Case 12-2c

To Recognize or Not to Recognize, That Is the Question

Shakespeare Inc. (Shakespeare or the "Company") is a privately held book printing and publishing company with a December 31 year-end. The summary balance sheet as of December 31, 20X3, included:

Current assets	$ 6,500,000
Noncurrent assets	28,250,000
Total assets	$34,750,000
Current liabilities	$ 4,500,000
Noncurrent liabilities	13,750,000
Total liabilities	$18,250,000
Total shareholder equity	$16,500,000

The summary results of operations for the year ended December 31, 20X3, included revenue of $10.7 million and net income of $1.2 million.

Shakespeare is planning to issue its financial statements on March 20, 20X4. On March 18, 20X4, Shakespeare's management will evaluate new information about one of its accruals and two subsequent events to determine whether this information or the events represent items that should be recognized or disclosed in the December 31, 20X3, financial statements.

Medical Benefits Payable

For the past several years, Shakespeare has offered self-insured medical benefits (health and dental) to its employees. The Company records the costs of medical care in the period in which covered events occur and includes its best estimate of the costs that have been incurred but not reported (IBNR) in its estimate of the medical benefits payable. Shakespeare looks to the *FASB Accounting Standards Codification*, which defines IBNR in the Master Glossary as "[l]osses incurred by the insured entity that have not yet been reported to the insurance entity." Shakespeare's management estimates its liability with the assistance of third-party experts using actuarial techniques, assumptions, and observations that are based on past experience of claims paid through the balance sheet date. The Company monitors the continued reasonableness of the assumptions and methods used to estimate the IBNR liability each reporting period. Management's process for estimating its medical benefits payable is disclosed in its "Significant Accounting Policies" footnote. Management has a history of accurately estimating the IBNR liability using these techniques as validated by the actual claims received. Historically, Shakespeare received all claims within two months of the medical services being provided to its employees.

Using this process, management estimated an IBNR liability of $1.25 million as of December 31, 20X3. As of management's review on March 18, 20X4, Shakespeare had received claims totaling $0.75 million for medical care costs incurred before December 31, 20X3.

Line of Credit Modification

As of December 31, 20X3, Shakespeare had a line of credit with a bank of $8 million (with a $10 million maximum amount available) due approximately three years from the balance sheet date. Interest accrues on amounts drawn under the line at the Secured Overnight Financing Rate (SOFR) (subject to a 3.5 percent floor) plus 7.5 percent per year. Shakespeare is also required to pay a commitment fee equal to 2 percent per year on the portion of the line of credit that was not drawn upon.

On March 1, 20X4, the Company completed its modification of the terms of the line of credit with the bank to finance the acquisition of a competitor printing and publishing company (see further facts of the acquisition below). The key modified terms are as follows:

- The maximum amount available under the line of credit was increased from $10 million to $20 million.
- The term was extended another three years past the original due date (i.e., now due in approximately six years from the balance sheet date).
- The interest rate on amounts drawn was reduced to SOFR plus 3 percent (still subject to a 3.5 percent floor).
- The commitment fee on undrawn amounts reduced to 0.5 percent.

Acquisition of a New Publishing Company

Using the funds from the modified line of credit, Shakespeare's management drew $10 million from the additional capacity on March 10, 20X4, to acquire Hamlet, a competitor publishing company in the northeast United States. On the basis of its initial assessment from the Company's due diligence (that started shortly before the balance sheet date), management's best estimate of the allocation of the $10 million purchase is as follows: $2 million of current assets and $8 million of noncurrent assets (comprising $5 million of identifiable noncurrent assets, $2 million of intangible assets, and $1 million of goodwill). Hamlet's prior-year audited financial statements included revenue of $3.2 million and EBITDA of $1.1 million. The estimated purchase price allocation has not been finalized and is expected to be after the financial statements are issued.