Lucent case

Business

-27- Lucent Technologies, Inc. —Revenue Recognition Lucent Technologies designs and delivers networks for the world's largest communications service providers. Backed by Bell Labs research and development, Lucent relies on its strengths in mobility, optical, data and voice networking technologies as well as software and services to develop next-generation networks. The company's systems, services and software are designed to help customers quickly deploy and better manage their networks and create new, revenue-generating services that help businesses and consumers.

As of December 31, 2002, Lucent employed approximately 40, 000 people worldwide (two years prior, the figure was close to 123, 000).

Lucent is listed on the New York Stock Exchange under the symbol LU. (Source: Company 2002 Form 10-K) Learning Objectives • Define revenues and gains. Explain the difference between the two. • Critically assess the revenue recognition policies of a particular company. • Consider the trade-offs between rules-based and principles-based accounting standards.

• Understand the role of audit committees in corporate governance and financial reporting. Explain how financial statement users can evaluate the quality of a company's reported revenue. Refer to the 2002 financial statements of Lucent Technologies, Inc. ? ?? Concepts? ? ?? a. In your own words, define " revenues. " Explain how revenues are different from " gains.

" b. Describe what it means for a business to " recognize" revenues. What specific accounts and financial statements are affected by the process of revenue recognition? c. When does Lucent recognize revenues? d. In general, what incentives do company managers have to make self-serving revenue recognition choices? ? ?? Process? ?? e.

Assume that all of Lucent’s sales revenue is “ on account. ” Prepare a journal entry that summarizes the sales activity for fiscal 2002. f. Consider the following hypothetical revenue recognition scenarios and answer the associated questions. Note that there may be more than one acceptable answer.

Support your answers with reasoned argumentation. Indicate where more information is required. i. In September 2002, Lucent contracted to provide services to a regional Bell operating company (RBOC) for a four-year period beginning November 1, 2002.

The $50 million contract calls for annual payments of $12 million in monthly installments of $1 million.

At the signing of the contract in September 2002, Lucent received $2 million. How much revenue will Lucent recognize in fiscal 2002? Provide a journal entry that records the receipt of the initial payment. On June 30, 2002, Lucent sold telecom equipment to a small start-up company. The contract states that the sales price is $15 million. The equipment has been installed, tested, and accepted by the customer.

Because the customer is short of cash, Lucent’s sales team agreed to provide vendor financing for the sale.

The customer is scheduled to make the $15 million payment in full on June 30, 2004, which represents the only cash Lucent will receive from the customer. Assume that Lucent’s cost of borrowing is 10% and the customer’s is 15%. Provide the journal entries recorded by Lucent on June 30 and September 30, 2002, as well as June 30, 2004. Assume that Lucent prepares formal financial statements quarterly. Lucent Technologies, Inc.

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On December 31, 2002, Lucent learned that the customer in part ii failed to achieve success in the marketplace with its main product. The start-up company remains short of cash and is having trouble negotiating with its lenders. Provide the journal entry Lucent would make if they learned that the customer’s borrowing cost had risen to 17%. At the end of September 2002, Lucent signed a $200 million contract to provide equipment, software, and services to an RBOC. By September 30, 2002, some of the equipment had been delivered and installed at the RBOC.

Other equipment had been manufactured and shipped, but not yet received by the customer.

Still other products are to be delivered over the following two fiscal years. All products contain a two-year warranty. Lucent has promised to maintain the products and provide software upgrades and a dedicated customer support team for a three-year period. How should Lucent recognize revenue on this contract? For the contract in part iv, how would your answer change if you learned that there was a side agreement allowing the RBOC to return the products, no questions asked, through January 31, 2003?