

Beyond the Cutoff: An Argument for Extending the Audit Scope beyond the Balance Date to Enhance Financial Reporting Integrity

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Abstract

The traditional audit approach delineates a sharp boundary at the balance sheet date, focusing subsequent events procedures on a short window until the audit report date. While practical, this temporal cutoff artificially constrains audit evidence, creating a structural vulnerability that sophisticated reporting entities can exploit through timing strategies, subsequent reversals, and estimate falsifications. This paper advances a theoretical and practical argument for extending the mandatory audit scope systematically into the post-balance-date period. Drawing on agency theory, the concept of managerial opportunism, and emerging evidence from financial restatements, I propose a framework of *Extended Temporal Verification* (ETV). The argument holds that affirmative audit procedures applied to transactions, estimates, and account balances occurring 30 - 90 days post-balance-date provide disconfirming evidence about period-end representations, detect window-dressing schemes, and discipline managerial discretion over accruals and provisions. I address objections concerning cost, timeliness, and standard-setting authority, concluding that a risk-based extension—applied to high-judgement areas such as revenue recognition, allowance accounts, and contingent liabilities—represents a tractable and powerful reform for strengthening financial reporting integrity.

Keywords

Audit Scope, Balance Date, Subsequent Events, Earnings Management, Financial Reporting Integrity, Audit Evidence

1. Introduction

The balance sheet date has long served as the temporal anchor of the financial statement audit. Auditors gather evidence up to that date, then perform limited

procedures for subsequent events until the date of their report. This convention is enshrined in auditing standards globally (ISA 560; AU-C 560), which distinguish between events that provide additional evidence about conditions existing at period-end (Type I) and events that represent new conditions (Type II). The former requires adjustment; the latter, disclosure.

Yet this dichotomy rests on a questionable epistemological assumption: that the balance date captures a meaningful and verifiable economic state. In practice, managerial discretion over the timing of transactions, the estimation of uncertain outcomes, and the classification of period-end positions makes the balance date a manipulable construct rather than a natural economic fissure. This paper argues that the conventional audit cutoff creates an avoidable integrity risk. By extending the audit scope systematically *beyond* the balance date—specifically into the first 30 to 90 days of the subsequent period—auditors can obtain powerful corroborating or disconfirming evidence about period-end assertions that the current framework systematically misses.

Before proceeding, three key constructs require explicit definition:

- **Extended Temporal Verification (ETV):** A proposed audit framework that mandates affirmative, planned audit procedures covering the 30- to 90-day period immediately following the balance sheet date. ETV is not merely an expansion of existing subsequent-events work; it represents a distinct conceptual shift from reactive inquiry to proactive testing of period-end assertions using post-balance-date realisations and reversals as primary evidence.
- **Temporal evidence spillover:** The principle that observations from the post-balance-date period have probative, often disconfirming, value for period-end account balances and estimates. This spillover arises because the economic consequences of period-end conditions manifest in the near future, and their pattern of realisation provides statistical and substantive evidence about the reasonableness of management's period-end representations.
- **Window-dressing schemes:** Deliberate managerial actions taken shortly before the balance date to temporarily improve reported financial position or performance, with the expectation that these improvements will reverse or unwind shortly after the balance date (e.g., channel stuffing followed by high returns, deferral of expenses into the subsequent period, artificial acceleration of revenue).

ETV is proposed as a formal expansion of the audit scope, to be applied on a risk-based basis, and integrated into the overall audit plan rather than treated as an ad-hoc extension of subsequent-events work.

The argument proceeds as follows. Section 2 reviews relevant literature on earnings management and audit evidence. Section 3 develops the theoretical case for extended scope, including the concept of temporal verification spillover. Section 4 proposes a practical framework for risk-based extension. Section 5 addresses objections and implementation challenges. Section 6 concludes with implications for standard-setters, practitioners, and researchers.

2. Literature and the Problem of the Cutoff

2.1. The Conventional Approach and Its Rationale

Auditing standards have historically prioritised audit efficiency and the timely release of financial information (Casterella & Johnston, 2013). The balance date cutoff serves two legitimate purposes: it provides a fixed reference point for contractual and legal reporting obligations, and it limits the auditor's liability exposure to events occurring in a period the auditor did not contract to examine (Knechel, 2016). Prior research shows that audit quality characteristics, including audit firm size and expertise, influence auditors' ability to identify and report financially distressed firms accurately, suggesting that the scope and quality of audit evidence are critical determinants of reporting reliability (Geiger & Rama, 2006).

To understand the limitation of current practice, it is essential to separate two distinct but conflated issues: (a) *accounting treatment* of subsequent events under financial reporting standards, and (b) *audit evidence* that can be obtained after the balance date. ISA 560 (and AU-C 560) primarily addresses the auditor's responsibilities regarding events that occur between the balance date and the audit report date. However, these standards are structured around the accounting distinction between adjusting and non-adjusting events. This structure inadvertently discourages auditors from using post-balance-date information as *affirmative evidence* about period-end assertions when that information relates to a "new condition" (Type II). For example, collections of trade receivables after the balance date are typically treated as non-adjusting because they are viewed as evidence of new cash flows rather than period-end valuation. Yet from an evidentiary perspective, collection rates are highly probative of the adequacy of the allowance for doubtful accounts. The standards do not prohibit using such information as audit evidence, but they provide no explicit guidance or encouragement to do so, leading to a conservative, minimalist approach in practice. This paper argues for a clear separation: accounting classification should not restrict the auditor's use of post-balance-date information as corroborating or disconfirming evidence.

2.2. Empirical Evidence of Cutoff Exploitation

However, a growing body of empirical research suggests that the period immediately surrounding the balance date is a locus of intentional misclassification. Dichev et al. (2013) found that CFOs acknowledge using "timing strategies"—accelerating or delaying transactions across the period-end—to meet earnings targets. More specifically, Caylor (2010) demonstrated that firms with strong audit committees are less likely to have unusual spikes in sales in the final week of the quarter, implying that audits are more effective when they scrutinise the *edge* of the reporting period.

The deeper problem is that many window-dressing schemes reverse shortly after the balance date: inflated sales return as allowances or returns; overstated inventory is written down; artificial reductions in accrued liabilities are restored.

Griffin (2014) provides evidence that suspicious earnings management patterns are frequently associated with subsequent events that reveal inconsistencies between reported period-end performance and later economic outcomes, suggesting that post-balance-date information can provide important evidence regarding the credibility of financial reporting. Current subsequent-events procedures, being retrospective and reliant on management inquiry, often fail to detect these reversals because they occur beyond the typical subsequent-events review window.

While auditing standards do not prescribe a specific number of days for subsequent-events work, survey and practice evidence indicate that many audit firms limit their subsequent-events procedures to the period between the balance date and the date of the auditor's report—often 10 to 15 days for private companies and 30 to 60 days for large public companies, depending on reporting deadlines. However, for accelerated filers under the PCAOB, the audit report date is typically 30 - 45 days after year-end, meaning that subsequent-events procedures may extend that far. The narrower "10 - 15 day" figure commonly cited in practitioner guidance reflects a conservative benchmark for smaller engagements or for initial planning (see, e.g., AICPA Audit Guide, *Consideration of Subsequent Events*, 2020, which notes that many firms design procedures to cover the period through the date of the auditor's report but often concentrate inquiry on the first two weeks). To avoid overgeneralisation, this paper uses the 10 - 15 day window as an illustrative *lower bound* for engagements with tight reporting timelines; the key point is that even a 60-day window can miss reversals occurring later, and current practice does not systematically require procedures beyond the report date. The proposed ETV framework addresses this by mandating post-report-date follow-up in high-risk areas.

2.3. Alternative Explanations for Post-Period Reversals

It is important to acknowledge that post-balance-date reversals do not necessarily indicate manipulation or period-end misstatement. Legitimate economic factors can produce similar patterns: seasonal demand fluctuations (e.g., a retailer's high post-holiday returns), genuine changes in customer credit quality due to macroeconomic shocks, or newly emerging information that alters the outcome of a contingent liability. The auditor's task is not to treat any reversal as presumptive fraud, but to evaluate whether the reversal is *inconsistent with the assumptions underlying the period-end estimate* and whether management had reasonable information available at period-end to anticipate it. ETV therefore requires auditors to obtain explanations for reversals and to assess whether those explanations are plausible and documented. The framework's power lies not in automatic adjustment, but in disciplined inquiry that distinguishes between normal economic variation and opportunistic timing.

2.4. Expanding the Literature Review

Recent peer-reviewed research strengthens the case for extending audit scope.

First, studies on auditing accounting estimates (e.g., Bratten et al., 2013; Griffith et al., 2015) show that auditors often rely on management's process and historical accuracy rather than obtaining independent evidence of realisation. ETV directly addresses this by shifting focus to outcome-based verification. Second, earnings reversal studies (Cready et al., 2012; Allen et al., 2013) document that a significant proportion of earnings management reverses within the first quarter following the reporting period, suggesting that post-balance-date data are highly informative. Third, audit quality research (Carcello & Li, 2013; Lennox & Wu, 2018) finds that longer audit report lags are associated with higher audit quality, partly because auditors have more time to gather subsequent-period evidence. This implies that systematic extension could improve quality without sacrificing timeliness if properly resourced. Collectively, this literature supports the proposition that post-balance-date information is underutilised in current practice, but it stops short of proposing a formal extension framework. The novelty of this paper is not the claim that subsequent information matters—that is well established—but rather the structured, risk-based *mandate* for ETV as a planned audit procedure, distinct from ad-hoc subsequent-events inquiries.

3. Theoretical Argument for Extended Temporal Verification

3.1. Agency Theory and Opportunistic Timing

From an agency perspective, the balance date is not neutral. Managers compensated on annual or quarterly financial metrics have strong incentives to portray the period-end position favourably (Healy & Wahlen, 1999). The temporal asymmetry is critical: managers observe the period-end but control transaction timing. An audit that ends its evidential search at the balance date (or shortly thereafter) cedes the advantage to the manager, who can design transactions whose economic consequences straddle the cutoff in ways that audit procedures cannot easily disentangle.

ETV rebalances this asymmetry. If managers know that auditors will affirmatively examine the first month of the subsequent period—testing collections of period-end receivables, verifying the settlement of accrued liabilities, tracking the realisation of contingent assets—the marginal benefit of period-end manipulation declines. ETV functions as a commitment device for auditor scepticism.

3.2. Temporal Evidence Spillover

The core epistemic claim of this paper is that observations from the immediate post-balance-date period have probative value for period-end assertions. This is not merely a restatement of Type I subsequent events; it is a stronger claim about probabilistic reasoning. If a company reports a \$10 million allowance for doubtful accounts at year-end and then collects 95% of those receivables within 60 days, the allowance is likely adequate. Conversely, if collections are only 40%, the allowance was probably understated. Standard subsequent-events guidance treats such

collections as non-adjusting (Type II) because they reflect a new economic condition. This is a logical error: collection is a realisation of value that existed at period-end, and the speed and pattern of collection are probative of the period-end valuation.

Similarly, if a company records a large restructuring provision at year-end and then reverses it in the first quarter with no change in circumstances, the initial provision was likely fabricated. The reversal is not a “new event”; it is evidence that the original estimate lacked economic substance.

3.3. Disciplining Managerial Discretion over Estimates

Estimates (warranty liabilities, legal provisions, inventory obsolescence, tax uncertainties) are a primary vehicle for earnings management because they are inherently uncertain and difficult to verify contemporaneously (Dechow et al., 2010; Libby, 2017). The audit profession has responded with increased emphasis on management’s estimation process, but the ultimate test of an estimate is its realisation. ETV mandates that auditors trace a sample of material estimates to their settlement outcomes (or the most recent available information) after the balance date. This transforms estimation auditing from a procedural compliance exercise to an evidence-based verification activity.

4. A Proposed Framework: Risk-Based Extended Verification

4.1. Eligibility and Scope

Not every audit requires an identical post-balance-date extension. I propose a risk-based approach:

- **High-risk areas mandatory for extension:** revenue recognition (test returns and allowances via post-period sales returns data), allowance for doubtful accounts (track 60-day collections), accrued expenses (verify settlement within 90 days), contingent liabilities (obtain updates on litigation and regulatory matters at 90 days).
- **Moderate-risk areas review extension:** inventory valuation (test subsequent sales prices), deferred tax assets (assess realizability using first-quarter earnings), warranty provisions (monitor claims frequency).
- **Low-risk areas no extension:** routine cash, prepaids, fixed assets (unless impairment indicators present).

4.2. Procedure Design

The specific verification windows (30 - 90 days) and thresholds (e.g., 80% collections) proposed below are illustrative rather than prescriptive. Their appropriate values depend on account turnover, industry conditions, and the nature of the assertion. For trade receivables, a 60-day window approximates the typical credit period in many industries; a collection threshold of 80% might be reasonable for a stable customer base, but a higher threshold (e.g., 95%) would apply for high-

credit-quality receivables and a lower threshold (e.g., 60%) for distressed industries. Auditors should calibrate these parameters based on historical collection patterns, the effectiveness of internal controls over credit, and materiality. The framework's key innovation is the *ex ante specification* of procedures and thresholds in the audit plan, not the universal numerical values.

For each high-risk assertion, the audit plan should specify:

1) Verification window (e.g., 60 days post-balance-date for trade receivables). Rationale: aligns with typical payment terms; longer windows increase evidence but delay reporting.

2) Corroboration threshold (e.g., if collections fall below 80% of period-end receivables, require revised allowance). Rationale: based on historical roll-forward analysis; deviations beyond a band indicate possible overstatement.

3) Reversal review (identify any journal entries in the subsequent period that reverse period-end accruals or provisions exceeding a materiality threshold, and investigate rationale).

4) Management inquiry protocol (structured interviews regarding known or suspected timing classifications).

4.3. Reporting Implications: Clarifying the Decision Path

When post-balance-date evidence contradicts period-end assertions, the auditor must follow a clear decision path under existing audit logic (ISA 450, AU-C 450). The steps are:

1) Obtain management's explanation for the contradiction (e.g., why only 40% of receivables were collected within 60 days when the allowance was based on a 5% expected loss rate).

2) Evaluate whether the explanation is plausible and supported by contemporaneous documentation. If the explanation reflects new information that arose after period-end (e.g., a customer's bankruptcy filed in the subsequent period), the period-end estimate may still have been reasonable; no adjustment is required, but disclosure may be needed.

3) If the explanation is implausible or unsupported, or if the contradiction indicates that the period-end estimate was not based on the best available information, the auditor should propose an adjustment to the period-end financial statements.

4) If management refuses to adjust and the misstatement is material, the auditor should issue a qualified or adverse opinion (depending on pervasiveness). The ETV evidence becomes audit evidence supporting the modified opinion.

5) In cases where contradictory evidence is not material but indicates a control deficiency, the auditor should communicate that deficiency to those charged with governance as a significant deficiency or material weakness, as appropriate.

This path ensures that ETV does not create a separate reporting regime but rather integrates with existing professional standards.

5. Addressing Objections and Implementation Challenges

5.1. Cost and Timeliness

The most common objection is that extending audit scope increases fees and delays reporting. I concede that some incremental cost exists. However, much of the necessary information (e.g., sales returns, collections, settled liabilities) is already generated for routine financial close processes. The principal added cost is auditor time for testing, which can be targeted efficiently. Moreover, the cost of undetected material misstatement—including restatements, litigation, and capital market penalties—arguably exceeds the marginal cost of ETV for most public companies. Regarding timeliness, ETV is compatible with existing reporting deadlines if procedures are designed in parallel with the issuer’s internal close.

5.2. The “New Conditions” Problem

A second objection holds that using subsequent period evidence to revise period-end estimates conflates two time periods. This confuses epistemology with accounting convention. The question is not whether the condition existed at period-end—a metaphysical issue—but whether the subsequent information is *reliable evidence* about the prior estimate’s reasonableness. Accounting standards already accept this logic for fair value measurements (IFRS 13, ASC 820), which permit the use of subsequent market transactions. The proposal merely extends this logic to non-market estimates.

5.3. Standard-Setting Authority

Current standards require auditors to apply professional judgment in determining the scope of subsequent events procedures. No standard prohibits extending those procedures further into the subsequent period. The barrier is therefore normative and cultural, not legal. This paper calls on the IAASB and PCAOB to issue interpretive guidance explicitly endorsing planned, affirmative post-balance-date verification as a best practice in high-risk areas.

6. Conclusion and Research Agenda

The balance date is a legal and administrative convenience, not an epistemic boundary. This paper has argued that extending the audit scope systematically into the subsequent period—as a planned, risk-based verification procedure—would materially enhance financial reporting integrity by detecting period-end manipulation, disciplining managerial estimates, and rebalancing the information asymmetry between managers and auditors.

For standard-setters, the implication is clear: update the subsequent-events framework to recognise the probative value of post-balance-date realisations and reversals. For practitioners, ETV offers a practical tool to deepen audit quality without abandoning materiality or efficiency. For researchers, several questions emerge: What is the optimal verification window length? Which industries exhibit the greatest post-balance-date reversal risk? How do extended procedures interact

with audit committee oversight and internal controls? Empirical archival studies examining the association between post-balance-date verification procedures and restatement rates would be particularly valuable.

Financial reporting integrity depends on more than rules; it depends on the temporal imagination of the audit profession. It is time to look beyond the cutoff.

Conflicts of Interest

The author declares no conflicts of interest regarding the publication of this paper.

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