

Events after the end of the reporting period (Lecture A795 – 18.42 minutes)

It is widely accepted that financial statements are prepared some time after the balance sheet date has passed. Most private companies have nine months from the year end to prepare financial statements before they must be lodged at Companies House otherwise filing penalties will be levied.

Events may take place between the balance sheet date and the date on which they are authorised for issue (approved) by management. Some of these events may need to be reflected in the primary financial statements; whereas others may need to be disclosed.

FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* deals with events after the end of the reporting period in Section 32 *Events after the End of the Reporting Period*. FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime* deals with them in Section 26 *Events after the End of the Reporting Period*.

1.1 Adjusting and non-adjusting events

FRS 102, para 32.2 states that 'events after the end of the reporting period are:

*... those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the **financial statements** are authorised for issue.*

FRS 102, para 32.2 (extract)

Both FRS 102 and FRS 105 distinguish between those events which are 'adjusting' events and those which are 'non-adjusting'. Adjusting events are those which provide evidence of conditions existing at the balance sheet date and non-adjusting events are those which are indicative of conditions arising after the reporting period.

Events will only fall under the scope of FRS 102, Section 32 or FRS 105, Section 26 when they arise **after** the balance sheet date and **before** the financial statements are authorised for issue.

Adjusting events

Adjusting events are those events which provide evidence of conditions that existed at the balance sheet date, but which arose after the balance sheet date. Adjusting events are adjusted for in the financial statements.

Example – Liquidation of a customer post-year end (1)

The financial statements of Howard Ltd for the year ended 31 August 2022 recognise trade debtors of £1.2m on which no impairment has been recognised. Total assets in the financial statements are £2.5m. On 8 September 2022, the company received notification from a liquidator that a customer owing £375,000 has gone into liquidation.

This debtor equates to 15% (£375,000 / £2.5m) of total assets and hence is a material figure.

Even though the liquidation occurred post-year end, there was no sudden change in circumstances and the liquidation was therefore evidence that the company was unable to pay its debts at the year end.

Trade debtors should be reduced by the value of this debt so that current assets are not overstated with a corresponding bad debt expense in profit and loss.

Example – Liquidation of a customer post-year end (2)

On 20 July 2022, Woodward Ltd sold goods on 90-days credit amounting to £50,000 to Byrne Ltd and immediately recognised the sale as revenue. Byrne Ltd is a large company generating a high level of profit and there were no doubts as to Byrne's ability to pay at the date of sale. Woodward's year end is 31 August 2022.

Preparation of Woodward's financial statements commenced on 8 September 2022. A few days later, the directors became aware that Byrne had ceased trading following a fire that had destroyed their premises and the company was uninsured.

The mere receipt of information that a customer is going into liquidation is not, in itself, an adjusting event. In this example, there were no doubts about the customer's ability to pay at the year end and the culmination of events leading to the customer's liquidation occurred post-year end. This is therefore a non-adjusting event after end of the reporting period.

This example illustrates that it not impossible for the bankruptcy of a customer which occurs post-year end to be treated as a non-adjusting event and the facts and circumstances should be considered on a case-by-case basis.

FRS 102, para 32.5 provides examples of adjusting events after the end of the reporting period which would require an entity to adjust the amounts in the financial statements, or to recognise items which may not have been recognised previously as follows:

- The settlement of a court case after the year end which confirms the entity had a present obligation at the end of the reporting period.
- Information received after the year end indicating that an asset may be impaired, such as:
 - the bankruptcy of a customer;
 - the sale of inventories after the year end which indicates that estimated selling price less costs to complete and sell is lower than cost;
 - the determination post-year end of the cost of assets purchased, or the proceeds from the sale of assets, before the end of the reporting period;
 - the determination post-year end of the amount of profit-sharing or bonus payments, if the entity had a legal or constructive obligation at the balance sheet date to make such payments because of events prior to that date; and

- the discovery of fraud or error which indicate that the financial statements are incorrect.

1.2 Non-adjusting events

Non-adjusting events do not necessitate changes to the amounts recognised in the financial statements but are instead disclosed where they are material.

FRS 102, para 32.7 provides two examples of non-adjusting events as follows:

- A decline in the market value of investments between the balance sheet date and the date on which the financial statements are authorised for issue.
- An amount which becomes receivable as a result of a favourable judgement or settlement of a court case after the balance sheet date but before the financial statements are authorised for issue.

Example – Customer fails to pay an invoice

Weaver Ltd has a year end of 31 August 2022. On 6 June 2022, the company sold goods on credit to a customer. The customer has failed to pay in accordance with the credit terms and Weaver has therefore issued a claim in the small claims court in respect of the amounts owed plus interest.

The courts awarded Weaver judgement and confirmed that the customer is required to pay for the goods plus interest to the date of payment. The awarding of judgement by the court indicates that Weaver had a receivable at the year end which was not impaired.

If the customer disputed the invoice, then careful consideration would need to be given as to whether there is a debtor or a contingent asset. If the customer disputes the invoice, but the courts find in favour of Weaver, the asset should continue to be recognised. Any awards by the court in respect of interest or penalties will be non-adjusting events if they occur after the balance sheet date but before the financial statements are authorised for issue.

Example – Material decline in the foreign exchange rate

Emery Ltd sells a large amount of goods to its overseas customer based in Farland and has a year end of 31 August 2022. At the year end, Emery correctly translates the debtor using the closing rate as required under FRS 102, Section 30 *Foreign Currency Translation*.

Due to political unrest in Farland, the country's currency was significantly devalued on 30 September 2022 which is after Emery's balance sheet date but before the financial statements are authorised for issue. The effect of the devaluation is material to the financial statements.

In this example, Emery has correctly translated the debtor using the closing rate at the balance sheet date. The fact that the overseas currency has been significantly devalued after the balance sheet date but before the financial statements are authorised for issue does not constitute an adjusting event. As the matter is material, Emery should disclose a non-adjusting event.

Example – Decline in the value of an investment

Walker Ltd has a significant portfolio of investments on its balance sheet as at its balance sheet date of 31 August 2022 which are measured under FRS 102, Section 11 *Basic Financial Instruments* at fair value through profit or loss. On 10 September 2022, the value of the investments fell considerably.

The fall in the market value of the investments occurs after the balance sheet date, but before the financial statements are authorised for issue. As the fall in fair value occurs after the year end, the entity does not alter the carrying amount of the investments, but as the fall in market value is material it discloses a non-adjusting event.

The overarching objective of non-adjusting events disclosures is to ensure that the user of the financial statements is made aware of material events that arise after the reporting date but before the financial statements are authorised for issue. As the conditions in respect of non-adjusting events did not exist at the balance sheet date, the amounts recognised in the financial statements are unaffected.

FRS 102, para 32.11 provides further examples of non-adjusting events which take place after the balance sheet date but before the financial statements are authorised for issue as follows:

- (a) *a major **business combination** or disposal of a major **subsidiary**;*
- (b) *announcement of a plan to discontinue an operation;*
- (c) *major purchases of assets, disposals or plans to dispose of assets, or expropriation of major assets by government;*
- (d) *the destruction of a major production plant by fire;*
- (e) *announcement, or commencement of the implementation, of a major **restructuring**;*
- (f) *issue or repurchases of an entity's debt or equity instruments;*
- (g) *abnormally large changes in asset prices or foreign exchange rates;*
- (h) *changes in tax rates or tax laws enacted or announced that have a significant effect on current and **deferred tax assets and liabilities**;*
- (i) *entering into significant commitments or contingent liabilities, for example, by issuing significant guarantees; and*
- (j) *commencement of major litigation arising solely out of events that occurred after the end of the reporting period.*

FRS 102, para
32.11

1.3 Going concern

'Going concern' is defined as follows:

An entity is a going concern unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so.

FRS 102
Glossary **going concern**

The going concern basis of accounting is a fundamental concept and the determination of whether, or not, an entity is a going concern is an important issue. Going concern is considered in FRS 102, paras 32.7A and 32.7B as well as in paras 3.8 and 3.9. FRS 105 covers the issue in paras 26.6 and 26.7 as well as in para 3.3.

Under UK GAAP, management are to assess the entity's ability to continue in operational existence as a going concern for a period of at least 12 months from the date of approval of the financial statements (not 12 months from the balance sheet date).

Example – Company to cease trading in 18 months' time

Heyes Ltd is a husband and wife run company with an accounting reference date of 31 August each year and prepares its financial statements under FRS 102. The financial statements for the year ended 31 August 2022 are going to be approved on 31 October 2022. The directors are planning on retiring in 18 months' time at which point the business will cease trading. The directors have assessed the company's ability to continue as a going concern for 12 months from 31 October 2022 and the financial statements have been prepared on a going concern basis.

FRS 102, para 3.8 states that the appropriateness of the going concern basis of accounting must be assessed for a period of at least, **but not limited to**, 12 months from the date on which the financial statements are authorised for issue. As the directors intend to cease trading in 18 months' time, the going concern basis of accounting is inappropriate and the financial statements should be prepared on a basis other than the going concern basis (but not the break-up basis as this is inconsistent with the requirements of FRS 102 which is discussed below).

FRS 102, para 32.7B states:

If the going concern assumption is no longer appropriate, the effect is so pervasive that this section requires a fundamental change in the basis of accounting rather than an adjustment to the amounts recognised within the original basis of accounting and therefore the disclosure requirements of paragraph 3.9 apply.

FRS 102, para 32.7B (extract)

Neither FRS 102 nor FRS 105 elaborate as to what the alternative basis of accounting should be. Many accountants are familiar with the concept of the 'break-up basis' of accounting (a concept which has never been defined nor discussed in UK GAAP). The break-up basis of accounting is inconsistent with the requirements of FRS 102 and FRS 105 because it recognises future costs of winding down the business. Under UK GAAP, only those costs that have been committed to at the balance sheet date can be recognised.

In practice, the basis to be applied when the going concern basis of accounting is no longer appropriate will not be too dissimilar to that of FRS 102.

Even when a company is experiencing serious cash flow difficulties, the default position is to prepare the financial statements on a going concern basis unless management intend to cease trading, liquidate the entity, or have no realistic alternative but to do so. The fact that the company is experiencing cash flow difficulties does not mean that the going concern basis automatically ceases to be appropriate, but the entity will make disclosure of the material uncertainties related to going concern.

1.4 Dividends

Dividends are dealt with in FRS 102, para 32.8 and FRS 105, para 26.10.

Dividends cannot be recognised as a liability at the balance sheet date if the entity declares such dividends after the reporting date. This is because no liability exists at the balance sheet date where the entity has discretion over whether, or not, to pay dividends. It is possible to segregate the component of distributable reserves at the balance sheet date which will be used to pay the dividend. Where the entity declares a dividend after the balance sheet date but before the financial statements are authorised for issue, it should provide disclosure in the financial statements of the dividend.

Where dividends are declared prior to the balance sheet date but are not paid until after the balance sheet date, care should be taken to ensure that such a liability is binding on the entity. Dividends declared should be appropriately authorised and will no longer be at the discretion of the entity if they are binding on the reporting entity.

Guidance on when a dividend becomes legally binding is outlined in TECH 02/17BL *Guidance on Realised and Distributable Profit under the Companies Act 2006*.

Dividends become binding, and hence a liability of the business, when they are declared by the company in a general meeting. For private companies, a dividend becomes legally binding when a written resolution is passed.

It is not uncommon for companies to declare an interim dividend to shareholders. Interim dividends are usually authorised by the Articles of Association and will normally be authorised when they are paid. Accordingly, interim dividends declared prior to the year end but not paid until after the year end will not usually result in a liability at the balance sheet date.

1.5 Repayment of dividends

S847, Companies Act 2006 makes provision for shareholders to repay the company in respect of distributions if, at the time the distribution was made, the shareholders were aware (or had reasonable grounds to be aware) that the distribution was in contravention of the law.

If the directors become aware that a distribution contravenes company law, they should seek legal advice. Whether the shareholder is liable to repay a distribution will depend on the facts of the case. In a group context, if a parent company received a dividend from its

subsidiary out of reserves which are not distributable, then it is likely that the parent would be required to repay the unlawful dividend.

In some private companies, dividends may be paid to shareholders at the detriment of creditors, or dividend may be regarded as unlawful. It is likely that in the event of a liquidation, where it can be proven that dividends are unlawful, or they have been paid at the detriment of creditors, that the liquidator forces the shareholder to repay the dividend to redress the inequity. In more serious cases, shareholders could be forced to sell personal assets to raise funds to repay the liquidator.

Conversely, a dividend may be paid to the shareholders which is, in fact, lawful at the time it is paid. However, circumstances could arise where the shareholders are requested to pay the dividend back to the company (for example, if the company runs into cash flow difficulties).

Example – A lawful dividend is repaid

On 31 August 2022, the directors of Humphries Ltd declared a dividend to ordinary shareholders. This dividend was also paid on 31 August 2022 resulting in no liability being recognised at the balance sheet date. The financial statements for the year ended 31 August 2022 are to be authorised in a board meeting to be held on 20 October 2022.

On 15 September 2022, the company's property was damaged following a storm and the company has had to incur additional cash expenditure to repair the damage which has caused the company to experience cash flow difficulties. The bank is unwilling to extend the company's overdraft facility.

The directors ask the shareholders to repay some of their dividend so that the company can continue to meet its obligations with creditors.

The return of the dividends is a non-adjusting event because the circumstances surrounding the request for the dividends to be returned (i.e. the damage to the building) occurred post-year end. In addition, the portion of the dividends that have been returned should not be treated as a reduction to the amount of dividend paid; instead, they are treated as a capital contribution as follows:

Dr Cash at bank

Cr Capital contribution (within equity)

The example above relates to shareholders that are returning a portion of their dividend which has been lawfully paid. In situations where dividends are returned because they are unlawful (for example where the law has not been correctly followed), the dividends returned should be accounted for as an adjusting event. They become an adjusting event if they are unlawful because the event provides evidence of conditions that existed at the balance sheet date as the dividends declared at that date were, in fact, unlawful, hence a debtor is recognised in the financial statements.

Dividends receivable

Dividends which are receivable are accounted for when the shareholder's right to receive payment is established.

In most cases, dividends receivable will arise in a group context where, for example, the parent company may have an investment in a subsidiary, associate or joint venture, which may declare dividends from time to time.

If dividends are declared by the investee after the balance sheet date, similar principles as discussed above will apply. No liability has arisen at the balance sheet date on the part of the investee; conversely no debtor arises to the investor so the financial statements of both the investee and the investor are not adjusted following declaration of the dividend after the balance sheet date.

If the dividend is declared prior to the balance sheet date, a debtor is recognised in the investor's individual financial statements. On consolidation, where appropriate, intra-group dividends are eliminated and only the non-controlling interest's portion of the dividend liability is recognised in the group accounts.