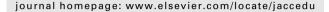


Contents lists available at SciVerse ScienceDirect

J. of Acc. Ed.





Educational Case

CV Technologies/Cold-fX

Charles P. Cullinan a,*, Gail B. Wright b,1

ARTICLE INFO

Article history:
Available online 15 September 2012

Keywords: Revenue recognition Audit risk Accounting estimates Subsequent events Materiality

ABSTRACT

The CV Technologies/Cold-fX case is based on real events at a Canadian company that attempted to enter the US market with a cold remedy called Cold-fX. CV shipped product to US retailers shortly before its fiscal year end of September 30. The product did not sell well in the US, and the company experienced a larger number of returns from US retailers than the company had historically experienced from their Canadian retailers. Many of these product returns occurred after the fiscal year end, but before the financial statements were issued. The case deals with auditing estimates related to the timing of revenue recognition and the auditor's responsibilities to consider subsequent events. Another distinctive aspect of the case involves the effects of selling in foreign markets and how entering new markets can affect the appropriate timing of revenue recognition.

© 2012 Elsevier Ltd. All rights reserved.

1. Introduction

CV Technologies (CV) was founded by Jacqueline Shan in 1992 and is headquartered in Edmonton, Alberta, Canada. The company develops natural products that are designed to strengthen the immune system to help prevent and treat colds and other maladies, and to assist in health maintenance. CV's major product, Cold-fX, is intended to aid in the prevention and relief of colds and flus by strengthening the immune system.

For the first 10 years of the company's life, sales were relatively modest, with 2003 sales of \$1.5 million. In 2003, a sales representative from CV discovered that Don Cherry was a regular user of Cold-fX. Cherry was the co-host of one of Canada's longest running and most popular television

^a Bryant University, Smithfield, RI 02917, United States

^b Florida Gulf Coast University, Fort Myers, FL 33965, United States

^{*} Corresponding author. Tel.: +1 401 232 6421; fax: +1 401 232 6319.

E-mail addresses: cullinan@bryant.edu (C.P. Cullinan), gwright@fgcu.edu (G.B. Wright).

¹ Tel.: +1 239 590 7595.

programs, *Hockey Night in Canada*. CV offered Cherry a contract to be a spokesman for Cold-fX. Under the terms of the contract, CV would donate \$1 for every bottle of Cold-fX sold to the Rose Cherry Home for Kids, a foundation named after Cherry's late wife. After the Cherry endorsement deal, sales of Cold-fX quadrupled, from \$1.5 million in 2003 to \$6.5 million in 2004.

1.1. CV enters the US market

Beginning in 2006, Jacqueline Shan, CV's Chief Executive Officer and Chief Scientific Officer, and Gordon Brown, the company's Chief Financial Officer, sought to expand the company's market for Cold-fX beyond Canada. CV applied to the US Food and Drug Administration (FDA) for approval to sell Cold-fX in the United States. In May, 2006, CV received approval from the FDA and developed a plan to enter the US market shortly before the end of CV's fiscal year on September 30, 2006. The Vice President for Sales and Marketing, P. Norman Oliver, developed the US marketing plan for Cold-fX, targeting retailers who would sell the product to US consumers.

2. Revenue recognition

Prior to the September 2006 year end, CV consulted with its auditors regarding its revenue recognition policy. CV's existing policy was to recognize revenue upon delivery to Canadian retailers. Historically, the rate of sales returns for the Cold-fX product from retailers was low in the Canadian market. Similar to US GAAP, Canadian GAAP at the time required the following four conditions be met before revenue was recognized: (1) evidence of an arrangement must exist; (2) delivery of product or rendering of services has been completed; (3) seller's price is fixed or determinable, and (4) collection is reasonably assured. In 2006, CV and its auditors agreed that its revenue recognition policy for Canadian sales also would be applied to upcoming sales in the US market. By September 30, 2006 (CV's 2006 fiscal year end), \$5.6 million of product had been shipped to US retailers and these shipments were reported as sales in CV's financial statements.

2.1. Annual report for fiscal 2006

On December 6, 2006, CV's auditor issued an unqualified opinion on the company's financial statements for the fiscal year ended September 30, 2006 and CV filed its fiscal 2006 annual report with the Alberta Securities Commission on December 11, 2006. Selected financial information from CV's 2006 financial statements is presented in Table 1. The annual report (p. 20) included the following statement in Management's Discussion & Analysis:

US sales in the fourth quarter of fiscal year 2006 represented initial stocking by retailers. Sell-through to consumers will occur in fiscal year 2007. Caution should be exercised in interpreting the initial sales figures. Consumer awareness and acceptance will ultimately determine sales volume and growth rates in the US. Customers [US retailers] may also request to return product to balance inventory with sales.

Concurrent with the annual report release, CV issued a news release to announce its earnings. In the news release, the CEO was quoted as saying:

Our management team is pleased with the progress made this past year. We had strong growth in Canada and the US market is tracking to plan.... We are now on the shelves of leading drug chains

Table 1CV's segmented revenue (in thousands).

	4th Quarter 9/30/2006	Fiscal year 2006
Canada	\$8286	\$41,336
United States	5590	5590
Other	0	41
Total	\$13,876	\$46,973

Download English Version:

https://daneshyari.com/en/article/359511

Download Persian Version:

https://daneshyari.com/article/359511

<u>Daneshyari.com</u>