

HIGH STAKES ENTERTAINMENT

High Stakes Entertainment (HSE) is a producer and distributor of motion picture films. It specializes in action-adventure films popular with males, mostly in the teen and young adult market. While it has only been in business for seven years, it has produced several money-making hits as well as many more minor "B" films that are shown on cable networks and through the Internet.

HSE has recently completed the production of five new films. This set of five films contains one film ("Hero's Revenge") that marketing research indicates will be a top box office hit. The other four (HR II, HR III, HR IV, HR V) are "filler" films that will be bundled with the hit and licensed to theaters for exhibition. To receive access to the hit, theaters must agree to show all films a minimum number of times.

In July 2020, High Stakes Entertainment entered into an exclusive contract with Seven Rays Theaters, Inc. (Seven Rays), a large theater chain with approximately 465 theaters across the United States. This contract is provided in part as follows:

Agreement: Seven Rays is granted the right, license, and permission to display the five films listed herein during the contract period. In consideration of this contract, High Stakes Entertainment will receive:

1. A contract (arrangement) fee of \$4,000,000, payable \$2,000,000 upon contract signature and \$2,000,000 on September 1, 2020.
2. \$475 for each film showing in each location.

Contract period: The contract period shall be six months commencing on September 1, 2020.

Limitation on screenings: Seven Rays agrees to show Hero's Revenge no fewer than 40 times per theater and the four accompanying films (HR II, HR III, HR IV and HR V) no fewer than 16 times each per theater.

Exclusivity: Seven Rays shall have exclusive screening rights during the contract period. High Stakes Entertainment acknowledges that an integral inducement in consideration of the contract is Seven Rays' interest in being the sole source, without competition from other theaters in the market, during the contract period.

At the signing of the contract, Seven Rays paid \$2,000,000 of the \$4,000,000.

Seven Rays sent checks to High Stakes Entertainment for \$2,000,000 on September 1, 2020, and \$6,266,675 January 20, 2021, along with an audited statement detailing the number of showings as of December 31, 2020. The following is a summary of that information:

Film	Number of Showings	Amount Due
Hero's Revenge	9,945	\$4,723,875
HR II-V	3,248	1,542,800
	13,193	\$6,266,675

In March 2021, High Stakes Entertainment received a demand notice from Seven Rays that all monies previously paid were to be returned or they would file a lawsuit. In their letter, they enclosed a newspaper clipping from a movie theater in Toronto, Canada that was advertising the set of five films for showing the second week of February 2021.

Required

Write a report.

In preparing your report, remember to review LDC financial accounting concept 5 (cash flow vs. GAAP income), financial accounting concept 8 (understanding the timing of revenue recognition), management accounting concept 5 (understanding how to budget revenue), and business law concept 1 (offer and acceptance of contracts; enforcement of contracts: interpreting the parties' intent).

Note: To the extent that you may recognize any antitrust issues (which we would not expect) please ignore them for the purpose of this analysis.