Case 01-04

Bag-Phones-R-Us

Jim’s Telecom, Inc. (“JTI”) manufactures and distributes bag phones in the United States. Bag phones are similar to cellular phones; however, they are equipped with advanced circuitry in a shoulder pack that allows user access to cellular communication in even the most rural areas. JTI’s products have been popular with rural farmers, as many rural areas do not have access to cellular telecommunications through traditional service providers.

JTI’s bag phone sales declined significantly in 20X2 and early 20X3 as compared with the sales levels achieved during 20X1 when the product was first introduced. JTI management implemented several marketing programs to improve sales. However, many consumers have expressed concerns about the excessive size and weight of the bag phones.

JTI’s CFO, Larry, and COO, Terry, became concerned about rumors regarding a potential takeover of the company because of JTI’s financial struggles and approached JTI’s CEO in February 20X4 requesting that they be given change in control agreements. The change in control agreements would provide that the executives receive 225% of their annual salary if, within the first 12 months after a change in control, employment is terminated (a) by JTI other than for cause, retirement, or disability, or (b) by the executive for good reason - defined as a demotion, significant reduction in compensation, or company relocation. JTI’s Board of Directors approved these requests at its March 20X4 Board meeting.

In April 20X4, JTI amended Larry’s change in control agreement to provide that he also would receive the noted benefits if he voluntarily resigned from JTI within twelve months following a change in control.

In June 20X4, a change in control occurred. As of September 30, 20X4, JTI’s year-end, neither Larry nor Terry have terminated their employment with JTI nor has there been an indication that JTI intends to terminate either executive. The new CEO believes that Larry is dissatisfied with his present job. However, Larry has not indicated that he intends to leave JTI.

Required:

• How should JTI account for the change in control agreements with Larry and Terry in its September 30, 20X4 financial statements?