15.2 Subsequent Events

Subsequent events also known as Events After the Reporting Period (IAS 10) or post balance sheet events are events that take place after the balance sheet date due but before the annual general meeting (IAS 10; ISA 560).

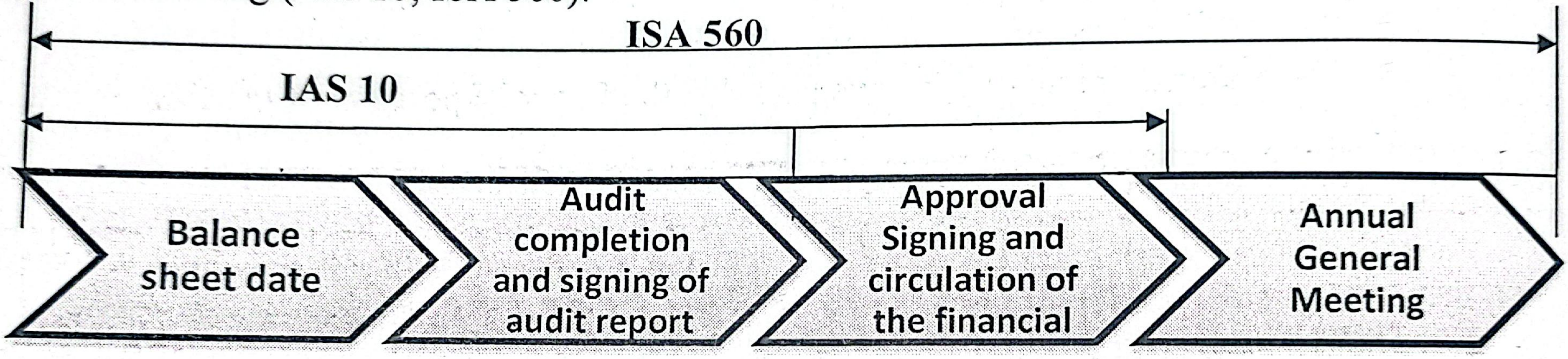

Figure 19.1 Post balance sheet events

Classification of subsequent events

Subsequent events are classified into two:

1) Adjusting events
2) Non-adjusting events

1. Adjusting events

These are events after the balance sheet date that provide additional confirmatory evidence about the conditions that were existing as the balance sheet date.

Examples:

1) Bankruptcy of a debtor after the balance sheet date.
2) Recovery of a bad debt after the balance sheet date
3) Determination of a court case for which a provision had been made.
4) Discovery of a fundamental error which indicates that the financial statements were incorrect.
5) Sale of goods at below cost after the balance sheet date
6) Return of goods which had been sold on a sale or return-basis.

2. Non-adjusting events

These are events after the balance sheet date that does not concern conditions that existed as at the balance sheet date.

Examples:

1) Destruction of a major plant by fire after the balance sheet date.
2) A major disposal of non-current assets after the balance sheet date.
3) Announcement to discontinue some operations.
4) Proposed dividends after the balance sheet date.

Accounting and disclosure for post-balance sheet events

1) Adjusting events require amendment of the figures on the face of the financial statements and a disclosure made in the notes to the accounts.
2) Non-adjusting events do not require amendment of the figures on the face of the financial statements, rather a disclosure of the event should be made in the notes to the accounts.
3) The disclosure of post of balance sheet in the notes to accounts should include the following:
   - ➔ Nature of the subsequent event.
   - ➔ The amount involved where appropriate.
   - ➔ The material impact of the event has on the financial position of the firm.

Audit objectives of reviewing subsequent events

1) To obtain audit evidence about whether the subsequent events that require amendment of the financial statements have been incorporated in the accounts appropriately.
2) To obtain audit evidence about whether the subsequent events that require disclosure, have been appropriately disclosed in the financial statements.
3) To enable the auditor to respond appropriately to facts that become known to him after the audit report which had they been known earlier, may have caused the auditor to amend the audit report.

4) To obtain audit evidence regarding cut-off.
5) To obtain audit evidence about certain values included in the financial statements such as provisions, recoverability of a doubtful debt etc.
6) The verify the Net realizable value of the closing inventory

Auditor's responsibility regarding subsequent events

A. After the balance sheet date up to the date of the audit report

- The auditor has a responsibility to carryout audit procedures to identify material subsequent events up to the date of the audit report.
- He should check to ensure that those events that require amendment have been incorporated in the financial statement and those that require disclosure have been disclosed.

B. Events after the audit report but before the financial statement are approved, signed and circulated.

1) The auditor has no obligation to make enquiries or to perform audit procedures on the financial statement after the date of the audit report.
2) If the auditor however becomes aware of a material subsequent event during this period:
   - ➔ He should discuss this with the management to determine whether the financial statement needs to be amended.
   - ➔ If the financial statements are amended, the auditor should extend audit procedures to the amendments
   - ➔ Consider whether the audit report needs to be revised.

C. Responsibilities after the financial statements have been approved and circulated but before the Annual General Meeting

1) The auditor has no responsibility to make enquiries or perform audit procedures during this period.
2) If, however the auditor becomes aware of a material subsequent event during this period:
   - ➔ The auditor should discuss the matter with the management to determine if the financial statement needs to be amended.
   - ➔ If the financial statements are amended extend audit procedures to the amendments.
   - ➔ Enquire into the management's plans of notifying those who had received the earlier financial statements about the changes.
   - ➔ Consider whether the audit report needs to be revised.
   - ➔ If the audit report is revised, write a new report with the current date and make reference to the earlier audit report
   - ➔ Consider whether the changes need to be publicized.
   - ➔ Seek legal advice.

Audit procedures to identify subsequent events

1) Seek to understand managements' procedures for identifying and dealing with subsequent events by discussing with the management.

2) Review and discuss with the management the latest available interim financial statement.
3) Review the accounting records after the balance sheet date, focusing on matters encountered during the audit that are vulnerable to change.
4) Read the minutes of the shareholders, the board of directors and management committees for meetings held after the balance date to identify subsequent events.
5) Enquire from the management as to whether any subsequent event has occurred that might affect the financial statement and make specific enquiries about the following:
   - ➔ Whether there has been new borrowings or commitments entered into.
   - ➔ Whether there has been any substantial sale or acquisition of assets.
   - ➔ Whether a disaster has occurred.
   - ➔ The status of litigation that existed as at the balance sheet date.
   - ➔ Any intention of a merger or a take-over.
6) Discuss with the company's lawyers about the status of a pending litigation as at the balance sheet date.
7) Obtain written management representation.

llustration Question

The date is 3 December 2019. The audit of Aprontis Co is nearly complete and the financial statements and the audit report are due to be signed next week. However, the following additional information on two material events has just been presented to the auditor. The company's year-end was 30 September 2019.

Event 1 – Occurred on 10 October 2019

The springs in a new type of mattress have been found to be defective making the mattress unsafe for use. There have been no sales of this mattress; it was due to be marketed in the next few weeks. The company's insurers estimate that inventory to the value of sh 7,500,000 has been affected. The insurers also estimate that the mattresses are now only worth sh 2250,000. No claim can be made against the supplier of springs as this company is in liquidation with no prospect of any amounts being paid to third parties. The insurers will not pay Aprontis for the fall in value of the inventory as the company was underinsured. All of this inventory was in the finished goods store at the end of the year and no movements of inventory have been recorded post year-end.

Event 2 – Occurred 5 November 2019

Production at the Valley cave factory was halted for one day when a truck carrying dye used in colouring the fabric on mattresses reversed into a metal pylon, puncturing the vehicle allowing dye to spread across the factory premises and into a local river. The Environmental Agency is currently considering whether the release of dye was in breach of environmental legislation. The company's insurers have not yet commented on the event.

Assume that the date is now 20 December 2019, the financial statements and the audit report have just been signed, and the annual general meeting is to take place on 10 January 2009. The Environmental Agency has issued a report stating that Aprontis Co is in breach of environmental legislation and a fine of sh 9000,000 will now be levied on the company. The amount is material to the financial statements.

Required:

a. For each of the two events above 1 & 2:

i) Explain whether the events are adjusting or non-adjusting according to IAS 10 *Events After the Reporting Period.*

ii) Explain the auditors' responsibility and the audit procedures and actions that should be carried out according to ISA 560 (Redrafted) *Subsequent Events.*

b. Explain the additional audit work the auditor should carry out in respect of this fine.