

Case 23-4c
ABC Software

ABC Software Inc. (ABC or the “Company”) is an SEC large accelerated filer with a fiscal year-end of December 31, 20X0. The Company develops hardware and software solutions, including an enterprise cloud platform (which can be pre-installed on its hardware or delivered separately), as well as related technical support subscriptions and professional services. ABC engages Public Accounting Firm (the “audit team”) to audit its financial statements, and the audit team issues an opinion on the financial statements in accordance with the standards of the PCAOB. The materiality for the audit engagement for 20X0 is \$100 million.

On March 1, ABC acquired a 100 percent ownership in XYZ Software (XYZ) for a net purchase price of \$1 billion. The transaction was determined to be a significant unusual transaction in the current year because acquisitions are not part of the Company’s normal course of business.

The audit team has identified two significant risks for purposes of the audit: management override of controls and revenue recognition. As disclosed in ABC’s 20X0 Form 10-K, the Company had identified business combinations, revenue recognition, and income taxes as critical accounting policies.

In October 20X0, the Company communicated to its audit committee that a breach of an applicable independence requirement had been identified by the Company during the period under audit. Despite the breach and the extent of the remediation procedures, the audit team concluded that the objectivity and impartiality of the audit engagement had not been impaired.

In June 2017, the PCAOB issued Auditing Standard 3101, *The Auditor’s Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion* (PCAOB AS 3101). The standard includes a requirement that independent auditors identify and describe in the auditor’s report critical audit matters (CAMs) arising from the audit of current-period financial statements. Paragraph 11 of PCAOB AS 3101 states that a CAM “is any matter arising from the audit of the financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the financial statements and (2) involved especially challenging, subjective, or complex auditor judgment.” See Handout 1 for the process flow in identifying, documenting, and communicating CAMs.

For purposes of this case study, assume the excerpt from the audit committee presentation (Handout 3) is the only communication made and required for purposes of the 20X0 audit. Using Handouts 1, 2, and 3, respond to the required discussion items below.

Required

1. For the year ended December 31, 20X0, describe the first step the audit team would perform in determining the CAMs for the audit of the current-period financial statements.

2. What matters communicated to the audit committee relate to an account or disclosure? Of these, which are material to the financial statements?
3. In determining whether revenue recognition and the XYZ acquisition are CAMs, what are some of the factors the auditor would consider?
4. Considering the facts and circumstances discussed in the case, as well as audit committee materials and the excerpt from the Company's Form 10-K, draft the CAM section of the auditor's report in accordance with the requirements of paragraph 14 of PCAOB AS 3101, which states, in part:

For each critical audit matter communicated in the auditor's report the auditor must:

- a. Identify the critical audit matter;
- b. Describe the principal considerations that led the auditor to determine that the matter is a critical audit matter;
- c. Describe how the critical audit matter was addressed in the audit; and

Note: In describing how the critical audit matter was addressed in the audit, the auditor may describe: (1) the auditor's response or approach that was most relevant to the matter; (2) a brief overview of the audit procedures performed; (3) an indication of the outcome of the audit procedures; and (4) key observations with respect to the matter, or some combination of these elements.

- d. Refer to the relevant financial statement accounts or disclosures that relate to the critical audit matter.

Within your draft, identify where additional information would be needed beyond that provided in the case.