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Subsequent events : (supersedes chapter 11 of Statement on auditing procedure no. 33); Statement on auditing procedure, No. 47

American Institute of Accountants. Committee on Auditing Procedure

SEPTEMBER 1971

STATEMENT ON AUDITING PROCEDURE 47

Subsequent Events

(Supersedes Chapter 11 of Statement on Auditing Procedure No. 33)

1. 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 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 and auditor's report, that have a material effect on the financial statements and therefore require adjustment or disclosure in the statements. These occurrences, hereinafter referred to as "subsequent events," are the subject of this Statement.

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

3. 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 state-

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ments should be adjusted for any changes in estimates resulting from the use of such evidence.

4. 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.

5. 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 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.

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

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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.

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.

7. 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 3) 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 5) because such changes typically reflect a concurrent evaluation of new conditions.

8. 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 Opinions of the Accounting Principles Board. 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.

9. 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

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[2] However, see paragraph 5 as to the desirability of presenting pro forma financial statements to supplement the historical financial statements in certain circumstances.

reader's attention to the event and its effects. (See paragraph 43, Chapter 10 of Statement on Auditing Procedure No. 33.)

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 examination. 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 examination 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 examination will be performed during the subsequent period, 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. These procedures should be performed at or near the completion of the field work. 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 examination.

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. Obtain from legal counsel a description and evaluation of any litigation, impending litigation, claims and contingent liabilities of which he has knowledge that existed at the date of the balance sheet being reported on, together with a description and evaluation of any additional matters of such nature coming to his attention up to the date the information is furnished.

e. Obtain a letter of representations, dated as of the date of the auditor's report, from appropriate officials, generally the chief executive officer and chief financial officer, as to whether any events 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 performance of the procedures in subparagraphs (a) to (d) above and (f) below.

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.

Dating of Independent Auditor's Report

13. Generally, the date of completion of the field work should be used as the date of the independent auditor's report. (See paragraph 17 for the procedure to be followed when a subsequent event occurring after the completion of the field work is disclosed in the financial statements.)

14. The auditor has no responsibility to make any inquiry or carry out any auditing procedures for the period after the date of his report.[3] However, with respect to filings under the Securities Act of 1933, reference should be made to paragraphs 21 through 25.

Events Occurring After Completion Of Field Work But Before Issuance of Report

15. In case a subsequent event of the type requiring adjustment of the financial statements (as discussed in paragraph 3) occurs after the date of the independent auditor's report but before its issuance, and the event comes to the attention of the auditor, the financial statements should be adjusted or the auditor should qualify his opinion.[4] When the adjustment is made without disclosure of the event, the report ordinarily should be dated in accordance with paragraph 13. However, if the financial statements are adjusted and disclosure of the event is made, or if no

[3] See Statement on Auditing Procedure No. 41 regarding 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.

[4] In some cases, a disclaimer of opinion or an adverse opinion may be appropriate.

adjustment is made and the auditor qualifies his opinion,[5] the procedures set forth in paragraph 17 should be followed.

16. In case a subsequent event of the type requiring disclosure (as discussed in paragraph 5) occurs after the date of the auditor's report but before issuance of his report, and the event comes to the attention of the auditor, it should be disclosed in a note to the financial statements or the auditor should qualify his opinion.[6] If disclosure of the event is made, either in a note or in the auditor's report, the auditor would date his report as set forth in the following paragraph.

17. The independent auditor has two methods available for dating his report when a subsequent event disclosed in the financial statements occurs after completion of his field work but before issuance of his report. He may use "dual dating," for example, "February 16, 19__, except for Note __ as to which the date is March 1, 19__," or he may date his report as of the later date. In the former instance, his responsibility for events occurring subsequent to the completion of his field work is limited to the specific event referred to in the note (or otherwise disclosed). In the latter instance, the independent auditor's responsibility for subsequent events extends to the date of his report and, accordingly, the procedures outlined in paragraph 12 generally should be extended to that date.

Reissuance of the Independent Auditor's Report

18. An independent auditor may reissue his report on financial statements contained in annual reports filed with the Securities and Exchange Commission or other regulatory agencies or in a long-form report subsequent to the date on which his report on the financial statements included therein was first issued. An independent auditor may also be requested by his client to furnish additional copies of a previously issued report. Use of the original report date in a reissued report removes any implication that records, transactions or events after that date have been examined or reviewed. In such cases, the independent auditor has no responsibility to make further investigation or inquiry as to

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[5] See note 4.
[6] See note 4.

events which may have occurred during the period between the original report date and the date of the release of additional reports. However, see paragraphs 21 through 25 as to an auditor's responsibility when his report is included in a registration statement filed under the Securities Act of 1933.

19. In some cases, it may not be desirable for the independent auditor to reissue his report in the circumstances described in paragraph 18 because he has become aware of an event that occurred subsequent to the date of his original report that requires adjustment or disclosure in the financial statements. In such cases, adjustment with disclosure or disclosure alone should be made as described in paragraph 8. The independent auditor should consider the effect of these matters on his opinion and he should date his report in accordance with the procedures described in paragraph 17.

20. If an event of the type requiring disclosure only (as discussed in paragraphs 5 and 8) occurs between the date of the independent auditor's original report and the date of the reissuance of such report, and if the event comes to the attention of the independent auditor, the event may be disclosed in a separate note to the financial statements captioned somewhat as follows:

Event (Unaudited) Subsequent to the Date of the Report of Independent Auditor.

Under these circumstances, the report of the independent auditor would carry the same date used in the original report.

Independent Auditor's Report In Filing Under Securities Act of 1933

21. Section 11 of the Securities Act of 1933 makes specific mention of the independent auditor's responsibility as an expert when his report is included in a registration statement filed under that Act. Section 11 states, in part, that no person shall be liable as provided therein if such person shall sustain the burden of proof that as to the part of the registration statement purporting to be made on his authority as an expert

> he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration

> statement became effective that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading . . . .

Section 11 further provides that, in determining what constitutes reasonable investigation and reasonable ground to believe, "the standard of reasonableness shall be that required of a prudent man in the management of his own property."

22. To sustain the burden of proof that he has made a "reasonable investigation" as required under the Securities Act of 1933, the auditor should extend his procedures with respect to subsequent events from the date of his report up to the effective date or as close thereto as is reasonable and practicable in the circumstances. In this connection, he should arrange to be kept advised by his client of the progress of the registration proceedings so that his review of subsequent events can be completed by the effective date. The likelihood of the auditor discovering subsequent events must necessarily decrease following the completion of field work and, as a practical matter, subsequent to that time the independent auditor may rely, for the most part, on inquiries of responsible officials and employees. In addition to performing the procedures outlined in paragraph 12 at or near the effective date, the auditor generally should:

a. Read the entire prospectus and other pertinent portions of the registration statement.
b. Inquire of and obtain written confirmation from officers and other executives having responsibility for financial and accounting matters (limited where appropriate to major locations) as to whether there have occurred any events other than those reflected or disclosed in the registration statement which, in the officers' opinion, have a material effect on the audited financial statements included therein or which should be disclosed in order to keep those statements from being misleading.

23. Because the independent auditor has not examined the unaudited financial statements which may be included in the registration statement, he cannot be expected to have an opinion as to whether such statements have been prepared in con-

formity with generally accepted accounting principles. However, if he concludes on the basis of facts known to him that the unaudited financial statements are not in conformity with generally accepted accounting principles, he should insist upon appropriate revision; failing that, he should add a comment in his report calling attention to the departure; further, he should consider, probably with advice of legal counsel, withholding his consent to the use of his report on the audited financial statements in the registration statement. (See paragraph 7 of Statement on Auditing Procedure No. 38.)

24. A registration statement filed with the Securities and Exchange Commission may contain the reports of two or more independent auditors on their examinations of the financial statements for different periods. An auditor who has not examined the financial statements for the most recent audited period included in the registration statement has a responsibility relating to events subsequent to the date of the financial statements on which he is reporting which continues to the effective date, and he generally should:

a. Read pertinent portions of the prospectus and of the registration statement.

b. Obtain a letter of representations from the successor independent auditor as to whether his examination (including his procedures with respect to subsequent events) revealed any matters which, in his opinion, might have a material effect on the financial statements reported on by the predecessor auditor or would require disclosure in the notes thereto.

25. If the predecessor auditor becomes aware of any events or transactions which require adjustment or disclosure in the financial statements examined by him, the financial statements should be adjusted or the subsequent event should be disclosed in a note to the financial statements or the auditor should qualify his report.[7] The predecessor auditor should follow the procedures set forth in paragraph 17 with respect to dating his report. He should satisfy himself as to the propriety of any adjustment or disclosure affecting the financial statements covered by his report. This may

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[7] In some cases, a disclaimer of opinion or an adverse opinion may be appropriate.

be done by performing appropriate auditing procedures or by obtaining a letter of representations from the successor auditor. In the latter instance, he may decide to express reliance on the successor auditor.

The Statement entitled "Subsequent Events" was adopted by the assenting votes of twenty-one members of the Committee, of whom Mr. Fitzgerald assented with qualification.

Mr. Fitzgerald qualifies his assent to the issuance of this Statement because he does not agree with the accounting requirement in paragraphs 4, 5, 6 and 7 which precludes adjustment of the financial statements for certain losses occurring after the balance sheet date and prior to issuance of the statements. He believes this requirement weakens the fundamental accounting convention of providing for all known and anticipated losses at the earliest opportunity and constitutes a change from current practice which can impair usefulness of financial statements to the reader. Further, such accounting requirement makes an unrealistic assumption regarding the certainty with which many financial events can be classified by date of occurrence and may cloud the evaluation process necessary, for example, to reflect assets at amounts not in excess of expected realizability. Mr. Fitzgerald believes that when subsequent to the balance sheet date and prior to issuance of the financial statements, a company has sustained a loss of the types referred to in the aforementioned paragraphs, adjustment for and disclosure of such loss in the financial statements would result in a better financial presentation than that prescribed in this Statement through footnote disclosure and occasional use of pro forma presentation.

NOTE

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.

COMMITTEE ON AUDITING PROCEDURE (1970-71)