# An Investigation of How Auditors Search for and Discover Subsequent Event Evidence, and Factors that Influence this Audit Task

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## SUMMARY

Subsequent events are events and/or transactions that occur after the balance sheet date but before the audit report is signed and dated. The evidence provided by these events may have a material effect on the financial statements, particularly on accounting estimates (AICPA 2004, AU 342.10; AICPA 2004, AU 560.05). The recent emphasis on more timely reporting and auditing has reduced and may eventually eliminate the time between balance sheet and report date, thus limiting the availability of subsequent event evidence (CICA 1999; Kogan et al. 1999; Elliott 2001; Greenstein and Vasarhelyi 2002; Jones and Xiao 2003). Decreased availability of subsequent event evidence may lower audit judgment quality (CICA 1999; Kogan et al. 1999; Elliott 2001). This study presents a field-based questionnaire exploring (1) how auditors search for and discover subsequent event evidence, and (2) factors that influence this process.

Responses from auditors employed by three Big 4 firms and one national firm suggest that subsequent event evidence is important in the current audit environment. Nearly all respondents found at least one material subsequent event within the past year. Auditors generally follow recommended audit procedures to search for subsequent event evidence; however the frequency to which any one procedure uncovers subsequent event evidence is not high. Implications for future research to increase our understanding of how reducing the availability of subsequent event evidence impacts audit judgment are discussed.

**Keywords:** subsequent event evidence, evidence evaluation, auditor judgment, accounting estimates, timely reporting.

**Data Availability:** Data is available from the authors upon written request.

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## INTRODUCTION

Auditors generally form their initial opinions by the balance sheet date (Koonce 1993; Hirst and Koonce 1996)[1], but subsequent events may challenge their judgments, particularly with respect to accounting estimates (AICPA 2004, AU 560.05). Subsequent events are events or transactions that occur *after* the balance sheet date but before the audit report is signed and dated. There are two types of subsequent events: adjusting events and non-adjusting events (AICPA 2004, AU 560.02). Adjusting events provide additional information about (1) conditions that existed at the balance sheet date or (2) accounting estimates inherent in the financial reporting process. The adjustments required by these events may have a material effect on the financial statements (AICPA 2004, AU 342.10; AICPA 2004, AU 560.03). Non-adjusting events provide information about conditions that have arisen *after* the balance sheet date. To the extent these events are material, the information provided by these events should be reflected in the financial statements through disclosure (AICPA 2004, AU 560.05). Even though standards require auditors to consider subsequent event evidence at or near the end of fieldwork, (AICPA 2004, AU 560.12), models of the audit process used in research typically do not include the subsequent event evidence task (see Felix and Kinney 1982; Bonner and Pennington 1991) nor could we

[1] The term "initial judgment" is based on the previous work of Koonce (1993) and Hirst and Koonce (1996). Koonce (1993) refers to a mental representation based on the current formulation of a problem, and states "Although the mental representation is dynamic and changes as new information or knowledge is considered and as potential judgments are appraised, the initial representation is particularly important since it can either facilitate or inhibit the subsequent problem-solving process (Carroll et al. 1980; Kassiter and Kopelman 1987, 1989)." Hirst and Koonce (1996) discuss the analytical procedures at the planning stage of the audit. Their interviews with practitioners provide data that indicates auditors develop expectations for account balances and that during planning they perform a variety of procedures to identify unexpected differences in account balances and other financial relationships.

find any prior research examining how auditors search for and whether they find subsequent event evidence.

The movement toward more timely financial reporting and auditing suggests that the availability of subsequent event evidence will diminish as the time period between the financial statement date and the audit report date becomes shorter or is eliminated (AICPA 1999; CICA 1999; Kogan et al. 1999; Botosan and Harris 2000; Ettredge et al. 2000; Elliott 2001; Kinney 2001; Greenstein and Vasarhelyi 2002; SEC 2002; Searcy et al. 2003). Understanding how changes in the needs of society (i.e. demand for more timely financial reporting and auditing) affect audit methods (i.e. diminished availability of subsequent event evidence) is an important research objective (Carmichael 2004). Reduced availability of subsequent event evidence may require auditors to rely on less persuasive[2] evidence, reducing audit effectiveness (CICA 1999). Further, to the extent that companies engage in earnings management, 'financial manipulations' may occur during the final closing process and subsequent event evidence may be key to uncovering these manipulations; the reduced availability of subsequent event evidence may make it more difficult to detect earnings management (Healy and Whalen 1999).

This study presents a field-based questionnaire exploring (1) how auditors search for and discover subsequent event evidence, and (2) factors that influence this process. Forty-six auditors from three Big 4 firms and one national firm provided responses. We use a field-based questionnaire to examine this important topic for several reasons. First, even though standards require auditors to search for subsequent event evidence, given the limited prior research we

[2] *Evidence persuasiveness* refers to the degree to which the auditor is convinced that the opinion is correct with a high level of assurance (Arens et al. 2003, 166). Subsequent event evidence is considered persuasive since it (1) provides evidence with respect to either conditions that existed at the balance sheet date or accounting estimates inherent in the process of preparing financial statements, and (2) is generally generated by external rather than internal sources. Prior research finds external rather than internal evidence is generally more persuasive (Hirst 1994; Caster and Pincus 1996; Reimers and Fennema 1999).

want to confirm that auditors perceive subsequent event evidence is important, and understand how auditors currently search for subsequent event evidence and whether they discover this evidence. Second, before we can experimentally manipulate subsequent event evidence to explore its impact on audit judgment, we need to understand the factors that influence the subsequent event evidence search and discovery process.

Results indicate that subsequent event evidence is perceived to be important in the current audit environment. Nearly all respondents discovered at least one material subsequent event within the past year and referred to subsequent event evidence during the audit process. The search for subsequent events is required by standards to occur after the balance sheet date, and at or near the end of the fieldwork, yet one third of respondents do not form their initial account judgment until after the balance sheet date and over sixty percent perform the majority of fieldwork during a typical audit after the balance sheet date, indicating potential implications for the timing of audit procedures. Although auditors generally follow recommended procedures to search for subsequent event evidence, the likelihood that any one procedure uncovers subsequent events is fairly low. Finally, several factors including balance sheet date judgment characteristics, characteristics of the challenge evidence, and environmental characteristics, impact how auditors search for subsequent event evidence and whether they discover it.

These findings are important as researchers consider how reducing the availability of subsequent event evidence will impact audit judgment. Given the lack of prior research, our attempt to develop a more complete understanding of the subsequent event evidence search and discovery process provides researchers with a solid foundation on which to build conceptual models and design experiments to evaluate how the demand for more timely financial reporting and auditing will impact audit methods. Our analysis will also help researchers and standard

setters to identify problems or issues related to the use of subsequent events in the audit, and then to find the appropriate theoretical framework for addressing these issues. Finally, our work informs audit educators about important aspects of current practice.

The paper proceeds as follows. The next section defines subsequent event evidence and reviews the sparse research examining its usage and importance. Second, a field-based questionnaire examining auditors' perceptions of (1) subsequent event importance and usage, (2) current subsequent event search and discovery process, and (3) factors that may influence the subsequent event search and discovery process is presented. A discussion of future research opportunities concludes the paper.

## OVERVIEW OF SUBSEQUENT EVENT EVIDENCE AND PRIOR RESEARCH

Auditors search for, discover, and evaluate evidence throughout the audit process. Koonce (1993) suggests that auditors generally form their initial account balance judgment by the balance sheet date based upon *historical* evidence (i.e. evidence concerning events that occur by balance sheet date). At or near the end of the fieldwork, before finalizing their opinion, auditors are required to search for evidence from events subsequent to the balance sheet date (AICPA 2004, AU 560.12). Some recommended search procedures are normally integrated into the year-end account balance verification process (i.e., examining client cutoff procedures, valuation tests) while others are specifically performed to search for and find subsequent events (i.e. reading interim financial statements prepared since balance sheet date, inquiring of management with regard to existence of contingent liabilities that existed at balance sheet date, obtaining a representation letter form client management) (AICPA 2004, AU 560.11-12).

As illustrated in Figure 1, evidence search, discovery, and evaluation are interdependent (Einhorn and Hogarth 1981; Knechel and Messier 1990; McMillan and White 1993; Green and

Trotman 2003). When auditors search for evidence, their efforts may or may not be successful (Asare and Wright 2003). If discovered, subsequent event evidence has the potential to challenge auditors' current judgments. Subsequent event evidence may reduce the probability that the financial statements are misstated by providing additional evidence with respect to (1) conditions that existed at the date of the balance sheet, (2) accounting estimates inherent in the process of preparing financial statements, and (3) material events that occurred after the balance sheet date (AICPA 2004, AU 560.03; AICPA 2004 AU 560.05). If no subsequent event evidence is found, auditors must decide, based on their current audit plan and assessed risk, whether to rely on their current judgments or expand their subsequent event evidence search.

<< Insert Figure 1 here >>

Subsequent event evidence differs from evidence collected prior to the balance sheet date (i.e. historical evidence) in that auditors may base their subsequent event search effort not only factors used to search for historical evidence (i.e. risk assessment and likelihood that evidence search will be successful), but also on (1) their initial (i.e. balance sheet date) judgment characteristics (Hogarth and Einhorn 1992), (2) the characteristics of the challenging evidence (Muthukrishnan et al. 1999), and (3) environmental characteristics (Libby and Luft 1993). Figure 2, which guides the discussion in this and subsequent sections of the paper, illustrates how we believe these factors influence subsequent event evidence search and discovery.

<< Insert Figure 2 here >>

We were unable to find any prior research directly exploring how auditors search for and whether they find subsequent event evidence. Prior research has examined factors impacting the likelihood that auditors will find errors (e.g., Houghton and Fogarty

1991; Kinney and Martin 1994). For example, Houghton and Fogarty (1991) suggest that auditors are more likely to find errors in non-routine accounts. However, this research does not explore whether auditors identified the errors based upon historical or subsequent event evidence. Thus, our goals in this project are to: (1) verify that, consistent with the standards, auditors perceive subsequent event evidence to be important, (2) understand the process auditors currently employ to search for and discover subsequent event evidence, and (3) examine factors influencing this process.

## THE STUDY

### Data Collection and Sample

Based upon prior auditing and psychology literature and discussion with practitioners, we developed a field-based questionnaire to examine these issues (see Gibbons et al. 2001; Nelson et al. 2002, 2003; Hodge 2003 for other examples of the use of field-based questionnaires and Rea and Parker 1997; Sapsford 1999 for discussion regarding field-based questionnaire validity and methodology). The instrument, presented in Appendix A, consists of four parts. First, we collect demographic information. Next, we ask respondents to rate how often they search for and discover subsequent event evidence in a typical audit for several scenarios designed to operationalize factors influencing how auditors search for and discover subsequent event evidence. Third, we elicit ratings on how often participants search for and discover subsequent event evidence using each of the ten search procedures recommended by audit standards. Finally, we ask for general current subsequent event search, discovery, and usage information. We collected the current subsequent event information last to reduce the potential for experimental demand (Schepanski et al. 1992).

We pilot-tested the instrument with five experienced auditors and made revisions based on their feedback. The data were collected in December 2002.

**Participants**

Forty-six practicing auditors from three Big 4 firms and one national firm participated in this study. Participant demographic information is shown in Table 1. Participants averaged 9.3 years of external audit experience. Most participants supervised at least two other auditors; one-third supervised fifteen or more auditors. Half the participants audited large regional clients, 21 percent served smaller regional clients and 17 percent audited Fortune 500 clients. Thirty-one males and 15 females participated in the study[3].

<< Insert Table 1 Participant Demographics here >>

**Methodology**

Contacts from each firm made arrangements for participants. These individuals distributed numbered envelopes with an introductory letter, the experimental instrument, and a

[3] Because prior literature in psychology and auditing suggests that demographic information may influence judgments (e.g., Abdolmohamadi and Wright 1987; Johnson et al. 1996), we examine the impact of three demographic variables on reported responses: firm affiliation, experience, and gender.

Firm affiliation was tested using dummy variables and planned contrasts examined whether differences between specific firms existed. Statistical analysis suggests that responses varied by firm affiliation for two procedures recommended by audit standards: (1) inquiry of management regarding changes in capital stock, long-term debt, or working capital, and (2) obtaining letter of representation. Results indicate that Firm A (mean = 9.92) *searches* for subsequent event evidence when inquiring of management regarding changes in equity and debt more often than Firm C (mean = 8.40; p =0.05). Firms A and D (Firm A mean = 10.00; Firm B mean = 10.00) are more likely to *search* for subsequent event evidence after obtaining a letter of representation than Firm C (Firm C mean = 8.40; p = 0.03 and 0.02). Interestingly, Firm C (mean = 4.80) is more likely to *find* subsequent event evidence after obtaining a letter of representation than Firms A and B (Firm A mean = 2.54; Firm B mean = 2.00; Firm C vs. Firm A p = 0.04; Firm C vs. Firm B p = 0.02).

Experience was operationalized with two levels based on discussions with contact auditors at each participating firm: low (i.e. staff and senior auditors) and high (i.e. managers, senior managers, and partners). Results indicate that experienced managers are more likely to *search* for subsequent event evidence when inquiring of management as to the presence of any unusual adjustments since the balance sheet date (experienced mean = 9.96; inexperienced mean = 9.52; p = 0.02). Demographic characteristics did not influence any other responses.

numbered return envelope, stamped and addressed to the researchers. There was no identifying number on the instrument.

Administrative assistants kept track of the number assigned to each participant in their firm. After two weeks, we sent a list of the numbers that had not been returned to each assistant, along with a second request for participation. The assistants forwarded the second request to the non-respondents.

To encourage the auditors to participate, a raffle was held whereby one of the returned envelopes was randomly selected, with the participant receiving a pair of tickets to an athletic event. After the number was drawn, the appropriate administrative assistant matched the name of the participant to the winning number. After the raffle, the numbered lists kept by each assistant were destroyed.

## Results

### *Subsequent Event Evidence Importance and Usage*

Given the lack of prior research related to subsequent event evidence, we first report respondents' perceptions regarding the importance and usage of subsequent event evidence. We asked participants to rate the following statement on an eleven point Likert-type scale where 0 = "extremely disagree" and 10 = "extremely agree": "I believe that subsequent event evidence is important". As shown in Table 2, the average response is 8.72. In addition, since auditors often face a tradeoff between timely reporting and searching for additional subsequent event evidence, we asked respondents to rate their agreement to the following statement: "Issuing timely reports is more important than searching for subsequent event evidence." The average response for the second statement is 2.87 (based on a 0 = "extremely disagree" and 10 = "extremely agree" scale).

<< Insert Table 2 Perceptions of Subsequent Event Evidence Importance and Usage >>

Almost half of the respondents refer to subsequent event evidence more than twice during a typical audit, and 55 percent of the respondents continually refer to subsequent event evidence throughout the post audit testing during a typical audit. Forty-four percent of respondents indicate that they always distinguish between historical and subsequent event evidence when reviewing evidence after the balance sheet date. Eighty-two percent of respondents use client-prepared monthly financial reports for periods both before and subsequent to the balance sheet date. These results indicate that auditors perceive that subsequent event evidence is important and that they use subsequent event evidence in the audit.

***Subsequent Event Evidence Search***

We elicit information regarding (1) whether respondents search for subsequent event evidence and (2) the procedures they employ during their search process. Results are shown in Table 3. Forty-seven percent of respondents spend two to four hours searching for subsequent event evidence in a typical audit and 29 percent search between five and ten hours.

If auditors form their initial account evaluation and/or perform fieldwork prior to the balance sheet date, they may have more time to devote to searching for subsequent events. Thus, we ask respondents to indicate when they (1) form their initial opinion, and (2) perform fieldwork required prior to consideration of subsequent events. Two-thirds of the respondents form their initial evaluation of account fairness in a typical audit during interim testing prior to the balance sheet date. Consistent with results reported by Searcy et al. (2003), the majority of respondents perform most of the fieldwork in a typical audit after the balance sheet date.

<< Insert Table 3 Current Subsequent Event Evidence Search Process and Procedures >>

Standards suggest procedures that auditors may use to search for subsequent event evidence (AICPA 2004, AU 560.12). We ask respondents to indicate how frequently they perform each search procedure. Results indicate that the participants generally performed each search procedure as they assigned search ratings greater than 9 (based on a 0 = "never" and 10 = "always" scale) for nine of the ten procedures.

***Subsequent Event Evidence Discovery***

As noted earlier, the search process is not always successful. We obtain information regarding how often respondents successfully find subsequent event evidence and the frequency to which specific audit procedures are successful. Results are shown in Table 4. Over 90 percent of the respondents discovered material subsequent event evidence in the past year. Almost half indicate that they discovered subsequent event evidence more than twice in the past year. One-third of the respondents discovered the subsequent event evidence within 30 days following the fiscal year end.

<< Insert Table 4 Current Subsequent Event Evidence Discovery Process and Procedures >>

Interestingly, the frequency of discovering subsequent event evidence using the subsequent event search procedures recommended by audit standards is fairly low as responses for each procedure varied from 3.13 (based on a 0 = "never" and 10 = "always" scale) for obtaining a letter of representation regarding events since balance sheet date to 5.11 for examining cutoffs.

***Factors Influencing Subsequent Event Evidence Search and Discovery***

Next, we explore factors, shown in Figure 2, that influence how auditors search for and whether they discover subsequent event evidence. Participants responded to pairs of questions designed to examine each factor. For example, to explore the impact of

account type (a balance sheet date judgment characteristic), participants were asked how often they search for subsequent event evidence when the account involved is a routine material account and when it is a non-routine material account. Responses were on a Likert-type scale ranging from 0 for "never" to 10 for "always." A paired t-test was used to examine each factor.

**Balance sheet date judgment characteristics.** Balance sheet date judgment characteristics, including account type, amount of supporting evidence, and prior expectations, may impact whether auditors search for and find subsequent event evidence.

***Account type.*** Accounts that are comprised primarily of common, recurring transactions may be thought of as routine accounts, while those comprised primarily of unusual or one-time transactions can be classified as non-routine accounts (Houghton and Fogarty 1991). Houghton and Fogarty (1991) suggest auditors are more likely to find errors in non-routine rather than routine accounts. We elicit auditors perceptions about their subsequent event search and discovery processes to determine if auditors follow a similar pattern (i.e. greater emphasis on non-routine rather than routine accounts) when they search for and discover subsequent event evidence.

Results, shown in Table 5, indicate that, on average, participants reported *searching* for subsequent evidence more often when the account is non-routine (mean = 9.20) than when the account is routine (mean = 8.59; $p = 0.02$). However, they indicated no significant difference *finding* subsequent event evidence for routine versus non-routine accounts ($p = 0.16$).

<< Insert Table 5 about here>>

***Amount of supporting evidence.*** The amount of evidence available to auditors when they form their balance sheet date judgments varies (Caster and Pincus 1996). The likelihood that

individuals will search for additional information is dependent on the sufficiency of evidence available when the initial (or balance sheet date) judgment is formed (Hogarth and Einhorn 1992; Eagly and Chaiken 1993; Petty et al. 1995). Thus, we examine whether auditors may be more likely to search for and to find subsequent event evidence when less rather than more supporting evidence is available at the time that the balance sheet date judgment was made.

Results suggest that, on average, participants reported *searching* for subsequent event evidence more frequently when there is minimal evidence available (mean = 8.83) than when there is ample evidence (mean = 6.63; p = 0.00). Participants also *find* subsequent event evidence (minimal evidence mean = 4.89; ample evidence mean = 3.46) more often when the amount of evidence supporting the initial judgment is low (p = 0.00).

***Prior expectations.*** Standards indicate that auditors should compare recorded financial information to their initial expectations (AICPA 2004; AU 329.05). Auditors are more likely to have lower confidence in the judgment they form at the balance sheet date if the historical evidence they collect and use for this judgment deviates from their initial account expectations (Pincus 1991). Lower confidence may trigger a search for subsequent event evidence. Thus, we examine whether auditors are more likely to search for and find subsequent event evidence when their balance sheet date judgments did not match their prior expectations.

Results indicate that auditors are more likely to search for, and to find, subsequent event evidence when their prior expectations for their balance sheet date judgments were not met rather than when the prior expectations were met. On average, participants reported *searching* for subsequent event evidence more often when expectations were not met (mean = 8.70) than when expectations were met (mean = 6.35; p = 0.00). Participants also *find* subsequent event evidence

more often when their prior expectations are not met (mean = 4.87) than when the expectations are met (mean = 3.48; p = 0.00).

**Challenge characteristics.** Consistent with prior research (Koonce, 1993; Hirst and Koonce 1996), our results indicate that two-thirds of respondents form their initial judgment prior to the balance sheet date. Subsequent event evidence can be viewed as a challenge to the balance sheet date evidence set; therefore challenge characteristics, such as consistency with prior evidence and materiality, may influence the likelihood of judgment revisions (Hogarth and Einhorn 1992; Muthukrishnan et al. 1999).

***Challenge consistency with prior evidence.*** Auditors' decisions to search for subsequent event evidence may be driven by the composition of the evidence set available as of the balance sheet date (i.e. evidence items used to form the initial judgment and all challenges available by the balance sheet date). Audit research indicates auditors perceive that mixed evidence sets (i.e. some evidence items confirm the initial judgment while others disconfirm) are less persuasive than one-sided evidence sets (i.e. all items either confirm or disconfirm the initial judgment). (Caster and Pincus 1996; Srivastava 1996). Thus, we examine whether auditors are more likely to search for and find subsequent event evidence if they perceive that the additional evidence will be inconsistent (i.e. more likely to revise their balance sheet date judgment as the complete evidence set becomes less persuasive) rather than consistent with the current evidence set.

Results suggest that, on average, participants do not report *searching* for subsequent event evidence more often when the evidence is perceived to be inconsistent with prior evidence (p = 0.16). Further, participants *find* subsequent event evidence that is consistent with prior evidence (mean = 5.59) more often than they find evidence that is inconsistent with prior evidence (mean = 4.46).

***Challenge materiality.*** Subsequent events may impact individual accounts (e.g. bankruptcy of an individual significant trade receivable customer or damage to inventory) or the entire financial statement (e.g. refinancing a significant portion of the firm's debt or settlement of a major pending litigation) (AICPA 2004, AU 342; AICPA 2004, AU 560). Financial statement level subsequent event evidence is more likely to be material than account level subsequent event evidence (Blokdijk et al. 2003; Gist and Sharstri 2003; Patterson and Smith 2003). Thus, we expect that auditors are more likely to search for and find subsequent event evidence at the financial statement rather than account level.

Results indicate that on average, participants are more likely to *search* for subsequent event evidence when it is likely to impact the financial statements as a whole (mean = 9.07) than when a single account is being examined (mean = 8.58; p = 0.03). However, participants indicated no significant difference in the likelihood that they *find* subsequent event evidence when they examine challenges of low (i.e. account level) or high (i.e. financial statement level) materiality (p = 0.22).

**Environmental characteristics.** Environmental characteristics, particularly the emphasis on more timely reporting and auditing, may impact judgment revision (Hogarth and Einhorn 1992; Libby and Luft 1993; Bamber et al. 1997). For example, the SEC recently reduced the time between balance sheet and report date by 30 days for annual reporting purposes and by 10 days for quarterly reporting (SEC 2002). Reducing the time between balance sheet and report date directly impacts the length of the search period for subsequent event evidence and may increase the time pressure auditors experience.

***Length of search period.*** Audit standards suggest that procedures to ascertain the occurrence of subsequent event evidence 'should be performed at or near the completion of the

field work' (AICPA 2004, AU 560.12). Thus, we expect that auditors are more likely to search for and find subsequent event evidence as the search period increases.

Results suggest that, on average, participants reported no difference in how often they *search* for subsequent event evidence when there are five days available to search versus 45 days available to search (p =0.24). However, participants are more likely to *find* subsequent event evidence when they have 45 days to search (mean = 5.02) rather than five days (mean = 4.24; p = 0.03).

***Time pressure.*** Time pressure impacts whether, how, and when audit procedures are performed (Glover 1997; Braun 2000). Time pressure varies depending upon total budget hours, actual hours used to date, and the number of audit procedures remaining to complete (Libby and Luft 1993). If auditors have ample time, they are more likely to search for and find subsequent event evidence than when their budget is tight.

We operationalize the time pressure construct as ample time remains, little time remains, and total audit time is over budget. Results suggest that, on average, participants are more likely to *search* for subsequent event evidence when there is ample time remaining (mean = 8.34) as opposed to little time remaining (mean = 7.86; p = 0.05). However, participants are marginally *more* likely to *search* when the audit is over budget (mean = 8.00) as opposed to little time remaining (mean = 7.86; p = 0.09). There were no significant differences across the three categories for the *find* variables (p > 0.70). Participants report time pressure makes a difference in the likelihood that they will search for subsequent event evidence, but it does not impact the likelihood that such evidence will be found.

## SUMMARY OF FINDINGS AND FUTURE RESEARCH OPPORTUNITIES

The growing demand for more timely reporting and advances in technology continue to reduce the availability of subsequent event evidence. With less subsequent event evidence, several academicians and practitioners argue that audit judgment will suffer since auditors would be forced to rely on less persuasive historical evidence (CICA 1999; Kogan et al. 1999; Elliott 2001). However, research examining the impact of less subsequent event evidence on audit judgment is sparse. Our study, by examining auditors' perceptions of subsequent event importance and usage, current subsequent event search and discovery process, and factors that may influence this process, provides a foundation of descriptive information that researchers can use in developing theoretical models and empirical inquires to address these critical issues.

Results, summarized in Exhibit 1, suggest that subsequent event evidence is important in the current audit environment and that auditors spend as much as ten hours searching for such evidence. Further, almost all participants have discovered at least one material subsequent event within the past year and refer to or use subsequent event evidence during a typical audit.

Because the search for subsequent events occurs after the balance sheet date and at or near the end of the fieldwork, the finding that over sixty percent perform the majority of fieldwork during a typical audit after the balance sheet date indicates potential implications for the timing of all audit procedures, including the search for subsequent event evidence, as the time between the balance sheet date and the reporting date decreases. Auditors generally follow suggested audit procedures to *search* for subsequent event evidence; however, the frequency of which auditors *find* subsequent event evidence using any one procedure is low. In addition, auditors are more likely to *search* for and *find* subsequent event evidence when (1) minimal historical evidence exists and (2) their balance sheet date judgments do not meet prior expectations. Auditors are more likely to *search* for evidence (1) when evaluating non-routine

account balances, (2) that potentially impacts the financial statements as a whole rather than one material account, and (3) when there is ample time to search. However, auditors are more likely to search for subsequent event evidence when the audit time is *over* budget, a finding that may have implications for the importance of subsequent event evidence as a function of risk. Auditors are more likely to *find* subsequent event evidence (1) that is consistent, rather than inconsistent, with their balance sheet date judgment, and (2) when search period is longer. Finally, time pressure does not impact whether auditors *find* subsequent event evidence.

<<Insert Exhibit 1 Here>>

**Opportunities for Future Research**

Our results suggest several research questions. These questions are summarized in Exhibit 2.

<<Insert Exhibit 2 Here>>

Triangulating research methodologies often improves our understanding of important issues (Campbell and Fiske 1959; Peecher and Solomon 2001). The current study uses a field-based questionnaire. Our findings that subsequent event evidence is important and is frequently used by auditors provides a basis that could be used to develop an empirical, archival, or field study to explore whether the discovery of subsequent event evidence could have prevented (or reduced) the recently-documented increase in restatements and audit failures (see Palmrose et al. 2004; Palmrose and Scholz 2004).

Alternatively, researchers could design an experiment to examine the impact of changes in the availability of subsequent event evidence on audit judgment. Our findings suggest that auditors refer to subsequent event evidence, but our research does not examine how auditors evaluate this evidence. For example, do they consider source objectivity issues? Do auditors

exhibit primacy / recency effects in their audit judgments? Do factors that influence subsequent event search and discovery (i.e. balance sheet date judgment, challenge, and environmental characteristics) also impact how auditors evaluate subsequent event evidence? How does risk relate to the perceived importance of subsequent event evidence? Is subsequent event evidence perceived to be more important for audits with high perceived risk?

One driving force behind the trend to reduce the subsequent event period is the demand for more timely financial reports. Thus, a tradeoff between the availability of subsequent event evidence and more timely reporting exists. An interesting research avenue may be to examine and potentially quantify this tradeoff. To date, research has identified several benefits of timely reporting. These include reducing information asymmetry between investors and firms (Kogan et al. 1999; Hayes and Lundholm 1996), and providing information to investors closer to the time they make buy/sell/hold decisions (Botosan and Harris 2000, 330). However, research examining the costs of reducing the availability of subsequent event evidence and/or the availability of alternative, persuasive evidence on audit judgment (and ultimately audit quality) is sparse.

Our search findings indicate that one-third of auditors do not form their initial account judgment by the balance sheet date and that 62 percent perform significant fieldwork after balance sheet date. As the period between the balance sheet date and the audit report decreases, auditors may need to change the scope, timing, and/or extent of their audit testing. Do auditors' initial risk assessments and/or the success of their historical search effort impact which changes they make? For example, auditors may be more willing to move the timing audit fieldwork to before the balance sheet date for low, rather than high, risk clients. Research that assists auditors

in determining which audit testing changes to make and their impact on audit efficiency and effectiveness would be valuable.

Our search results indicate that auditors employ recommended subsequent event search procedures; however, our findings also suggest that the frequency with which auditors discover subsequent event evidence using these procedures is fairly low. We did not ask about the scope, sample size, or extent to which these procedures are used. An interesting research extension would be to determine if auditors currently vary the scope, sample size, or extent of recommended subsequent event search procedures. Also, if differences in scope, sample size and/or extent exist, do they impact auditor search effort and/or the frequency to which these procedures uncover subsequent events. In addition, research could examine if other search procedures that are more successful exist. Finally, researchers may design and evaluate various decision search aids to increase search procedure success.

The low frequency with which auditors discover subsequent event evidence using procedures suggested by auditing standards, coupled with the fact that most auditors report finding evidence of at least one material subsequent event within the past year, has significant research implications. Auditors may be using additional strategies to search for subsequent event evidence, and discovery of these factors may improve overall audit efficiency. It is also possible that auditors are missing existing subsequent event evidence. Auditing and information systems researchers argue that detected errors may not represent the actual error characteristics in a population since subjects often can not find all seeded errors (Caster 1990; Galletta et al. 1993; Galletta et al. 1996-97; Caster et al. 2000; Engel and Hunton 2001). Similarly, future research projects could explore whether detected subsequent event evidence represents the actual evidence that exists. If we discover that auditors have difficulty detecting existing subsequent

event evidence, designing and evaluating decision search aids becomes more critical. Further, we did not examine the likelihood that the discovery of subsequent event evidence leads to material changes in the financial statements; further research might evaluate the diagnosticity of different types of subsequent events and the likelihood that these events materially affect the financial statements.

Our factor results suggest that the balance sheet date judgment has significant influence on subsequent event evidence search and discovery. For example, all balance sheet date judgment characteristics except account type for the *find* variable were significant. For account type, our results indicate that, in contrast to Houghton and Fogarty (1991)'s findings related to errors, auditors do not appear to *find* subsequent event evidence more often for non-routine rather than routine accounts. Future research could investigate whether existing (not necessarily detected) subsequent event evidence is more likely to support non-routine or routine accounts.

Additional research examining how challenge characteristics influence subsequent event search and discovery is warranted. For example, does a confirmatory bias exist since our factors results suggest that auditors tend to *find* subsequent event evidence that is consistent rather than inconsistent with balance sheet date judgments? If yes, how does this impact audit judgment? Can we design decision aids to reduce confirmatory bias? Also, could decision aids be created to improve the frequency to which auditors *find* subsequent event evidence that impacts the financial statement as a whole rather than one material account?

Similarly, additional work examining how environmental characteristics impact subsequent event search and discover is needed. Our results indicating that length of time does not appear to impact auditor *search* effort but does impact likelihood that evidence will be discovered suggests that reducing the subsequent event search period may influence the scope,

sample size, and/or extent to which auditors are performing recommended audit procedures. Finally, our finding that time pressure does not influence the frequency that auditors *find* subsequent event evidence needs further investigation.

**Conclusion and Study Limitations**

Understanding how auditors currently search for and discover subsequent event evidence has significant implications for both academicians and practitioners. Although (1) auditors are required by standards to search for subsequent event evidence, (2) recent changes in the needs of society (i.e. demand for more timely financial reporting and auditing) are reducing the availability of subsequent event evidence, (3) standard setters are examining this topic (CICA 2004), and (4) subsequent event evidence may assist auditors to detect financial manipulations that occur during the final closing process, we could not find any prior research exploring how auditors search for and whether they discover subsequent event evidence. Our results, based on responses from auditors employed by three Big 4 firms and one national firm, provide researchers with a broad foundation from which to examine this timely topic.

Accounting estimates have recently received significant attention from regulators and standard setters given that (1) estimates are subjective, and (2) managers may use estimates to manage earnings (Levitt 1998; Ramos 1998; AICPA 1999; Kinney 2001; Ballou and Heitger 2003; CICA 2004). This study is important since auditors often rely on subsequent event evidence to evaluate the reasonableness of accounting estimates (AICPA 2004, AU 342.10).

Audit firm management may benefit from understanding how professional trends impact audit effectiveness and efficiency. As pressure to implement more timely reporting intensifies, this study assists audit management by identifying (1) how subsequent event evidence is currently used and (2) important audit risk factors (i.e. minimal historical evidence, unmet prior

expectations, etc.) to consider as firms are forced to replace subsequent event procedures with alternative audit methods.

Finally, certain limitations exist in this research. First, our participants typically serve large regional firms rather than Fortune 500 clients. Thus, our results may not generalize to auditors serving larger clients. Second, conversations with practitioners indicate that auditors may find subsequent event evidence without searching for it. For example, one practitioner indicated that a client called him to report a stock split after the balance sheet date. We did not explicitly ask participants to distinguish between finding subsequent event evidence with or without searching for it.

Research examining subsequent event evidence is sparse. Given the potential for subsequent event evidence to detect earnings managements and the current movement toward more timely financial reporting and auditing which may reduce the availability of subsequent event evidence, this paper is a first attempt to understand this important topic.

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## TABLE 1

## Participant Characteristics

| | Number | Mean (s.d.) |
|---|---|---|
| Years in current job | 46 | 7.85 (6.26) |
| Years of external audit experience | 46 | 9.26 (8.30) |
| Years of internal audit experience | 46 | 0.07 (0.33) |
| **Number of auditors supervised** | **Number** | **Percent** |
| 0 | 4 | 9% |
| 1-4 | 13 | 28% |
| 4-8 | 8 | 17% |
| 9-15 | 6 | 13% |
| 15+ | 15 | 33% |
| Totals | 46 | 100% |
| Number of auditors in office[a] | | |
| 21+ | 44 | 100% |
| Client size[b] | | |
| Fortune 500 | 7 | 17% |
| Large regional firm | 21 | 50% |
| Small regional firm | 9 | 21% |
| Small business | 5 | 12% |
| Totals | 42 | 100% |
| Firm description | | |
| Big 4 | 33 | 72% |
| Large regional | 13 | 28% |
| Totals | 46 | 100% |
| Highest educational level obtained | | |
| Bachelor degree | 42 | 91% |
| Master degree | 4 | 9% |
| Totals | 46 | 100% |
| Age category | | |
| 20-25 | 15 | 33% |
| 26-30 | 11 | 24% |
| 31-40 | 12 | 26% |
| 41-50 | 5 | 11% |
| 51 + | 3 | 6% |
| Totals | 46 | 100% |
| Gender | M = 31 | 67% |
| | F = 15 | 33% |

[a] Two participants indicated number of auditors in office was 11-20. All other participants from that firm office indicated 21+ auditors. A firm partner indicated that the actual number of auditors in the office in question varies between 21 and 25.

[b] Two participants did not answer the question. Two participants indicated they serve both large and small regional clients.

## TABLE 2
## Subsequent Event Evidence Importance and Usage

| | Number | Mean (s.d.) |
|---|---|---|
| I believe that subsequent event evidence is important.[a] | 46 | 8.72 (0.15) |
| I believe that issuing timely reports is more important than searching for subsequent event evidence.[a] | 46 | 2.87 (0.23) |
| Number of times participant refers to or uses subsequent event evidence during typical audit[b] | | |
| Never | 2 | 4% |
| Once | 13 | 29% |
| Twice | 8 | 18% |
| More than twice | 22 | 49% |
| Totals | 45 | 100% |
| Circumstances under which participant refers to or uses subsequent event evidence during typical audit[c] | | |
| Continually throughout the post audit testing (i.e. testing between balance sheet date and audit report date) | 36 | 55% |
| Only at the end of post audit testing | 16 | 24% |
| Only for material accounts | 14 | 21% |
| Totals | 66 | 100% |
| Thought process when reviewing evidence after balance sheet date[b] | | |
| I never distinguish between historical and subsequent event evidence. | 3 | 7% |
| I sometimes distinguish between historical and subsequent event evidence. | 6 | 14% |
| I often distinguish between historical and subsequent event evidence. | 15 | 35% |
| I always distinguish between historical and subsequent event evidence. | 19 | 44% |
| Totals | 43 | 100% |
| Auditor's use of client-prepared monthly financial reports[b] | | |
| No access to client's monthly financial reports. | 1 | 2% |
| Use only monthly financial reports prepared before fiscal year end | 7 | 16% |
| Use monthly financial reports prepared both before and subsequent to fiscal year end | 37 | 82% |
| Totals | 45 | 100% |

[a] Participants rated statements on an eleven point Likert-type scale where 0 = "extremely disagree" and 10 = "extremely agree".

[b] One or more participants did not answer the question.

[c] Participants could choose more than one answer.

## TABLE 3

## Current Subsequent Event Evidence Search Process and Procedures

| **Panel A: Varables Influencing Current Subsequent Event Evidence Search Process** | **Number** | **Percent** |
|---|---|---|
| Subsequent event evidence effort level[a] | | |
| < 2 hours | 8 | 18% |
| Between 2 and 4 hours | 21 | 47% |
| Between 5 and 10 hours | 13 | 29% |
| Between 11 and 20 hours | 2 | 4% |
| > 20 hours | 1 | 2% |
| Totals | **45** | **100%** |
| Time when auditor forms initial evaluation of account fairness in typical audit [a] | | |
| During interim testing before balance sheet date | 23 | 52% |
| On balance sheet date | 6 | 14% |
| During post balance sheet date testing | 10 | 23% |
| Only at end of post balance sheet date testing | 5 | 11% |
| Totals | **44** | **100%** |
| Time when auditor performs majority of fieldwork in typical audit [a] | | |
| During interim (i.e. 5 weeks or longer before balance sheet date) | 9 | 20% |
| Immediately before balance sheet date | 1 | 2% |
| On balance sheet date | 7 | 16% |
| After balance sheet date | 28 | 62% |
| Totals | **45** | **100%** |

| **Panel B: Recommended Subsequent Event Search Procedures** | **Number** | **Search for Mean[b] (s.d.)** |
|---|---|---|
| Examine cutoffs[a] | 45 | 9.29 (0.13) |
| Examine data to aid in evaluating balance sheet date assets and liabilities[a] | 45 | 9.09 (0.17) |
| Read minutes of meetings of stockholders, directors, and appropriate committees | 46 | 9.70 (0.14) |
| Inquire of client's legal counsel re: litigation, claims, and assessments | 46 | 9.17 (0.19) |
| Inquire of management re: substantial contingent liabilities or commitments existing at balance sheet date | 46 | 9.89 (0.05) |
| Read interim financial statements | 46 | 8.00 (0.26) |
| Inquire of management re: status of financial items initially based on tentative, preliminary, or inconclusive evidence | 46 | 9.33 (0.14) |
| Inquire of management re: changes in capital stock, long-term debt, or working capital | 46 | 9.48 (0.14) |
| Inquire of management re: any unusual adjustments since balance sheet date | 46 | 9.74 (0.07) |
| Obtain letter of representation re: events since balance sheet date that require adjustment or disclosure | 46 | 9.65 (0.14) |

[a] One or more participants did not answer the question.
[b] Responses on an eleven-point scale where 0 = "never" and 10 = "always".

## TABLE 4

## Current Subsequent Event Evidence Discovery Process and Procedures

| **Panel A: Current Subsequent Event Discovery Process** | **Number** | **Percent** |
|---|---|---|
| Number of times participant discovered material subsequent event evidence in past year | | |
| Never | 4 | 9% |
| Once | 15 | 32% |
| Twice | 5 | 11% |
| More than twice | 22 | 48% |
| Totals | **46** | **100%** |
| Number of days following balance sheet date material subsequent event evidence was discovered[a] | | |
| Within 5 days | 6 | 8% |
| Within 30 days | 25 | 34% |
| Within 60 days | 24 | 33% |
| Within 90 days | 18 | 25% |
| Totals | **73** | **100%** |

| **Panel B: Frequency of Success: Recommended Subsequent Event Search Procedures** | **Number** | **Discovery Mean[c] (s.d.)** |
|---|---|---|
| Examine cutoffs[b] | 45 | 5.11 (0.22) |
| Examine data to aid in evaluating balance sheet date assets and liabilities[b] | 45 | 4.78 (0.21) |
| Read minutes of meetings of stockholders, directors, and appropriate committees | 46 | 4.70 (0.24) |
| Inquire of client's legal counsel re: litigation, claims, and assessments | 46 | 4.37 (0.25) |
| Inquire of management re: substantial contingent liabilities or commitments existing at balance sheet date | 46 | 4.46 (0.24) |
| Read interim financial statements | 46 | 3.50 (0.24) |
| Inquire of management re: status of financial items initially based on tentative, preliminary, or inconclusive evidence | 46 | 3.96 (0.23) |
| Inquire of management re: changes in capital stock, long-term debt, or working capital | 46 | 3.96 (0.27) |
| Inquire of management re: any unusual adjustments since balance sheet date | 46 | 3.80 (0.25) |
| Obtain letter of representation re: events since balance sheet date that require adjustment or disclosure | 46 | 3.13 (0.26) |

[a] Participants could choose more than one answer.

[b] One or more participants did not answer the question.

[c] Responses to an eleven-point scale where 0 = "never" and 10 = "always".

**TABLE 5**
**Factors Influencing Subsequent Event Evidence Search and Discovery**
**Means and T-tests**

**Panel A: Transaction Type**

| Condition | n | Routine Material Accounts Mean[a] | Non-Routine Material Accounts Mean[a] | One-tailed p-value |
|---|---|---|---|---|
| Search | 46 | 8.59 | 9.20 | 0.02 |
| Discover | 46 | 4.17 | 4.59 | 0.16 |

**Panel B: Amount of Evidence Supporting Balance Sheet Date Judgment**

| Condition | n | Ample Supporting Evidence Available Mean | Minimal Supporting Evidence Available Mean | One-tailed p-value |
|---|---|---|---|---|
| Search | 46 | 6.63 | 8.83 | 0.00 |
| Discover | 46 | 3.46 | 4.89 | 0.00 |

**Panel C: Prior Expectations Regarding Balance Sheet Date Judgment**

| Condition | n | Met Prior Expectations Mean | Did Not Meet Prior Expectations Mean | One-tailed p-value |
|---|---|---|---|---|
| Search | 46 | 6.35 | 8.70 | 0.00 |
| Discover | 46 | 3.48 | 4.87 | 0.00 |

[a] Responses to an eleven point scale where 0 = " never" and 10 = "always".

**TABLE 5 (continued)**
**Factors Influencing Subsequent Event Evidence Search and Discovery**
**Means and T-tests**

**Panel D: Challenge Consistency with Prior Evidence**

| Condition | n | Will Confirm the Initial Evaluation Made Mean | Will Disconfirm the Initial Evaluation Made Mean | One-tailed p-value |
|---|---|---|---|---|
| Search | 46 | 7.96 | 7.65 | 0.16 |
| Discover | 46 | 5.59 | 4.46 | 0.00[b] |

**Panel E: Challenge Materiality**

| Condition | n | Impacts One Material Financial Account Mean | Materially Impacts Financial Statement as a Whole Mean | One-tailed p-value |
|---|---|---|---|---|
| Search | 45 | 8.58 | 9.07 | 0.03 |
| Discover | 45 | 4.84 | 5.02 | 0.22 |

**Panel F: Length of Search Period**

| Condition | n | Will be Found Approximately 5 Days After Balance Sheet Date Mean | Will be Found Approximately 45 Days After Balance Sheet Date Mean | One-tailed p-value |
|---|---|---|---|---|
| Search | 46 | 7.72 | 7.98 | 0.24 |
| Discover | 45 | 4.24 | 5.02 | 0.03 |

**TABLE 5 (continued)**
**Factors Influencing Subsequent Event Evidence Search and Discovery**
**Means and T-tests**

**Panel G: Time Pressure**

| Condition | n | Total Audit Time is Over Budget Mean | Little Time Remains in Audit Budget Mean | Ample Time Remains in Audit Budget Mean |
|---|---|---|---|---|
| Search | 44 | 8.00 | 7.86 | 8.34 |
| Discover | 44 | 4.59 | 4.77 | 4.66 |

| Paired-Sample T-tests | One-tailed p-value |
|---|---|
| Over Budget vs. Little Tme Remains Search | 0.09 |
| Little Remains vs. Ample Time Remains Search | 0.05 |

## EXHIBIT 1
## Summary of Field-Based Descriptive Study Findings

**Panel A: Subsequent Event Evidence Importance and Usage**

- Subsequent event evidence is perceived as (1) generally important and (2) relatively more important than issuing timely reports.
- Over 95 percent of respondents refer to subsequent event evidence during a typical audit.
- Eighty-two percent of participants examine monthly financial reports prepared by the client after balance sheet date.

**Panel B: Current Subsequent Event Evidence Search Process**

- Auditors generally spend between two to ten hours searching for subsequent event evidence.
- Two thirds of respondents form their initial account judgment by balance sheet date; one-third do not.
- Sixty-two percent of respondents perform majority of fieldwork after balance sheet date.
- Auditors follow recommended audit procedures to search for subsequent event evidence.

**Panel C: Current Subsequent Event Evidence Discovery Process**

- Over 90 percent of participants have discovered at least one material subsequent event within the past year.
- Subsequent event evidence is generally discovered within 60 days following balance sheet date.
- Discovery rates per individual recommended audit procedure are generally low.

**Panel D: Factors Influencing Subsequent Event Evidence Search and Discovery**

***Balance Sheet Date Judgment Characteristics***

Account type

- Auditors *search* for subsequent event evidence more often for non-routine rather than routine accounts.
- No difference noted in whether auditors *find* subsequent event evidence between non-routine and routine accounts.

Amount of supporting evidence

- Auditors *search* for and *find* subsequent event evidence more often when minimal, rather than ample, evidence supporting balance sheet date judgment exists.

Prior expectations

- Auditors *search* for and *find* subsequent event evidence more often when their balance sheet date judgment did not, rather than did, meet initial account expectations.

***Challenge Characteristics***

Challenge consistency with prior evidence

- No difference in whether auditors *search* for evidence that is consistent or inconsistent with their balance sheet date judgment.
- Auditors *find* subsequent event evidence more often that is consistent, rather than inconsistent, with their balance sheet date judgment.

Challenge materiality

- Auditors *search* for subsequent event evidence more often that impacts the financial statement as a whole rather than one material financial account.
- No difference in whether auditors *find* evidence that impacts the entire financial statement vs. one material account.

***Environmental Characteristics***

Length of search period

- No difference in *search* efforts when auditors expect to find subsequent event evidence within 5 days vs. 45 days after balance sheet date.
- Auditors *find* subsequent event evidence more often if the search period is longer.

Time pressure

- Auditors *search* for subsequent event evidence more often when (1) ample time or (2) little time remains in audit budget rather than when total time is over budget.
- No differences in whether auditors *find* subsequent events between various time pressure scenarios.

## EXHIBIT 2
## Future Research Questions

**Subsequent Event Evidence Importance and Usage**

- Could the discovery of subsequent event evidence have prevented (or reduced) the recent increase in restatements and audit failures?

- Given documented importance and usage of subsequent event evidence, how does reducing the availability of subsequent event evidence impact audit judgment?

- Can the tradeoff between the availability of subsequent event evidence and the recent movement toward more timely reporting be analyzed and possibly quantified? Do alternative persuasive sources of evidence exist?

**Subsequent Event Evidence Search Process**

- How will initial risk assessments and/or success of historical evidence search efforts impact any changes to the scope, timing, and/or extent of audit procedures auditors may need to make due to reductions in subsequent event evidence availability? Can researchers assist auditors in determining which audit procedure changes to make and their impact on audit efficiency and effectiveness?

- Does the scope, sample size, or extent of recommended subsequent event search procedures vary? If yes, how do these differences impact auditor search effort and/or ability to discover subsequent event evidence?

**Subsequent Event Evidence Discovery Process**

- Would decision aids increase the frequency to which recommended search procedures discover subsequent event evidence? Are there other search procedures that are more successful?

- Does the subsequent event evidence discovered accurately represent existing subsequent event evidence?

**Factors Influencing Subsequent Event Evidence Search and Discovery**

- Is actual subsequent event evidence more likely to support non-routine or routine accounts?

- Our results suggest that auditors tend to find subsequent event evidence that is consistent, rather than inconsistent, with balance sheet date judgment. How does this confirmation bias impact audit judgment? Can researchers design decision aids to reduce this confirmatory bias?

- Would decision aids improve auditors' ability to discover subsequent event evidence that impacts the financial statement as a whole rather than one material account?

- How will reducing the search time period influence the scope, sample size, and or extent to which auditors perform recommended search procedures?

- Why does time pressure appear to impact search time but not likelihood that subsequent event evidence is discovered?

**FIGURE 1**
**A Model of Subsequent Event Evidence Search, Discovery, and Evaluation**

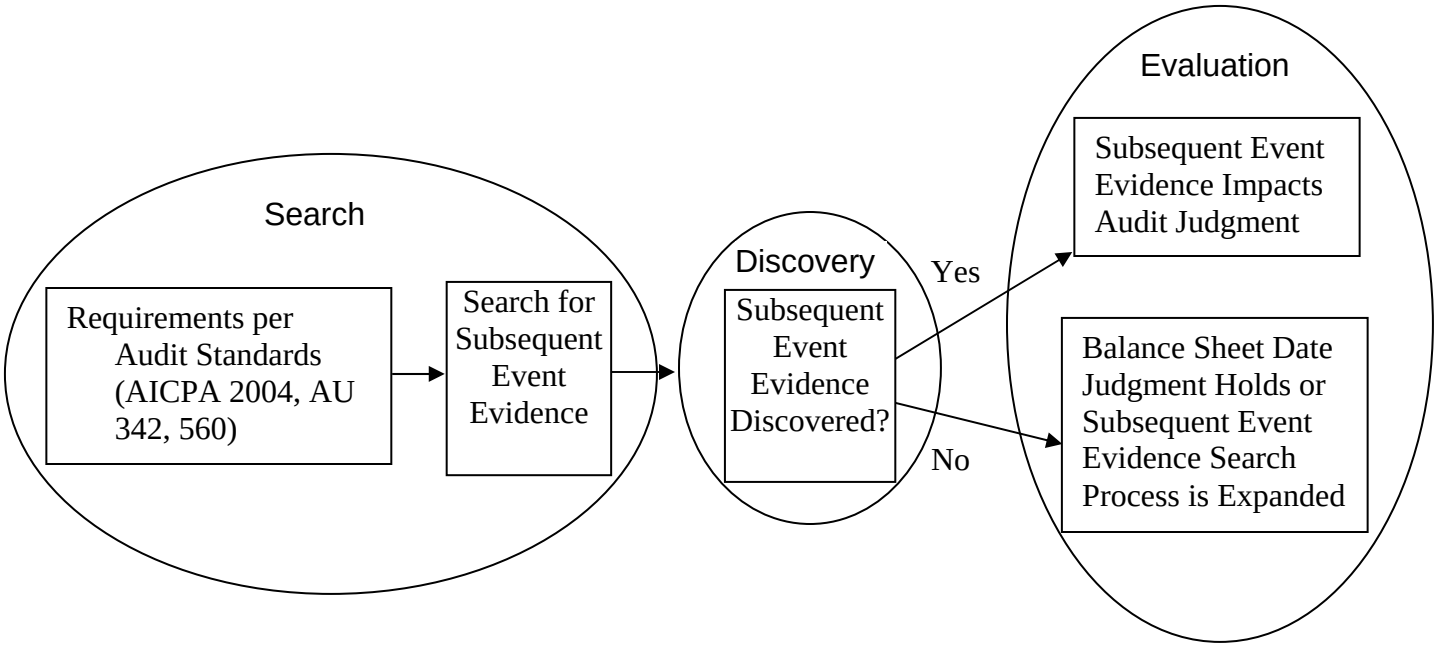
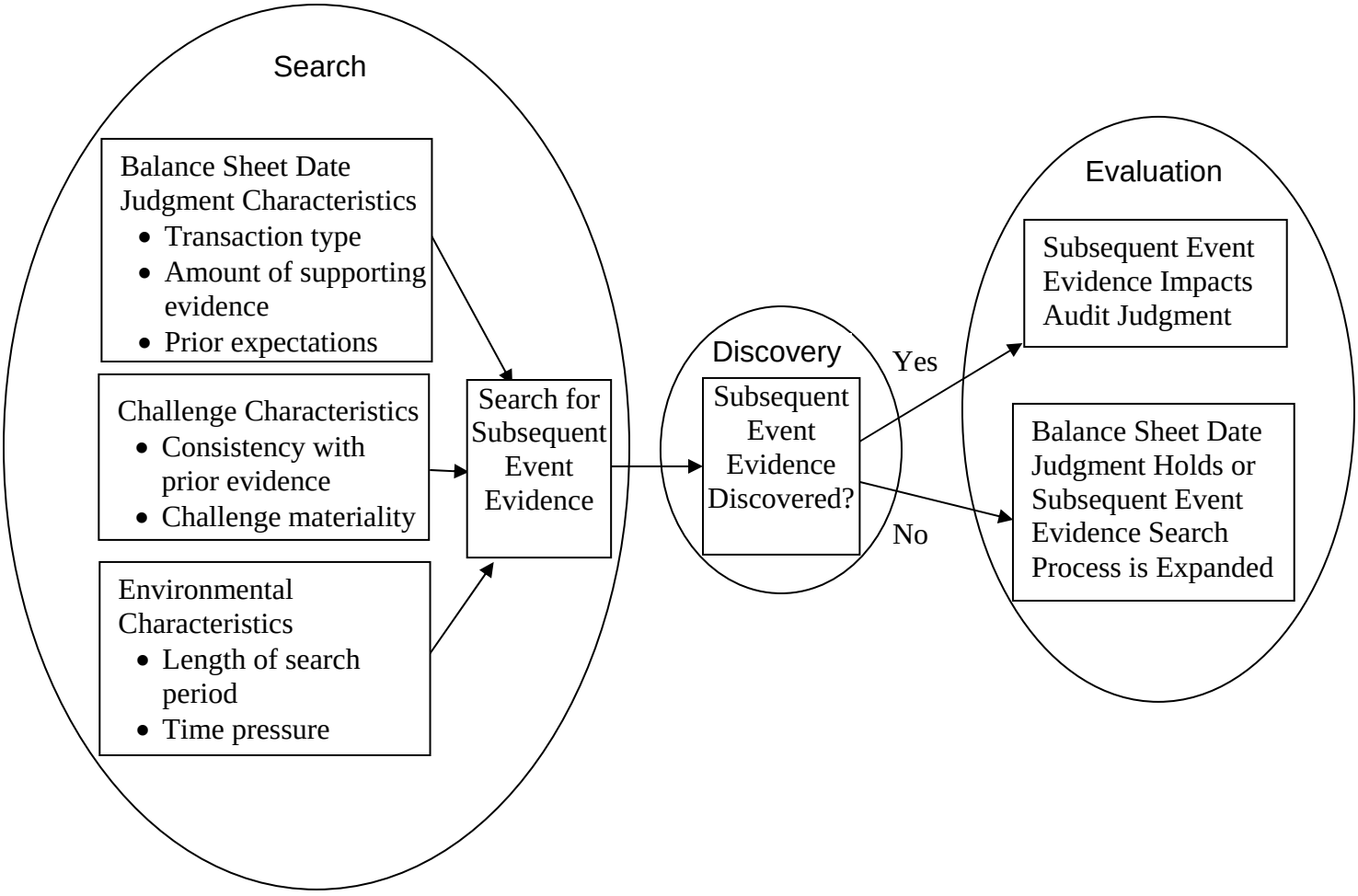


**FIGURE 2**
**Factors Influencing Subsequent Event Evidence Search and Discovery**



**APPENDIX**
**Department of Accounting Survey**

This survey addresses the role of subsequent event evidence in the audit process. For purposes of this study, SAS 1 defines **subsequent event evidence** as 'events or transactions which occur subsequent to the balance-sheet date, but prior to the issuance of the financial statements and auditors' report, that have a material effect on the financial statements and therefore require adjustment or disclosure in the statements' (AICPA 2001A, AU 560.01).

**If you already submitted a survey over the Web, please DO NOT duplicate your responses by also submitting a hardcopy version.** Thank you in advance for your voluntary participation. It indicates your willingness to contribute to the enhancement of our profession. All responses you provide are **confidential** and will be published **only** in summary, statistical form. You or your firm will not be identified in any way. Accordingly, there are no foreseeable risks to you or your firm.

**Part I – Demographics**

1. What is your current job title? _____

2. Which best describes your current work environment?
   External audit  Internal audit  Other

3. How many years have you held your current job? _____

4. How many years of external auditing experience do you have? _____

5. How many years of internal auditing experience do you have? _____

6. Number of auditors you directly supervise:
   0  1  2-4  4-8  9-15  15+

7. Number of auditors in your office:
   1  2-5  6-10  11-20  21 +

8. Size of your typical client:
   Fortune 500  Large regional firm  Small regional firm  Small business (one office only)

9. Firm description:
   Big 5  Large regional  Small regional  Local (one office only)

10. Circle the highest educational level you have obtained:
    Bachelor Degree  Master Degree  Coursework beyond Masters Degree

11. Circle your gender: Male  Female

12. Circle your age category:
    20-25  26-30  31-40  41-50  51-60  60+

**Part II – Subsequent Event Evidence Search Scenarios**

For each scenario, rate (1) how often you search for potential subsequent event evidence on a typical audit, and (2) how often you find subsequent event evidence on a typical audit. Assume that each scenario involves a **material** account.

---

*For example, assume you always search for subsequent event evidence if the account is a non-routine material account but you only sometimes find subsequent event evidence as a result of your search, you would code this as:*

*I **search** for subsequent event evidence in the above scenario*

0 1 2 3 4 5 6 7 8 9 ~~10~~

Never  Sometimes  Always

*I **find** subsequent event evidence in the above scenario*

0 1 2 3 4 ~~5~~ 6 7 8 9 10

Never  Sometimes  Always

---

13. Account involved is a routine material account (for example, accounts receivable or accounts payable).

*I **search** for subsequent event evidence in the above scenario*

0 1 2 3 4 5 6 7 8 9 10

Never  Sometimes  Always

*I **find** subsequent event evidence in the above scenario*

0 1 2 3 4 5 6 7 8 9 10

Never  Sometimes  Always

**Part II – Subsequent Event Evidence Search Scenarios (continued)**

14. Account involved is a non-routine material account (for example, a restructuring charge or estimated loss due to litigation)

*I **search** for subsequent event evidence in the above scenario*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

*I **find** subsequent event evidence in the above scenario*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

15. There was ample supporting evidence available when I made the initial evaluation at period-end.

*I **search** for subsequent event evidence in the above scenario*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

*I **find** subsequent event evidence in the above scenario*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

16. There was minimal evidence available when I made the initial evaluation at period-end.

*I **search** for subsequent event evidence in the above scenario*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

*I **find** subsequent event evidence in the above scenario*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

17. The initial evaluation I made at period-end met my a priori expectations.

*I **search** for subsequent event evidence in the above scenario*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

*I **find** subsequent event evidence in the above scenario*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

18. The initial evaluation I made at period-end was not consistent with my apriori expectations.

*I **search** for subsequent event evidence in the above scenario*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

*I **find** subsequent event evidence in the above scenario*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

19. The subsequent event evidence (if discovered) will confirm the initial evaluation I made at period-end.

*I **search** for subsequent event evidence in the above scenario*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

*I **find** subsequent event evidence in the above scenario*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

20. The subsequent event evidence (if discovered) will disconfirm the initial evaluation I made at period-end.

*I **search** for subsequent event evidence in the above scenario*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

*I **find** subsequent event evidence in the above scenario*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

21. The subsequent event evidence (if discovered) will confirm the initial evaluation I made at period-end that the account is misstated.

*I **search** for subsequent event evidence in the above scenario*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

*I **find** subsequent event evidence in the above scenario*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

22. The subsequent event evidence (if discovered) will disconfirm the initial evaluation I made at period-end that the account is misstated.

*I **search** for subsequent event evidence in the above scenario*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

*I **find** subsequent event evidence in the above scenario*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

23. The subsequent event evidence (if discovered) will be found approximately 5 days after period-end.

*I **search** for subsequent event evidence in the above scenario*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

***find** subsequent event evidence in the above scenario*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

**Continued on Next Page**

**Part II – Subsequent Event Evidence Search Scenarios (continued)**

24. The subsequent event evidence (if discovered) will be found approximately 45 days after period-end.

*I **search** for subsequent event evidence in the above scenario*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

*I **find** subsequent event evidence in the above scenario*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

25. The subsequent event evidence (if discovered) will impact one material financial account.

*I **search** for subsequent event evidence in the above scenario*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

*I **find** subsequent event evidence in the above scenario*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

26. The subsequent event evidence (if discovered) will materially impact the financial statement as a whole.

*I **search** for subsequent event evidence in the above scenario*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

*I **find** subsequent event evidence in the above scenario*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

27. Total audit time is over budget when I consider whether to search for subsequent event evidence.

*I **search** for subsequent event evidence in the above scenario*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

*I **find** subsequent event evidence in the above scenario*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

28. Little time remains in audit budget when I consider whether to search for subsequent event evidence.

*I **search** for subsequent event evidence in the above scenario*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

*I **find** subsequent event evidence in the above scenario*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

29. Ample time remains in audit budget when I consider whether to search for subsequent event evidence.

*I **search** for subsequent event evidence in the above scenario*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

*I **find** subsequent event evidence in the above scenario*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

**Part III – Subsequent Event Evidence Search Procedures**
For each procedure, rate (1) how often you **search** for potential subsequent event evidence on a typical audit by using the identified audit procedure, and (2) how often you **find** subsequent event evidence on a typical audit using the identified audit procedure.

---

*For example, assume you always perform procedures to assure proper cutoffs but only sometimes find subsequent event evidence as a result of this procedure. Thus, you would code this as:*

*I **search** for subsequent event evidence using the above procedure*
0 1 2 3 4 5 6 7 8 9 ~~**10**~~
Never Sometimes Always

*I **find** subsequent event evidence using the above procedure*
0 1 2 3 4 ~~**5**~~ 6 7 8 9 10
Never Sometimes Always

---

30. Examine data to assure that proper cutoffs have been made.

*I **search** for subsequent event evidence using the above procedure*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

*I **find** subsequent event evidence using the above procedure*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

31. Examine data that provides information to aid in your evaluation of the assets and liabilities as of the balance-sheet date.

*I **search** for subsequent event evidence using the above procedure*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

*I **find** subsequent event evidence using the above procedure*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

**Continued on Next Page**

**Part III – Subsequent Event Evidence Search Procedures (continued)**

32. Read the latest available interim financial statements and confirm with management that the interim statements were prepared on the same basis as that used for the statements under audit.

*I **search** for subsequent event evidence using the above procedure*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

*I **find** subsequent event evidence using the above procedure*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

33. Inquire of management as to whether any substantial contingent liabilities or commitments existed at the date of the balance sheet being reported on or at the date of inquiry.

*I **search** for subsequent event evidence using the above procedure*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

*I **find** subsequent event evidence using the above procedure*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

34. Inquire of management as to whether there were any significant changes in the capital stock, long-term debt, or working capital to the date of inquiry.

*I **search** for subsequent event evidence using the above procedure*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

*I **find** subsequent event evidence using the above procedure*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

35. Inquire of management as to current status of items, in the financial statements being reported on, that were accurate for on the basis of tentative, preliminary, or inconclusive evidence.

*I **search** for subsequent event evidence using the above procedure*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

*I **find** subsequent event evidence using the above procedure*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

36. Inquire of management as to whether any unusual adjustments had been made during the period from the balance-sheet date to the date of inquiry.

*I **search** for subsequent event evidence using the above procedure*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

*I **find** subsequent event evidence using the above procedure*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

37. Read the available minutes of meetings of stockholders, directors, and appropriate committees. (If minutes are not available, inquire of management about matters dealt with at such meetings.)

*I **search** for subsequent event evidence using the above procedure*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

*I **find** subsequent event evidence using the above procedure*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

38. Inquire of client's legal counsel concerning litigation, claims, and assessments.

*I **search** for subsequent event evidence using the above procedure*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

*I **find** subsequent event evidence using the above procedure*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

39. Obtain a letter of representation, dated as of the audit report date, from the appropriate officials as to whether any events occurred subsequent to period-end that in the officer's opinion would require adjustment or disclosure in the financial statements.

*I **search** for subsequent event evidence using the above procedure*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

*I **find** subsequent event evidence using the above procedure*
0 1 2 3 4 5 6 7 8 9 10
Never Sometimes Always

**Continued on Next Page**

**Part IV – Current Subsequent Event Evidence Usage**

40. How many times have you discovered material subsequent event evidence on an audit within the past year? (circle one)
Never Once Twice More than Twice

41. If you discover material subsequent event evidence, when is that evidence discovered? (check all that apply)
_____ within 5 days following the fiscal year end
_____ within 30 days following the fiscal year end
_____ within 60 days following the fiscal year end
_____ within 90 days following the fiscal year end

42. How much effort during an average audit do you put into searching for subsequent event evidence? (circle one)
< 2 hours 2 –4 hours 5 – 10 hours 11-20 hours over 20 hours

43. How often do you refer to or use subsequent event evidence during a typical audit? (circle one)
Never Once Twice More than Twice

44. When do you refer to or use subsequent event evidence during a typical audit? (check all appropriate choices)
_____ Continually throughout the post audit testing (i.e. testing between balance sheet date and audit report date)
_____ Only at the end of post audit testing
_____ Only for material accounts

45. Indicate your level of agreement or disagreement with the following statements:
(i.) I believe subsequent event evidence is important.
0 1 2 3 4 5 6 7 8 9 10
*Extremely Disagree* *Extremely Agree*

(ii.) Issuing timely reports is more important than searching for subsequent event evidence.
0 1 2 3 4 5 6 7 8 9 10
*Extremely Disagree* *Extremely Agree*

46. Which statement best characterizes your thought process when reviewing evidence after period-end? (check one)
_____ I never distinguish between historical (i.e. evidence produced before or at period-end) and subsequent event evidence.
_____ I sometimes distinguish between historical and subsequent event evidence.
_____ I often distinguish between historical and subsequent event evidence.
_____ I always distinguish between historical and subsequent event evidence.

47. In a typical audit, when do you form your initial evaluation of account fairness? (check one)
_____ During interim testing before period-end
_____ At period-end
_____ During post balance sheet testing
_____ Only at the end of post balance sheet testing

48. In a typical audit, when do you perform the majority of the field work? (check one)
_____ During interim (i.e. 5 weeks or longer before period-end)
_____ Immediately before period-end
_____ At period-end
_____ After period-end

49. If you have a client that prepares monthly financial reports, do you use these reports in the audit process?
_____ No access to client's monthly financial reports
_____ Use only monthly financial reports prepared subsequent to the fiscal year end
_____ Use only monthly financial reports prepared before the fiscal year end
_____ Use monthly financial reports prepared both before and subsequent to the fiscal year end

**THANK YOU FOR PARTICIPATING IN THIS STUDY. YOUR HELP IS GREATLY APPRECIATED!!!**