

Case 09-1
Velocity Cellular

In conjunction with quarterly review procedures, the controller of Velocity Cellular Services (Velocity or the Company) provided the audit engagement team with background information about the Company's promotion of its new prepaid phone service plan. The controller also provided the engagement team with an accounting memo discussing the Company's new plan.

MEMO

To: Audit Engagement Team
From: Controller, Velocity Cellular Services
Subject: Accounting for New Prepaid Phone Service Plan
Date: August 31, 2008

Velocity Cellular Services (Velocity or the Company) sells wireless services and products based on the Global System for Mobile Communications (GSM) standard. Under the GSM standard, each subscriber is required to have an activation card to access the network; the activation card is therefore necessary for subscribers to use their cellular phones. The activation card identifies the subscriber, provides the subscriber with a unique phone number, and only works on a specific carrier's network (i.e., the activation card is not interchangeable with other carrier networks).

The Company is planning to promote and market a prepaid phone service plan called "Power Starterpack" as part of its line of service plans to existing wireless subscribers (i.e., individuals who already own a cellular phone).

The Company adopted ASU 2009-13, "Revenue Arrangements With Multiple Deliverables" in the current fiscal year.

Power Starterpack — Prepaid Phone Service Plan

The Power Starterpack will provide each subscriber with a new activation card and a prepaid voucher for a total nonrefundable fee of \$200. By replacing the old activation card with the updated 2008 activation card, the following additional functionalities are provided:

- Bluetooth®-enabled technology that allows current subscribers to have wireless control of and communication between their existing cellular phone and a hands-free headset (hands-free headset is sold separately).
- Technology that enables the existing cellular phone to make international phone calls. The older activation cards limited existing cellular phones to domestic calls.

- Additional memory for the subscriber's existing cellular phone provides storage for an additional 300 names and phone numbers.

When they purchase a Power Starterpack, subscribers are required to return the old activation card to the Company and install the new activation card in their existing cellular phones.

Also included in the purchase of the Power Starterpack is a prepaid voucher that gives the subscriber an airtime window of 360 days to use \$50 worth of minutes. However, if there is no activity for a consecutive period of seven months, the subscriber's account is terminated (including the assigned phone number) and no refund is given. Additional prepaid vouchers are available in \$50, \$100, \$150, and \$200 increments.

Replacement Activation Cards

Current subscribers can also purchase a new activation card if an existing activation card is lost, malfunctions, or new functionalities are needed on the subscriber's existing cellular phone. New activation cards can be purchased on a standalone basis directly from Velocity. The same model activation cards, with the same additional functionalities as those sold in the Power Starterpack, can also be purchased through other independent wireless phone retailers. Standalone transactions for new activation cards are infrequent and typically stem from owners of old activation cards who need to upgrade to new activation cards when new phones are purchased.

There are no general rights of return held by the subscriber relative to the delivered item contained in the prepaid plan.

Required:

- Refer to current, relevant accounting guidance to determine and support the appropriate method for recognizing revenue for the Power Starterpack.