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Subsequent discovery of facts existing at the date of the auditor's report; Statement on auditing procedure, No. 41

American Institute of Accountants. Committee on Auditing Procedure

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STATEMENT ON AUDITING PROCEDURE 41

Subsequent Discovery of Facts Existing at the Date Of the Auditor's Report

1. Previous pronouncements of the Committee on Auditing Procedure have dealt with the auditor's reporting responsibility (a) when the effects of events or transactions known to have occurred prior to the balance sheet date are not reasonably determinable at the date of his report (Chapter 10 of *Statement on Auditing Procedure No. 33*) and (b) for events which occur after the balance sheet date but prior to the date of his report (Chapter 11 of *Statement on Auditing Procedure No. 33*). However, previous pronouncements have not dealt with situations involving information which existed at the date of the auditor's report on the financial statements but of which the auditor then had no knowledge.

2. The purpose of this statement is to establish procedures to be followed by the auditor who, subsequent to the date of his report upon audited financial statements, becomes aware that facts may have existed at that date which might have affected his report had he then been aware of such facts.

3. Because of the variety of conditions which might be encountered, some of the procedures in this statement are neces-

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sarily set out only in general terms; the specific actions to be taken in a particular case may vary somewhat in the light of the circumstances. The auditor would be well advised to consult with his attorney when he encounters the circumstances to which this statement may apply, because of legal implications that may be involved in actions contemplated by this statement, including, for example, the possible effect of state statutes regarding confidentiality of auditor-client communications.

4. This statement is not intended to suggest that, after he has issued a report, the auditor has any obligation[1] 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 his report comes to his attention. Further, this statement does not apply to situations arising from developments or events occurring after the date of the auditor's report; neither does it apply to situations where, after issuance of the auditor's report, final determinations or resolutions are made of contingencies or other matters which had been disclosed in the financial statements or which had resulted in a qualification in the auditor's report. This statement establishes procedures which go beyond current practice and it is not intended to be retroactive.

5. When the auditor becomes aware of information which relates to financial statements previously reported on by him, but which was not known to him at the date of his report, and which is of such a nature and from such a source that he would have investigated it had it come to his attention during the course of his examination, he should, as soon as practicable, undertake to determine whether the information is reliable and whether the facts existed at the date of his report. In this connection, the auditor should discuss the matter with his client at whatever management levels he deems appropriate, including

1 However, see paragraphs 11 through 14 of Chapter 11 of *Statement on Auditing Procedure No. 33* as to an auditor's obligation with respect to audited financial statements included in registration statements filed under the Securities Act of 1933 between the date of the auditor's report and the effective date of the registration statement.

the board of directors, and request co-operation in whatever investigation may be necessary.

6. When the subsequently discovered information is found both to be reliable and to have existed at the date of the auditor's report, the auditor should take action in accordance with the procedures set out in subsequent paragraphs of this statement if the nature and effect of the matter are such that (a) his report would have been affected if the information had been known to him at the date of his report and had not been reflected in the financial statements, and (b) he believes there are persons currently relying, or likely to rely on the financial statements who would attach importance to the information. With respect to (b), consideration should be given, among other things, to the time elapsed since the financial statements were issued.

7. When the auditor has concluded, after considering (a) and (b) in paragraph 6, that action should be taken to prevent future reliance on his report, he should advise his client to make appropriate disclosure of the newly discovered facts and their impact on the financial statements to persons who are known to be currently relying, or who are likely to rely on the financial statements and the related auditor's report. When the client undertakes to make appropriate disclosure, the method used and the disclosure made will depend on the circumstances.

a. If the effect on the financial statements or auditor's report of the subsequently discovered information can promptly be determined, disclosure should consist of issuing, as soon as practicable, revised financial statements and auditor's report. The reasons for the revision usually should be described in a note to the financial statements and referred to in the auditor's report. Generally, only the most recently issued audited financial statements would need to be revised, even though the revision resulted from events that had occurred in prior years.[2]

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[2] See paragraphs 26 and 27 of Accounting Principles Board Opinion No. 9 regarding disclosure of adjustments applicable to prior periods.

b. When issuance of financial statements accompanied by the auditor's report for a subsequent period is imminent, so that disclosure is not delayed, appropriate disclosure of the revision can be made in such statements instead of reissuing the earlier statements pursuant to subparagraph (a).[3]

c. When the effect on the financial statements of the subsequently discovered information cannot be determined without a prolonged investigation, the issuance of revised financial statements and auditor's report would necessarily be delayed. In this circumstance, when it appears that the information will require a revision of the statements, appropriate disclosure would consist of notification by the client to persons who are known to be relying, or who are likely to rely on the financial statements and the related report that they should not be relied upon, and that revised financial statements and auditor's report will be issued upon completion of an investigation. If applicable, the client should be advised to discuss with the Securities and Exchange Commission, stock exchanges, and appropriate regulatory agencies, the disclosure to be made or other measures to be taken in the circumstances.

8. The auditor should take whatever steps he deems necessary to satisfy himself that the client has made the disclosures specified in paragraph 7.

9. If the client refuses to make the disclosures specified in paragraph 7, the auditor should notify each member of the board of directors of such refusal and of the fact that, in the absence of disclosure by the client, the auditor will take steps as outlined below to prevent future reliance upon his report. The steps that can appropriately be taken will depend upon the degree of certainty of the auditor's knowledge that there are persons who are currently relying or who will rely on the financial statements and the auditor's report, and who would

[3] See paragraphs 26 and 27 of Accounting Principles Board Opinion No. 9 regarding disclosure of adjustments applicable to prior periods.

attach importance to the information, and the auditor's ability as a practical matter to communicate with them. Unless the auditor's attorney recommends a different course of action, the auditor should take the following steps to the extent applicable:

a. Notification to the client that the auditor's report must no longer be associated with the financial statements.

b. Notification to regulatory agencies having jurisdiction over the client that the auditor's report should no longer be relied upon.

c. Notification to each person known to the auditor to be relying on the financial statements, that his report should no longer be relied upon. In many instances it will not be practicable for the auditor to give appropriate individual notification to stockholders or investors at large, whose identities ordinarily are unknown to him; notification to a regulatory agency having jurisdiction over the client will usually be the only practicable way for the auditor to provide appropriate disclosure. Such notification should be accompanied by a request that the agency take whatever steps it may deem appropriate to accomplish the necessary disclosure. The Securities and Exchange Commission and the stock exchanges are appropriate agencies for this purpose as to corporations within their jurisdictions.

10. The following guidelines should govern the content of any disclosure made by the auditor in accordance with paragraph 9 to persons other than his client:

a. If the auditor has been able to make a satisfactory investigation of the information and has determined that the information is reliable:

(i) The disclosure should describe the effect the subsequently acquired information would have had on the auditor's report if it had been known to him at the date of his report and had not been reflected in the financial statements. The disclosure should include a description of the nature of the subsequently acquired information and of its effect on the financial statements.

(ii) The information disclosed should be as precise and factual as possible, and should not go beyond that which is reasonably necessary to accomplish the purpose mentioned in the preceding paragraph (i). Comments concerning the conduct or motives of any person should be avoided.

b. If the client has not co-operated and as a result the auditor is unable to conduct a satisfactory investigation of the information, his disclosure need not detail the specific information but can merely indicate that information has come to his attention which his client has not co-operated in attempting to substantiate and that, if the information is true, the auditor believes that his report must no longer be relied upon or be associated with the financial statements. No such disclosure should be made unless the auditor believes that the financial statements are likely to be misleading and that his report should not be relied on.

11. The concepts embodied in this statement are not limited solely to corporations but apply in all cases where financial statements have been examined and reported on by independent auditors.

The statement entitled "Subsequent Discovery of Facts Existing at the Date of the Auditor's Report" was adopted unanimously by the twenty-four members of the committee.

NOTES

Statements on Auditing Procedure present the considered opinion of the Committee on Auditing Procedure, which is the senior technical committee of the Institute designated to issue pronouncements on auditing matters. Departures from the Committee's recommendations must be justified by those who do not follow them.

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