

TIS Section 9070
Subsequent Events

.05 Consideration of Impact of Losses From Natural Disasters Occurring After Completion of Audit Field Work and Signing of the Auditor's Report But Before Issuance of the Auditor's Report and Related Financial Statements

Inquiry – An auditor completes the field work with respect to an audit of financial statements, performs all of the post-field work procedures required by the firm's quality control standards and signs the audit report but does not immediately issue the auditor's report and the related financial statements to the client. During the period that the report was signed but not issued, the client suffers a significant loss due to a natural disaster. What are the auditor's responsibilities with respect to consideration of a material subsequent event that occurs after completion of field work and after the signing of the auditor's report but before issuance of the auditor's report and the audited financial statements?

Reply – AU section 561.04 states that after the date of the report, the auditor has no obligation to make any further or continuing inquiry or perform any other auditing procedures with respect to the audited financial statements covered by that report, unless new information which may affect the report comes to his or her attention. In addition, AU 560.01 defines a subsequent event as events or transactions which 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 financial statements.

A loss from a natural disaster occurring after year end would be considered a type II subsequent event. AU section 560.05 defines such a subsequent event as an event that provides 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 an adjustment to the financial statements. 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. In addition, the auditor should always remember that the financial statements belong to the client and the client may wish to disclose the event in the notes to the financial statements even if not required to do so.

Management and the auditor should consider whether a type II subsequent event would be of such a nature that disclosure of the event is necessary in order to keep the financial statements from being misleading. Management and the auditor should also consider whether the event affects the entity's ability to continue as a going concern.

For example, if the auditee owns a major distribution center in an area that is declared a disaster area by a local, state, or federal government due to natural disaster (e.g. hurricane, earthquake, tornado), management and the auditor should assess the damage done to that asset and the impact on the entity's current and future operations and determine whether disclosure of the impact of the disaster 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 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.

The auditor may conclude that the event has such a material impact on the entity that it would be appropriate to include an emphasis of matter paragraph in the auditor's report directing the reader's attention to the event and its effects. As AU Section 508.19 notes, emphasis paragraphs are never required and are added solely at the auditor's discretion.

If the auditor concludes that the effects of the disaster are such that substantial doubt exists as to the entity's ability to continue as a going concern for a reasonable period of time, the auditor should include an explanatory paragraph (following the opinion paragraph) to reflect that conclusion. AU section 341.13 provides an example of such an explanatory paragraph.