Research Case – spring 2021Crimson Tide Shipping

ACCT 352 Research Case – spring 2021Crimson Tide Shipping (“Crimson”) provides domestic and international transportation and logistics services to customers. The company contracts shipping vessels, trucks, and aircraft to provide regional, long-haul, and international shipments of customer goods. Crimson has entered into the following contracts: In March 2019, Crimson entered into a revenue contract with a customer, Matador Manufacturing (“Matador”), in which Crimson would be the exclusive shipper of Matador’s products between Shanghai and Los Angeles. Crimson’s contract with Matador is effective on July 1, 2019. Before signing the contract with Matador, Crimson did not operate the Shanghai? Los Angeles route, and to satisfy the contract with Matador, in April 2019, Crimson leases a cargo ship from Buckeyes Vessel Manufacturing (“Buckeyes”), which commences on July 1, 2019.Because the shipping route is new, on July 1, 2019, (1) Crimson has no other customers to deliver goods on the Shanghai-Los Angeles route and (2) because of operational costs, Crimson does not have alternative uses for the leased cargo ship. Crimson adopted ASC 842, Leases, on January 1, 2019.The following are relevant facts about Crimson’s revenue with Matador, and Crimson’s lease with Buckeyes. Crimson’s Revenue Contract with Matador The revenue contract’s stated term with Matador is for one year. Matador can renew the contract annually for up to four additional years. Therefore, the revenue contract can extend to five full years. Matador pays a significant up-front nonrefundable fee for the initial one-year term; the same amount is due at the beginning of every renewal period. Matador can cancel at any time without incurring a penalty outside of forfeiting any up? Front nonrefundable fees already paid or owed at the beginning of the initial contract term and any and each renewed period. Although the contract is new, Crimson and Matador have entered into similar arrangements with similar terms and historically, Matador has renewed for one or more years. Crimson appropriately concludes that (1) the revenue contract meets the scope of, and criteria in, ASC 606, Revenue From Contracts With Customers, and (2) the contract term for its revenue contract with Matador is one year. Crimson’s Lease with Buckeyes The contract between Crimson and Buckeyes contains a lease under ASC 842. Rental payments are at market and fixed each year. To mitigate risks, Crimson negotiated the lease period and renewal options to mirror those of Crimson’s revenue contract with Matador. As a result, the fixed, non-cancelable term of the lease is one year, and Crimson can renew annually for four additional years (i.e., up to five full years).Crimson believes that since Matador can terminate the revenue contract after one year (even though Matador may need to ship products for longer than a year and has historically renewed under other similarly structured contracts), it is uncertain whether Matador will renew the revenue contract. Because of this uncertainty, Crimson believes that the renewal options related to the lease are not reasonably certain at the commencement date of the lease. As a result, Crimson concludes that the lease term for its lease contract with Buckeyes is also oneyear.Required:1. Do you agree with Crimson’s conclusion that the lease term for the cargo vessel is one year because the revenue contract is for one year?2. What factors should Crimson consider in supporting its conclusion related to the lease term? Additional Facts on December 1, 2019, Crimson entered into a shipping contract with Red hawks Manufacturing Company (“Red hawks”) to ship Red hawks’ products between Shanghai and Los Angeles. The contract with Red hawks commences on January 1, 2020, and on the basis of Crimson’s evaluation of its enforceable rights and obligations in the contract with Red hawks, Crimson concludes that term of the revenue contract with Red hawks is for a period of two years.