How to Account for Events Occurring after the Reporting Period
(Relevant to Paper 7 – Financial Accounting)

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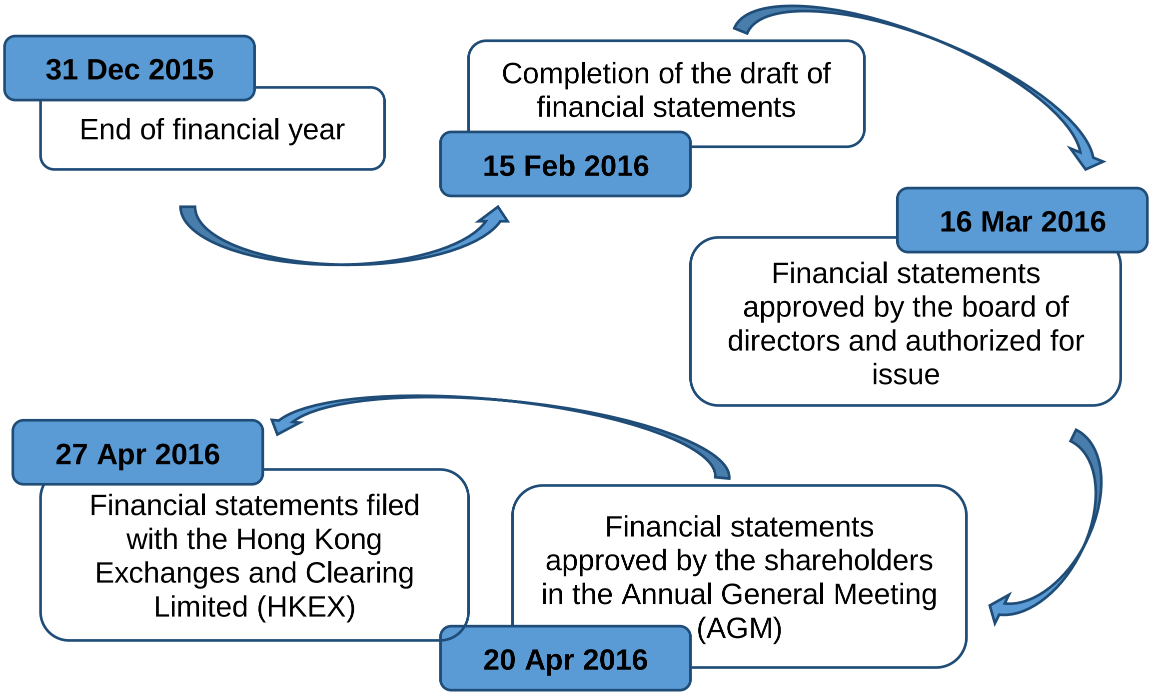
Introduction

Each year, when a new calendar year begins, we receive a lot of WhatsApp and Facebook messages from friends wishing everybody a happy new year. One of the most common greetings or messages is "New Year, New Start!". A fresh start in a new calendar year brings with it new opportunities and new hopes. However, does this mean that we can start everything anew and ignore what we have done in the previous year? Let's take some examples from our daily lives. A mother may, after the calendar year, ask her son to review the homework he did last year and amend the faults he finds. A garage may, after the calendar year, inform the owner on the repair costs for the damage done to his car last year.

Similarly, in the accounting world, although we summarize the financial performance and financial position at the end of each financial year, we need to consider how events occurring after the end of the reporting period may affect the financial statements and perform necessary adjustments if needed. However, what is the cut-off date after the end of the reporting period and what kind of events constitute an adjustment to the financial statements? Let's look briefly at the relevant accounting standard governing these events — HKAS 10 *Events after the Reporting Period*.

Authorization Date

We should review events subsequent to the end of the reporting period up to the date when the financial statements are authorized for issue. Let's look at the following timeline in preparing the financial statements of XYZ Limited:



The above timeline of XYZ Limited reveals that the financial statements are authorized for issue on 16 March 2016, and hence this is regarded as the cut-off date on reviewing events after the reporting period. The company must examine those events, both favourable and unfavourable, that occurred from 1 January 2016 to 16 March 2016 in order to consider whether further amendments to the financial statements are needed.

Adjusting Events

Adjusting events are those events that provide additional or new evidence of conditions that exist at the end of the reporting period. Adjustments should be made in the financial statements so as to reflect the true financial performance and position at the end of the reporting period.

Example 1 — Changes in asset fair value:

XYZ Limited ended its financial year on 31 December 2015 and the financial statements were authorized for issue on 16 March 2016.

On 31 December 2015, the cost of closing inventory was $52,000. Before the end of the financial year, the accountant of XYZ Limited asked a staff member to estimate the selling value of closing inventory. On 2 January 2016, the staff reported that the inventory could only be sold at a value of $50,000, after incurring selling costs of $5,000.

This is an example of an adjusting event. In this case, the information reported by the staff member on 2 January 2016 provided additional evidence proving that the value of closing inventory was in fact impaired at the end of the reporting period. Due to the delay in the supply of information by the staff, the accountant did not incorporate such value in the financial statements. To reflect the true status of the value of closing inventory and in line with the "lower of cost and net realisable value" treatment of HKAS 2 *Inventory*, XYZ Limited should revise the value of closing inventory to its net realisable value, i.e. $45,000 (being $50,000 − $5,000).

__Example 2 — Changes in provision for legal claim:__

Assume the same facts as in Example 1. On 1 October 2015, XYZ Limited has been sued by its competitors for infringement of copyright. On 1 December 2015, the lawyer advised that it is highly likely that XYZ Limited will lose the case and made a provision for a legal claim of $1,000,000.

On 2 February 2016, the case was finalized and XYZ Limited was ordered to pay a compensation of $1,500,000.

This is an example of an adjusting event. In this legal case, the final decision of the court provided a new piece of information concluding that the provision for the legal claim made at the end of the reporting period was insufficient. An adjustment on the previously made provision is needed in order to reflect the true and most updated status of the legal claim.

Also, the adjustment was in line with the treatment of HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. The final decision of the court confirmed that XYZ Limited will lose the case and the compensation should be $1,500,000 instead of $1,000,000. According to HKAS 37, it is probable that XYZ Limited has to settle the compensation and the amount could be estimated reliably. Therefore, for the year ended 31 December 2015, the company should increase the provision for the legal claim to $1,500,000.

Non-adjusting Events

Non-adjusting events are those events that provide an indication of conditions that exist after the end of the reporting period. These events are not related to the reporting period and hence should only be reflected and recognised in the financial statements of the next reporting period.

However, for the purpose of supplying relevant and sufficient information for the decision-making of users, it is necessary to disclose those non-adjusting events if they are found to be material. Information including the nature of the events and an estimation on the financial effect should be disclosed.

Example 3 — Changes in assets' fair value:

Assume the same facts as in Example 1. On 31 December 2015, XYZ Limited invested in ordinary shares of a listed company, World Holdings Limited, and recognised them at their fair value of $1,200,000.

On 5 February 2016, the share price of World Holdings Limited increased sharply and the investment is now worth $1,500,000.

This is an example of a non-adjusting event. In this case, the changes in the fair value of the investment in World Holdings Limited occurred after the end of the reporting period. It has just provided an indication of conditions that exist on 5 February 2016. Therefore, the relevant adjustment should be made in the financial statements for the year ended 31 December 2016.

In view of the significance of the event, XYZ Limited should disclose such changes in the fair value of investment and its financial effect in the financial statements for the year ended 31 December 2015.

Example 4 — Legal case:

Assume the same facts as in Example 1. On 3 January 2016, XYZ Limited has been sued by its customer for the consequential damages caused by the delay in the supply of products by XYZ Limited. The lawyer advised that it is probable that the company will lose the case with an estimation on the total compensation of $800,000.

On 15 February 2016, the case was finalized and the company was ordered to pay a final compensation of $750,000.

This is another example of a non-adjusting event. Unlike Example 2, this legal case was started after the end of reporting period and hence the case was totally unrelated to the financial statements for the year ended 31 December 2015. It has just provided an indication of conditions existing after the reporting period and provision should be made in the financial statements for the year ended 31 December 2016.

In view of the significance of the event, XYZ Limited should disclose the details of the court case and its financial effect in the financial statements for the year ended 31 December 2015.

Conclusion

This article has demonstrated the applications of HKAS 10 *Events after the Reporting Period*. In summary, HKAS 10 governs the recognition of events subsequent to the reporting period. However, the accounting treatments and criteria set in other relevant accounting standards also need to be considered when we recognise an adjusting event in our financial statements.