Subsequent Events: Key Challenges in Financial Reporting

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A transparent view of corporate financial reporting helps in identifying potential issues, making strategic decisions, and ensuring compliance with financial regulations. According to Zatravina & Nezametdinova (2022), company financial reporting provides stakeholders with relevant and reliable accounting information about the company's financial position, financial performance and changes in cash flows, ensuring successful economic interaction and cooperation. The purpose of financial reporting is to deliver financial information that benefits the stakeholders, lenders and other creditors in making investment decisions about the provision of economic resources to the reporting entity (Anwar et al. 2022). The provided financial information should be accurate and reliable, giving them a complete understanding of the company's financial state, progress, and any changes that have occurred. Furthermore, Maines & Wahlen (2006) stated that the reliability of accounting information is useful for decision making process, representing the extent to which the financial information is neutral, free from error, and a faithful representation. This enables stakeholders to make informed decisions about investments, lending, or other financial commitments. This article addresses the challenges and possible outcomes associated with subsequent events which are part of accounting information that is crucial for enhancing the accuracy, transparency, and reliability of financial statements of companies.

Malaysian Accounting Standard Board (MASB) has issued Malaysian Financial Reporting Standard (MFRS)110 *Events after the reporting period,* also known as subsequent events, which applied to all companies in November 2011. MFRS110 *Events after the reporting period define* subsequent events as significant events that occur at post reporting date. Post reporting date is the date between the end of the reporting period and the date when the financial statements are authorized for issue by the board of directors (FRF MASB, 2011). For instance, the post reporting date for company X is on 31st December 20x4 and authorization date for financial statement is on 30th April 20x5, therefore post reporting date is from 1st January 20x5 to 30th April 20x5. Subsequent events can have material implications for a company's financial position and performance, and thus need to be appropriately reflected in financial statements. However, Brumley et al. (2021) found that 67% of subsequent events considered to be irrelevant and were not reported in the financial statements. Properly addressing these events is key for ensuring that the financial statements present a true and fair view of the company's financial status.

In reporting accounting information, subsequent events can be classified into adjusting and non-adjusting events based on their nature and timing (FRF MASB, 2011). The preparer of financial statements may experience difficulty in identifying and classifying both events in enhancing the credibility of financial information provided to stakeholders. According to Brumley et al. (2021), auditors were struggle in the process of identifying and classifying events due to lack of internal control. Misclassification can lead to inappropriate financial adjustments or disclosures, affecting the overall accuracy of the financial statements.

Furthermore, timely identification and reporting of subsequent events can be challenging as the existing regulatory framework for accounting and auditing events after the reporting date is not comprehensive (Egorova, 2021), particularly for events occurring close to the financial statement authorization date. Cut-off issues may arise when determining whether an event should be reflected in the current reporting period or disclosed in the subsequent period, leading to potential inaccuracies or omissions. The non-reporting of an event would contribute to inaccurate reporting of financial statements (Kanu & Onuoha, 2016). Inadequate disclosures can obscure the true impact of these events on the company's financial position and future outlook, leading to stakeholders drawing inappropriate conclusions.

Adjusting events are those favourable or unfavourable occurrences that provide further evidence about situations that occurred at the end of the reporting period, thereby requiring some adjustments to the financial statements (FRF MASB, 2011). The situations that require adjustment in the company's financial statements as per MFRS110 are shown in Table 1.

Table 1: Adjusting Events

Adjusting events	
Settlement of Court Cases	An ongoing court case during the reporting period is subsequently completed, and the settlement amount may provide evidence about the extent of liabilities existing at the end of the reporting date (Figure 1).
Bankruptcy of a Customer	The customer becomes insolvent and leads to irrecoverable debt.
Discovery of Errors or Fraud	Errors or fraud discovered after the reporting date, which show that the financial statements were misstated, require adjustments to correct the figures
Adjustments for Inventory Valuation	The inventory cost reported in the financial statements was sold at net realisable value and below the cost price.
Adjustments to Asset Valuation	When the net selling price of the assets is less than the carrying value or book value in the financial statements indicated impairment losses at the reporting date.

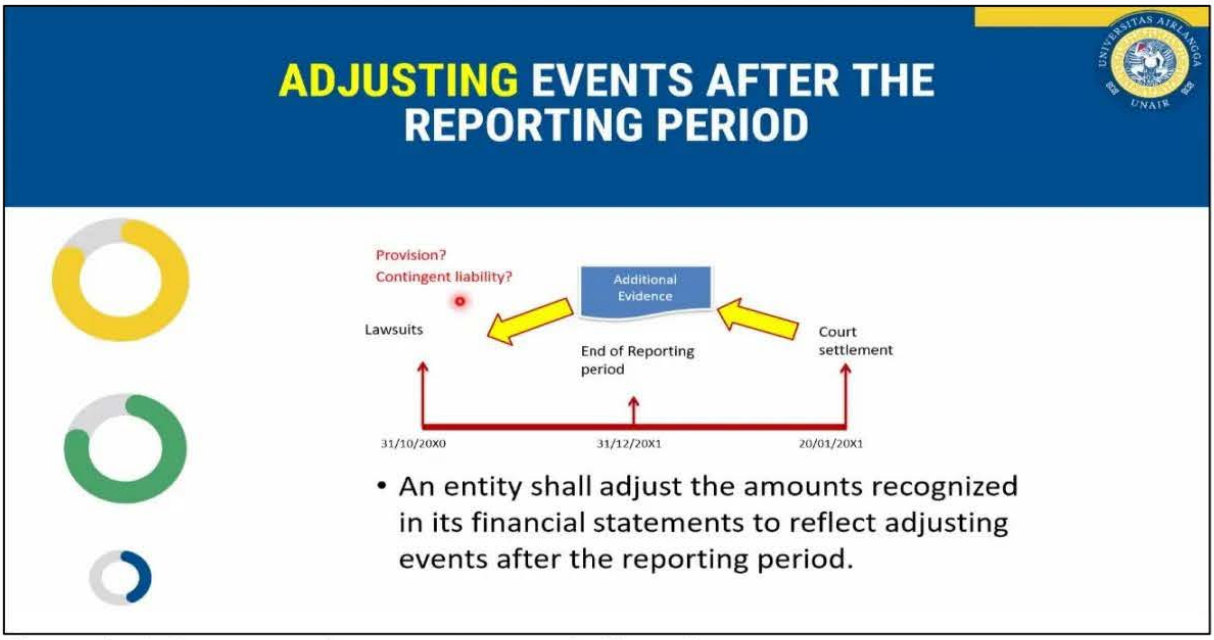

Figure 1: Adjustment of court settlement in financial statements
Source: Online Collaborative Teaching Financial Reporting during International Accounting Alliances Summit 2024 by Mrs Wahyu Firmandani, Universitas Airlangga, Indonesia

Non-adjusting events indicate conditions that arose after the reporting date and generally do not require adjustments but may require disclosure in the notes to the financial statements (FRF MASB, 2011). The disclosure of the events should include the nature, an estimated amount and a statement when such an estimate cannot be made. Non-adjusted events are reported in the notes to financial statements to avoid confusion and provide transparency to stakeholders. The situations that require disclosure notes in the company's financial statements as per MFRS110 are shown in Table 2.

Table 2: Non-Adjusting Events

Non-adjusting events	
Major Business Combinations or Acquisitions	The announcement or completion of a significant business acquisition after the reporting period should be disclosed if it has a significant impact on the company.
Issuance of New Shares or Debt	Issuing new shares or taking on significant new debt after the reporting period should be disclosed as it could affect the financial position and capital structure of the company.
Natural Disasters and Catastrophes	Natural disasters that occur after the reporting date and significantly impact the company's operations or assets require disclosure, especially if they affect the going concern assumption.
Changes in Foreign Exchange Rates	Significant fluctuations in foreign exchange rates after the reporting date that could affect future operations and profitability may require disclosure.
Significant Legal Developments	Legal changes, such as new regulations or pending lawsuits, that arise after the reporting period and could affect the company's operations or financial position should be disclosed.
Dividends Declared	Dividends declared after the reporting date are considered non-adjusting events because there is no present obligation for the entity, and they should be disclosed in the notes to financial statements.

The above situations illustrate how subsequent events can impact financial reporting and the importance of distinguishing between adjusting and non-adjusting events to ensure accurate and comprehensive financial disclosures. Implementing robust internal controls and procedures for identifying and reporting subsequent events is essential in addressing the challenges in reporting events after the reporting period. Companies should establish clear protocols for communication between departments to ensure timely identification and reporting of significant events. Regular training for financial and operational staff on the importance of subsequent events and related reporting requirements can further enhance awareness and compliance. Additionally, standard setters and professional bodies are required to provide additional guidance to preparers about internal control best practices, and guide auditors when evaluating and planning for subsequent event searches (Brumley et al., 2021).

Companies should develop a clear and consistent framework to mitigate the risk of misclassification of the events. This framework should be based on MFRS110 *Events after the reporting period* and be consistently applied across all reporting periods. Furthermore, companies should prioritize transparency in their disclosures by providing detailed and clear information about the nature, timing, and financial impact of non-adjusting events. This includes disclosing any uncertainties and potential future implications to give stakeholders a comprehensive understanding of the company's situation. Prior research by Szulc & Zieniuk (2020), majority of listed companies complied with the relevant international standards with 90% of the company's financial statements disclosing a separate note on subsequent events.

Addressing challenges such as misclassification and timely recognition of events will assist companies in enhancing the accuracy, transparency, and reliability of financial statements. The possible outcomes to overcome challenges are implementing robust internal controls and procedures, providing additional guidance for preparers of financial statements, and developing a clear and consistent framework that will improve their financial reporting practices, thereby fostering greater trust and confidence among stakeholders. As the financial landscape continues to evolve, ongoing attention to these issues remains essential for upholding the integrity of financial reporting. According to Ozdemir & Gokcen (2016), disclosures of events after the reporting period are important enough to affect all the financial statements, the independent audit opinion and investment decisions. Effectively identifying and classifying events enables accurate reporting of financial transactions and ensures compliance with relevant accounting standards. This, in turn, leads to better accountability, transparency, and decision-making for stakeholders.

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