



POST-BALANCE SHEET EVENTS REVIEW

HIGHLIGHTS OF TECHNICAL CLINIC

Financial statements may be affected by certain events that occur after the date of the financial statements which require adjustment of or disclosure in the financial statements. The public accountants are required to perform sufficient audit procedures to check that such events have been appropriately reflected in the financial statements. In the last five years of the practice monitoring programme (PMP), post-balance sheet events review (PBSE) performed by the public accountants, particularly those in the small and medium-sized practices (SMPs), has been an area with frequent findings. Why is PBSE important? What are the challenges faced by SMPs in this area and how should the challenges be addressed? Michael Chin, Deputy Managing

Partner, PKF-CAP LLP, shed light on this topic during the discussion.

Q1 **Why is it important to perform PBSE review?**

PBSE review helps to identify events occurring after the balance sheet date which may have an implication on the financial statements, and it is the auditor's responsibility to perform such review as stated in para 6 of Singapore Standard on Auditing (SSA) 560. An example illustrating the importance of PBSE review would be the disposal of a building after year-end at a price significantly below its net book value. Through the enquiry with the management on significant events that occurred after the balance sheet date and review of Directors' meeting minutes, the audit team was made aware of such events and

had requested that an impairment charge be provided for in the financial statements under audit. Had the PBSE review not been performed, the auditor would not have been aware of the subsequent sale and would have proceeded to issue a clean report on the financial statements which did not include this significant impairment provision.

Another example which illustrates the importance of PBSE review relates to review of credit notes issued after year-end. The audit team, in the course of the review of credit notes issued after year-end, had identified a credit note issued to a customer for a substantial amount which was unusual. Through further enquiry with the management, the audit team discovered that the credit



note issued relates to sales discount provided to a distributor for meeting the sales target for the financial year. It was then that the audit team realised that the management had not made any provision for such liability as at balance sheet date. Further procedures were subsequently performed by the audit team to assess the pervasiveness of the issue and to evaluate the need for adjustments in the financial statements.

Q2 What are the challenges faced by SMPs in performing PBSE review?

Given that SMPs have a large number of clients, they tend to grapple with resource constraints as well as pressure to complete the audit engagements within a shorter time frame. Consequently,

PBSE is an area that is frequently overlooked by the audit team, including the public accountant. Accordingly, deficiency in this area is unlikely to be picked up throughout the audit process.

In addition, audit staff, especially inexperienced ones, do not possess knowledge of the procedures which should be performed in a PBSE review and which are appropriate in a particular audit engagement. Not knowing what to do, audit staff tend to complete the PBSE review by filling the audit programmes with “yes”, “no” or “not applicable” responses without providing further details. Due to the absence of proper supervision and guidance, the deficiencies may not be detected and corrected. Such deficiencies will be carried through as the audit staff progress to the next level and will set a bad example for the junior staff.

To add to the challenge, some small and medium-sized entities (SMEs) in Singapore may not have proper procedures to identify subsequent events, maintain formal records of internal management meeting minutes or have in place updated interim financial statements subsequent to year-end. In such situations, audit teams may be at a loss for audit procedures which could be performed.

Q3 How should SMPs address the challenges?

Educating the audit staff is a way to address these challenges. Specifically for PBSE, the areas to

be covered include (1) objective of the PBSE review, (2) designing and performing effective PBSE audit procedures, and (3) documenting the PBSE review. Once the audit staff understand the purpose of such a review, they will perform their audit work conscientiously. Also, using the knowledge acquired, the audit staff will be able to determine appropriate PBSE audit procedures and perform and document the audit work. Such education need not be formal training but could be in the form of small group sharing or on-the-job training.

Furthermore, expectations of proper documentation should be established upfront and clearly communicated to the audit teams.

AUDIT DOCUMENTATION IS AN ESSENTIAL ELEMENT OF AUDIT QUALITY. SMPs SHOULD EMPHASISE THE IMPORTANCE OF DOCUMENTATION AND ENSURE THAT THE WORK PERFORMED IS REFLECTED IN THE AUDIT FILE.

For example, answering “yes”, “no” or “not applicable” in the audit programme without furnishing details is not acceptable. Audit teams need to document details of the work performed

or cross-reference to relevant audit working papers which contain such details. Generally, documentation in respect of PBSE audit procedures performed should include details of:

- ➕ the nature, timing and extent of the audit procedures;
- ➕ the audit evidence obtained and the detailed findings from the audit procedures performed;
- ➕ significant matters arising during the audit;
- ➕ the conclusions reached, and

- + the significant professional judgements made in reaching those conclusions

In the event that companies under audit do not have proper subsequent events review procedures in place, the audit team can consider the common PBSE audit procedures illustrated in Q4. The nature and extent of the PBSE audit procedures to be performed should be discussed and agreed with the public accountants.

Lastly, SMPs may consider including PBSE review in the audit completion checklist to make sure that the review is properly performed and is under the radar of the reviewers. Also, for firms which have adopted quality review programmes, PBSE can be included as one of the areas under review so that specific deficiencies in this area are identified and corrective actions can then be taken to address these deficiencies.

Q4 Would PBSE audit procedures be the same for all companies?

Not necessarily. However, some common PBSE audit procedures include:

- + inquiry of management or those charged with governance;
- + review of subsequent management accounts of the company;
- + review of subsequent minutes of Directors' and shareholders' meetings;
- + review of credit notes issued after year-end;
- + review of journal entries made subsequent to the date of financial statements;
- + review of legal correspondences and update of legal replies (if applicable) until the date of audit report;

- + review of subsequent payments;
- + review of significant contracts and agreements signed after year-end;
- + review of unpaid suppliers' invoices and correspondences with suppliers, and
- + search for unrecorded liabilities

Q5 Wouldn't an enquiry with management be sufficient for PBSE audit procedures?

Not necessarily. When deciding on the types and extent of PBSE audit procedures, auditors need to consider their understanding of the company and the risks assessed. Generally, more extensive PBSE audit procedures are expected to be performed in the audit of a company with messy records or which lacks a clear reporting line and ownership of accounting function. Also, a specific risk identified in the audit may require more extensive or specific audit procedures to be performed.

Other PBSE audit procedures which may be performed include but are not limited to the review of subsequent utilisation of warranty provision, and review of correspondences with suppliers, customers and other relevant parties in cases of dispute. For example, in the audit of a manufacturing or trading company where goods sold are covered by warranty, a review of subsequent utilisation of warranty provision may be performed to assess that the warranty provision is adequate but not excessive.

Q6 What if my SME client does not prepare interim management accounts on a monthly basis and has no budgetary control in place? What are the alternative PBSE audit procedures that the audit

team can consider?

This is not an excuse for the audit team not to perform PBSE audit procedures. There are many other PBSE audit procedures that the audit team can perform, as illustrated in Q4.

Q7 What can SMPs do to make sure all outstanding matters have been properly addressed up to the date of the auditor's report?

Training the audit teams to systematically summarise in writing the outstanding matters with sufficient clarity at the end of the audit fieldwork is an efficient and effective way. In the absence of an audit team, another audit staff can follow up and update on outstanding matters. Of course, there needs to be a second pair of eyes to check that the audit teams have properly addressed and documented the details in the audit file before the audit report is signed off.

Q8 If the interval between audit fieldwork and the date of audit report is short, is a PBSE review still required to be performed?

Yes, audit teams need to perform sufficient PBSE audit procedures to cover the period between the audit fieldwork and the date of the auditor's report, regardless of the length of the interval. However, the extent of the PBSE audit procedures performed varies depending on the length of the interval. For illustrative purposes, an audit team has completed the audit fieldwork on 7 February 2012 but the audit report cannot be issued until the receipt of a significant outstanding amount from a customer subsequently on 21 February 2012. In addition to the followup on the

documentation of the subsequent receipt received, the audit team needs to perform PBSE audit procedures to address the 14-day lapse between the completion date of the audit fieldwork and the date of the audit report, 21 February 2012. Given the relatively short interval, the amount of work is not expected to be as extensive as that for a one-month or longer interval. Judgement needs to be exercised by the public accountant and manager with significant experience when determining the nature, timing and extent of PBSE audit procedures, taking into account their understanding of the company and the risks assessed.

Q9 Is it necessary to perform the PBSE audit procedure to address the time lapse between the date of the audit report and the date of issuance of the financial statements?

According to para 10 of SSA 560, the auditor has no obligation to perform any audit procedures after the date of the auditor's report. However, if a material matter becomes known to the auditor before the financial statements are issued that may cause the auditor to amend the auditor's report, then the auditor is required to discuss the matter with management and/or those charged

GIVEN THAT SMPs HAVE A LARGE NUMBER OF CLIENTS, THEY TEND TO GRAPPLE WITH RESOURCE CONSTRAINTS AS WELL AS PRESSURE TO COMPLETE THE AUDIT ENGAGEMENTS WITHIN A SHORTER TIME FRAME. CONSEQUENTLY, PBSE IS AN AREA THAT IS FREQUENTLY OVERLOOKED BY THE AUDIT TEAM, INCLUDING THE PUBLIC ACCOUNTANT.

with governance and determine whether the financial statements need amendment either in terms of disclosure or/ and adjustment.

The extent of the PBSE audit procedure to be performed on the interval is an area requiring significant judgement. It is explained in SSA 210 that the terms of the audit engagement include the agreement of management to inform the

auditor of facts that may affect the financial statements, of which management may become aware during the period from the date of the auditor's report to the date the financial statements are issued. Hence, at the minimum, the auditor is expected to make an enquiry with the management.


Additional PBSE audit procedures will be necessary in circumstances where the auditor determines that the financial statements need to be amended and a new audit report at a later date is to be issued on the amended financial statements.

Q10 What are the useful takeaways that SMPs learnt from the discussion?

Firstly, SMPs need to set the right tone at the top to emphasise audit quality for all engagements.

Secondly, training is necessary to educate the audit staff on the relevant audit procedures in a PBSE review. The objective and purpose of such a review can be emphasised in inhouse training or sharing sessions using the experience learnt from the audit of clients. Also, SMPs may consider issuing year-end or periodic audit reminders to remind audit teams of the common pitfalls of PBSE review audit procedures.

Externally, there are various technical resources available to assist SMPs, such as those at the ICPAS Centre for Audit and Assurance website at www.icpascaa.org.sg. Specifically for the PBSE review, SMPs can refer to Practical Guidance 9 *Subsequent Events Review* issued by ICPAS, which provides guidance on the appropriate audit procedures to identify subsequent events. SMPs can also continue the discussion at the ICPAS Online Technical Forum at <http://forum.icpas.org.sg/index.php>.

Last but not least, audit documentation is an essential element of audit quality. SMPs should emphasise the importance of documentation and ensure that the work performed is reflected in the audit file. To reinforce the importance of documentation, an extract from ACRA Practice Direction 2 of 2005 *Practice Monitoring Programme* was shared during the discussion, "In the event the PMP reviewer finds an absence of documentary evidence of audit work performed in the audit working papers during the PMP review, it shall be considered that no audit work had been performed by the public accountants concerned." 

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