AU Section 560

Subsequent Events

Source: SAS No. 1, section 560; SAS No. 12; SAS No. 98; SAS No. 113.

Issue date, unless otherwise indicated: November, 1972.

.01 An independent auditor's report ordinarily is issued in connection with historical financial statements that purport to present financial position at a stated date and results of operations and cash flows for a period ended on that date. However, events or transactions sometimes occur subsequent to the balance-sheet date, but prior to the issuance of the financial statements, that have a material effect on the financial statements and therefore require adjustment or disclosure in the statements. These occurrences hereinafter are referred to as "subsequent events." [As amended, effective September 2002, by Statement on Auditing Standards No. 98.]

.02 Two types of subsequent events require consideration by management and evaluation by the independent auditor.

.03 The first type consists of those events that provide additional evidence with respect to conditions that existed at the date of the balance sheet and affect the estimates inherent in the process of preparing financial statements. All information that becomes available prior to the issuance of the financial statements should be used by management in its evaluation of the conditions on which the estimates were based. The financial statements should be adjusted for any changes in estimates resulting from the use of such evidence.

.04 Identifying events that require adjustment of the financial statements under the criteria stated above calls for the exercise of judgment and knowledge of the facts and circumstances. For example, a loss on an uncollectible trade account receivable as a result of a customer's deteriorating financial condition leading to bankruptcy subsequent to the balance-sheet date would be indicative of conditions existing at the balance-sheet date, thereby calling for adjustment of the financial statements before their issuance. On the other hand, a similar loss resulting from a customer's major casualty such as a fire or flood subsequent to the balance-sheet date would not be indicative of conditions existing at the balance-sheet date and adjustment of the financial statements would not be appropriate. The settlement of litigation for an amount different from the liability recorded in the accounts would require adjustment of the financial statements if the events, such as personal injury or patent infringement, that gave rise to the litigation had taken place prior to the balance-sheet date.

.05 The second type consists of those events that provide evidence with respect to conditions that did not exist at the date of the balance sheet being reported on but arose subsequent to that date. These events should not result in adjustment of the financial statements.[1] Some of these events, however, may be of such a nature that disclosure of them is required to keep the financial statements from being misleading. Occasionally such an event may be so significant that disclosure can best be made by supplementing the historical

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[1] This paragraph is not intended to preclude giving effect in the balance sheet, with appropriate disclosure, to stock dividends or stock splits or reverse splits consummated after the balance-sheet date but before issuance of the financial statements.

financial statements with pro forma financial data giving effect to the event as if it had occurred on the date of the balance sheet. It may be desirable to present pro forma statements, usually a balance sheet only, in columnar form on the face of the historical statements.

.06 Examples of events of the second type that require disclosure to the financial statements (but should not result in adjustment) are:

a. Sale of a bond or capital stock issue.

b. Purchase of a business.

c. Settlement of litigation when the event giving rise to the claim took place subsequent to the balance-sheet date.

d. Loss of plant or inventories as a result of fire or flood.

e. Losses on receivables resulting from conditions (such as a customer's major casualty) arising subsequent to the balance-sheet date.

.07 Subsequent events affecting the realization of assets such as receivables and inventories or the settlement of estimated liabilities ordinarily will require adjustment of the financial statements (see paragraph .03) because such events typically represent the culmination of conditions that existed over a relatively long period of time. Subsequent events such as changes in the quoted market prices of securities ordinarily should not result in adjustment of the financial statements (see paragraph .05) because such changes typically reflect a concurrent evaluation of new conditions.

.08 When financial statements are reissued, for example, in reports filed with the Securities and Exchange Commission or other regulatory agencies, events that require disclosure in the reissued financial statements to keep them from being misleading may have occurred subsequent to the original issuance of the financial statements. Events occurring between the time of original issuance and reissuance of financial statements should not result in adjustment of the financial statements[2] unless the adjustment meets the criteria for the correction of an error or the criteria for prior period adjustments set forth in Financial Accounting Standards Board *Accounting Standards Codification* 250, *Accounting Changes and Error Corrections*. Similarly, financial statements reissued in comparative form with financial statements of subsequent periods should not be adjusted for events occurring subsequent to the original issuance unless the adjustment meets the criteria stated above. [Revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

.09 Occasionally, a subsequent event of the second type has such a material impact on the entity that the auditor may wish to include in his report an explanatory paragraph directing the reader's attention to the event and its effects. (See section 508 paragraph .19.)

Auditing Procedures in the Subsequent Period

.10 There is a period after the balance-sheet date with which the auditor must be concerned in completing various phases of his audit. This period is known as the "subsequent period" and is considered to extend to the date of the auditor's report. Its duration will depend upon the practical requirements of each audit and may vary from a relatively short period to one of several months. Also, all auditing procedures are not carried out at the same time and some phases of an audit will be performed during the subsequent period,

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[2] However, see paragraph .05 as to the desirability of presenting pro forma financial statements to supplement the historical financial statements in certain circumstances.

whereas other phases will be substantially completed on or before the balance-sheet date. As an audit approaches completion, the auditor will be concentrating on the unresolved auditing and reporting matters and he is not expected to be conducting a continuing review of those matters to which he has previously applied auditing procedures and reached satisfaction.

.11 Certain specific procedures are applied to transactions occurring after the balance-sheet date such as (*a*) the examination of data to assure that proper cutoffs have been made and (*b*) the examination of data which provide information to aid the auditor in his evaluation of the assets and liabilities as of the balance-sheet date.

.12 In addition, the independent auditor should perform other auditing procedures with respect to the period after the balance-sheet date for the purpose of ascertaining the occurrence of subsequent events that may require adjustment or disclosure essential to a fair presentation of the financial statements in conformity with generally accepted accounting principles. These procedures should be performed at or near the date of the auditor's report. The auditor generally should:

a. Read the latest available interim financial statements; compare them with the financial statements being reported upon; and make any other comparisons considered appropriate in the circumstances. In order to make these procedures as meaningful as possible for the purpose expressed above, the auditor should inquire of officers and other executives having responsibility for financial and accounting matters as to whether the interim statements have been prepared on the same basis as that used for the statements under audit.

b. Inquire of and discuss with officers and other executives having responsibility for financial and accounting matters (limited where appropriate to major locations) as to:

   (i) Whether any substantial contingent liabilities or commitments existed at the date of the balance sheet being reported on or at the date of inquiry.

   (ii) Whether there was any significant change in the capital stock, long-term debt, or working capital to the date of inquiry.

   (iii) The current status of items, in the financial statements being reported on, that were accounted for on the basis of tentative, preliminary, or inconclusive data.

   (iv) Whether any unusual adjustments had been made during the period from the balance-sheet date to the date of inquiry.

c. Read the available minutes of meetings of stockholders, directors, and appropriate committees; as to meetings for which minutes are not available, inquire about matters dealt with at such meetings.

d. Inquire of client's legal counsel concerning litigation, claims, and assessments. [As amended, January 1976, by Statement on Auditing Standards No. 12.] (See section 337.)

e. Obtain a letter of representations, dated as of the date of the auditor's report, from appropriate officials, generally the chief executive officer, chief financial officer, or others with equivalent positions in the entity, as to whether any events have occurred subsequent to the date of the financial statements being reported on by the independent auditor that in the officer's opinion would require adjustment or disclosure in these statements. The auditor may elect to have the client include representations as to significant matters disclosed to the auditor in his or her performance of the procedures in subparagraphs (*a*) to (*d*) above and (*f*) below. (See section 333, *Management Representations*.)

f. Make such additional inquiries or perform such procedures as he considers necessary and appropriate to dispose of questions that arise in carrying out the foregoing procedures, inquiries, and discussions.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2006, by Statement on Auditing Standards No. 113.]