Basic Financials for The Education Business

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CEdMA Workshop

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Topics

- Introduction and Objectives
- Speaking Financial Language –Terminology
  - Revenue
  - Sales & Unearned Revenue
  - Revenue Recognition
  - Expense and Expense Types
  - Profit, Margin
  - P&L Statement
- Typical Education Business Models, Implications, and Measurements
  - Cost Center, Cost Recovery, Profit Center
- Impact of Recent Legislation

Introduction and Objectives

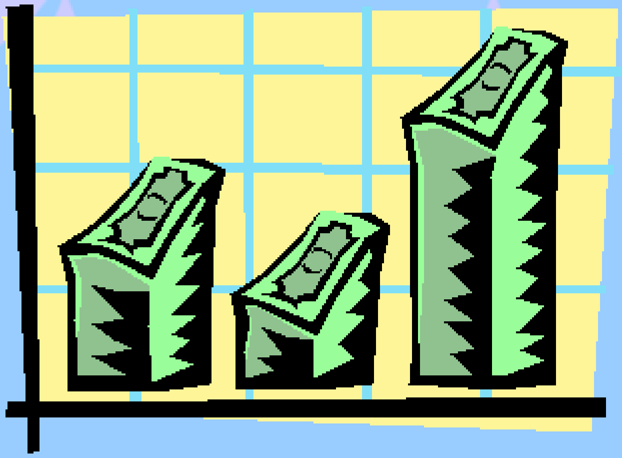
- Acknowledgements
  - Jesse Finn, formerly Interwoven now Taleo
- *Objectives*
  - Understand GAAP = Generally Accepted Accounting Practices, per Education
  - Learn What to Clarify with Your Finance Team - Each Company's Finance group overlays their own practices
  - Acquire Ideas for ROI and Measurements to Gain Credibility

Terminology: Revenue

- REVENUE = Money received in exchange for <u>services rendered</u> or <u>products delivered</u>.
- To recognize Revenue, the sale must be both
  - CERTAIN
  - MEASUREABLE

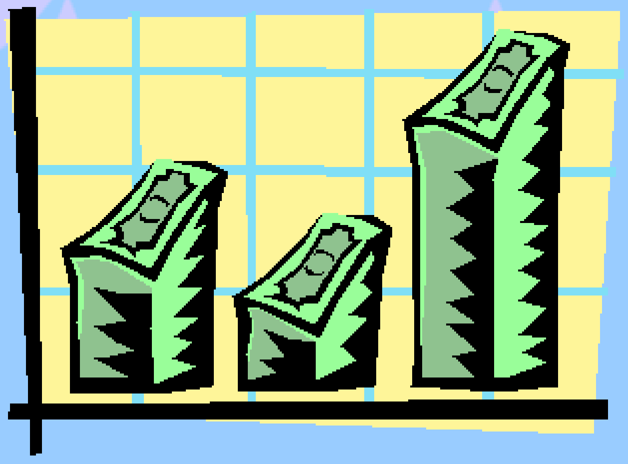
Terminology: Sales and Unearned Revenue

- Sales Order = Contract between buyer and seller that gives the transaction
    - CERTAINTY
    - MEASUREABILITY
- “Booking” versus Revenue
  – Sales Order Signed
  – Commitment
- Unearned Revenue
  – Deferred Revenue
  – Prepaid Training
  – Volume PO
  – Backlog
- Each Finance Group establishes policies for treatment of unearned revenue



Terminology: Revenue Recognition

- Earned Revenue
- Education Revenue Recognition based on:
  - Delivery of the Class/Service
  - Shipment of Courseware
  - Value of Offering Transferred
- Delivery of the Service or Product has Occurred
- Value Transfer Has Commenced
- Deferred Revenue – some differences in recognition methods



Terminology: Expense

- EXPENSE = Money spent for the purpose of generating revenue
- Different Expense Types
  - Cost of Sales
    - Labor and materials costs associated with the delivery of goods/services
  - Operating Expense (OPEX)
    - Indirect costs, I.e. marketing, curriculum development, SG&A
  - Capital Expenses
    - Depreciation, amortization
- Expense Types can be Viewed Differently Department Level versus Corporate Level

Terminology: Profit and Margin

- PROFIT = Revenue minus Expense
  - Gross Profit = Revenue – COS
  - Operating Profit = Gross Profit – OPEX

    Frequently termed Margin
  - Net Profit = Operating Profit – Non operating expenses
- MARGIN as $$ Contribution or %
- What is Your Department giving back to the Company in $$ or as a % of Revenue

Terminology: Typical P&L Statement for Education Business

P & L Statement Covers a Period of Time for the Business

Revenue	$20m
COS (ex. Royalties)	($ 2m)
Net Revenue or Gross Margin	$18m
Operating Expense	($12m)
Salaries/Benefits	
Equipment/Facilities	
Development, etc.	
Operating Margin	$ 6m
Other income (expense)	($ 1m)
Net Margin	$ 5m
Margin %	25%

Sample Business Models, Implications, and Measurements

Business Model: Cost Center

- Company has budgeted for Expense of Education, not Revenue
- Fixed Budget
- Often each activity measured per its associated expense
- ROI of the expense is realized outside the department
- Department value indirect and harder to quantify

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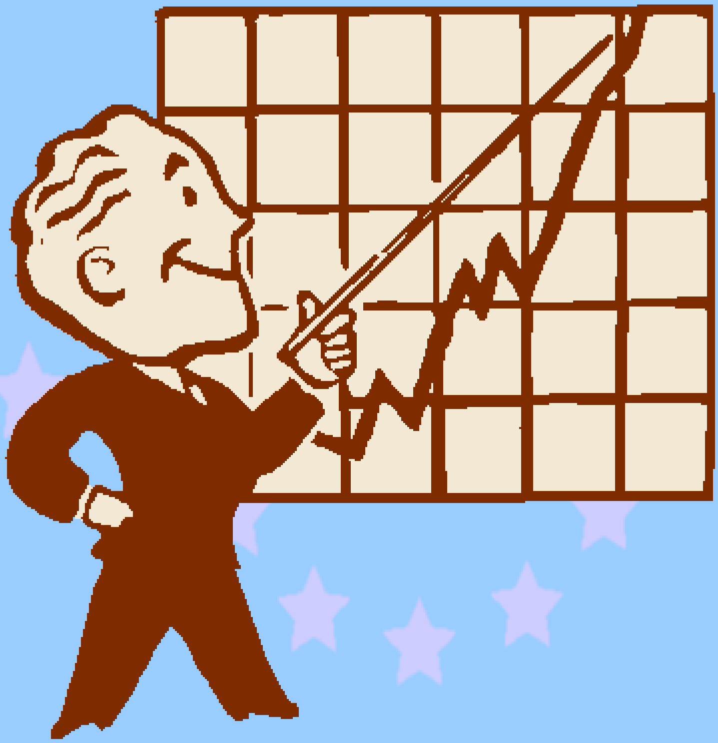
Measurements: Cost Center

- Students Trained
- Student Days Trained
- Courses/Course Days Developed (ILT, eLearning)
- Courses/Course Days Delivered (ILT, eLearning)
- Satisfaction Levels, Level One Evals
- Utilization

Desirable:

- Readiness for New Tasks
- Application of New Skills
- Increased Business Results: Productivity, Revenue, Pipeline, etc?



Business Model: Cost Recovery

- Company has budgeted for Expense of Education, and sometimes Revenue
- Departmental Margin Target or Break Even
- Expense offsets realized from “funded” activity at “cost”
- Ensure “opportunity cost” recovery as appropriate
- ROI of the expense is often realized outside the department <u>and</u> within

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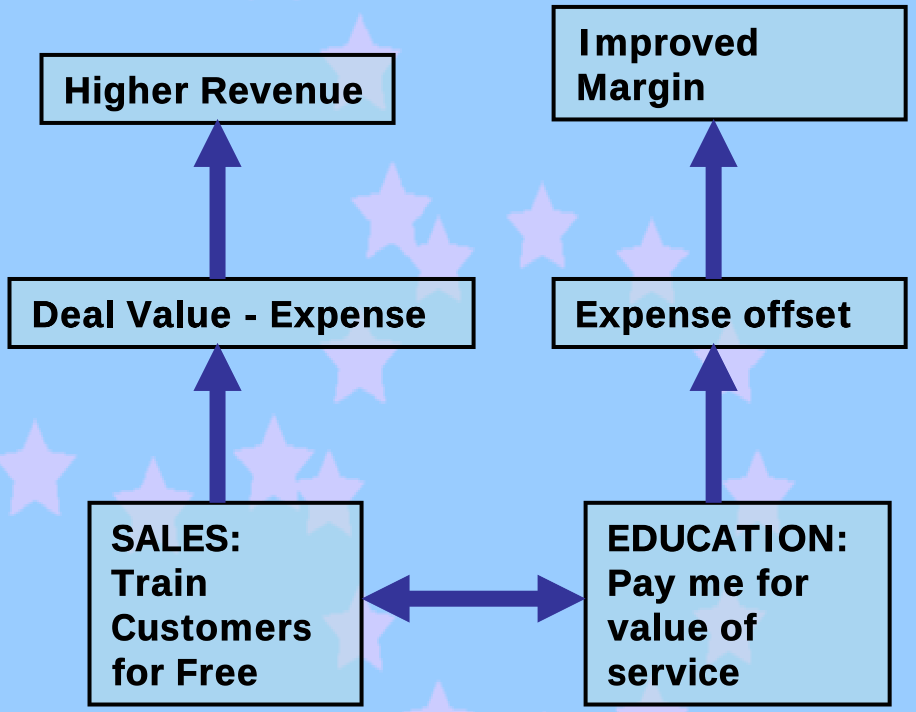


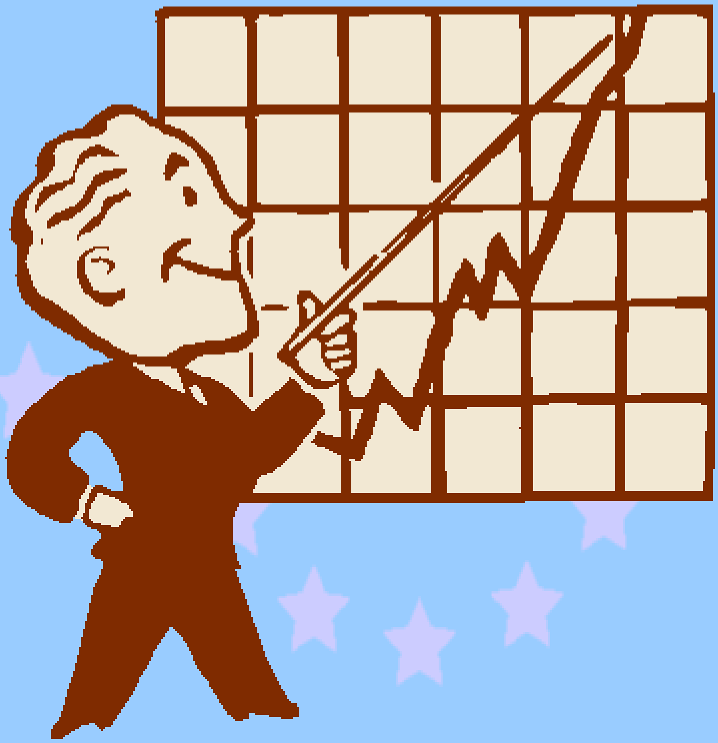
Did you cover costs?

Measurements: Cost Recovery

- Break Even or Better
- Payback period
- Students Trained
- Courses/Course Days Developed (ILT, eLearning)
- Courses/Course Days Delivered (ILT, eLearning)

Desirable:

- Increased Business Results of Target Program: Productivity, Revenue, Greater Pipeline, etc?



Business Model: Profit Center

- Company has budgeted for Revenue, Expense and expected Margin: Self Funding
- Revenue and Margin rule – sales engine required
- Utilize cost recovery when possible - Opportunity cost more frequent
- Fully loaded expense a consideration in setting targets
- Primary ROI is realized <u>inside</u> the department and monitored/contributed outside

Business Model: Profit Center

- Company has budgeted for Revenue, Expense and expected Margin: Self Funding
- Revenue and Margin rule - sales engine required
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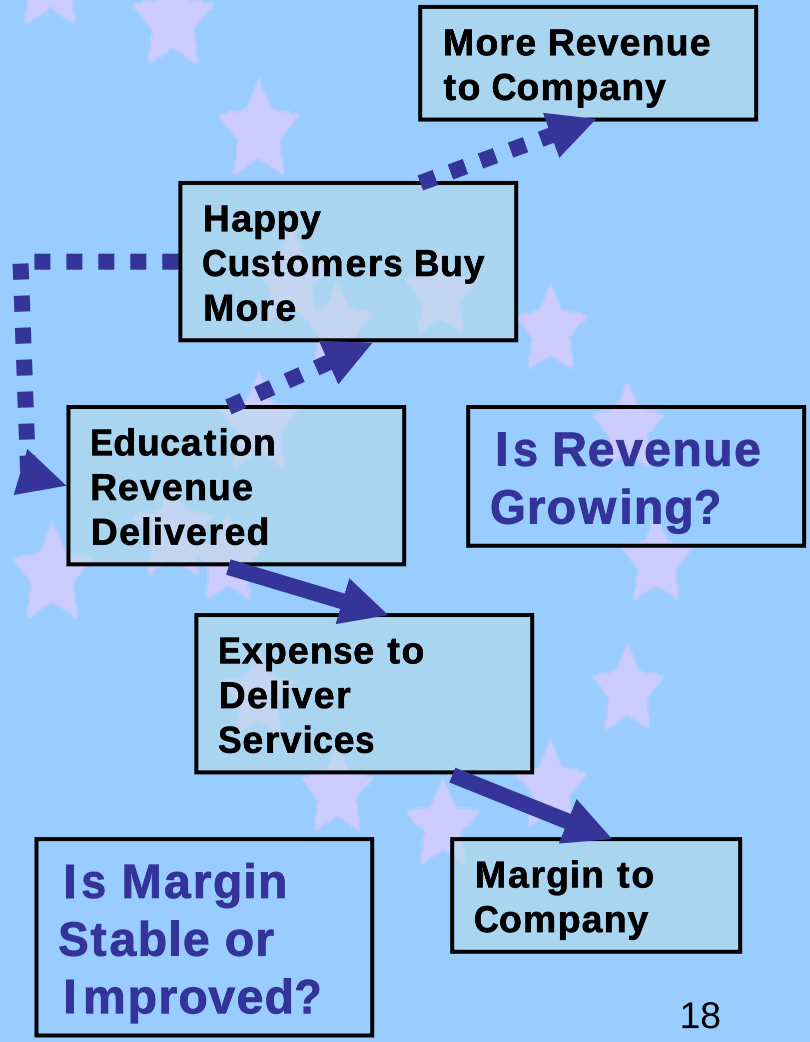
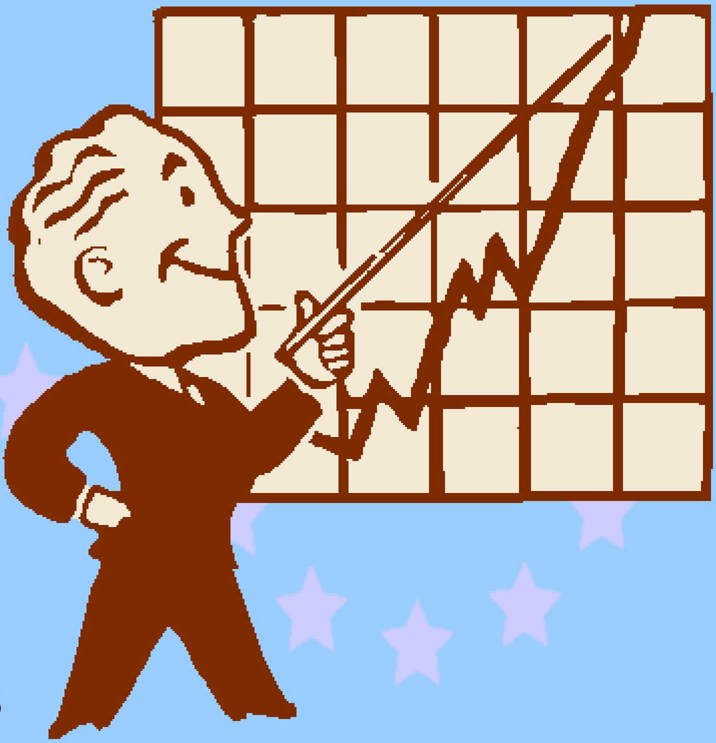
- Revenue Recognition methods *
- Primary ROI is realized <u>inside</u> the department and monitored/contributed outside



Measurements: Profit Center

- Revenue, per Plan, Current and YOY
- Margin, per Plan, Current and YOY
- Revenue per Headcount, per Billable Headcount, per Instructor Day, etc.
- Backlog
- Utilization, all Resources
- Courses/Course Days Delivered
- Student Days
- Customer Satisfaction
  - Level 1 Evals
  - Readiness for New Tasks
  - Application of New Skills
- Increased Business Results – Sales Add-ons, Customer Results



Measurements: VSOE

- VSOE = Vendor Specific Objective Evidence
- Refers to: level of discounting represented in sales history
- VSOE level set as result of audits
- Services $ giveaways > VSOE must be carved out of license revenue, given to services
- Accurate representation of company’s expense to get the deal and the real value of the license revenue
- **Critical to the Education Profit Center**

Impact of Recent Legislation on Education Businesses

SOX - Sarbanes Oxley, Section 404

- What It Is:

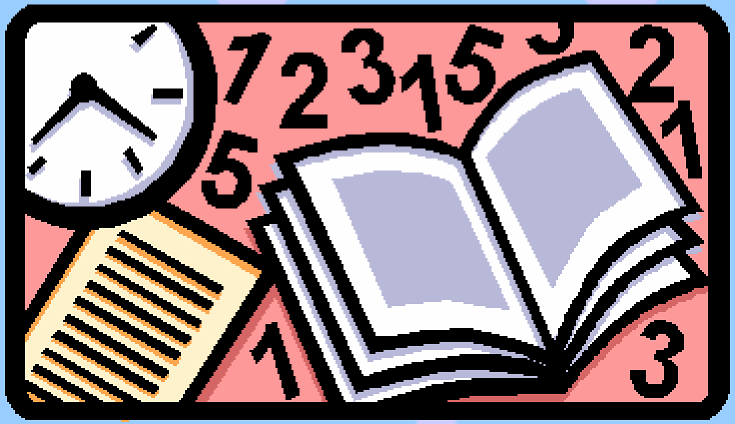
- Regulation stipulating the establishment and use of consistent processes in invoicing and reporting business financial transactions
- Procedure for proving compliance

- What It’s Not:

- Specific rules about how to process business transactions
- Concerned with size of transaction, size of customer

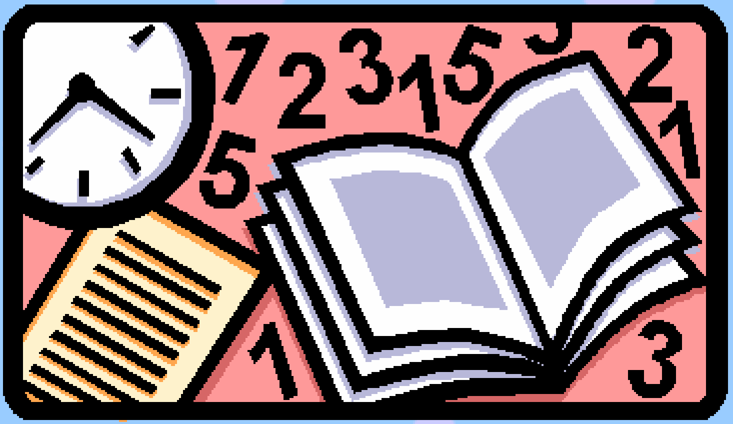
SOX – Sarbanes Oxley, Section 404

- A Company Must:
  - Have established, documented processes for all transactions
  - Apply and execute those processes consistently
  - Be able to prove that they applied the processes consistently



SOX – Impact on Education Business

- Must have processes for recording and invoicing transactions
  - Makes an LMS or LCMS more important
- You and Finance will document how you process revenue & expense
- You must be able to prove that rules were applied consistently for types of business
- Your Finance team will apply its processes to your business
- New programs will require process agreement



Summary

- Work with your Finance & Accounting Team
  - Understand how they apply GAAP to your business
  - Get clarification where you want and need it
  - Build ROI and measurements to present and gain advocacy

- **Questions?**

- Thank You!