

Revenue recognition for mcdonald's corporation essay



REVENUE RECOGNITION MCDONALD'S CORPORATION INTRODUCTION

McDonald's and Burger King have been in competition for over 50 years. Similar companies can choose different revenue recognition methods that can cause them to appear different. This report's purpose is to explain McDonald's revenue recognition policies and methods in comparison to Burger King's.

DISCUSSION FOR ACCOUNTING POLICIES AND METHODS

McDonald's and Burger King's revenues mainly consist of two things, sales and franchise fees. The sales they record are by company-operated restaurants.

McDonald's records these sales using a cash basis system. This system means that the accountants record revenues when the company receives cash, and it records expenses when it pays cash.

By using a cash basis, McDonald's does not have to estimate what it will not receive in its sales. McDonald's "presents sales net of sales tax and other sales-related taxes" (McDonald's Annual Report, 44). Franchise fees are for the services McDonald's offers to the franchisees. Franchise fees included on the balance sheet are from the franchisees paying rent and a percentage of their sales. Currently this percentage is 4.

0% of monthly sales (mcdonalds.com/corp). The company recognizes continuing fees and royalties from the franchise fees in the period in which they are earned. McDonald's recognizes initial franchise fees when the franchise opens for business. The franchisee must pay 25% cash as a down payment and pay the rest within the next seven years. Because McDonald's

does not show uncollectible accounts or offer information on it, it is difficult to determine how exposed the company is on collectibles.

Burger King includes all of these items in its revenue recognition process. However, it separates franchise fees from franchise rent in a section called property revenues. It receives revenue from property income that it leases or subleases to franchisees. In addition, Burger King's Annual Report states, "Royalties paid by franchisees are based on a percentage of franchise restaurant sales and are recorded as franchise revenues" (bk. com).

The sales percentage for Burger King is 4.5% per month (franchiseadvantage. com). Because Burger King states it has more franchises than company owned restaurants in comparison to its major competitors, most of its revenues come from the franchises. (bk.

com) It also does not state uncollectible accounts which would be from franchises. Therefore, it is difficult to determine the company's stability.

DISCUSSION FOR RELEVANCE OF ACCOUNTING POLICIES McDonald's primary revenue source is cash. Due to small transaction amounts between customers and the corporation, credit sales are very uncommon.

Because credit sales are low, McDonalds has no future uncollectible accounts to estimate. McDonalds requires minimal financial assets because it is a cash business. Therefore, McDonalds uses the cash basis to record revenues.

Investors and creditors have concerns about receiving an adequate return on their investments given their degree of risk. Using the cash basis of accounting, McDonald's provides accurate and reliable revenue figures that

assist its investors in making educated guesses regarding the company's future financial state.

The after tax sales revenue, reported by McDonalds, helps its investors assess past performance (sales), predict future performance (based on historical trends), confirm or correct expectations, and provide feedback on earlier expectations. Investors can estimate future revenues based on historical after tax sales revenue. The risk of uncollectible accounts is extremely low due because McDonalds does not have to use any estimation. The cash basis method allows investors to maintain easy comparability with past years' performance. McDonalds' recognition of continuing fees and royalties in the period they are earned provides investors with useful information to analyze the amount of cash generated from the ongoing operations of its franchises.

In regards to the four percent monthly sales percentage that franchises pay corporate McDonalds, investors can analyze the success of its franchises.

CONFORMITY WITH ACCOUNTING CONCEPTS According to Generally Accepted Accounting Principles (GAAP), an item should meet four criteria to gain recognition as an asset, liability, expense, or in our case, revenue. The item should meet the definition of the financial element and should be measurable, relevant, and reliable. Revenues are inflows of assets of an entity or settlements of its liabilities during the appropriate earning period. The element must also be measurable with sufficient reliability and have relevance in user decisions.

Once the item meets this criteria and the company determines that the item should be recognized, the company must determine when to recognize it.

The recognition of revenue depends on two factors: being realized or realizable and being earned. Revenues are realized when a company exchanges assets for cash or claims to cash. Revenues are realizable when assets received can be readily convertible to known amounts of cash or claims to cash.

Companies view revenues as earned when the entity has met all of its obligations to the corresponding benefits. Both McDonald's and Burger King conform with GAAP in recognizing revenues. McDonald's and Burger King both record product sales through their company-owned stores on a cash basis. However, they record their services and sales to franchisees on an accrual basis.

Although cash basis accounting fails to meet GAAP requirements, McDonald's' primary method is on an accrual basis. McDonald's and Burger King both recognize continuing fees and royalties. Burger King recognizes royalties on a percentage of franchise restaurant sales and records them as franchise revenues. They both realize the revenues in the period in which they are earned, in compliance with GAAP principles. Also, both entities record revenue from initial franchise fees to compliance with GAAP principles. CONCLUSION In conclusion, both McDonald's Corporation and Burger King utilize the cash basis method when recognizing its revenues.

This policy simplifies revenue recognition in the fast food industry. APPENDIX A REFERENCE LIST Burger King Corporation, Annual report for fiscal 2006.

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