ILLINOIS
Gies College of Business

Financial Accounting

Module 3 Cases

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QUESTION 1-1: Background

Ring the Bells, Inc. provides doorbell repair services to customers. On December 5, 2018, Ring the Bells provided services worth $27,050 on credit to customers. On December 13, 2018, Ring the Bells, Inc. collected $14,280 in cash from customers for services performed on credit in December 2017. On December 19, 2018, Ring the Bells, Inc. collected $11,060 in cash for services that will be provided on January 9, 2019.

QUESTION 1-1

How will these transactions affect Ring the Bells' balance sheet at December 31, 2018? [Ignore any tax effects.]

Cash (asset): Increase by $25,340 ($14,280 + $11,060)

Accounts receivable (asset): Increase by $12,770 ($27,050 − $14,280)

Unearned revenues (current liability): Increase by $11,060

Retained earnings (Shareholders' equity): Increase by $27,050 ($27,050 increase in revenues)

QUESTION 1-2

How will these transactions affect Ring the Bells' income statement for the fiscal year ended December 31, 2018? [Ignore any tax effects.]

Revenue (income statement): Increase by $27,050

QUESTION 1-3

What transaction will Ring the Bells record when the service is provided to the customer on January 9, 2019?

Unearned revenues (current liability): Decrease by $11,060

Revenue (income statement): Increase by $11,060

QUESTION 2: Costco

Costco Wholesale Corporation and its subsidiaries operate membership warehouses. Costco accounts for membership fee revenue, net of refunds, on a deferred basis, ratably over the one-year membership. The following table details deferred membership fees and the amount of revenue recognized for fiscal years 2016, 2017, and 2018.

QUESTION 2

Excerpt from Costco Wholesale Corporation's consolidated balance sheets from their 2018 and 2017 annual reports (amounts in millions):

	September 2, 2018	September 3, 2017	August 28, 2016
Deferred membership fees	$1,624	$1,498	$1,362

Excerpt from Costco Wholesale Corporation's consolidated statements of income from their 2018 and 2017 annual reports (amounts in millions):

	September 2, 2018	September 3, 2017	August 28, 2016
Membership fees revenue	$3,142	$2,853	$2,646

QUESTION 2-1

What is the amount of Costco membership fees recorded as revenue for fiscal year 2018?

$3,142 million

QUESTION 2

Excerpt from Costco Wholesale Corporation's consolidated balance sheets from their 2018 and 2017 annual reports (amounts in millions):

	September 2, 2018	September 3, 2017	August 28, 2016
Deferred membership fees	$1,624	$1,498	$1,362

Excerpt from Costco Wholesale Corporation's consolidated statements of income from their 2018 and 2017 annual reports (amounts in millions):

	September 2, 2018	September 3, 2017	August 28, 2016
Membership fees revenue	$3,142	$2,853	$2,646

QUESTION 2-2

How much of the membership fees recorded as revenue in 2018 is related to memberships initiated or renewed during fiscal year 2017?

$1,498 million

QUESTION 2

Excerpt from Costco Wholesale Corporation's consolidated balance sheets from their 2018 and 2017 annual reports (amounts in millions):

	September 2, 2018	September 3, 2017	August 28, 2016
Deferred membership fees	$1,624	$1,498	$1,362

Excerpt from Costco Wholesale Corporation's consolidated statements of income from their 2018 and 2017 annual reports (amounts in millions):

	September 2, 2018	September 3, 2017	August 28, 2016
Membership fees revenue	$3,142	$2,853	$2,646

QUESTION 2-3

What is the total amount of membership fees collected in fiscal year 2018 on membership initiations and renewals? What percentage of these fees was also recorded as revenues in 2018?

Beginning unearned revenue	*$1,498*
+ Membership fees collected	*X*
−Membership revenue recognized	*($3,142)*
= Ending unearned revenue	*$1,624*

Membership fees collected = $3,268 million

Percentage of these fees recorded as revenue = ($3,142 − $1,498) / $3,268 = 50%

QUESTION 2

Excerpt from Costco Wholesale Corporation's consolidated balance sheets from their 2018 and 2017 annual reports (amounts in millions):

	September 2, 2018	September 3, 2017	August 28, 2016
Deferred membership fees	$1,624	$1,498	$1,362

Excerpt from Costco Wholesale Corporation's consolidated statements of income from their 2018 and 2017 annual reports (amounts in millions):

	September 2, 2018	September 3, 2017	August 28, 2016
Membership fees revenue	$3,142	$2,853	$2,646

QUESTION 2-4

Suppose that an alternative accounting treatment of Costco membership fees was to record them as revenues when memberships are initiated or renewed.

Had this alternative treatment been used would net income, total assets, liabilities, and shareholder’s equity in fiscal year 2018 be higher than, lower than, or the same as the amounts currently recorded?

QUESTION 2-4

If this alternative method has been used, net income would be $3,268 and there would be no deferred membership fees recorded on the balance sheet.

QUESTION 2-4

Net Income: Higher ($3,268 million now vs. $3,142 million before)

Total assets: The same (it does not impact total assets)

Liabilities: Lower (there is no deferred membership fees anymore)

Shareholders' equity: Higher (if assets do not change and liabilities decrease shareholders' equity should go up according to the fundamental accounting equation)

QUESTION 3: The Economist

The Economist Group are international businesses covering publishing, the supply of business information and consulting services, conferences, marketing services, and data design. One business segment of The Economist Group includes *The Economist* magazine, which is sold on a subscription basis.

Note 18 *Trade and other Liabilities* from the 2018 annual report of The Economist Group is presented in the next page. Using the information provided, please answer the following questions. Assume that the entire balance of deferred income relates to *The Economist* magazine subscriptions.

QUESTION 3

NOTE 18 Trade and other liabilities

	2018 £000	2017 £000
Current		
Trade payables	16,212	17,378
Social security and other taxes	2,234	1,610
Accruals	22,057	18,321
Liability for share-based payments	2,982	1,259
Deferred income	102,001	110,508
Other liabilities	3,544	3,104
	149,030	152,180
Non-current		
Liability for share-based payments	1,200	2,880
Deferred income	12,434	14,431
	13,634	17,311
Total	162,644	169,491

QUESTION 3-1

When do you think that The Economist Group recognizes revenue for the subscriptions for *The Economist* magazine? (Note: Assume all subscribers pay for all subscriptions in cash in advance of receiving them.)

As magazines are delivered monthly

QUESTION 3-2

The Economist Group's fiscal year ends on March 31 each year. As of March 31, 2018, what was the total value of magazine subscriptions that had been sold, but that The Economist Group had not yet recognized as revenue?

£102,001 thousand (current deferred income) +
£12,434 thousand (non-current deferred income)
= £114,435 thousand

QUESTION 3

NOTE 18 Trade and other liabilities

Current	2018 £000	2017 £000
Trade payables	16,212	17,378
Social security and other taxes	2,234	1,610
Accruals	22,057	18,321
Liability for share-based payments	2,982	1,259
Deferred income	102,001	110,508
Other liabilities	3,544	3,104
	149,030	152,180
Non-current		
Liability for share-based payments	1,200	2,880
Deferred income	12,434	14,431
	13,634	17,311
Total	162,644	169,491

The Economist Group - Revenue Recognition

QUESTION 3-3

Assume that the revenue recognized for magazine subscriptions during fiscal year 2018 was £261,926 thousand. Estimate how much The Economist Group collected during the year.

Beginning deferred income	*£124,939*
Collections during the year	X
Revenues recognized during the year	*(£261,926)*
= *Ending deferred income*	£114,435

X = £251,422 thousand

QUESTION 3

NOTE 18 Trade and other liabilities

	2018 £000	2017 £000
Current		
Trade payables	16,212	17,378
Social security and other taxes	2,234	1,610
Accruals	22,057	18,321
Liability for share-based payments	2,982	1,259
Deferred income	102,001	110,508
Other liabilities	3,544	3,104
	149,030	152,180
Non-current		
Liability for share-based payments	1,200	2,880
Deferred income	12,434	14,431
	13,634	17,311
Total	162,644	169,491

QUESTION 4-1: Runaground Co.

Suppose that on November 27, 2016, Runaground Co. paid $24,000 in cash in advance for a new insurance policy that will cover the six-month period beginning on December 1, 2016. On December 19, 2016 Runaground Co. paid $16,840 in cash to employees for work done during the two-week pay period of December 5–December 19, 2016. On December 28, 2016, Runaground Co. received a bill of $230 from the utility company for December’s utilities expenses. This utility bill will not be paid until January 10, 2017.

QUESTION 4-1

How will these transactions affect Runaground Co.'s balance sheet for the fiscal year ended December 31, 2016? [Ignore any tax effects.]

Cash (asset): Decrease by $40,840 ($24,000 + $16,840)

Prepaid Insurance (asset): Increase by $20,000 ($24,000 − $4,000)

Utilities payable (current liability): Increase by $230

Retained earnings (shareholders' equity): Decrease by $21,070 ($16,840 + $230 + $4,000 increase in expenses)

QUESTION 4-2

How will these transactions affect Runaground Co.'s income statement for the fiscal year ended December 31, 2016? [Ignore any tax effects.]

Expenses (income statement): Increase by $21,070 ($16,840 + $230 + $4,000)

QUESTION 4-3

What transaction will Runaground Co. record when the insurance policy expires on May 31, 2017?

Prepaid insurance (current asset): Decrease by $20,000

Insurance expense (income statement): Increase by $20,000

QUESTION 5: BJ’s Wholesale

BJ’s Wholesale Club is a leading warehouse club operator on the east coast of the United States. BJ’s charges a membership fee to its customers and they recognize membership fees on a straight-line basis over the life of the membership, which is generally 12 months. The following table details deferred membership fee income and the amount of revenue recognized for fiscal years ended February 3, 2018, and February 2, 2019.

QUESTION 5

Excerpt from Note 16: Accrued Expenses and Other Current Liabilities of BJ's Wholesale Club's 2018 annual report:

The following table summarizes membership fee income activity for each of the last two fiscal years (in thousands):

	Fiscal Year Ended February 2, 2019	Fiscal Year Ended February 3, 2018
Deferred MFI, beginning of period	$ 126,216	$ 116,483
Cash received from members	291,092	268,327
Revenue recognized in earnings	(282,893)	(258,594)
Deferred MFI, end of period	$ 134,415	$ 126,216

Using the information in the table, please answer the following questions.

QUESTION 5-1

What is the amount of BJ’s membership fees recorded as revenue for the fiscal year ended February 2, 2019?

$282,893 thousand

QUESTION 5

Excerpt from Note 16: Accrued Expenses and Other Current Liabilities of BJ's Wholesale Club's 2018 annual report:

The following table summarizes membership fee income activity for each of the last two fiscal years (in thousands):

	Fiscal Year Ended February 2, 2019	Fiscal Year Ended February 3, 2018
Deferred MFI, beginning of period	$ 126,216	$ 116,483
Cash received from members	291,092	268,327
Revenue recognized in earnings	(282,893)	(258,594)
Deferred MFI, end of period	$ 134,415	$ 126,216

QUESTION 5-2

How much of the membership fees recorded as revenue in for the fiscal year ended February 2, 2019 is related to memberships initiated or renewed during the fiscal year ended February 3, 2018?

$126,216 thousand

QUESTION 5

Excerpt from Note 16: Accrued Expenses and Other Current Liabilities of BJ's Wholesale Club's 2018 annual report:

The following table summarizes membership fee income activity for each of the last two fiscal years (in thousands):

	Fiscal Year Ended February 2, 2019	Fiscal Year Ended February 3, 2018
Deferred MFI, beginning of period	$ 126,216	$ 116,483
Cash received from members	291,092	268,327
Revenue recognized in earnings	(282,893)	(258,594)
Deferred MFI, end of period	$ 134,415	$ 126,216

QUESTION 5-3

What is the total amount of membership fees collected in the fiscal year ended February 2, 2019, on membership initiations and renewals? What percentage of these fees was also recorded as revenues in the fiscal year ended February 2, 2019?

The total amount of membership fees collected = $291,092

Percentage of these fees recorded as revenue = ($282,893 − $126,216) / $291,092 = 54%

QUESTION 5

Excerpt from Note 16: Accrued Expenses and Other Current Liabilities of BJ's Wholesale Club's 2018 annual report:

The following table summarizes membership fee income activity for each of the last two fiscal years (in thousands):

	Fiscal Year Ended February 2, 2019	Fiscal Year Ended February 3, 2018
Deferred MFI, beginning of period	$ 126,216	$ 116,483
Cash received from members	291,092	268,327
Revenue recognized in earnings	(282,893)	(258,594)
Deferred MFI, end of period	$ 134,415	$ 126,216

QUESTION 5-4

Suppose that an alternative accounting treatment of BJ’s Wholesale Club membership fees was to record them as revenues when memberships are initiated or renewed.

Had this alternative treatment been used would net income, total assets, liabilities, and shareholder’s equity in the fiscal year ended February 2, 2019, be higher than, lower than, or the same as the amounts currently recorded?

QUESTION 5-4

If this alternative method has been used, membership fee income would be $291,092 and there would be no deferred membership fee income recorded on the balance sheet. Therefore,

QUESTION 5-4

Net income: Higher ($291,092 thousand now vs. $282,893 thousand before)

Total assets: The same (it does not impact total assets)

Liabilities: Lower (there is no deferred membership fee income anymore)

Shareholders' equity: Higher (if assets do not change and liabilities decrease shareholders' equity should go up according to the fundamental accounting equation)

QUESTION 6: Meredith

Meredith Corporation is a diversified media company. The Company's national media segment includes print magazines, digital and mobile media, brand licensing activities, affinity marketing, database-related activities, business-to-business marketing products, and other related operations. Meredith's print magazines, which include *People, Better Homes & Gardens, Family Circle,* and *Real Simple* are sold on a subscription basis.

An excerpt of the balance sheet of Meredith Corporation is presented in the next page. Using the information provided, please answer the following questions. Assume that the entire balance of unearned revenues relates to magazine subscriptions.

QUESTION 6

Meredith Corporation and Subsidiaries
Consolidated Balance Sheets *(continued)*

Liabilities, Redeemable Convertible Preferred Stock, and Shareholders' Equity — June 30,	2018	2017
(In millions except per share data)		
Current liabilities		
Current portion of long-term debt	$ 17.7	$ 62.5
Current portion of long-term broadcast rights payable	8.9	9.2
Accounts payable	194.7	66.6
Accrued expenses		
Compensation and benefits	122.3	69.0
Distribution expenses	10.0	5.3
Other taxes and expenses	277.9	28.1
Total accrued expenses	410.2	102.4
Current portion of unearned revenues	360.4	219.0
Liabilities associated with assets held-for-sale	198.4	—
Total current liabilities	1,190.3	459.7
Long-term debt	3,117.9	635.7
Long-term broadcast rights payable	20.8	22.5
Unearned revenues	124.1	106.5
Deferred income taxes	437.0	384.7
Other noncurrent liabilities	217.0	124.6
Total liabilities	5,107.1	1,733.7

QUESTION 6-1

When do you think that Meredith Corporation recognizes revenue for the subscriptions for their magazines? (Note: Assume all subscribers pay for all subscriptions in cash in advance of receiving them.)

As magazines are delivered monthly

QUESTION 6-2

Meredith Corporation's fiscal year ends on June 30 each year. As of June 30, 2018, what was the total value of magazine subscriptions that had been sold, but that Meredith Corporation had not yet recognized as revenue?

$360.4 million (current unearned revenue) +
$124.1 million (long-term unearned revenue) =

$484.5 million

QUESTION 6

Meredith Corporation and Subsidiaries
Consolidated Balance Sheets *(continued)*

Liabilities, Redeemable Convertible Preferred Stock, and Shareholders' Equity	June 30,	2018	2017
(In millions except per share data)			
Current liabilities			
Current portion of long-term debt		$ 17.7	$ 62.5
Current portion of long-term broadcast rights payable		8.9	9.2
Accounts payable		194.7	66.6
Accrued expenses			
Compensation and benefits		122.3	69.0
Distribution expenses		10.0	5.3
Other taxes and expenses		277.9	28.1
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Current portion of unearned revenues		360.4	219.0
Liabilities associated with assets held-for-sale		198.4	—
Total current liabilities		1,190.3	459.7
Long-term debt		3,117.9	635.7
Long-term broadcast rights payable		20.8	22.5
Unearned revenues		124.1	106.5
Deferred income taxes		437.0	384.7
Other noncurrent liabilities		217.0	124.6
Total liabilities		5,107.1	1,733.7

Meredith Corporation- Revenue Recognition

QUESTION 6-3

Assume that the revenue recognized for magazine subscriptions during fiscal year ended June 30, 2018, was $489.3 million. Estimate how much Meredith Corporation collected during the year.

Beginning unearned revenue	*$325.5*
Collections during the year	X
Revenues recognized during the year	*($489.3)*
= *Ending unearned revenue*	*$484.5*

X = $648.3 million

QUESTION 6

Meredith Corporation and Subsidiaries
Consolidated Balance Sheets *(continued)*

Liabilities, Redeemable Convertible Preferred Stock, and Shareholders' Equity June 30,	**2018**	**2017**
(In millions except per share data)		
Current liabilities		
Current portion of long-term debt	$ 17.7	$ 62.5
Current portion of long-term broadcast rights payable	8.9	9.2
Accounts payable	194.7	66.6
Accrued expenses		
Compensation and benefits	122.3	69.0
Distribution expenses	10.0	5.3
Other taxes and expenses	277.9	28.1
Total accrued expenses	410.2	102.4
Current portion of unearned revenues	360.4	219.0
Liabilities associated with assets held-for-sale	198.4	—
Total current liabilities	1,190.3	459.7
Long-term debt	3,117.9	635.7
Long-term broadcast rights payable	20.8	22.5
Unearned revenues	124.1	106.5
Deferred income taxes	437.0	384.7
Other noncurrent liabilities	217.0	124.6
Total liabilities	5,107.1	1,733.7

Meredith Corporation- Revenue Recognition