**My homework:**

During the fourth quarter of 2019, the Board of Directors of ABC Company (a private company), an auto parts supply company with 200 stores in the continental United States, discovered that certain members of senior management had been “cooking the books” for a number of years to improve the Company’s appearance of profitability. Over an undetermined period of time, management had also embezzled approximately $10 million of Company assets. The fraud was primarily concealed by the CFO and the controller by falsifying the Company’s accounting records. Over the years, they overstated the inventory, accounts receivable, and property, plant, and equipment accounts (P,P&E).

The Board of Directors fired the CFO and controller and hired a new management team. You were appointed as the auditor of the 2020 financial statements. The 2019 financial statements were not audited. New management attempted to correct the prior years’ accounting records; however, since the records were so scrambled and detailed records could not be located, management realized their attempts would be fruitless. Management was able to quantify the misstatements in inventory and accounts receivable as of January 1, 2020 and adjusted the books accordingly. Management was unable to quantify the misstatements in P,P&E but recorded estimated amounts as of January 1, 2020.

The fraud had been concealing the true financial results of the Company for several years. Although the Company had been reporting an increase in net income each year, it should have been reporting increasing losses. In the fourth quarter of 2020, management concluded the Company might not be able to remain in business for the next year (2021).

**Additional Information:**

Only the 2020 financial statements will be presented. There will be no comparative financial statements.

Management of ABC did not engage you to communicate key audit matters (critical audit matters).

The notes to the 2020 financial statements include the following disclosures:

* A description of the fraud that had taken place and the actions taken by the new management team.
* The uncertainty regarding the viability of the Company.
* Management’s belief that after all of the adjustments had been recorded, the 2020 financial statements, except for the P,P&E and related depreciation expense accounts, were presented in accordance with generally accepted accounting principles.
* A statement that management could not determine if the P,P&E and related depreciation expense accounts in the 2020 financial statements were presented fairly in accordance with generally accepted accounting principles.

After completing your audit:.

* You agree with each of the disclosures described in the previous bullet points.
* You have concluded the possible P,P&E (approximately 25% of assets) and depreciation expense misstatements could be a highly material and pervasive matter.

**Required** (assuming no problems, other than those described in the case, were noted during the 2020 audit):

1. Select the type of auditor’s report you would issue in this case. By referring to the professional pronouncements below, explain why you chose that type of auditor’s report.
2. Prepare your auditor’s report related to the 2020 financial statements. The date of the auditor’s report should be March 31, 2021.

**Applicable Professional Pronouncements – Access AICPA.org, click on Financial Reporting, click on Audit and Attest, Click on Statements on Auditing Standards (in second paragraph), scroll down and select SAS # and scroll down and select AU-C section #).**

* SAS #138 AU-C section 700 (paragraph #s 1,2,4,18,19 and A81-Illustration 3)
* SAS #134 AU-C section 705 (paragraph #s 1,2,5,6,A1 and A38-Illustrations 1,3,4 and 5)
* SAS #132 AU-C section 570 (paragraph #s 1,24,25 and A65-Illustration 1)

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**My questions:**

* The type of auditor’s report I would issue in this case is — An Auditor’s Report Containing an Adverse Opinion Due to a Material Misstatement of the Financial Statements. Is that correct?
* And the following explanation of why I chose that type of auditor’s report is correct or not?

XYZ company management was able to quantify the misstatements in inventory and accounts receivable as of January 1, 2020 and adjusted the books accordingly. Management was unable to quantify the misstatements in property, plant & equipment (PPE) but recorded estimated amounts as of January 1, 2020.

As describe in the notes to the financial statements, management believe that after all of the adjustments have been recorded, the 2020 financial statements, except for the PPE and related depreciation expense accounts, were presented in accordance with generally accepted accounting principle (GAAP). Management could not determine if the PPE and related depreciation expense accounts in 2020 financial statements were presented fairly in accordance with GAAP.

After completing our audit, we have concluded the possible PPE, approximately 25% of assets, and depreciation expense misstatements could be a highly material and pervasive matter. The class of assets affected, PPE, represents a significant portion of the financial statements, about 25%, whose uncertainty about the precise figure, is material. Additionally, depreciation expense, a class under the income statement, was materially misstated, which is also material with respect to income statement. The effect of the misstatements is highly pervasive on the company, to the effect of affecting the going concern of the company.

* I issued an adverse opinion audit report. Is my following “Basic for Adverse Opinion” section correct? Any corrections need to be made?

***Basic for Adverse Opinion***

ABC company was able to quantify the misstatements in inventory and accounts receivable as of January 1, 2020 and adjusted the books accordingly but was unable to quantify the misstatements in property, plant & equipment (PPE). PPE are recorded at estimated amounts as of January 1, 2020. As describe in the notes to the financial statements, ABC company could not determine if the PPE and related depreciation expense accounts in 2020 financial statements were presented fairly in accordance with generally accepted accounting principle. The class of assets affected, PPE, represents a significant portion of the financial statements, approximately 25%, whose uncertainty, is material. Additionally, depreciation expense, a class under the income statement, was materially misstated, which is also material with respect to income statement. The effect of the misstatements is highly pervasive on the company, to the effect of affecting the going concern of the company.

* I stated that the effect of the misstatements is highly pervasive on the company, to the effect of affecting the going concern of the company. Is that correct?
* Do I need to state or describe the fraud that had taken place and the actions taken by the new management team in “Basic for Adverse Opinion” Section” Or state it as Key audit matter or any paragraph in my audit report?
* Do I need to state the uncertainty regarding the viability of the Company or the “going concern” issue in “Basic for Adverse Opinion” Section” Or state it as Key audit matter or any paragraph in my audit report?