

EXPOSURE DRAFT

ED 22/05
(October 2005)

Proposed Auditing Standard: Subsequent Events (Re-issuance of AUS 706)

Prepared and Issued by the **Auditing and Assurance Standards Board**



Australian Government

Auditing and Assurance Standards Board

Commenting on this Exposure Draft

Comments on this Exposure Draft should be forwarded so as to arrive by 15 December 2005. Comments should be addressed to:

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A copy of all non-confidential submissions will be placed on public record on the AUASB website: www.auasb.gov.au.

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PREFACE

Reasons for Issuing ED 22/05

The Auditing and Assurance Standards Board (AUASB) is proposing to re-issue Auditing Standard (AUS 706) *Subsequent Events* due to the requirements of the legislative provisions explained below.

The *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (the CLERP 9 Act) established the AUASB as an independent statutory body under section 227A of the *Australian Securities and Investments Commission Act 2001*, as from 1 July 2004. Under section 336 of the *Corporations Act 2001*, the AUASB may make Auditing Standards for the purposes of the corporations legislation. These Auditing Standards will be legislative instruments under the *Legislative Instruments Act 2003*.

Main Proposals

This proposed Auditing Standard:

- (a) requires the auditor to consider the effect of subsequent events on the financial report and on the auditor's report;
- (b) establishes standards and provides guidance on the auditor's responsibility regarding events occurring up to the date of the auditor's report;
- (c) establishes standards and provides guidance on the auditor's responsibility regarding facts discovered after the date of the auditor's report but before the financial report is issued; and
- (d) establishes standards and provides guidance on the auditor's responsibility regarding facts discovered after the financial report has been issued.

Proposed Operative Date

It is intended that this proposed Auditing Standard will be operative for financial reporting periods commencing on or after 1 July 2006.

Main changes from existing AUS 706 (October 1995)

The main differences between this proposed Auditing Standard and the Auditing Standard issued by the former Auditing & Assurance Standards Board of the Australian Accounting Research Foundation that it supersedes, AUS 706 *Subsequent Events* (October 1995), is that in this proposed Auditing Standard:

1. the word 'shall', in the **bold-type** paragraphs, is the terminology used to describe an auditor's mandatory requirements, whereas an auditor's degree of responsibility was previously described by the word 'should';
2. the explanatory paragraphs provide guidance and illustrative examples to assist the auditor in fulfilling the mandatory requirements, whereas previously some obligations were implied within certain explanatory paragraphs. Accordingly, such paragraphs have been redrafted to clarify that the matter forms part of the explanatory guidance;
3. the terminology and overall concepts have been aligned to the Audit Risk Standards. The issue and re-issue of the Audit Risk Standards in February 2004, comprising:
 - AUS 402 "Understanding the Entity and Its Environment and Assessing the Risks of Misstatement";
 - AUS 406 "The Auditor's Procedures in Response to Assessed Risks";
 - AUS 502 "Audit Evidence"; and
 - AUS 702 The Independent Auditor's Report on a complete General Purpose Financial Report"gave rise to necessary conforming amendments to certain existing AUSs, including AUS 706.
4. the following implied obligations, previously in AUS 706, have been elevated and re-stated as specific mandatory requirements:
 - (a) when the auditor becomes aware of a fact which may materially affect the financial report after the date of the auditor's report but before the date the financial report is issued and management amends the financial report, the

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- auditor shall carry out the procedures necessary in the circumstances and shall provide management with a new report on the amended financial report (paragraph 15);
- (b) when the auditor becomes aware of a fact which may materially affect the financial report after the date of the auditor's report but before the date the financial report is issued and the auditor's report has been released to the entity, the auditor shall notify those charged with governance of the entity not to issue the financial report and the auditor's report thereon to third parties (paragraph 18); if the financial report is subsequently released, the auditor shall endeavour to take action to prevent reliance on the auditor's report (paragraph 19);
 - (c) when the auditor becomes aware of a fact which may materially affect the financial report after the financial report has been issued and management revises the financial report, the auditor shall carry out the audit procedures necessary in the circumstances, shall review the steps taken by management to endeavour to ensure that anyone in receipt of the previously issued financial report together with the auditor's report thereon is informed of the situation, and shall issue a new report on the revised financial report (paragraph 23); and
 - (d) when the auditor becomes aware of a fact which may materially affect the financial report after the financial report has been issued and management does not take the necessary steps to endeavour to ensure that anyone in receipt of the previously issued financial report together with the auditor's report thereon is informed of the situation and does not revise the financial report in circumstances where the auditor believes it needs to be revised, the auditor shall notify those charged with governance of the entity that action shall be taken by the auditor to endeavour to prevent future reliance on the auditor's report (paragraph 26).
5. the explanatory paragraphs on the definitions of "reporting date", "date of approval of the financial report", "date of the auditor's report" and "date the financial report is issued" as contained in ISA 560, are adopted and adjusted, where appropriate, to align to the wordings in AASB 110, "Events after the Balance Sheet Date."

A Table of Proposed Changes, excluding conforming amendments mentioned at point 3 above, is provided as an attachment to the Exposure Draft.

Proposed Auditing Standard: *Subsequent Events (Re-issuance of AUS 706)*

Request for Comments

Comments are invited on this Exposure Draft of the proposed re-issuance of Auditing Standard (AUS 706) *Subsequent Events* by 15 December 2005. The AUASB would prefer that respondents express a clear overall opinion on whether the proposed Auditing Standard, as a whole, is supported and that this opinion be supplemented by detailed comments, whether supportive or critical, on any matter. The AUASB regards both critical and supportive comments as essential to a balanced review of the proposed Auditing Standard.

AUTHORITY STATEMENT

The Auditing and Assurance Standards Board (AUASB) makes Auditing Standard << >> *Subsequent Events* as set out in paragraphs 1 to 29, pursuant to section 227B of the *Australian Securities and Investment Commission Act 2001* and section 336 of the *Corporations Act 2001*.

This Auditing Standard is to be read in conjunction with the *Preamble to AUASB Standards*, which sets out the intentions of the AUASB on how the Auditing Standards are to be understood, interpreted and applied.

The mandatory requirements of this Auditing Standard are set out in **bold-type** paragraphs.

AUDITING STANDARD

Subsequent Events

Application

- 1 **This Auditing Standard applies to:**
 - (a) **an audit of a financial report for a financial year, or an audit of a financial report for a half-year, in accordance with Part 2M.3 of the *Corporations Act 2001*; and**
 - (b) **an audit of a financial report for any other purpose.**
- 2 This Auditing Standard also applies, as appropriate, to an audit of other financial information.

Operative Date

- 3 **This Auditing Standard is operative for financial reporting periods commencing on or after 1 July 2006.**

Introduction

- 4 The purpose of this Auditing Standard is to establish requirements and to provide guidance on the auditor's responsibility regarding subsequent events. In this Auditing Standard, the term "subsequent events" is used to refer to both events occurring between the reporting date and the date of the auditor's report, and facts discovered after the date of the auditor's report.
- 5 **The auditor shall consider the effect of subsequent events on the financial report and on the auditor's report.**
- 6 Accounting Standard AASB 110, "Events After the Balance Sheet Date," deals with the treatment in a financial report of events, both favourable and unfavourable, that occur between the reporting date and the date when the financial report is authorised for issue and identifies two types of events:
 - (a) those that provide evidence of conditions that existed at the reporting date (*adjusting events after the reporting date*); or

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- (b) those that are indicative of conditions that arose after the reporting date (*non-adjusting events after the reporting date*).

Definitions

7 The following terms have the meanings attributed below:

- (a) “Reporting date” is the date of the end of the latest period covered by the financial report, which is normally the date of the most recent balance sheet in the financial report subject to audit.
- (b) “Date of approval of the financial report” is the date on which those with the recognised authority assert that they have prepared the entity’s complete financial report, including the related notes, and that they have taken responsibility for them. In some jurisdictions, the law or regulation identifies the individuals or bodies (for example, the directors) that are responsible for concluding that a complete financial report has been prepared, and specifies the necessary approval process. In other jurisdictions, the approval process is not prescribed in law or regulation and the entity follows its own procedures in preparing and finalising its financial report in view of its management and governance structures. In some jurisdictions, final approval of the financial report by shareholders is required before the financial report is issued publicly. In these jurisdictions, final approval by shareholders is not necessary for the auditor to conclude that sufficient appropriate audit evidence has been obtained. The date of approval of the financial report for purposes of the Auditing Standards is the earlier date on which those with the recognised authority determine that a complete financial report has been prepared.
- (c) “Date of the auditor’s report” is the date selected by the auditor to date the report on the financial report. The auditor’s report is not dated earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the opinion on the financial report.¹ Sufficient appropriate audit evidence includes evidence that the entity’s complete financial report has been

¹ In rare circumstances, law or regulation also identifies the point in the financial report reporting process at which the audit is expected to be complete.

prepared and that those with the recognised authority have asserted that they have taken responsibility for them.

- (d) “Date the financial report is issued” is the date that the auditor’s report and audited financial report are made available to third parties, which may be, in many circumstances, the date that they are filed with a regulatory authority.

Events Occurring Up to the Date of the Auditor’s Report

8 The auditor shall perform procedures designed to obtain sufficient appropriate audit evidence that all events up to the date of the auditor’s report that may require adjustment of, or disclosure in, the financial report have been identified.

9 These procedures are in addition to routine procedures which may be applied to specific transactions occurring after the reporting date to obtain audit evidence as to account balances as at the reporting date, for example, the testing of inventory cut-off and payments to creditors. The auditor is not, however, expected to conduct a continuing review of all matters to which previously applied procedures have provided satisfactory conclusions.

10 The procedures to identify events that may require adjustment of, or disclosure in, the financial report would be performed as near as practicable to the date of the auditor’s report and ordinarily include the following:

- (a) reviewing procedures management has established to ensure that subsequent events are identified;
- (b) reading minutes of the meetings of shareholders, the board of directors and audit and executive committees held after the reporting date and inquiring about matters discussed at meetings for which minutes are not yet available;
- (c) reading the entity’s latest available interim financial report and, as ordinarily considered necessary and appropriate, budgets, cash flow forecasts and other related management reports;
- (d) inquiring, or extending previous oral or written inquiries, of the entity’s lawyers concerning litigation and claims; and
- (e) inquiring of management as to whether any subsequent events have occurred which might affect the financial

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report. Examples of inquiries of management on specific matters are:

- (i) the current status of items that were accounted for on the basis of preliminary or inconclusive data;
- (ii) whether new commitments, borrowings or guarantees have been entered into;
- (iii) whether sales of assets have occurred or are planned;
- (iv) whether the issue of new shares or debentures or an agreement to merge or liquidate has been made or is planned;
- (v) whether any assets have been appropriated by government or destroyed, for example, by fire or flood;
- (vi) whether there have been any developments regarding risk areas and contingencies;
- (vii) whether any unusual accounting adjustments have been made or are contemplated; and
- (viii) whether any events have occurred or are likely to occur which will bring into question the appropriateness of accounting policies used in the financial statements as would be the case, for example, if such events call into question the validity of the going concern assumption.

11 When a component, such as a division, branch or subsidiary, is audited by another auditor, the auditor would ordinarily consider the other auditor's procedures regarding events after the reporting date and the need to inform the other auditor of the planned date of the auditor's report.

12 **When the auditor becomes aware of events which materially affect the financial report, the auditor shall consider whether such events are properly accounted for and adequately disclosed in the financial report.**

Facts Discovered After the Date of the Auditor's Report but Before the Financial Report is Issued

- 13 The auditor does not have any responsibility to perform procedures or make any inquiry regarding the financial report after the date of the auditor's report. During the period from the date of the auditor's report to the date the financial report is issued, the responsibility to inform the auditor of facts which may affect the financial report rests with management.
- 14 **When, after the date of the auditor's report but before the date the financial report is issued, the auditor becomes aware of a fact which may materially affect the financial report, the auditor shall consider whether the financial report needs amendment, shall discuss the matter with management, and shall take the action appropriate in the circumstances.**
- 15 **When management amends the financial report, the auditor shall carry out the procedures necessary in the circumstances and shall provide management with a new report on the amended financial report.**
- 16 Pursuant to AUS 702, "The Auditor's Report on a General Purpose Financial Report", the new auditor's report would be dated no earlier than the date of approval of the amended financial report. Under such circumstances, pursuant to paragraph 8 of this Auditing Standard, the auditor is required to extend the procedures referred to in paragraph 8 to the date of the new auditor's report.
- 17 **When management does not amend the financial report in circumstances where the auditor believes it needs to be amended and the auditor's report has not been released to the entity, the auditor shall express a qualified opinion, as described in AUS 702 "The Auditor's Report on a General Purpose Financial Report".**
- 18 **When the auditor's report has been released to the entity, the auditor shall notify those charged with governance not to issue the financial report and the auditor's report thereon to third parties.**
- 19 **If the financial report is subsequently released, the auditor shall endeavour to take action to prevent reliance on the auditor's report.**

- 20 The action taken will ordinarily depend on the auditor's legal rights and obligations and the recommendations of the auditor's lawyer.

Facts Discovered After the Financial Report has been Issued

- 21 After the financial report has been issued, the auditor has no obligation to make any inquiry regarding such a financial report.
- 22 **When, after the financial report has been issued, the auditor becomes aware of a fact which existed at the date of the auditor's report and which, if known at that date, may have caused the auditor to modify the auditor's report, the auditor shall consider whether the financial report needs revision, shall discuss the matter with management, and shall take the action appropriate in the circumstances.**
- 23 **When management revises the financial report, the auditor shall carry out the audit procedures necessary in the circumstances, shall review the steps taken by management to endeavour to ensure that anyone in receipt of the previously issued financial report together with the auditor's report thereon is informed of the situation, and shall issue a new report on the revised financial report.**
- 24 **The new auditor's report shall include an emphasis of matter paragraph referring to a note to the financial report that more extensively discusses the reason for the revision of the previously issued financial report and to the earlier report issued by the auditor.**
- 25 Pursuant to AUS 702, the new auditor's report would be dated not earlier than the date of approval of the revised financial report and, accordingly, the procedures referred to in paragraphs 8 and 9 would ordinarily be extended to the date of the new auditor's report. Local regulations of some countries permit the auditor to restrict the audit procedures regarding the revised financial report to the effects of the subsequent event that necessitated the revision. In such cases, the new auditor's report would contain a statement to that effect.
- 26 **When management does not take the necessary steps to endeavour to ensure that anyone in receipt of the previously issued financial report together with the auditor's report thereon is informed of the situation and does not revise the financial report in circumstances where the auditor believes it needs to be revised, the auditor shall notify those charged with governance of the entity that action shall be taken by the auditor to endeavour to prevent future reliance on the auditor's report.**

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- 27 The action taken will ordinarily depend on the auditor's legal rights and obligations and the recommendations of the auditor's lawyers.
- 28 It may not be necessary to revise the financial report and issue a new auditor's report when issue of the financial report for the following period is imminent, provided appropriate disclosures are to be made in such a report.

Conformity with International Standards on Auditing

- 29 Except as noted below, this Auditing Standard conforms with International Standard on Auditing ISA 560, "Subsequent Events", issued by the International Auditing and Assurance Standards Board of the International Federation of Accountants. The differences between this Auditing Standard and ISA 560 are that this Auditing Standard:
- Includes the following specific mandatory requirements which are included only as guidance in the explanatory paragraphs of ISA 560:
 - ◆ when the auditor becomes aware of a fact which may materially affect the financial report after the date of the auditor's report but before the date the financial report is issued and management amends the financial report, the auditor shall carry out the procedures necessary in the circumstances and shall provide management with a new report on the amended financial report (paragraph 15);
 - ◆ when the auditor becomes aware of a fact which may materially affect the financial report after the date of the auditor's report but before the date the financial report is issued and the auditor's report has been released to the entity, the auditor shall notify those charged with governance of the entity not to issue the financial report and the auditor's report thereon to third parties (paragraph 18); if the financial report is subsequently released, the auditor shall endeavour to take action to prevent reliance on the auditor's report (paragraph 19);
 - ◆ when the auditor becomes aware of a fact which may materially affect the financial report after the financial report has been issued and

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management revises the financial report, the auditor shall carry out the audit procedures necessary in the circumstances, shall review the steps taken by management to endeavour to ensure that anyone in receipt of the previously issued financial report together with the auditor's report thereon is informed of the situation, and shall issue a new report on the revised financial report (paragraph 23); and

- ◆ when the auditor becomes aware of a fact which may materially affect the financial report after the financial report has been issued and management does not take the necessary steps to endeavour to ensure that anyone in receipt of the previously issued financial report together with the auditor's report thereon is informed of the situation and does not revise the financial report in circumstances where the auditor believes it needs to be revised, the auditor shall notify those charged with governance of the entity that action shall be taken by the auditor to endeavour to prevent future reliance on the auditor's report (paragraph 26).

- (a) Does not deal with the offering of securities to the public.

Table of Proposed Changes from AUS 706 <i>Subsequent Events</i>
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Base Standard

ISA 560, "Subsequent Events," was used as the base standard when re-drafting this proposed Auditing Standard.

Main differences between the Base Standard and the existing AUS 706

The main differences between ISA 560 and the existing AUS 706 are:

1. the terminology and overall concepts have been aligned to the Audit Risk Standards. The issue and re-issue of the Audit Risk Standards in February 2004, comprising:
 - AUS 402 "Understanding the Entity and Its Environment and Assessing the Risks of Misstatement";
 - AUS 406 "The Auditor's Procedures in Response to Assessed Risks";
 - AUS 502 "Audit Evidence"; and
 - AUS 702 "The Independent Auditor's Report on a complete General Purpose Financial Report"
- gave rise to necessary conforming amendments to certain existing AUSs, including AUS 706.
2. the following additional specific mandatory requirements are included:
 - (a) when the auditor becomes aware of a fact which may materially affect the financial report after the date of the auditor's report but before the date the financial report is issued and management amends the financial report, the auditor shall carry out the procedures necessary in the circumstances and shall provide management with a new report on the amended financial report (paragraph 15);
 - (b) when the auditor becomes aware of a fact which may materially affect the financial report after the date of the auditor's report but before the date the financial report is issued and the auditor's report has been released to the entity, the auditor shall notify those charged with governance of the entity not to issue the financial report and the auditor's report thereon to third parties (paragraph 18); if the financial report is subsequently released, the auditor shall endeavour to take action to prevent reliance on the auditor's report (paragraph 19);
 - (c) when the auditor becomes aware of a fact which may materially affect the financial report after the financial report has been issued and management revises the financial report, the auditor shall carry out the audit procedures necessary in the circumstances, shall review the steps taken by management to endeavour to ensure that anyone in receipt of the previously issued financial report together with the auditor's report thereon is informed of the situation, and shall issue a new report on the revised financial report (paragraph 23); and
 - (d) when the auditor becomes aware of a fact which may materially affect the financial report after the financial report has been issued and management does not take the necessary steps to endeavour to ensure that anyone in receipt of the previously issued financial report together with the auditor's report thereon is informed of the situation and does not revise the financial report in circumstances where the auditor believes it needs to be revised, the auditor shall notify those charged with governance of the entity that action shall be taken by the auditor to endeavour to prevent future reliance on the auditor's report (paragraph 26).

Table of proposed changes from the Base Standard

The table below details the proposed changes from the base standard, ISA 560 (excluding changes to reflect Australian terminology and references to Australian Auditing Standards).

Paragraph No. in Proposed Exposure Draft	Status (Requirement, Guidance, Footnote or Appendix)	Description of Proposed Change(s)
1, 2	Requirement / Guidance	New Application Paragraph.
3	Requirement	Re-position Operative Date paragraph.
5, 8, 12, 14, 15, 17, 18, 19, 22, 23, 24, 26	Requirement	Replace “should” with “shall”.
4, 5, 7(c), 7(d), 8, 9, 10, 11, 13, 14, 17, 18, 19, 22, 24, 25, 26, 28	Requirement / Guidance	Replace “audit report” with “auditor’s report”.
Old 14, 15	Guidance	Elevate implied obligation to a mandatory requirement.
Old 16, 18, 19, 20	Guidance	Elevate implied obligation to a mandatory requirement. Replace term “persons ultimately responsible for the overall direction of the entity” with “those charged with governance.”
Old 19, 23	Guidance	Elevate implied obligation to a mandatory requirement.
Old 24, 26	Guidance	Elevate implied obligation to a mandatory requirement. Replace term “persons ultimately responsible for the overall direction of the entity” with “those charged with governance.”
11, 20, 27	Guidance	Insert “ordinarily” to clarify implied obligation.
4, 6, 7(a), 9, 10, 11	Guidance	Replace “period end” with “reporting date” to correspond to AASB 110, “Events After the Balance Sheet Date”.
6(a), 6(b)	Guidance	Add guidance.

Paragraph No. in Proposed Exposure Draft	Status (Requirement, Guidance, Footnote or Appendix)	Description of Proposed Change(s)
9, 25, 27	Guidance	Separate guidance from mandatory requirement.
16, 25	Guidance	Insert "Pursuant to AUS 702..."