

Notes to Consolidated Financial Statements

(Table amounts in thousands, except per share data)

1. Nature of Operations

Agilysys is a leading technology company that provides innovative software for point-of-sale (POS), property management, inventory and procurement, workforce management, analytics, document management and mobile and wireless solutions and services to the hospitality industry. Our solutions and services allow property managers to better connect, interact and transact with their customers and enhance their customer relationships by streamlining operations, improving efficiency, increasing guest recruitment and wallet share, and enhancing the overall guest experience. We serve four major market sectors: Gaming, both corporate and tribal; Hotels, Resorts and Cruise; Foodservice Management; and Restaurants, Universities, Stadia and Healthcare. A significant portion of our consolidated revenue is derived from contract support, maintenance and subscription services.

We operate throughout North America, Europe and Asia, with corporate services located in Alpharetta, GA, and offices in Singapore, Hong Kong and Malaysia.

The sales of our RSG business and UK entity each represented a disposal of a component of an entity. As such, the operating results of RSG and the UK entity have been reported as a component of discontinued operations in the Condensed Consolidated Statement of Operations and the Condensed Consolidated Statement of Cash Flows for the twelve months ended March 31, 2014 and 2013.

Reference herein to any particular year or quarter refers to periods within the fiscal year ended March 31. For example, fiscal 2015 refers to the fiscal year ended March 31, 2015.

2. Summary of Significant Accounting Policies

Principles of consolidation. The consolidated financial statements include the accounts of Agilysys, Inc. and subsidiaries. Investments in affiliated companies are accounted for by the equity or cost method, as appropriate. All inter-company accounts have been eliminated. Unless otherwise indicated, amounts in Notes to Consolidated Financial Statements refer to continuing operations.

Use of estimates. Preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles ("GAAP") requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reported periods. Actual results could differ from those estimates.

Cash and cash equivalents. We consider all highly liquid investments purchased with an original maturity from date of acquisition of three months or less to be cash equivalents. Other highly liquid investments considered cash equivalents with no established maturity date are fully redeemable on demand (without penalty) with settlement of principal and accrued interest on the following business day after instruction to redeem. Such investments are readily convertible to cash with no penalty and can include certificates of deposit, commercial paper, treasury bills, money market funds and other investments.

Allowance for doubtful accounts. We maintain allowances for doubtful accounts for estimated losses resulting from the inability or unwillingness of our customers to make required payments. These allowances are based on both recent trends of certain customers estimated to be a greater credit risk as well as historic trends of the entire customer pool. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. To mitigate this credit risk we perform periodic credit evaluations of our customers.

Inventories. Our inventories are comprised of finished goods. Inventories are stated at the lower of cost or market, net of related reserves. The cost of inventory is computed using a weighted-average method. Our inventory is monitored to ensure appropriate valuation. Adjustments of inventories to the lower of cost or market, if necessary, are based upon contractual provisions such as turnover and assumptions about future demand and market conditions. If assumptions about future demand change and/or actual market conditions are less favorable than those projected by management, additional adjustments to inventory valuations may be required. We provide a reserve for obsolescence, which is calculated based on several factors, including an analysis of historical sales of products and the age of the inventory. Actual amounts could be different from those estimated.

Goodwill and Other Indefinite-Lived Intangible Assets. Goodwill represents the excess purchase price paid over the fair value of the net assets of acquired companies. Goodwill is subject to impairment testing at least annually, unless it is determined after a qualitative assessment that it is more likely than not that the fair value of the reporting unit is greater than its carrying amount. Goodwill is

measured for impairment on an annual basis, or in interim periods if indicators of potential impairment exist. The Company is also required to compare the fair values of other indefinite-lived intangible assets to their carrying amounts at least annually, or when current events and circumstances require an interim assessment. If the carrying amount of an indefinite-lived intangible asset exceeds its fair value, an impairment loss is recognized.

For fiscal 2015 and 2014, we conducted a qualitative assessment (Step Zero Analysis) to determine whether it would be necessary to perform step one of the two-step goodwill impairment test. It was determined based on the Step Zero Analysis that it is more likely than not that the fair value exceeded the carrying amount as of February 1, 2015. Additional information regarding our goodwill and impairment analyses is provided in Note 7, *Goodwill and Intangible Assets*.

We had two indefinite-lived intangible assets relating to purchased trade names. During the fourth quarter of fiscal 2015, one of the two trade names was determined to have a finite life and subsequently written down to its fair value to be amortized over five years. The remaining indefinite-lived intangible asset is not amortized; rather, it is tested for impairment at least annually by comparing the carrying amount of the asset with the fair value. An impairment loss is recognized if the carrying amount is greater than fair value. The income approach using “the relief from royalty method” was used to value the trade names as of February 1, 2015. Additional information regarding our intangible assets and impairment analyses is provided in Note 7, *Goodwill and Intangible Assets*.

Intangible assets. Purchased intangible assets with finite lives are primarily amortized using the straight-line method over the estimated economic lives of the assets. Purchased intangible assets relating to customer relationships are amortized using an accelerated or straight-line method, which reflects the period the asset is expected to contribute to the future cash flows. Our finite-lived intangible assets are amortized over periods between two and eight years. Customer relationships are amortized over estimated useful lives between two and seven years; non-competition agreements are amortized over estimated useful lives between two and eight years; developed technology is amortized over estimated useful lives between three and eight years; supplier relationships are amortized over estimated useful lives between two and eight years.

Long-lived assets. Property and equipment are recorded at cost. Major renewals and improvements are capitalized. Minor replacements, maintenance, repairs, and reengineering costs are expensed as incurred. When assets are sold or otherwise disposed of, the cost and related accumulated depreciation are eliminated from the accounts and any resulting gain or loss is recognized.

Depreciation and amortization are provided in amounts sufficient to amortize the cost of the assets, including assets recorded under capital leases, which make up less than one percent of total assets, over their estimated useful lives using the straight-line method. The estimated useful lives for depreciation and amortization are as follows: buildings and building improvements - 7 to 30 years; furniture - 7 to 10 years; equipment - 3 to 10 years; software - 3 to 10 years; and leasehold improvements over the shorter of the economic life or the lease term. Internal use software costs are expensed or capitalized depending on the project stage. Amounts capitalized are amortized over the estimated useful lives of the software, ranging from 3 to 10 years, beginning with the project's completion. Capitalized project expenditures are not depreciated until the underlying project is completed.

We evaluate the recoverability of our long-lived assets whenever changes in circumstances or events may indicate that the carrying amounts may not be recoverable. An impairment loss is recognized in the event the carrying value of the assets exceeds the future undiscounted cash flows attributable to such assets.

Foreign currency translation. The financial statements of our foreign operations are translated into U.S. dollars for financial reporting purposes. The assets and liabilities of foreign operations whose functional currencies are not in U.S. dollars are translated at the period-end exchange rates, while revenue and expenses are translated at weighted-average exchange rates during the fiscal year. The cumulative translation effects are reflected as a component of “Accumulated other comprehensive loss” within shareholders' equity in the Consolidated Balance Sheets. Gains and losses on monetary transactions denominated in other than the functional currency of an operation are reflected within “Other (income) expenses, net” in the Consolidated Statements of Operations. Foreign currency gains and losses from changes in exchange rates have not been material to our consolidated operating results.

Revenue recognition. We derive revenue from the sale of products (i.e., server, storage, and point of sale hardware, and software), support, maintenance and subscription services and professional services. Revenue is recorded in the period in which the goods are delivered or services are rendered and when the following criteria are met: persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the sales price to the customer is fixed or determinable, and collection is reasonably assured. We reduce revenue for estimated discounts, sales incentives, estimated customer returns, and other allowances. Discounts are offered based on the volume of products and services purchased by customers. Shipping and handling fees billed to customers are recognized as revenue and the related costs are recognized in cost of goods sold. Revenue is recorded net of any applicable taxes collected and remitted to governmental agencies.

We frequently enter into multiple-element arrangements with customers including hardware, software, professional consulting services and maintenance support services. For arrangements involving multiple deliverables, when deliverables include software and non-

software products and services, we evaluate and separate each deliverable to determine whether it represents a separate unit of accounting based on the following criteria: (a) the delivered item has value to the customer on a stand-alone basis; and (b) if the contract includes a general right of return relative to the delivered item, delivery or performance of the undelivered items is considered probable and substantially in our control.

Consideration is allocated to each unit of accounting based on the unit's relative selling prices. In such circumstances, we use a hierarchy to determine the selling price to be used for allocating revenue to each deliverable: (i) vendor-specific objective evidence of selling price (VSOE), (ii) third-party evidence of selling price (TPE), and (iii) best estimate of selling price (BESP). VSOE generally exists only when we sell the deliverable separately and is the price actually charged by us for that deliverable. VSOE is established for our software maintenance services and we use TPE or BESP to establish selling prices for our non-software related services. BESP is primarily used for elements that are not consistently priced within a narrow range or TPE is not available. We determine BESP for a deliverable by considering multiple factors including product class, geography, average discount, and management's historical pricing practices. Amounts allocated to the delivered hardware and software elements are recognized at the time of sale provided the other conditions for revenue recognition have been met. Amounts allocated to the undelivered maintenance and other services elements are recognized as the services are provided or on a straight-line basis over the service period. In certain instances, customer acceptance is required prior to the passage of title and risk of loss of the delivered products. In such cases, revenue is not recognized until the customer acceptance is obtained. Delivery and acceptance generally occur in the same reporting period.

In situations where our solutions contain software that is more than incidental, revenue related to the software and software-related elements is recognized in accordance with authoritative guidance on software revenue recognition. For the software and software-related elements of such transactions, revenue is allocated based on the relative fair value of each element, and fair value is determined by VSOE. If we cannot objectively determine the fair value of any undelivered element included in such multiple-element arrangements, we defer revenue until all elements are delivered and services have been performed, or until fair value can objectively be determined for any remaining undelivered elements. When the fair value of a delivered element has not been established, but fair value exists for the undelivered elements, we use the residual method to recognize revenue. Under the residual method, the fair value of the undelivered elements is deferred and the remaining portion of the arrangement fee is allocated to the delivered elements and is recognized as revenue.

Revenue recognition for complex contractual arrangements, especially those with multiple elements, requires a significant level of judgment and is based upon a review of specific contracts, past experience, the selling price of undelivered elements when sold separately, creditworthiness of customers, international laws and other factors. Changes in judgments about these factors could impact the timing and amount of revenue recognized between periods.

Revenue for hardware sales is recognized when the product is shipped to the customer and when obligations that affect the customer's final acceptance of the arrangement have been fulfilled. A majority of our hardware sales involves shipment directly from its suppliers to the end-user customers. In these transactions, we are responsible for negotiating price both with the supplier and the customer, payment to the supplier, establishing payment terms and product returns with the customer, and we bear the credit risk if the customer does not pay for the goods. As the principal contact with the customer, we recognize revenue and cost of goods sold when we are notified by the supplier that the product has been shipped. In certain limited instances, as shipping terms dictate, revenue is recognized upon receipt at the point of destination or upon installation at the customer site.

We offer proprietary software as well as remarketed software for sale to our customers. We offer our customers the right to license the software under a variety of models. Our customers can license our software under a perpetual model for an upfront fee or a subscription model. For subscription arrangements, we allow customers the right to use software, receive unspecified products as well as unspecified upgrades and enhancements and entitle the customer to receive hosting services for a specified term. The subscription revenue is generally recognized ratably over the term of the arrangement, typically three to five years. Revenue from subscription service arrangements is included in Support, maintenance and subscription services in the Consolidated Statements of Operations. A majority of our software sales do not require significant production, modification, or customization at the time of shipment (physically or electronically) to the customer. Substantially all of our software license arrangements do not include acceptance provisions. As such, revenue from both proprietary and remarketed software sales is typically recognized when the software has been shipped. For software delivered electronically, delivery is considered to have occurred when the customer either takes possession of the software via downloading or has been provided with the requisite codes that allow for immediate access to the software based on the U.S. Eastern time zone time stamp.

We also offer proprietary and third-party services to our customers. Proprietary services generally include: consulting, installation, integration and training. Many of our software arrangements include consulting services sold separately under consulting engagement contracts. When the arrangements qualify as service transactions, consulting revenue from these arrangements are accounted for separately from the software revenue. The significant factors considered in determining whether the revenue should be accounted for separately include the nature of the services (i.e., consideration of whether the services are essential to the functionality of the software), degree of risk, availability of services from other vendors, timing of payments, and the impact of milestones or other

customer acceptance criteria on revenue realization. If there is significant uncertainty about the project completion or receipt of payment for consulting services, the revenue is deferred until the uncertainty is resolved.

For certain long-term proprietary service contracts with fixed or “not to exceed” fee arrangements, we estimate proportional performance using the hours incurred as a percentage of total estimated hours to complete the project consistent with the percentage-of-completion method of accounting. Accordingly, revenue for these contracts is recognized based on the proportion of the work performed on the contract. If there is no sufficient basis to measure progress toward completion, the revenue is recognized when final customer acceptance is received. Adjustments to contract price and estimated service hours are made periodically, and losses expected to be incurred on contracts in progress are charged to operations in the period such losses are determined. The aggregate of collections on uncompleted contracts in excess of related revenue is shown as a current liability

If an arrangement does not qualify for separate accounting of the software and consulting services, then the software revenue is recognized together with the consulting services using the percentage-of-completion or completed contract method of accounting. Contract accounting is applied to arrangements that include: milestones or customer-specific acceptance criteria that may affect the collection of revenue, significant modification or customization of the software, or provisions that tie the payment for the software to the performance of consulting services.

We also offer proprietary and third-party support to our customers. Support generally includes: support and maintenance of software and hardware products and subscription services. Revenue relating to proprietary support services is recognized evenly over the coverage period of the underlying agreement within support, maintenance and subscription revenue. In instances where we offer third-party support contracts to our customer, and the supplier is determined to be the primary obligor in the transaction, we report revenue at the time of the sale, only in the amount of the “commission” (equal to the selling price less the cost of sale) received rather than reporting revenue in the full amount of the selling price with separate reporting of the cost of sale.

Comprehensive (loss) income. Comprehensive (loss) income is the total of net (loss) income, as currently reported under GAAP, plus other comprehensive (loss) income. Other comprehensive (loss) income considers the effects of additional transactions and economic events that are not required to be recorded in determining net (loss) income, but rather are reported as a separate statement of comprehensive (loss) income.

Fair value measurements. We measure the fair value of financial assets and liabilities on a recurring or non-recurring basis. Financial assets and liabilities measured on a recurring basis are those that are adjusted to fair value each time a financial statement is prepared. Financial assets and liabilities measured on a non-recurring basis are those that are adjusted to fair value when a significant event occurs. In determining fair value of financial assets and liabilities, we use various valuation techniques. Additional information regarding fair value measurements is provided in Note 16, *Fair Value Measurements*.

Investments in corporate-owned life insurance policies and marketable securities. Agilysys invests in corporate-owned life insurance policies and has historically invested in marketable securities primarily to satisfy future obligations of our employee benefit plans, including a benefit equalization plan (“BEP”) and supplemental executive retirement plan (“SERP”). Certain of these corporate-owned life insurance policies were held in a Rabbi Trust and were classified within “Other non-current assets” in the Consolidated Balance Sheets. Our investment in corporate-owned life insurance policies were recorded at their cash surrender value, which approximates fair value, at the balance sheet date. All obligations related to our employee benefit plans, BEP and SERP, were fulfilled in April 2012 with funds held in the Rabbi Trust.

Certain of these corporate-owned life insurance policies are endorsement split-dollar life insurance arrangements. We entered into a non-cancelable separate agreement with each of the former executives covered by these arrangements whereby we must maintain the life insurance policy for the specified amount and split a portion of the policy benefits with the former executive's designated beneficiary.

Additional information regarding the investments in corporate-owned life insurance policies and marketable securities is provided in Note 12, *Employee Benefit Plans*.

Income Taxes. Income tax expense includes U.S. and foreign income taxes and is based on reported income before income taxes. We recognize deferred tax assets and liabilities based on the differences between the financial statement carrying amounts and the tax basis of assets and liabilities. The deferred tax assets and liabilities are determined based on the enacted tax rates expected to apply in the periods in which the deferred tax assets or liabilities are anticipated to be settled or realized.

We regularly review our deferred tax assets for recoverability and establish a valuation allowance if it is more likely than not that some portion or all of a deferred tax asset will not be realized. The determination as to whether a deferred tax asset will be realized is made on a jurisdictional basis and is based on the evaluation of positive and negative evidence. This evidence includes historical

taxable income, projected future taxable income, the expected timing of the reversal of existing temporary differences and the implementation of tax planning strategies.

We recognize the tax benefit from uncertain tax positions only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized from uncertain tax positions are measured at the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. No tax benefits are recognized for positions that do not meet this threshold. Interest related to uncertain tax positions is recognized as part of the provision for income taxes and is accrued beginning in the period that such interest would be applicable under relevant tax law until such time that the related tax benefits are recognized. Our income taxes are described further in Note 11, *Income Taxes*.

Changes to Prior Period Presentation. In the first quarter of fiscal 2014, as a result of increased visibility into our services organization, certain costs previously classified in product development expenses were recorded in cost of goods sold to more properly reflect the nature of these expenses. The portion of these expenses that was erroneously recorded in previous periods was immaterial to the overall financial statements. Prior period presentation has been modified to conform to the current presentation.

Correction of Error. During the first quarter of fiscal 2013, we recorded out-of-period adjustments to increase revenues, restructuring, severance and other charges and asset write-offs and other fair value adjustments by \$0.3 million, \$0.7 million and \$0.2 million, respectively. The net impact of the adjustments increased our operating loss by \$0.6 million, or \$(0.03) per share, and represents a correction of error. In fiscal 2012, we erroneously omitted certain revenue transactions, the costs associated with certain terminated individuals and certain third party development costs for our previously impaired developed technology. Management performed an evaluation under Staff Accounting Bulletin No. 108 and concluded the effect of the adjustment was immaterial to prior year's financial statements as well as the full-year fiscal 2013 financial statements.

Capitalized Software Development Costs. The capitalization of software development cost for external use begins when a product's technological feasibility has been established. Capitalization ends when the resulting product is available for general market release. Amortization of the capitalized software is classified within products cost of goods sold in the Consolidated Statements of Operations. For each capitalized software product, the annual amortization is equal to the greater of: (i) the amount computed using the ratio that the software product's current fiscal year gross revenue bears to the total current fiscal year and anticipated future gross revenues for that product or (ii) the amount computed based on straight-line method over the remaining estimated economic life of the product, which is a range between three and eight years. The amount by which unamortized software costs exceeds the net realizable value, if any, is recognized as a charge to income in the period it is determined. We capitalized approximately \$17.2 million, \$13.7 million and \$4.9 million during fiscal 2015, 2014 and 2013, respectively. Amortization of non-acquired developed capitalized software was \$1.2 million, \$0.2 million and \$0.1 million during fiscal 2015, 2014 and 2013, respectively.

Adopted and Recently Issued Accounting Pronouncements.

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers*, which converges the FASB and the International Accounting Standards Board standard on revenue recognition. Areas of revenue recognition that will be affected include, but are not limited to, transfer of control, variable consideration, allocation of transfer pricing, licenses, time value of money, contract costs and disclosures. This is effective for the fiscal years and interim reporting periods beginning after December 15, 2016. In April 2015, the FASB voted for a one-year deferral of the effective date of the new revenue recognition standard. Transition to the new guidance may be done using either a full or modified retrospective method. We are currently evaluating the impact that the adoption of ASU 2014-09 will have on our consolidated financial statements or related disclosures.

In April 2014, FASB issued ASU No. 2014-08, *Presentation of Financial Statements and Property, Plant and Equipment: Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity*, which requires only disposals representing a strategic shift in operations that have a major effect on operations and financial results to be presented as discontinued operations. The guidance also requires expanded financial disclosures about discontinued operations and significant disposals that do not qualify as discontinued operations. This is effective for the fiscal years and interim reporting periods beginning after December 15, 2014. The adoption of the ASU did not have any impact on our financial statements.

In July 2013, FASB issued ASU No. 2013-11, *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*. ASU 2013-11 clarifies guidance and eliminates diversity in practice on the presentation of unrecognized tax benefits when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists at the reporting date. This new guidance is effective on a prospective basis for fiscal years and interim reporting periods within those years, beginning after December 15, 2013. We adopted the provisions of ASU 2013-11 beginning April 1, 2014. The adoption of the ASU did not have any impact on our financial statements.