

AS 2801: Subsequent Events

Amendments: Amending releases and related SEC approval orders

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.10 Auditing Procedures in the Subsequent Period

.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."

Note: When performing an integrated audit of financial statements and internal control over financial reporting, refer to paragraphs .93-.97 of AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*, which provide direction with respect to subsequent events in an audit of internal control over financial reporting.

.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 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 statements² 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.

.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 emphasis paragraph directing the reader's attention to the event and its effects. (*See* paragraph .19 of AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion.*)

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, 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.
 - (v) Whether there have been any changes in the company's related parties.

- (vi) Whether there have been any significant new related party transactions.
 - (vii) Whether the company has entered into any significant unusual transactions.
- 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. (*See AS 2505, Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments.*)
 - 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 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. (*See AS 2805, 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.

Footnotes (AS 2801 - Subsequent Events):

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.

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

* *See also* Statement of Financial Accounting Standards No. 16, *Prior Period Adjustments* (AC section A35).

AS 2905: Subsequent Discovery of Facts Existing at the Date of the Auditor's Report

Amendments: Amending releases and related SEC approval orders

Interpretations of AS 2905: AI 22

Guidance on AS 2905: Staff Audit Practice Alert No. 15

.01 The procedures described in this section should be followed by the auditor who, subsequent to the date of the report upon audited financial statements, becomes aware that facts may have existed at that date which might have affected the report had he or she then been aware of such facts.¹

Note: When performing an integrated audit of financial statements and internal control over financial reporting, refer to paragraph .98 of AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*, which provides direction with respect to the subsequent discovery of information existing at the date of the auditor's report on internal control over financial reporting.

.02 Because of the variety of conditions which might be encountered, some of these procedures are necessarily 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 an attorney when he or she encounters the circumstances to which this section may apply because of legal implications that may be involved in actions contemplated herein, including, for example, the possible effect of state statutes regarding confidentiality of auditor-client communications.

.03 After the date of the report, the auditor has no obligation² 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.

.04 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 audit, 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 the board of directors, and request cooperation in whatever investigation may be necessary.

.05 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 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.

.06 When the auditor has concluded, after considering (a) and (b) in paragraph .05, 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.³
- 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).⁴
- 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.

.07 The auditor should take whatever steps he deems necessary to satisfy himself that the client has made the disclosures specified in paragraph .06.

.08 If the client refuses to make the disclosures specified in paragraph .06, 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 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.

.09 The following guidelines should govern the content of any disclosure made by the auditor in accordance with paragraph .08 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 subparagraph (i). Comments concerning the conduct or motives of any person should be avoided.
- b. If the client has not cooperated 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 cooperated 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.

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

Footnotes (AS 2905 - Subsequent Discovery of Facts Existing at the Date of the Auditor's Report):

¹ If the financial statements have not yet been issued, see the guidance found in AS 2801, *Subsequent Events*.

² However, see paragraphs .10-.13 of AS 4101, *Responsibilities Regarding Filings Under Federal Securities Statutes*, 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.

³ See paragraphs 26 and 27 of Accounting Principles Board Opinion No. 9 and paragraphs 25 and 26 of FASB Statement No. 154, regarding disclosure of adjustments applicable to prior periods.

⁴ *Ibid.*

AS 3105: Departures from Unqualified Opinions and Other Reporting Circumstances

Adopting Release: [PCAOB Release No. 2017-001](#).

Effective Date of Standard: For audits of fiscal years ending on or after Dec. 15, 2017

Amendments: Amending releases and related SEC approval orders

Interpretations of AS 3105: AI 23

Guidance on AS 3105: Staff Questions and Answers on Adjustments to Prior-Period Financial Statements Audited by a Predecessor Auditor and Staff Guidance – Changes to the Auditor's Report Effective for Audits of Fiscal Years Ending on or After December 15, 2017

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Introduction

.01 The auditor's report contains either an expression of opinion on the financial statements, taken as a whole,¹ or an assertion that an opinion cannot be expressed. This standard discusses the circumstances that may require the auditor to depart from the auditor's unqualified report² and provides reporting guidance in the following circumstances:

NOTE

For purposes of the discussion, we have only included the relevant paragraphs (.54-.57) beginning on the next page.

Report of Predecessor Auditor

.54 A predecessor auditor ordinarily would be in a position to reissue his or her report on the financial statements of a prior period at the request of a former client if he or she is able to make satisfactory arrangements with the former client to perform this service and if he or she performs the procedures described in paragraph .55.¹⁶

Predecessor Auditor's Report Reissued

.55 Before reissuing (or consenting to the reuse of) a report previously issued on the financial statements of a prior period, when those financial statements are to be presented on a comparative basis with audited financial statements of a subsequent period, a predecessor auditor should consider whether his or her previous report on those statements is still appropriate. Either the current form or manner of presentation of the financial statements of the prior period or one or more subsequent events might make a predecessor auditor's previous report inappropriate. Consequently, a predecessor auditor should (a) read the financial statements of the current period, (b) compare the prior-period financial statements that he or she reported on with the financial statements to be presented for comparative purposes, and (c) obtain representation letters from management of the former client and from the successor auditor. The representation letter from management of the former client should state (a) whether any information has come to management's attention that would cause them to believe that any of the previous representations should be modified, and (b) whether any events have occurred subsequent to the balance-sheet date of the latest prior-period financial statements reported on by the predecessor auditor that would require adjustment to or disclosure in those financial statements.¹⁷ The representation letter from the successor auditor should state whether the successor's audit revealed any matters that, in the successor's opinion, might have a material effect on, or require disclosure in, the financial statements reported on by the predecessor auditor. Also, the predecessor auditor may wish to consider (a) making inquiries about the professional reputation and standing of the successor auditor,^{17A} (b) obtaining a representation from the successor auditor that he or she is independent under the requirements of the PCAOB and the Securities and Exchange Commission, and (c) making inquiries of the successor auditor to determine that the successor auditor knows the relevant requirements of the applicable financial reporting framework, standards of the PCAOB, and financial reporting requirements of the Securities and Exchange Commission. However, the predecessor auditor should not refer in his or her reissued report to the report or work of the successor auditor.

.56 A predecessor auditor who has agreed to reissue his or her report may become aware of events or transactions occurring subsequent to the date of his or her previous report on the financial statements of

a prior period that may affect his or her previous report (for example, the successor auditor might indicate in the response that certain matters have had a material effect on the prior-period financial statements reported on by the predecessor auditor). In such circumstances, the predecessor auditor should make inquiries and perform other procedures that he or she considers necessary (for example, reviewing the working papers of the successor auditor as they relate to the matters affecting the prior-period financial statements). The auditor should then decide, on the basis of the evidential matter obtained, whether to revise the report. If a predecessor auditor concludes that the report should be revised, he or she should follow the guidance in paragraphs .52, .53, and .57 of this section.

.57 A predecessor auditor's knowledge of the current affairs of his former client is obviously limited in the absence of a continuing relationship. Consequently, when reissuing the report on prior-period financial statements, a predecessor auditor should use the date of his or her previous report to avoid any implication that he or she has examined any records, transactions, or events after that date. If the predecessor auditor revises the report or if the financial statements are adjusted, he or she should dual-date the report. (See AS 3110.05.)

NOTE

Footnotes relevant for AS 3105.54-.57 are provided below.

¹⁶ It is recognized that there may be reasons why a predecessor auditor's report may not be reissued and this section does not address the various situations that could arise.

¹⁷ See AS 2805, *Management Representations*, Appendix C [paragraph .18], "Illustrative Updating Management Representation Letter."

^{17A} Inquiries may be made to one or more professional organizations or other relevant parties.

AS 3110: Dating of the Independent Auditor's Report

Amendments: Amending releases and related SEC approval orders

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.03 Events Occurring After Completion of Field Work But Before Issuance of Report

.06 Reissuance of the Independent Auditor's Report

.01 The auditor should date the audit report no earlier than the date on which the auditor has obtained sufficient appropriate evidence to support the auditor's opinion. Paragraph .05 describes the procedure to be followed when a subsequent event occurring after the report date is disclosed in the financial statements.

Note: When performing an integrated audit of financial statements and internal control over financial reporting, the auditor's reports on the company's financial statements and on internal control over financial reporting should be dated the same date.

Note: If the auditor concludes that a scope limitation will prevent the auditor from obtaining the reasonable assurance necessary to express an opinion on the financial statements, then the auditor's report date is the date that the auditor has obtained sufficient appropriate evidence to support the representations in the auditor's report.

.02 The auditor has no responsibility to make any inquiry or carry out any auditing procedures for the period after the date of his report.¹ However, with respect to filings under the Securities Act of 1933, reference should be made to paragraphs .10-.13 of AS 4101, *Responsibilities Regarding Filings Under Federal Securities Statutes*.

Events Occurring After the Date of the Independent Auditor's Report But Before Issuance of Report

.03 In case a subsequent event of the type requiring adjustment of the financial statements (as discussed in paragraph .03 of AS 2801, *Subsequent Events*) occurs after the date of the independent auditor's report but before the issuance of the related financial statements, and the event comes to the attention of the auditor, the financial statements should be adjusted or the auditor should qualify his or her opinion.² When the adjustment is made without disclosure of the event, the report ordinarily should be dated in accordance with paragraph .01. However, if the financial statements are adjusted and disclosure of the event is made, or if no adjustment is made and the auditor qualifies his or her

opinion,³ the procedures set forth in paragraph .05 should be followed.

.04 In case a subsequent event of the type requiring disclosure (as discussed in AS 2801.05) occurs after the date of the auditor's report but before the issuance of the related financial statements, 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 or her opinion.⁴ If disclosure of the event is made, either in a note or in the auditor's report, the auditor would date the report as set forth in the following paragraph.

.05 The independent auditor has two methods for dating the report when a subsequent event disclosed in the financial statements occurs after the auditor has obtained sufficient appropriate evidence on which to base his or her opinion, but before the issuance of the related financial statements. The auditor may use "dual dating," for example, "February 16, 20__, except for Note __, as to which the date is March 1, 20__," or may date the report as of the later date. In the former instance, the responsibility for events occurring subsequent to the original report date 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 later report date and, accordingly, the procedures outlined in AS 2801.12 generally should be extended to that date.

Reissuance of the Independent Auditor's Report

.06 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 document he submits to his client or to others that contains information in addition to the client's basic financial statements subsequent to the date of his original report on the basic financial statements. 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 events which may have occurred during the period between the original report date and the date of the release of additional reports. However, *see* AS 4101 as to an auditor's responsibility when his report is included in a registration statement filed under the Securities Act of 1933 and *see* paragraphs .54–.57 of AS 3105, *Departures from Unqualified Opinions and Other Reporting Circumstances*, for the predecessor auditor's responsibility when reissuing or consenting to the reuse of a report previously issued on the financial statements of a prior period.

.07 In some cases, it may not be desirable for the independent auditor to reissue his report in the circumstances described in paragraph .06 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 AS 2801.08. 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 .05.

.08 However, if an event of the type requiring disclosure only (as discussed in AS 2801.05 and AS 2801.08) 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 Independent Auditor's Report

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

Footnotes (AS 3110 - Dating of the Independent Auditor's Report):

- ¹ See AS 2905, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report*, 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.
- ² In some cases, a disclaimer of opinion or an adverse opinion may be appropriate.
- ³ Ibid.
- ⁴ Ibid.

AS 4101: Responsibilities Regarding Filings Under Federal Securities Statutes

Amendments: Amending releases and related SEC approval orders

Interpretations of AS 4101: AI 26

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.10 Subsequent Events Procedures in 1933 Act Filings

.12 Response to Subsequent Events and Subsequently Discovered Facts

.01 As in the case of financial statements used for other purposes, management has the responsibility for the financial representations contained in documents filed under the federal securities statutes. In this connection the Securities and Exchange Commission has said:

The fundamental and primary responsibility for the accuracy of information filed with the Commission and disseminated among the investors rests upon management. Management does not discharge its obligations in this respect by the employment of independent public accountants, however reputable. Accountants' certificates are required not as a substitute for management's accounting of its stewardship, but as a check upon the accounting.¹

.02 When an independent accountant's report is included in registration statements, proxy statements, or periodic reports filed under the federal securities statutes, the accountant's responsibility, generally, is in substance no different from that involved in other types of reporting. However, the nature and extent of this responsibility are specified in some detail in these statutes and in the related rules and regulations. For example, section 11(a) of the Securities Act of 1933, as amended, imposes responsibility for false or misleading statements in an effective registration statement, or for omissions that render statements made in such a document misleading, on every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared or certified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration statement, report, or valuation, which purports to have been prepared or certified by him.

Note: When performing an integrated audit of financial statements and internal control over financial reporting, refer to paragraphs .C16-.C17 of Appendix C, *Special Reporting Situations*, of AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*, which provide direction when an auditor's report on internal control over financial reporting is included or incorporated by reference in filings under federal securities statutes.

.03 Section 11 also makes specific mention of the independent accountant's responsibility as an expert when his report is included in a registration statement filed under that act.² Section 11(b) states, in part, that no person shall be liable as provided therein if that person sustains the burden of proof that

as regards any part of the registration statement purporting to be made upon his authority as an expert or purporting to be a copy of or extract from a report or valuation of himself as an expert, (i) 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, or (ii) such part of the registration statement did not fairly represent his statement as an expert or was not a fair copy of or extract from his report or valuation as an expert

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."

.04 This discussion of the independent accountant's responsibilities in connection with filings under the federal securities statutes is not intended to offer legal interpretations and is based on an understanding of the meaning of the statutes as they relate to accounting principles and auditing standards and procedures. The discussion is subject to any judicial interpretations that may be issued.

.05 Because a registration statement under the Securities Act of 1933 speaks as of its effective date, the independent accountant whose report is included in such a registration statement has a statutory responsibility that is determined in the light of the circumstances on that date. This aspect of responsibility is peculiar to reports used for this purpose (*see* paragraphs .10 through .12).

.06 Under rules of the Securities and Exchange Commission, an independent accountant's report based on a review of interim financial information is not a report by the accountant within the meaning of section 11. Thus, the accountant does not have a similar statutory responsibility for such reports as of the effective date of the registration statement (*see* paragraph .13).

.07 The other federal securities statutes, while not containing so detailed an exposition, do impose responsibility, under certain conditions, on persons making false or misleading statements with respect to any material fact in applications, reports, or other documents filed under the statute.

.08 In filings under the Securities Act of 1933, a statement frequently is made in the prospectus (sometimes included in a section of the prospectus called the *experts section*) that certain information is included in the registration statement in reliance upon the report of certain named experts. The independent accountant should read the relevant section of the prospectus to make sure that his name is not being used in a way that indicates that his responsibility is greater than he intends. The experts section should be so worded that there is no implication that the financial statements have been prepared by the independent accountant or that they are not the direct representations of management.

.09 The Securities and Exchange Commission requires that, when an independent accountant's report

based on a review of interim financial information is presented or incorporated by reference in a registration statement, a prospectus that includes a statement about the independent accountant's involvement should clarify that his review report is not a "report" or "part" of the registration statement within the meaning of sections 7 and 11 of the Securities Act of 1933. In this respect, wording such as the following in a prospectus would ordinarily be considered a satisfactory description for the accountant's purposes of the status of his review report that was included in a Form 10-Q filing that was later incorporated by reference in a registration statement.³

Independent Public Accountants

The consolidated balance sheets as of December 31, 19X2 and 19X1, and the consolidated statements of income, retained earnings, and cash flows for each of the three years in the period ended December 31, 19X2, incorporated by reference in this prospectus, have been included herein in reliance on the report of _____ independent public accountants, given on the authority of that firm as experts in auditing and accounting.

With respect to the unaudited interim financial information for the periods ended March 31, 19X3 and 19X2, incorporated by reference in this prospectus, the independent public accountants have reported that they have applied limited procedures in accordance with professional standards for a review of such information. However, their separate report included in the company's quarterly report on Form 10-Q for the quarter ended March 31, 19X3, and incorporated by reference herein, states that they did not audit and they do not express an opinion on that interim financial information. Accordingly, the degree of reliance on their report on such information should be restricted in light of the limited nature of the review procedures applied. The accountants are not subject to the liability provisions of section 11 of the Securities Act of 1933 for their report on the unaudited interim financial information because that report is not a "report" or a "part" of the registration statement prepared or certified by the accountants within the meaning of sections 7 and 11 of the act.

The independent accountant should also read other sections of the prospectus to make sure that his name is not being used in a way that indicates that his responsibility is greater than he intends.

Subsequent Events Procedures in 1933 Act Filings

.10 To sustain the burden of proof that he has made a "reasonable investigation" (see paragraph .03), as required under the Securities Act of 1933, an auditor should extend his procedures with respect to subsequent events from the date of his audit report up to the effective date or as close thereto as is reasonable and practicable in the circumstances. In this connection, he should arrange with his client to be kept advised of the progress of the registration proceedings so that his review of subsequent events can be completed by the effective date. The likelihood that the auditor will discover subsequent events necessarily decreases following the date of the auditor's report, and, as a practical matter, after 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 of AS 2801, *Subsequent Events*, 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 representations from officers and other executives responsible for financial and accounting matters (limited where appropriate to major locations) about whether any events have occurred, other than those reflected or disclosed in the registration statement, that, in the officers' or other executives' opinion, have a material effect on the audited financial statements included therein or that should be disclosed in order to keep those statements from being misleading.

.11 A registration statement filed with the Securities and Exchange Commission may contain the reports of two or more independent auditors on their audits of the financial statements for different periods. An auditor who has audited the financial statements for prior periods but has not audited 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 prior-period financial statements, and extending to the effective date, that bear materially on the prior-period financial statements on which he reported. Generally, he should

- a. Read pertinent portions of the prospectus and of the registration statement.
- b. Obtain a letter of representation from the successor independent auditor regarding whether his audit (including his procedures with respect to subsequent events) revealed any matters that, 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.

The auditor should make inquiries and perform other procedures that he considers necessary to satisfy himself regarding the appropriateness of any adjustment or disclosure affecting the prior-period financial statements covered by his report (*see AS 3105, Departures from Unqualified Opinions and Other Reporting Circumstances*).

Response to Subsequent Events and Subsequently Discovered Facts

.12 If, subsequent to the date of his report on audited financial statements, the auditor (including a predecessor auditor) (a) discovers, in performing the procedures described in paragraphs .10 and .11 above, subsequent events that require adjustment or disclosure in the financial statements or (b) becomes aware that facts may have existed at the date of his report that might have affected his report had he then been aware of those facts, he should follow the guidance in AS 2801 and AS 2905, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report*. If the financial statements are appropriately adjusted or the required additional disclosure is made, the auditor should follow the guidance in paragraph .05 of AS 3110, *Dating of the Independent Auditor's Report*, and AS 3110.07 and .08, with respect to dating his report. If the client refuses to make appropriate adjustment or disclosure in the financial statements for a

subsequent event or subsequently discovered facts, the auditor should follow the procedures in AS 2905.08 and .09. In such circumstances, the auditor should also consider, probably with the advice of his legal counsel, withholding his consent to the use of his report on the audited financial statements in the registration statement.

.13 If an accountant concludes on the basis of facts known to him that unaudited financial statements or unaudited interim financial information presented or incorporated by reference in a registration statement are not in conformity with generally accepted accounting principles, he should insist on appropriate revision. Failing that,

- a. If the accountant has reported on a review of such interim financial information and the subsequently discovered facts are such that they would have affected his report had they been known to him at the date of his report, he should refer to AS 2905, because certain provisions of that section may be relevant to his consideration of those matters (*see* paragraph .46 of AS 4105, *Reviews of Interim Financial Information*).
- b. If the accountant has not reported on a review of the unaudited financial statements or interim financial information, he should modify his report on the audited financial statements to describe the departure from generally accepted accounting principles contained in the unaudited financial statements or interim financial information.

In either case, the accountant should communicate the matter to the audit committee and also consider withholding his consent to the use of his report on the audited financial statements in the registration statement.

Footnotes (AS 4101 - Responsibilities Regarding Filings Under Federal Securities Statutes):

¹ 4 S. E. C. 721 (1939).

² Under rules of the Securities and Exchange Commission, a report based on a review of interim financial information is not a report by the accountant under section 11 (*see* paragraph .06).

³ A similar description of the status of the accountant's report would also ordinarily be satisfactory for the accountant's purposes when the accountant's review report is presented in the registration statement rather than incorporated by reference. In that case, the description in the prospectus would specifically refer to that report in the registration statement.