NORTHERN ILLINOIS UNIVERSITY

Service Sale Transactions

A Thesis Submitted to the
University Honors Program
In Partial Fulfillment of the
Requirements of the Baccalaureate Degree
With University Honors

Department of Accountancy

By

Min-Ying Lu

DeKalb, Illinois

May 1990
AUTHOR: Min-Ying Lu

THESIS TITLE: Service Sale Transactions

THESIS ADVISOR: Thomas Hrubec

ADVISOR'S DEPT: Accountancy

DATE: May 1988

HONORS PROGRAM: Northern Illinois University

NAME OF COLLEGE: Business

PAGE LENGTH: 27

BIBLIOGRAPHY: Yes?

ILLUSTRATED: Yes????

COPIES AVAILABLE: Hard Copy


ABSTRACT (100-200 words):

In any economic society, there are various service industries. There is no specific category that all types of services can fit into because the services offered are so broad. Accounting for service sale transactions vary widely. However, four methods of revenue recognition established by Generally Accepted Accounting Principles are useful for assessing revenue and costs of service sale transactions. The four methods are: the specific performance method, the completed performance method, the proportional performance method, and the collection method. The most widely accepted methods for all possible service sale transactions. The best way to handle any particular service sale transaction is to use the few written rules as guidelines and apply the logic in these rules to the situation.

For Office Use:

THESIS NUMBER: __________
APPROVED BY: [Signature]

DEPARTMENT OF: ACCOUNTANCY
SERVICE SALE TRANSACTIONS

Introduction

In economic society, there are various service industries. These service industries include advertising agencies, commentary associations, computer service companies, correspondence schools, banking, electronic security, equipment and office maintenance, employment agencies, entertainment, health spas, interior design or decoration, modeling agencies, moving and storage, professional or legal or consulting firms (attorneys, accountants, architecture, physicians, engineers, etc.), security, latent service industry (which provides an ancillary to support the sale of goods), stock and real estate brokerage firms, leasing and franchise enterprises, transportation, travel agencies, and many others. From an accounting standpoint, these transactions are referred to as service sale transactions because the product these companies offer is their service. There is no specific category that all types of services can fit into because the services offered by the service industries are so broad.

Even though service sales are playing an important role in economic society, there are no specific accounting guidelines written that are applicable to all service sale transactions.
However, there are some pronouncements of the American Institute of Certified Public Accountants (AICPA) and the Financial Accounting Standards Board (FASB) that can be used to apply to some common service sale transactions.

These pronouncements give rules as to when revenues and costs should be recognized in some specific situations. But these points still only cover a small portion of all possible service transactions. Service transactions are defined by the FASB as:

Transactions between a seller and a purchaser in which, for a mutually agreed price, the seller performs, agrees to perform at a later date, or agrees to maintain readiness to perform and act or acts, including permitting others to use enterprise resources that do not alone produce a tangible commodity or product as the principal intended results.

Service and Product Sale Transactions

Sale transactions can be intangible, tangible or both.

Intangible selling services involve only rendering services. Tangible selling services involve only selling products. Tangible and intangible selling services together involve both rendering and selling products.

If selling products is required in order to perform services, this is accounted as a service sale transaction. For example, a computer repairer replaces an IC board to make a computer run. Even though this transaction involves selling an IC board, it is still accounted as a service sale transaction.
since without the IC board, the computer will not be able to work
and the performance will never be done.

If rendering a service is required in order to sell a
product, this is accounted as a product sale transaction. For
instance, an air conditioning company installs an air conditioner
for a customer. Even though the labor fee is added to the cost
of this air conditioner, the whole transaction is still accounted
as a product sale transaction since without the installation, the
air conditioner will not be able to work, and of course, the
customer will not buy the air conditioner.

If services and products are sold and stated separately,
this transaction is accounted as both a service and a product
sale transaction. For example, assume a telecommunication firm
manufactures and installs telephones. The original telephone
installation for a new customer is a product sale transaction,
because the installation is necessary in order to sell
telephones. After the installed telephones start running, the
maintenance, warranty, training, repairing, and agreement
services are service sale transactions. Even though these
transactions after installation might involve installing or
replacing some telephone equipment, they are still accounted as a
service sale transaction. Therefore, this telecommunications
firm has both service and product sale transactions recorded. In
this paper the service sale transactions, which are only related
tangible service sales, will be researched and analyzed.
Revenue

Revenue, in general, is the inflow of all dollar amounts such as fees, charges, rents, commissions, dues, tuition, etc.

Revenue is defined as:

Results from the sale of goods and rendering of service and is measured by the change made to customers, clients or tenants for goods and service furnished them. It also includes gains from the sale or exchange of assets (other than stock in trade), interest and dividends earned on investments, and other increases in the owners' equity except those arising from capital contributions and capital adjustments.

As a rule, revenues should be recognized as soon as "the fire has exerted a substantial portion of its production and/or sale effort as measured by the proportion of costs already incurred to those expected be incurred; and the remaining costs can be estimated with reasonable reliability and precision." However, savings and cost offsets are not revenues, such as purchase discounts and other cost savings. Purchase discounts are treated as reduction in the cost base of the assets purchased; they are not revenues.

Revenue from the sale of a by-product is accounted as reduction in the cost base of the main asset. When two similar assets are exchanged, the gain is not considered as revenue, but is deducted from the cost of the asset acquired.

For service sale transactions, revenues are generally recognized based on seller's performance. "Performance
determines the extent to which the earnings process is complete or virtually complete."

Costs

Costs can be the outflows of all dollar amounts such as "property transferred, capital stock issued, service performed, or a liability incurred, in consideration for goods or services received or to be received."

Costs should be recognized in the period associated with the revenue generation. Costs can be divided into three categories: (1) initial direct costs, (2) direct costs, and (3) indirect costs.

Initial direct costs are costs incurred before the sale agreement is made. For example, commissions, legal fees, paper processing fees, investigation fees, but not including supervisory fees.

Direct costs are directly related and identifiable expenses incurred on a particular job. For example, direct materials, direct labor, direct manufacturing overhead, and all direct cost outflows to a particular job are direct costs.

Indirect manufacturing overhead, freight, compensation expenses, administrative expenses, advertising expenses, selling expenses, and all other costs not included in initial direct costs and direct costs are indirect costs.
Accounting for Service Sale Transactions

Accounting for service sale transactions varies widely. In 1977, however, AICPA intended to narrow accounting for service sale transactions. An AICPA proposed Statement of Position recognized revenue based on performance.

If the performance is a single service, the revenue is recognized when the single service is completed. If the performance is a series of services, revenue is recognized based on the relative value of each service to the total.

Initial costs and indirect costs are recorded when incurred.

"Clearly identifiable beneficial or causal relationship to the service performed would be matched with the revenue recognized." However, if any uncertain amount or factors may not be recorded until actual expenses incurred.

Although AICPA statement narrowed service sale transactions, this statement is not flexible to apply to all situations. In order to accurately assess revenue and costs of service sale transactions, it is beneficial to utilize the four methods for revenue and cost recognition. These four methods as to when revenue should be recognized for service sale transactions are (1) the specific performance method, (2) the completed performance method, (3) the proportional performance method, and (4) the collection method."
Specific Performance Method

The specific performance method identifies revenues for a specific job or customer. It is appropriate to use this method when the company's service transactions can be easily identified to a specific customer for a specific service sale transaction involved. A real estate broker, for example, can easily recognize commissions based on each single service when each house or unit of land is sold to a specific client.

Revenues are recognized at the time the service action is performed. At this point an allowance account can be set up to offset any uncertain revenue incomes when future inflows are in doubt.

For example, when an employment agency replaces a candidate on a job, the agency can record the revenue. Upon the agreement, the contingent liability will incur if the candidate leaves the company within a certain period. So when the agency recognizes revenues, the agency can set an allowance account to offset against the revenue.

Deferred initial direct costs and direct costs are recognized at the same time when revenue recognition takes place. Indirect costs are grouped into a lump sum amount and written off as job costs by the end of the closing period.
Completed Performance Method

The completed performance method involves multiple consequential actions for a job. Usually these actions consist of a series of service transactions and these transactions cannot be separated or identified. It is more appropriate to use this method for revenue recognition when revenue measurements at earlier stages of performance are unreliable.

Thus, revenue is recognized when the performance is completed or during the final stage of a service commitment because revenue can be more predictable at both stages.

For example, a freight company is hired to move household furniture. Each delivery may require packing, loading, storing, and delivering. The length of time to pack, load, store, and delivery is not easy to estimate and freight companies are usually paid on an hourly basis. Consequently, it is not appropriate to recognize the revenue until delivery is completed. Sometimes, the revenues can be recognized at the point when each delivery is shipped out to a customer because each delivery may require a few days. Usually the length of delivery time is short and ignominious.

Alternatively, a company can set up a fixed ratio for a job completed to a certain percentage in order to recognize revenues. For example, Rolm, an IBM company which was acquired by IBM in 1984, recognizes revenues when eighty percent of a job, based on the contract, has been performed.
Under the completed performance method, costs are classified as expenses in the same way as under the specific performance method.

**Proportional Performance Method**

The proportional performance method is used when the service transaction cycle takes place over more than one closing period. Under this method, there are four acceptable ways to recognize revenues.

First, if a particular job is actually many individual services, and those services are identifiable, measurable, and similar, total revenues can be divided into an equal amount to match each individual service. Revenue is recognized when each single service takes place.

Second, if a job consists of several measurable services but these services are not similar, revenues can be multiplied by the amount of direct costs on each service to the total amount of direct costs required to perform the entire job.

Third, if a job consists of a series of unidentifiable and unmeasurable services, but these services have to be performed within a specific period, revenues can be recognized by using a straight-line method.

Fourth, this method is used for long-term service contracts. Revenues are recognized proportionally based on progress of work done as measured by the percentage of the entire job required.
Under the proportional performance method, initial direct costs are recognized with each revenue recognition. Direct costs are recognized periodically by the end of a closing period.

Collection Method

The collection method is used to recognize revenues when cash is collected. This method is used when the company renders services to customers who have a high degree of significant inability to pay. The company cannot be sure how much it will receive until it actually receives the payments.

A company will also use the collection method when it grants cash discounts to its customers. A company cannot always be sure whether customers will take the cash discount benefits until customers actually pay.

Under the collection method, initial direct costs, direct costs, indirect costs are all recognized when they are actually incurred even though some direct costs will be incurred after cash is received. The reason to charge expenses when costs are actually incurred is due to "the uncertainty surrounding the ultimate recognition of revenue." Therefore, there are no accrual or deferred costs under the collection method.

The above four methods, the specific performance method, the completed performance method, the proportional performance method and, the collection method, are general guidelines for the service sale transactions. There is no limitation on what
industry should use what specific method. This means that two
equal industries may use the different methods to recognize
service sale transactions, or they may not use any of the four
methods discussed above. The following paragraphs will describe
several types of service industries and demonstrate how they may
recognize revenues, or costs, or both.

Franchise Sales

A franchise is authorization to sell a company's goods or
services in a particular area. A franchisor is the one who
grants a franchise. A franchisee is the one who receives or has
a franchise.

In some cases, when a franchisor sells the franchise, the
franchisee requires the franchisor to assist. This assistance
may include locating franchisee's store, training workers,
providing consultants or other services for a specific number of
years, as indicated on the contract.

For this additional assistance, the franchisee has to pay
extra cash or provide the franchisor with a promissory note or
any combination. The promissory notes are treated as the initial
franchise fee. If the promissory notes are long-term notes, the
franchisor should record at the discounted present value.
Whether the promissory notes are long-term notes depends on the
collectibility of the promissory notes. The collectibility is
depending on the success of the franchisee.
The main objective for accounting recognition of revenues on franchise sales is (1) when the revenues should be recognized (2) what amount of the revenues should be recorded, and (3) how to measure the collectibility of the promissory notes.

The principles to recognize franchise fee revenue are stated in FASB Statement No. 45, "Accounting for Franchise Fee Revenue," as follows:

Franchise fee revenue from an individual franchise sale ordinarily shall be recognized, with an appropriate provision for estimated uncollectible amounts, when all material services or conditions relating to the sale have been substantially performed or satisfied by the franchisor. Substantial performance for the franchisor means that (a) the franchisor has no remaining obligation or intent - by agreement, trade practice, or law - to refund any cash received or forgive any unpaid notes or receivables; (b) substantially all of the initial services of the franchisor required by the franchise agreement have been performed and (c) no other material conditions or obligations related to the determination of substantial performance exist . . . The commencement of operations by the franchisee shall be presumed to be the earliest point at which substantial performance has occurred, unless it can be demonstrated that substantial performance of all obligations, including services rendered voluntarily, has occurred before that time. Installment or cost recovery accounting methods shall be used to account for franchise fee revenue only in those exceptional cases when revenue is collectible over an extended period on no reasonable basis for estimating collectibility.

There are many possible forms of a franchise sale, one of which will be illustrated below.

On January 1, 1987, Mrubec Company sold a franchise to Heger Company for an initial fee of $200,000, with a $40,000 down payment and $80,000 to be paid on December 31, 1987, and on December
31, 1988. These two promissory notes, with a face amount of $80,000, were issued by Hager to Hrubec.

The current fair rate of interest on January 1, 1987, was 12%. The present value of the two notes discounted at 12% was $135,204 ($80,000$*.89286 + $80,000$*.79719 = $135,204).

Hrubec considered the notes to be fully collectible since Hrubec was confident in the success of Hager upon the request of additional franchise services. Consequently, Hrubec provided the additional services to Hager in opening a franchise and counseling operations in 1987.

The $40,000 cash down payment was non-refundable, but the first $80,000 payable would be paid only if the franchise would be opened or almost ready to be opened by the end of 1987. The second payment of $80,000 would be paid only if Hager would operate profitably by the end of 1988.

By the end of the 1987, the franchise was open and by the end of the 1988, Hager was operating profitably. Hager paid $80,000 to Hrubec on December 31, 1987 and 1988. The journal entries for Hrubec Company to be recorded in 1987 and 1988 would be:

January 1, 1987

Cash .......................... 40,000
Notes Receivable .......... 160,000
Franchise Fee Revenue .......... 40,000
Discount on Notes Receivable ... 24,796#
Deferred Franchise Fee Revenue ... 135,204

To record sale of franchise to Hager Company
# $180,000 - $135,204 = $24,796

13
December 31, 1987

Cash ..................... 80,000
Notes Receivable ................. 80,000

To record collection of notes receivable from Hager Company

December 31, 1987

Deferred Franchise Fee Revenue .... 67,602
Franchise Fee Revenue ................. 67,602

To recognize franchise fee revenue
$135,204 / 2 = $67,602

December 31, 1987

Discount on Notes Receivable........ 16,224
Interest Revenue .................. 16,224

To recognize realized interest
$ (160,000 - 24,796) x 0.12 = $16,224

December 31, 1988

Cash ..................... 80,000
Notes Receivable ................. 80,000

To record collection of notes receivable from Hager Company

December 31, 1988

Deferred Franchise Fee Revenue .... 67,602
Franchise Fee Revenue ................. 67,602

To recognize franchise fee revenue
$135,204 / 2 = $67,602

December 31, 1988

Discount on Notes Receivable........ 8,572
Interest Revenue ................... 8,572

To recognize realized interest
$24,796 - 16,224 = $8,572

14
Hospital Transactions

Standards for hospital accounting transactions have evolved through the pronouncements of the American Hospital Association (AHA), the Healthcare Financial Management Association (HFMA), and the American Institute of Certified Public Accountants (AICPA). The following service sale transactions for hospital accounting are according to the AICPA pronouncements.

Revenue from nursing services and other professional services for Pretending Angel Hospital is the total amount of $4,000,000 during 1988. This revenue is recorded at gross amount.

Accounts and Notes Receivable ..........4,000,000
Patient Service Revenue .................. 4,000,000

Generally, this amount cannot be fully collected. At this point, it will be realistic to set an estimated provision for bad debts. Assume Pretending Angel Hospital estimates that $200,000 is uncollectible during 1988. The entry for bad debt expense is the following:

Bad Debt Expense .......................... 200,000
Allowance for Uncollectible Receivables ....200,000

If there are any credits due to hospital policies or for other reasons, these credits are credited to the patients' account and treated as deductions from revenues other than as operating expenses.
The entry for the total amount to be credited or adjusted would be:

Contractual and Other Adjustments... 1,000,000
Accounts and Notes Receivable... 1,000,000

However, if any recovery of adjustments was received, the amount is offset to the account of "contractual and other adjustments". For example, if Pretending Angel Hospital receives $30,000 from the recovery of the adjustments, the entry is as follows:

Cash... 500,000
Contractual and Other Adjustments... 300,000

In addition to patient services revenues, hospitals may have other revenues other than operating revenues, such as cafeteria revenues, parking fees, gift shop revenues, and other activities which related to the provision of patient services. If Pretending Angel Hospital receives $40,000 in cash, the entry would be:

Cash... 40,000
Other Operating Revenues... 40,000

In addition to the operating revenues and other operating revenues, hospitals may receive revenues from donations. Under the Hospital Audit Guide such donations are treated as non-operating revenues. Assume Pretending Angel Hospital receives $20,000 as a donation from Ms Estock.
The entry for receiving the amount of $20,000 as a donation from Ms Estock would be:

Cash . . . . . . . . . . . . . . . . 20,000
Non-operating revenue - Donation . . . . . . . . 20,000

In 1988, the expenses incurred for the Pretending Angel Hospital are $1,000,000 for nursing services, $800,000 for other professional services, $500,000 general services, $300,000 for administrative service, and $200,000 for other expenses. The entry is as follows:

Nursing Service Expenses . . . . . . . . . . 1,000,000
Other Professional Services Expenses . . . . 800,000
General Service Expenses . . . . . . . . . . 500,000
Administrative Service Expenses . . . . . . . . 300,000
Other Expenses . . . . . . . . . . . . . . . . . . . . . 200,000
Cash . . . . . . . . . . . . . . . . . . . . . . . . . . . . 2,800,000

The total amount collected on account is $2,950,000 in 1988. The entry would be:

Cash . . . . . . . . . . . . . . . . . . . . . . . . . . . . 2,950,000
Accounts and Notes Receivable . . . . . . . . . . 2,950,000

The total amount of $200,000 has been written off. The entry would be:

Allowance for Uncollectible Receivables . . . 200,000
Accounts and Notes Receivable . . . . . . . . . . 200,000

Supply expenses should be allocated to the different functions. The total amount of $120,000 of supply expenses can
be allocated as follows: $50,000 to nursing services, $40,000 to other professional services, $20,000 to general services, $7,000 to administrative service, and $3,000 to other expenses.

The entry would be:

Nursing Service Expenses .............. 50,000
Other Professional Services Expenses ... 40,000
General Service Expenses ............. 20,000
Administrative Service Expenses ...... 7,000
Other Expenses ......................... 3,000
Cash .................................... 120,000

Prepaid expenses $75,000 in 1987 has expired during 1988.

This amount should be allocated same as the above entry in different functions. The entry would be:

Nursing Service Expenses .............. 40,000
Other Professional Services Expenses ... 20,000
General Service Expenses ............. 10,000
Administrative Service Expenses ...... 3,000
Other Expenses ......................... 2,000
Prepaid Expenses ...................... 75,000

By the end of 1988, the total amount of the prepaid expenses is $90,000. The entry would be:

Prepaid Expenses ...................... 90,000
Cash .................................... 90,000

The accrual expenses is $100,000 at year-end of 1988.

Nursing Service Expenses .............. 28,000
Other Professional Services Expenses ... 15,000
General Service Expenses ............. 9,000
Administrative Service Expenses ...... 1,000
Other Expenses ......................... 500
Prepaid Expenses ...................... 46,500

18
College and University Transactions

There are two more authoritative pronouncements related to the college and university accounting. One is College and University Business Administration, published by the National Association of College and University Business Officers (NACUBO). The other one is Audits of Colleges and Universities, published by AICPA. However, these two are quite similar.

The main revenue for the college and university is from student tuition and fees. This revenue is recorded at gross amount. Fee remissions, tuition waivers, scholarships, and fellowships should be recorded as expenditures. But actual refunds of tuition or fees should be recorded as a reduction of revenues.

Norton University has billed $5,000,000 for student tuition and fee. The entry would be:

Accounts Receivable . . . . 5,000,000
Revenues . . . . . . . . . . . 5,000,000

A total amount of $4,500,000 has been collected. The entry would be:

Cash . . . . . . . . . . . 4,500,000
Accounts Receivable . . . . . . 4,500,000

Norton University estimates $15,000 will be uncollected.

Bad Debt Expense . . . . . . . . . . 15,000
Allowance for Bad Debt . . . . . . . . . . 15,000
Students' deposits are a liability account. In 1988 Norton University increases $7,000 on students' deposits. The entry would be:

Students' Deposits . . . . . . . . . . . . . . . . . . 7,000
Cash . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 7,000

Education and general expenses incurred is $3,500,000 and for other expense is $500,000. The entry would be:

Educational and General Expenses . . 3,500,000
Other Expenses . . . . . . . . . . . . 500,000
Accounts Payable . . . . . . . . . . . . 4,000,000

Donations would be accounted as other revenues. In 1988, Norton University receives the total amount of $700,000 from donations. The entry would be:

Cash . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 700,000
Other Revenues - Donations . . 700,000

Usually, there are some loans available for students, faculty and staff. The total amount of $100,000 were borrowed by student, faculty and staff. The entry would be:

Loans to Student, Faculty, and Staff . . . . 100,000
Cash . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . 100,000

Assume the total amount of $71,400 from previous loans were paid back to Norton University in 1988. In this repayments $70,000 is loan principal and $1,4000 is interest.

The entry for the collection of loans would be:
Cash .................................. 71,400
Loans to Students, Faculty, and Staff ........ 70,000
Interest Revenue from Loans ................ 1,400

Assume the total amount of $2,000 was estimated as uncollectible from loans write-offs. The entry would be:

Loans Write-Offs .......................... 2,000
Allowance for Uncollectible Loans ........ 2,000

Most of time college fiscal years and academic years are not the same. Often colleges bill students for tuition and fees near the end of a fiscal year. But these bills are deferred services to be rendered for the next fiscal year. Therefore, these revenues should be deferred. By the end of 1988, Norton University bills $80,000 of tuition and fees for the academic year of 1989. The entry would be:

Accounts Receivable .................. 800,000
Deferred Revenues ...................... 800,000

When any amount collected in 1989 is related to the deferred revenues, deferred revenues should be adjusted and revenues should be credited. Therefore, if $750,000 of deferred revenues is collected in 1989, the entry would be:

Deferred Revenues ..................... 750,000
Revenues ................................ 750,000
Cable Television Industry

The financial accounting and reporting standards for cable television industry are separated into two periods in the FASB Statement 51. One period is the prematurity period when a cable television system is still under construction but starts rendering services. The other period is after the cable television system is fully constructed.

The only difference between these two periods is the costs incurred during the prematurity period shall be partially capitalized and partially expensed. Costs for the prematurity period includes; television plant cost, which are materials, labor, and manufacturing overhead costs; subscriber-related costs which are general and administrative expenses; programming and system costs.

Costs for television plants are capitalized in full and amortized over the same length as to depreciate the main cable television plant. For example, Keys' Cable Company initiated business in 1987. Keys paid $200,000 for television plant construction, and he expected the life of the main cable television plant would be 10 years. The entry for capitalized television plant costs would be:

Television Cable Plant . . . . . . . 200,000
Cash . . . . . . . . . . . . . . . . . . . . . . . 200,000
At the end of the year, Keys would depreciate television cable plant costs for $20,000 ($200,000 / 10) for ten years.

Depreciation Expenses .......... 20,000
Accumulated Depreciation ...... 20,000

The total amount of subscriber-related costs for Key's Cable Company in 1987 was $30,000, which would be expensed as period costs.

General and Administrative Expenses ........ 30,000
Cash ...................................... 30,000

Cost recognition for programming and system costs are more complicated. If any portion of costs is attributed to current operations, the amount will be accounted and expensed in the current period. The remaining portion will be capitalized and amortized each month for the rest of the prematureity period. The current expired portion shall be determined by the fraction, as stated in the FASB Statement 51.

The following fraction shall be determined each month of the prematureity period. The denominator of the fraction shall be the total number of subscribers expected at the end of the prematureity period. The numerator of the fraction shall be the greatest of (a) the average number of subscribers expected that month as estimated at the beginning of the prematureity period, (b) the average number of monthly progress in adding new subscribers towards the estimate of subscribers at the end of the prematureity period, and (c) the average number of actual subscribers.

The total costs of programming and system costs were $60,000 and the attributable portion cost for January 1987 was $20,000.
The total number of expected subscribers at the end of the prematurity period would be 10,000. The highest of the three numbers mentioned in the above paragraph is 1,250 for the average number of actual subscribers in January, 1987. As a result, current portion costs of $20,000 was expensed in January, 1987.

Programming and System Expenses ........ 20,000
Cash ........................................ 20,000

The remaining $40,000 should be capitalized and was treated as a current asset.

Programming and System .................... 40,000
Cash ........................................ 40,000

The additional cost for amortization in January 1987 would be $5,000 ([1,250 / 10,000] x 40,000).

Amortization of Programming and System .... 5,000
Accumulated Depreciation Programming and System .... 5,000

Both the prematurity period and the period after full construction have the same accounting standards for operation revenue, hook-up revenue and costs, direct selling costs and subscriber-related costs. The following examples will illustrate how Keys' Cable Company records transactions after full plant construction.
The operation revenue from the subscribers for the Keys' Cable Company is $200,000 for 1988.

<table>
<thead>
<tr>
<th>Accounts Receivable</th>
<th>300,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>300,000</td>
</tr>
</tbody>
</table>

However, the total amount of $30,000 is estimated as uncollectible.

<table>
<thead>
<tr>
<th>Bad Debt Expense</th>
<th>30,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Allowance for Bad Debt</td>
<td>30,000</td>
</tr>
</tbody>
</table>

The total revenue for hookup is $150,000. There is no uncollectible hookup revenue since the advanced payment is required before installation.

<table>
<thead>
<tr>
<th>Cash</th>
<th>150,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hookup revenue</td>
<td>150,000</td>
</tr>
</tbody>
</table>

The total amount for hookup costs is $100,000. The installation costs are material, labor, and overhead cost. The amount should be capitalized and depreciated over a period not longer than cable television plant depreciation period. If any subscription are disconnected, the unamortized costs should be charged as expenses.

<table>
<thead>
<tr>
<th>Hookup</th>
<th>100,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Account payable</td>
<td>100,000</td>
</tr>
</tbody>
</table>
If the total amortizing expense for 1988 is $10,000, the entry would be:

Depreciation expense . . . . . . . . . . . . 10,000
   Accumulated depreciation . . . . . . . . . . . . 10,000

Direct selling costs are commissions, salesperson's compensation, advertising expenses, and costs of processing documents related to new subscribers acquired. Direct selling costs are not general and administrative expenses, or indirect expenses, such as rent and costs of facilities. For example, the total amount of direct selling costs is $50,000 during 1988.

Direct selling expense . . . . . . . . 50,000
   Accounts payable . . . . . . . . . . . . . . . . . . . 50,000

Subscriber-related costs are costs in order to obtain or retain subscribers, billing and collection, bad debts, and mailing, repairs and maintenance, franchise fees, general and administrative costs, and marketing and other selling expenses. If Keys' Cable Company has $100,000 for subscriber-related costs, this cost can be accounted into general and administrative costs.

General and administrative expense . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . .
Conclusion

There are no specified guidelines for recognizing revenues and classifying costs for all possible service sale transactions. It appears that acceptable methods are limited. However, four methods of revenue recognition established in GAAP are useful for assessing revenue and costs of service sale transactions. These four methods, the specific performance, the completed performance, proportional performance and collection methods are widely accepted for all possible service sale transactions. The best way to handle any particular service sale transaction is to use the few written rules as guidelines and apply the logic in these rules to the situation.
FOOTNOTE


BIBLIOGRAPHIES


