to when Harvard pays for them. The tubs and Central administration are each responsible for recording balance sheet entries for certain types of expenses. See Appendix A.
- C. **Do not record balance sheet entries for internal transactions.** No accruals or prepaid expense items should be recorded for internal transactions. See the University's Internal Billing Transactions Policy.

#### 2. Record balance sheet entries as needed.

- A. Central offices process certain types of expenses, such as accrued expenses for quarter-end salaries and wages. See Appendix B for school/tub responsibilities by expense type.
- B. Thresholds: At the end of each quarter, tubs must record certain manual entries for items not yet paid through the Central A/P system, if over the thresholds below (which exclude construction in progress (CIP) items). Smaller items may be recorded at each tub's discretion.
  - a. Quarter-end: manual entries are required for items of \$50,000 or more (\$100,000 for large schools – FAS, HMS, HBS, SPH).
  - b. Year-end: manual entries are required for items greater than or equal to \$10,000.

#### 3. Apply special accounting rules for certain types of expenses.

- A. Expense credits
  - a. Receipts that offset or reduce expense items are considered credits to expenses. Expense credits include purchase discounts; rebates and allowances; recoveries or indemnities on losses; and adjustments for overpayments or erroneous charges.



Expense Recognition Appendix A - Quick Reference Guide

|  | <b>Accrued Expense</b>   | <b>Prepaid Expense</b>   | <b>Nonrefundable Deposits Paid</b>   | <b>Refundable Deposit Paid</b>  |
|--|--|--|--|---|
| <b>When is it needed?</b>                    | When Harvard receives goods or services and won't pay for them until a subsequent quarter, Harvard recognizes the expense and records an ACCRUED EXPENSE LIABILITY | When Harvard pays a vendor in advance and won't receive the goods or services until a subsequent quarter, Harvard records a PREPAID EXPENSE until it actually receives the goods or services | When the Harvard pays a nonrefundable deposit on goods or services and won't receive the goods or services until a subsequent quarter, Harvard records a DEPOSITS PAID asset until it actually receives the goods or services. | When Harvard pays a refundable deposit (like a security deposit on a lease) that will be returned to Harvard at the end of the lease or other agreement, Harvard records a DEPOSITS PAID asset until the end of the related lease or other agreement. |
| <b>How do I record it?</b>                   | Process a journal entry:<br>DEBIT expense (6000-8879)<br>CREDIT accrued expense liability (2191)   | Use the following object codes when requesting an A/P payment:<br>DEBIT prepaid expense asset (0540)<br>(AP will automatically CREDIT cash 0010*)  | Use the following object codes when requesting an A/P payment:<br>DEBIT prepaid expense asset (0540)<br>(AP will automatically CREDIT cash 0010*)  | Use the following object codes when requesting an A/P payment:<br>DEBIT security deposits paid asset (0550)<br>(AP will automatically CREDIT cash 0010*)  |
| <b>When do I reverse the original entry?</b> | Reverse/reduce the accrual when A/P pays the vendor.   | Reverse the prepaid expense asset and recognize the expense when Harvard receives the goods or services.   | Reverse the prepaid expense asset and recognize the expense when Harvard receives the goods or services.   | Reverse the deposit paid asset when the deposit is returned to Harvard, generally at the end of the lease or other agreement.   |
| <b>What is the reversal entry?</b>           | Process a journal entry:<br>DEBIT accrued expense liability (2191)<br>CREDIT expense (6000-8879)   | Process a journal entry:<br>DEBIT expense code (6000-8879)<br>CREDIT prepaid asset (0540)  | Process a journal entry:<br>DEBIT expense code (6000-8879)<br>CREDIT prepaid asset (0540-0599)   | Process the refund on a credit voucher:<br>DEBIT cash 0010*<br>CREDIT security deposits paid asset (0550)   |
| <b>Examples</b>                              | <ul style="list-style-type: none"> <li>Harvard receives supplies but is not invoiced for them until the following quarter</li> </ul>                               | <ul style="list-style-type: none"> <li>Harvard pays in advance for a \$3,000 piece of equipment that will not be shipped until the following quarter.</li> </ul>                             | <ul style="list-style-type: none"> <li>Harvard pays a deposit on a consulting engagement that will not take place until the following quarter</li> </ul>   | <ul style="list-style-type: none"> <li>Security or other lease-related deposits: record as asset until lease term ends and amount is returned to Harvard</li> </ul>   |

\*Object code 0010 "Cash" is debited on the Central Bank's balance sheet and a due to/from entry is created crediting object code 0375 "CO^Due to/from Tub" on the Central Bank's balance sheet and debiting object code 0375 on the appropriate tub's balance sheet.

## Appendix B: Guide to Expense Recognition by Expense Type

**Tubs are responsible for recording the following types of accrued expenses:**

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| <b>Library purchases</b>                                 | Due to limitations in certain library systems, units must develop processes to ensure purchases are recorded in the correct quarter.  |
| <b>Employee termination costs</b>                        | <p>If an employee is terminated, any termination costs (e.g., severance, enhanced severance, work security, career outplacement fees, training, and other severance-related costs including benefits) that will be paid after the fiscal year-end must be accrued if the following qualifications are met:</p> <ul style="list-style-type: none"> <li>• Notice was given to the employee prior to quarter-end; and</li> <li>• The University does not require the employee to work or otherwise provide services or consultation after quarter-end for more than two months' time.</li> </ul> <p>If a terminated employee continues to work for the University for more than two months during the subsequent quarter-end, a portion of the termination costs may be accrued. Consult Financial Accounting and Reporting in such cases.</p> |
| <b>Extra/additional compensation</b>                     | Extra/additional compensation is not accrued by Central Administration as part of the year-end payroll accrual. To the extent that significant bonuses and other extra/additional compensation paid in July or later relate to the fiscal year ending in June, tubs must record an accrual at year-end. Payments that cross the calendar year may create deferred compensation that has income tax implications to the recipient; contact Tax Reporting for more information.   |
| <b>Insurance</b>   | Insurance accruals must be recorded for policies managed directly by the tubs rather than through the Insurance Office. The accrual should be based upon the number of days/months in the policy period that fall into the current fiscal year as compared to the total contractual term for policies that are billed and paid subsequent to year-end.  |
| <b>Financial Aid</b>                                     | Financial aid expense should be recognized in conjunction with the associated student revenue. See the Revenue Recognition policy, Appendix B.  |
| <b>Fellowships and stipends</b>                          | To the extent that significant fellowships or stipends paid in July or later relate to the fiscal year ending in June, tubs must record an accrual at year-end.   |
| <b>Incurred but not recorded (IBNR) insurance claims</b> | In order to account for the time lag in claims, both the University and UHS record "IBNR accruals." These accruals estimate the amount of claims that will be received in the future relating to the current period. These accruals are recorded on a periodic basis throughout the fiscal year.  |
| <b>Other</b>   | Accruals other than A/P accruals may be reduced as payments are made (i.e. severance or IBNR accruals). If the payment in the subsequent period is more or less than was accrued, the difference will be reflected in the following period's results.   |

**Central Administration is responsible for recording the following accrued expenses for the University:**

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| <b>Quarter-end salaries and wages</b>                           | <p>The portion of the weekly and biweekly payrolls paid in the subsequent month for the previous quarter (e.g., pay date in October for September work days). This accrual depends upon the number of days of pay for the current quarter that are paid in the first payrolls of the next month. For example, if June 30th falls on a Wednesday and seven out of ten days for the first biweekly payroll period of fiscal year 20X2 are within fiscal year 20X1, then 70% of that payroll would be accrued in fiscal year 20X1.</p> <p>This accrual only includes regular, casual and less-than-half-time pay, and excludes other salaries and wages as well as extra compensation.</p> |
| <b>Employee benefits</b>  | <p>Including deferred compensation (savings and investment plans), as well as liabilities associated with the retirement plans, postretirement benefits and other costs.</p>  |
| <b>Paid time off for outstanding employee vacation balances</b> | <p>For most units, the accrual is recorded at the University level based upon PeopleSoft data; certain units may have special processes and make manual accruals at year end. Sick time is not accrued, since employees are not paid for their outstanding balances when they leave the University.</p>   |
| <b>Interest</b>   | <p>On external debt held by the Central Bank.</p>   |
| <b>Insurance</b>  | <p>For policies managed by the Central Insurance Office. The accrual is based upon the number of days/months in the policy period that fall into the current fiscal year for policies that are billed and paid subsequent to year-end</p>   |
| <b>Taxes</b>  | <p>Including taxes associated with payroll, unrelated business income and real property</p>   |
| <b>Legal costs</b>  | <p>For outstanding legal bills and settlements. The Office of the General Counsel accrues both the Central Administration and tub portions of legal costs.</p>  |
| <b>Environmental costs</b>                                      | <p>Including remediation, abatements, etc.</p>  |

**Depending on the particular arrangement with the vendor, either the tubs or Central Administration may be responsible for recording prepaid expense assets, examples of which include:**

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| <p><b>Insurance</b></p>  | <p>Insurance contracts generally cover a one-year period. A prepaid expense asset must be recorded at the quarter-end for the amount of the contract that relates to the next period. This prepaid expense asset must be reduced and recognized as expense proportionately over the contract term. The tubs are responsible for recording prepaid expense assets associated with insurance policies managed directly by them rather than through the Insurance Office. The Insurance Office is responsible for recording prepaid expense assets associated with insurance policies managed by their office.</p>   |
| <p><b>Service and maintenance contracts</b></p>                    | <p>Service and maintenance contracts generally cover a period of time. A prepaid expense asset must be recorded at the quarter-end for the amount of any non-sponsored contract that relates to the next period. This prepaid expense asset must be reduced and recognized as expense proportionately over the contract term.</p> <p>Certain service agreements (e.g., for consulting or systems implementations) may contain milestones (i.e., significant dates) to which payments are tied. In these cases, Financial Accounting and Reporting and the local tub finance office must be consulted regarding the timing of recording prepaid expense assets and recognizing the related expenses.</p> |
| <p><b>Expenses for summer and executive education programs</b></p> | <p>Any direct expenses (i.e., not indirect costs, such as marketing expenses) that relate to a summer school or executive education program must be recognized proportionately over the term of the program. Therefore, payments relating to the following quarter must be recorded as prepaid expense assets at quarter-end; these prepaid expense assets would subsequently be reduced and the associated expense would be recognized in the following fiscal period(s).</p>  |
| <p><b>Rent and equipment lease payments</b></p>                    | <p>Rent payments for space and equipment leases are often made prior to the beginning of each month. These prepayments must be recorded as prepaid expense assets at quarter-end and then reversed and recognized as expense in the subsequent period(s), when the rental services are provided.</p>  |

## Appendix C: Examples of Proper Expense Recognition Accounting

### Example: Accounting for Accrued Expenses

**Example 1. The Commencement Office does not receive a bill for the Commencement tent rental prior to the year-end Accounts Payable close.**

| Fiscal year 20X1  | Fiscal year 20X2  |
|---|---|
| Debit/charge object code 6773:<br>Rentals, Short Term^ Rentals of Equipment,<br>Furniture+Fixtures, GENERAL | Debit/charge object code 2191:<br>A/P Closing Accruals  |
| Credit object code 2191:<br>A/P Closing Accruals  | Credit object code 6773:<br>Rentals, Short Term^ Rentals of Equipment,<br>Furniture+Fixtures, GENERAL |

The tent rental expense and any known installation or other related costs must be accrued. The amounts of these costs are determined by contacting the vendor or by calculating an estimate based upon the terms of the rental contract. The entry is recorded as of June 30, 20X1 and reversed in fiscal year 20X2, when the rental company's invoice will be paid. When the rental company's invoice is paid in fiscal year 20X2, it would be charged to the same expense object code used in the accrual. The net effect of these transactions is to record the expense in fiscal 20X1 and zero out the expense in fiscal year 20X2, when the payment is made.

### Example: Accounting for Prepaid Expenses

**Example 1: Radcliffe enters into a six-month software maintenance agreement. When the initial payment is made in April of 20X1, it is fully expensed to object code 8092, "Software^Hardware, Software+Network Fees, Repairs, Maintenance Svcs." At the end of June, three months of the contract term remain.**

*A prepaid expense asset must be recorded for half of the payment amount, given that three out of six months remain in the contract term. The entry is recorded as of June 30, 20X1 and reversed in fiscal year 20X2, when the remaining services will be provided. The net effect of the following two entries is to recognize the expense over the term of the agreement: three months' worth in fiscal year 20X1 and three months' worth in fiscal year 20X2.*

| Fiscal year 20X1   | Fiscal year 20X2   |
|--|--|
| Debit/charge object code 0540:<br>Prepaid+Accrued Items  | Debit/charge object code 8092:<br>Software^Hardware, Software+Network Fees,<br>Repairs, Maintenance Svcs |
| Credit object code 8092:<br>Software^Hardware, Software+Network Fees,<br>Repairs, Maintenance Svcs | Credit object code 0540:<br>Prepaid+Accrued Items  |

Alternatively, Radcliffe could have initially charged half of the payment to object code 8092, "Software^Hardware, Software+Network Fees, Repairs, Maintenance Svcs" and half to object code 0540, "Prepaid+Accrued Items," thereby recording the prepaid expense asset upon payment and avoiding the need to record a journal entry at year-end. If the prepaid expense asset were recorded in this manner, a separate entry would need to be recorded after year-end to recognize the remaining three months of expense in fiscal year 20X2 and reduce the prepaid expense asset.

**Example: Accounting for Deposits Paid**

**Example 1: HRES rents overflow office space. The rental agreement requires a security deposit of \$10,000. HRES expenses the security deposit payment to object code 7230, "Rentals+Leases of Space, GENERAL." The following entry is recorded to move the payment to object code 0550, "Security Deposits Paid."**

|  |  |
|--|--|
| Debit/charge object code 0550:<br>Security Deposits Paid | Credit object code 7230:<br>Rentals+Leases of Space, GENERAL |
|--|--|

This amount must be recorded as a deposit asset upon payment or no later than quarter-end. Alternatively, HRES could have initially charged the payment to object code 0550, "Security Deposits Paid," thereby recording the deposit asset appropriately upon payment and avoiding the need to record a journal entry at quarter-end.

When a security deposit is returned to the University, HRES would fill out a Credit Voucher and submit it to the Cash Receipts department to credit the deposit to object code 0550, "Security Deposits Paid" in order to reduce the deposit asset.

**Example 2: The Medical School leases an MRI machine from Brigham & Women's Hospital (BWH). In connection with this lease, BWH requires a deposit of \$10,000. The Medical School pays the deposit amount in February of 20X1 and charges the payment to object code 0550, "Security Deposits Paid."**

|  |   |
|--|---|
| Debit/charge object code 0550:<br>Security Deposits Paid | Credit object code 0010*:<br>Cash (automatically credited when the payment is made) |
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This amount was correctly recorded as a deposit asset upon payment. If the Medical School had initially charged the payment to an expense object code, the Medical School would have needed to process a journal entry to credit the expense and debit the security deposit asset prior to quarter-end.

When the security deposit is returned to the University, the Medical School would instruct the Cash Receipts department to credit the deposit to object code 0550, "Security Deposits Paid" in order to reduce the deposit asset.

\*Object code 0010 "Cash" is debited on the Central Bank's balance sheet and a due to/from entry is created crediting object code 0375 "CO^Due to/from Tub" on the Central Bank's balance sheet and debiting object code 0375 on the appropriate tub's balance sheet.