Franchise, Consignment and Construction Revenue

Franchises

- Various applications
  - Manufacturing $\rightarrow$ wholesaler
  - Wholesaler $\rightarrow$ retailer
  - Service sponsor $\leftrightarrow$ retailer
- Revenue for franchisor (the one granting the franchise) comes from sale of franchise, assets and services to the franchisee (the one receiving the franchise)
- Franchisor gives franchisee: site location, income evaluation, construction supervision, signs, fixtures, bookkeeping, employee and management training, quality control, advertising and promotion
- Initial franchise fee is revenue when there is substantial performance
  - Substantial performance ends any obligation to refund

Consignment

- Revenue is recognized when consignor (person consigning goods) gets notification from consignee (the seller)
- The inventory belongs to the consignor, not consignee
- Consignee deducts fee and expenses from sale price and remits to the consignor the remainder
- Consignor has duty of due care with the consigned goods

Revenue Recognition before delivery

- For construction contracts, military and commercial aircraft, weapons systems, and space exploration hardware
- Seller (builder) may bill the customer at intervals, with delivery (passage of title) done in installments

Construction: Percentage of Completion method

- Revenues and profits are recognized each period based on progress of construction
- Cost to cost: costs to date are divided by the recent estimate of total costs this equals the percentage complete; multiply this percentage by total revenue to be realized on the contract to get the amount of revenue recognized in the present period
  - When changing estimate, use new estimate of total costs
  - Costs + gross profit earned $\rightarrow$ Construction in Process
    1. An inventory account
    2. A contra inventory account
  - Progress billings $\rightarrow$ Billings on Construction in Process
  - If Construction in Progress are greater than the Billings $\rightarrow$ asset
  - If Billings are greater than the Construction in Progress $\rightarrow$ liability
  - Inputs: costs, hours worked, efforts devoted to contract
  - Output: Production, stories or miles completed

Construction: Completed contract method

- Revenues and profits are recognized only when contract is complete
- When changing estimates $\rightarrow$ recognize a loss or gain
- When entire loss is expected $\rightarrow$ recognize loss in current period
- If profit recognized the year before and now a loss is expected on entire contract, add profit to loss figure
- JE: 
  - Loss from long-term contracts $\rightarrow$ xxx
  - Construction-in-progress $\rightarrow$ xxx

- Rationale for completed contract
  - Short term contracts
  - Cannot meet conditions for % completion
  - There are inherent hazards in contract

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