**Ardmore Beer Distributors, Inc.**

Identification of Tests of Controls for the Revenue Cycle

**LEARNING OBJECTIVES**

Upon completion of this case, students will be able to:

1. Identify typical documents and records needed to record transactions within the revenue cycle.
2. Understand typical control activities implemented to record transactions within the revenue cycle.
3. Know which control activities a client can utilize to reduce the probability of a material misstatement.
4. Recognize the management assertions to which certain control activities pertain.
5. Specify appropriate tests of controls for each client control activity.

**INTRODUCTION**

Ardmore Beer Distributors (ABD) is a closely held business that was founded twenty-seven years ago by Michael Donohoe and Timothy Bauer. ABD is a distributor that purchases and sells domestic and international beer to retail stores located in medium-sized markets. The company does not have any clients located in major cities such as Philadelphia or New York. The primary focus of the company is to maintain a broad selection of beers, both inexpensive and premium, at a low cost and then resell its inventory to small retail outlets that have difficulty obtaining adequate, or any, amounts of the various types of beer. ABD is capable of keeping its costs low by purchasing large blocks of over-production by firms, ordering quantities of various beers during off-peak periods, and sourcing inventory directly from individual breweries thus saving suppliers on shipping costs. Additionally, ABD manages its labor costs by leveraging lower-cost labor where it can. For example, workers in its warehouses are typically undergraduates with ages ranging between 18 and 21.

Over the course of the past year, ABD purchased beer from 30 different domestic and 80 different international beer companies. The brands that ABD carry include Miller, Budweiser, Stella, Victory, Dogfish Head, Rochefort, and Westmalle. At the current time, ABD has two warehouses. The first is located in Wilmington, DE and the second is located in Fayetteville, NC. In the prior year, ABD had 148 retail beer store customers and net sales of $16,548,951. Generally, sales are strongest in the third and fourth quarters of the calendar year with sales being the weakest in the second quarter.

**BACKGROUND**

ABD is compelled to have an audit of its annual financial statements under the requirements of its loan agreement with its primary financial institution. The audit must be completed consistent with AICPA professional standards for the audit of a nonpublic company. Your audit firm is currently planning for the 2014 fiscal year audit in accordance with these standards. ABD has the following accounts on its general ledger pertaining to sales and cash collection:

* Sales
* Sales discounts
* Sales returns and allowances
* Uncollectible accounts expense
* Accounts receivable
* Allowance for uncollectible accounts

Following professional standards, Tracie Majors, an audit manager with Elliott and Associates, reviewed ABD’s control environment, risk assessment process, and monitoring system. Her assessment is that they are strong. Tim Brown, a staff auditor at Elliott and Associates, reviewed ABD’s information system and control activities related to sales, cash receipts, and returns and prepared the enclosed flowcharts (labeled in the upper right hand corner as *R 25-1*, *R 25-2*, *R 25-3*, and *R 25-4*). Your team is assuming the role of the audit senior on this engagement. Your role requires you to (i) identify internal control activities that assure transactions, accounts and disclosures related to sales and cash collection activities are not materially misstated and (ii) identifying tests of controls that would test the design and operating effectiveness of internal control activities identified for sales and cash collection activities.

**REQUIRED**

1. As a first step, ascertain “what could go wrong” with ABD’s sales, cash receipts, and returns activities by completing step 5 of the audit program *R 1-1*. Your work should be documented in audit schedules *R 1-1*, *R 26-1*, *R 26-2*, and *R 26-3* (numbering the examples for what could go wrong similar to the examples provided in the case).
2. List ABD’s control activities by completing step 6 of the audit program *R 1-1*. Document your work in audit schedules *R 1-1*, *R 27-1*, *R 27-2*, and *R 27-3*  (assume only that the control activities identified in flowcharts exist and number control activities similar to the activity provided).
3. Consider and note potential tests of controls by completing step 7 of the audit program *R 1-1*. Your work should be recorded in schedules *R 1-1*, *R 33-1*, *R 33-2*, and *R 33-3* (tests should be number similar to the example provided).
4. Complete step 8 of the audit program *R 1-1* by ascertaining any internal control deficiencies the company has. Your work should be recorded in schedules *R 1-1* and *R 28*.
5. Would your work differ if ABD was public? What else might you need to consider in that case?
6. For each internal control deficiency you noted in the audit schedule *R 28* list at least one control activity that would remediate the deficiency.
7. Discuss the importance of controls for ABD due to the large number of customers and vendors the company has.
8. Assume that ABD is public. Prepare an audit opinion on internal controls and a supporting memo underlying your rationale for the opinion.

**Ardmore Beer Distributors**

Reference: \_\_\_\_*R 1-1*\_\_\_

Prepared by: \_\_\_\_*TB*\_\_\_\_\_

Date: \_\_8/12/14\_\_\_

Reviewed by: \_\_\_\_\_\_\_\_\_\_\_

**Ardmore Beer Distributors**

**Revenue Cycle Planning Audit Program – Identification of Tests of Controls**

**For the Year Ended December 31, 2014**

|  |  |  |  |
| --- | --- | --- | --- |
| **Audit Procedures** | **Initial** | **Date** | **Ref.** |
| 1. Obtain and study a copy of the client’s policies and procedures manuals related to sales, cash receipts, and returns. | TB | 8/12/14 | N/A |
| 2. Discuss with and observe client personnel performing control activities related to sales, cash receipts, and returns. | TB | 8/12/14 | N/A |
| 3. Perform a document walk-through of the client’s policies and procedures related to sales, cash receipts, and returns.  | TB | 8/12/14 | N/A |
| 4. Obtain or prepare a flowchart for sales, cash receipts, and returns showing control activities, document flows, and records. | TB | 8/19/14 | *R 25-1**R 25-2**R 25-3**R 25-4* |
| 5. Use the “what could go wrong” matrix to identify what could go wrong with sales, cash receipts, and returns activities. |  |  | *R 26-1**R 26-2**R 26-3* |
| 6. Use the control activities matrix to identify client control activities that address “what could go wrong” related to sales, cash receipts, and returns. |  |  | *R 27-1**R 27-2**R 27-3* |
| 7. Use the planning audit test matrices to identify potential tests of controls. |  |  | *R 33-1**R 33-2**R 33-3* |
| 8. Based on the previous procedures, identify internal control deficiencies that may need to be reported to the client on the internal control deficiencies schedule. |  |  | *R 28* |

**Ardmore Beer Distributors**

Reference: \_\_\_*R 25-1*\_\_\_

Prepared by: \_\_\_\_*TB*\_\_\_\_\_

Date: \_\_8/19/14\_\_\_

Reviewed by: \_\_\_\_\_\_\_\_\_\_\_

**Ardmore Beer Distributors**

**Revenue Cycle – Sales Flowchart**

**For the Year Ended December 31, 2014**

 **Sales Clerk Office Manager**

Customer Order

(Mail, Phone, or Web)

- Authorize All Sales and Initial Customer Orders

- Confirm order does not exceed credit limit (if applicable)

Review or Prepare Customer Order

Input Transaction

Update Sales Register, A/R Master File, and G/L Prints Pre-numbered Sales Invoice

* Sales Register
* A/R Master File
* G/L

Customer Order 1

- Automatic Computer Update of Sales Register, A/R Master File, and G/L Using Standardized Chart of Accounts

- Automatic Computation of Invoice Amounts using Standard Price List

Sales Invoice 1

Customer Order 2

Sales Invoice 2

Sales Invoice 3

NUM (sales invoice)

A

**Ardmore Beer Distributors**

Reference: \_\_\_*R 25-2*\_\_\_

Prepared by: \_\_\_\_*TB*\_\_\_\_\_

Date: \_\_8/19/14\_\_\_

Reviewed by: \_\_\_\_\_\_\_\_\_\_\_

**Ardmore Beer Distributors**

**Revenue Cycle – Sales Flowchart**

**For the Year Ended December 31, 2014**

 **Shipping Accounting Clerk**

A

Check for Office Manager Authorization

File Customer Order

Prepare Pre-numbered Bill of Lading

Sales Register

Reconcile Sales Invoices and Bills of Lading to Sales Register and Follow-up on Missing Documents

Accounting Clerk Prepares Pre-numbered Adjustment Memo and Updates Journals/Ledgers as Required

Merchandise

Customer Order 2

Bill of Lading 2

Sales Invoice 2

Sales Register

Sales Invoice 3

Sales Invoice 3 is used as a Remittance Advice

Bill of Lading 3

Customer Order 2

NUM

CHRON

Sales Invoice 2

Bill of Lading 2

A/R Master File

Prepare Monthly Customer Statements

Customer Statement 2

Accounting Clerk

Follow-up on Exceptions Noted by Customers

To Customer

Customer Statement 1

ALPHA

NUM

To Customer

**Ardmore Beer Distributors**

Reference: \_\_\_*R 25-3*\_\_\_

Prepared by: \_\_\_\_*TB*\_\_\_\_\_

Date: \_\_8/19/14\_\_\_

Reviewed by: \_\_\_\_\_\_\_\_\_\_\_

**Ardmore Beer Distributors**

**Revenue Cycle – Cash Receipts Flowchart**

**For the Year Ended December 31, 2014**

 **Receptionist Accounting Clerk**

Cash Receipts

(Received from Customers)

- C/R Journal

- A/R Master File

-G/L

Input Transactions

Updates Cash Receipts Journal, A/R Master File, and G/L for Cash Receipts and Sales Discounts

Two Individuals Open Mail, Restrictively Endorse Checks, and Prepare and Sign Cash Receipt Summary

Computer Automatically Updates Cash Receipts Journal and General Ledger Using Standardized Chart of Accounts

Deposit Slip 2

Sales Invoice 2

Cash Receipt Summary

Deposit Slip Prepared Cash Deposited at Bank Deposit Slip Validated by Bank

Cash Receipts Journal

Customer Checks

Deposit Slip 1

Deposit Slip 2

Sales Invoice 2

CHRON

CHRON

Cash Receipt Summary

To Bank (Daily)

**Ardmore Beer Distributors**

Reference: \_\_\_*R 25-4*\_\_\_

Prepared by: \_\_\_\_*TB*\_\_\_\_\_

Date: \_\_8/19/14\_\_\_

Reviewed by: \_\_\_\_\_\_\_\_\_\_\_

**Ardmore Beer Distributors**

**Revenue Cycle – Cash Receipts Flowchart**

**For the Year Ended December 31, 2014**

**Office Manager**

Cash Receipts and Disbursements Journals

Bank Statement

(Received from Bank)

The Journals are Temporarily Obtained from the Accounting Department

- Reconciles Cash Receipt/Disbursement Journals Monthly

- Identifies Adjusting Entries

Bank Statement

Cash Receipts Journal

Cash Disbursements Journal

CHRON

CHRON

CHRON

**Ardmore Beer Distributors**

Reference: \_\_\_*R 25-5*\_\_\_

Prepared by: \_\_\_\_*TB*\_\_\_\_\_

Date: \_\_8/19/14\_\_\_

Reviewed by: \_\_\_\_\_\_\_\_\_\_\_

**Ardmore Beer Distributors**

**Revenue Cycle – Returns Flowchart**

**For the Year Ended December 31, 2014**

 **Receiving Clerk Accounting Clerk**

Retrieve Sales Invoice

Merchandise Returns

Sales Invoice 3

Prepare receiving records

Packing slip A

Match documents

Receiving report 1

Packing slip B

Packing slip C

Sales Invoice 3

Receiving report 1

Receiving report 2

CHRON

CHRON

Credit Memo 1

Update returns records