Improper Disclosures - Subsequent Events

The Scenario

Auditors conducting an annual financial statement audit of a DoD agency questioned management and other employees about the existence or suspicion of fraud and inquired about each individual’s knowledge about the risks of fraud. During one interview, it was revealed to the auditors that a manager did not want to include a required disclosure for a subsequent event that will have a significant impact on the agency’s financial position.

An employee disclosed that a subsequent event occurred after the balance sheet date but before the issuance of the financial statements. Specifically, there was a facility contamination at one of the installation’s buildings that will require clean-up. The costs of the clean-up and the amount of inventory destroyed could not be quantified at the present time. The employee also informed the auditors that the mishap affected the agency’s functions and it is anticipated that additional cash requirements resulting from the impact of the contamination and their related health and safety investments will be funded through a combination of debt and appropriations.

The employee also revealed that lower-level management did not want this information disclosed in the financial statements because a manager believed that making this information known would cause the agency’s financial position to be viewed negatively. As they should, the auditors brought the suspected fraudulent activity to the attention of the proper level of management.

The auditors and senior management interviewed the low-level managers and employees and it was confirmed that the managers instructed staff to:

- Omit the disclosure from the financial statements.
- Destroy any documentation related to the contamination.

The auditors informed senior management about the line items that will require adjustment to the financial statements.

General Comments / Lessons Learned: The omission of disclosure of subsequent events occurring after the balance sheet date and issuance date of the financial statements could mislead the reader who is otherwise unaware of those events. Statement of Financial Accounting Standards No. 165 states that an entity shall recognize in the financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. The auditor will need to review the figures within the financial statements and the disclosures and other information contained within them in order to form an opinion on whether the financial statements, as a whole, give a true and fair view of the agency’s financial position.
FRAUD INDICATORS

- Intentional omission of the disclosure for subsequent events in the financial statements.
- Instructions given to staff to destroy supporting documentation.