

SA 510*
**Initial Audit Engagements -
Opening Balances**
*(Effective for audits of financial statements for periods
beginning on or after April 1, 2010)*

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Standard on Auditing (SA) 510, “Initial Audit Engagements—Opening Balances” should be read in the context of the “Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services,” which sets out the authority of SAs and SA 200, “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing”.

* Published in March, 2009 issue of the Journal.

Introduction

Scope of this SA

1. This Standard on Auditing (SA) deals with the auditor's responsibilities relating to opening balances when conducting an initial audit engagement. In addition to financial statement amounts, opening balances include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments. When the financial statements include comparative financial information, the requirements and guidance in SA 710¹ also apply. SA 300² includes additional requirements and guidance regarding activities prior to starting an initial audit.

Effective Date

2. This SA is effective for audits of financial statements for periods beginning on or after April 1, 2010.

Objective

3. In conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether:

- (a) Opening balances contain misstatements that materially affect the current period's financial statements; and
- (b) Appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

Definitions

4. For the purposes of the SAs, the following terms have the meanings attributed below:

- (a) *Initial audit engagement* – An engagement in which either:
 - (i) The financial statements for the prior period were not audited; or
 - (ii) The financial statements for the prior period were audited by a predecessor auditor.

¹ SA 710, "Comparative Information-Corresponding Figures and Comparatives Financial Statements".

² SA 300, "Planning an Audit of Financial Statements".

- (b) *Opening balances* – Those account balances that exist at the beginning of the period. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods and accounting policies applied in the prior period. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.
- (c) *Predecessor auditor* – The auditor from a different audit firm, who audited the financial statements of an entity in the prior period and who has been replaced by the current auditor.

Requirements

Audit Procedures

Opening Balances

5. The auditor shall read the most recent financial statements, if any, and the predecessor auditor's report thereon, if any, for information relevant to opening balances, including disclosures.
6. The auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by:
 - (a) Determining whether the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, any adjustments have been disclosed as prior period items in the current year's Statement of Profit and Loss³;
 - (b) Determining whether the opening balances reflect the application of appropriate accounting policies; and
 - (c) Performing one or more of the following: (Ref: Para. A1–A4)
 - (i) Where the prior year financial statements were audited, perusing the copies of the audited financial statements including the other relevant documents relating to the prior period financial statements;
 - (ii) Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or
 - (iii) Performing specific audit procedures to obtain evidence regarding the opening balances.

³ Accounting Standard (AS) 5, "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" requires that prior period items should be separately disclosed in the Statement of Profit and Loss in a manner that their impact on the current profit or loss can be perceived.

7. If the auditor obtains audit evidence that the opening balances contain misstatements that could materially affect the current period's financial statements, the auditor shall perform such additional audit procedures as are appropriate in the circumstances to determine the effect on the current period's financial statements. If the auditor concludes that such misstatements exist in the current period's financial statements, the auditor shall communicate the misstatements with the appropriate level of management and those charged with governance in accordance with SA 450⁴.

Consistency of Accounting Policies

8. The auditor shall obtain sufficient appropriate audit evidence about whether the accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, and whether changes in the accounting policies have been properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

Relevant Information in the Predecessor Auditor's Report

9. If the prior period's financial statements were audited by a predecessor auditor and there was a modification to the opinion, the auditor shall evaluate the effect of the matter giving rise to the modification in assessing the risks of material misstatement in the current period's financial statements in accordance with SA 315.⁵

Audit Conclusions and Reporting

Opening Balances

10. If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate, in accordance with SA 705(Revised).⁶ (Ref: Para. A5)

11. If the auditor concludes that the opening balances contain a misstatement that materially affects the current period's financial statements, and the effect of the misstatement is not properly accounted for or not adequately presented or disclosed, the auditor shall express a qualified opinion or an adverse opinion, as appropriate, in accordance with SA 705(Revised).

⁴ SA 450, "Evaluation of Misstatements Identified During the Audit", paragraphs 8 and 12.

⁵ SA 315, "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment".

⁶ SA 705(Revised), "Modifications to the Opinion in the Independent Auditor's Report".

Consistency of Accounting Policies

12. If the auditor concludes that:

- (a) the current period's accounting policies are not consistently applied in relation to opening balances in accordance with the applicable financial reporting framework; or
- (b) a change in accounting policies is not properly accounted for or not adequately presented or disclosed in accordance with the applicable financial reporting framework,

the auditor shall express a qualified opinion or an adverse opinion as appropriate in accordance with SA 705(Revised).

Modification to the Opinion in the Predecessor Auditor's Report

13. If the predecessor auditor's opinion regarding the prior period's financial statements included a modification to the auditor's opinion that remains relevant and material to the current period's financial statements, the auditor shall modify the auditor's opinion on the current period's financial statements in accordance with SA 705(Revised) and SA 710. (Ref: Para. A6)

Application and Other Explanatory Material

Audit Procedures (Ref: Para. 6)

Opening Balances (Ref: Para. 6(c))

A1. The nature and extent of audit procedures necessary to obtain sufficient appropriate audit evidence regarding opening balances depend on such matters as:

- The accounting policies followed by the entity.
- The nature of the account balances, classes of transactions and disclosures and the risks of material misstatement in the current period's financial statements.
- The significance of the opening balances relative to the current period's financial statements.
- Whether the prior period's financial statements were audited and, if so, whether the predecessor auditor's opinion was modified.

A2. If the prior period's financial statements were audited by a predecessor auditor, the auditor may be able to obtain sufficient appropriate audit evidence regarding the opening balances by perusing the copies of the audited financial

statements including the other relevant documents relating to the prior period financial statements such as supporting schedules to the audited financial statements. Ordinarily, the current auditor can place reliance on the closing balances contained in the financial statements for the preceding period, except when during the performance of audit procedures for the current period the possibility of misstatements in opening balances is indicated.

A3. For current assets and liabilities, some audit evidence about opening balances may be obtained as part of the current period's audit procedures. For example, the collection (payment) of opening accounts receivable (accounts payable) during the current period will provide some audit evidence of their existence, rights and obligations, completeness and valuation at the beginning of the period. In the case of inventories, however, the current period's audit procedures on the closing inventory balance provide little audit evidence regarding inventory on hand at the beginning of the period. Therefore, additional audit procedures may be necessary, and one or more of the following may provide sufficient appropriate audit evidence:

- Observing a current physical inventory count and reconciling it to the opening inventory quantities.
- Performing audit procedures on the valuation of the opening inventory items.
- Performing audit procedures on gross profit and cut-off.

A4. For non-current assets and liabilities, such as property plant and equipment, investments and long-term debt, some audit evidence may be obtained by examining the accounting records and other information underlying the opening balances. In certain cases, the auditor may be able to obtain some audit evidence regarding opening balances through confirmation with third parties, for example, for long-term debt and investments. In other cases, the auditor may need to carry out additional audit procedures.

Audit Conclusions and Reporting

Opening Balances (Ref: Para. 10)

A5. SA 705(Revised) establishes requirements and provides guidance on circumstances that may result in a modification to the auditor's opinion on the financial statements, the type of opinion appropriate in the circumstances, and the content of the auditor's report when the auditor's opinion is modified. The inability of the auditor to obtain sufficient appropriate audit evidence regarding opening balances may result in one of the following modifications to the opinion in the auditor's report:

- (a) A qualified opinion or a disclaimer of opinion, as is appropriate in the circumstances; or
- (b) Unless prohibited by law or regulation, an opinion which is qualified or disclaimed, as appropriate, regarding the results of operations*, and cash flows, where relevant, and unmodified regarding State of Affairs*.

The **Appendix** includes illustrative auditor's reports.

Modification to the Opinion in the Predecessor Auditor's Report (Ref: Para. 13)

A6. In some situations, a modification to the predecessor auditor's opinion may not be relevant and material to the opinion on the current period's financial statements. This may be the case where, for example, there was a scope limitation in the prior period, but the matter giving rise to the scope limitation has been resolved in the current period.

Material Modifications *vis a vis* ISA 510, "Initial Audit Engagements - Opening Balances"

Deletions

1. Paragraph 6(a) of ISA 510 (Para 6(a) of SA 510) dealt with the procedure for obtaining sufficient appropriate audit evidence about the opening balances which contain misstatements that materially affect the current period's financial statements by determining whether the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, have been restated. Since in India Accounting Standard (AS) 5, "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" requires that prior period items should be separately disclosed in the Statement of Profit and Loss in a manner that their impact on the current profit or loss can be perceived, the restatement of the prior period financial statements does not exist in the Indian scenario. Hence, to align with the requirements of AS 5, the requirement of restatement of prior period items has been replaced with the requirement to disclose the prior period items in the current year's Statement of Profit & Loss.

2. Paragraph 6(c) (i) of ISA 510 (Paragraph 6(c) (i) of SA 510) dealt with the procedure for obtaining sufficient appropriate audit evidence about the opening balances which contain misstatements that materially affect the current period's financial statements by reviewing the predecessor auditor's working papers, where the prior year financial statements were audited. Since in India Clause 1 of

* Profit & Loss Account.

* Balance Sheet.

Handbook of Auditing Pronouncements-I.A

Part I of the Second Schedule to the Chartered Accountants Act, 1949 provides that a Chartered Accountant in Practice shall be deemed to be guilty of professional misconduct if he discloses information acquired in the course of his professional engagement to any person other than his client, an auditor cannot provide access to his working paper to the another auditor. Therefore, keeping in view the requirements of the Chartered Accountants Act, 1949, the requirement of reviewing the predecessor auditor's working papers has been replaced with the requirement of perusing the copies of the audited financial statements including the other relevant documents relating to the prior period financial statements. Corresponding change has also been made in the Paragraph A4 of ISA 510 (A2 of SA 510) and Paragraphs A1 and A5 of ISA 510 have been deleted.

3. Paragraph A2 of ISA 510 dealt with the outsourcing of an audit of a public sector entity by the statutorily appointed auditor to a private sector audit firm. Since in the Indian context such situation does not exist, the paragraph A2 of ISA 510 has been deleted completely.

Appendix

(Ref: Para. A5)

Illustrations of Auditor's Reports with Modified Opinions

Illustration 1:

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of financial statements of a non-corporate entity using a fair presentation framework. The audit is not a group audit (i.e., SA 600 does not apply).
- The financial statements are prepared by management of the entity in accordance with the Accounting Standards issued by ICAI.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in SA 210.
- The auditor did not observe the counting of the physical inventory at the beginning of the current period and was unable to obtain sufficient appropriate audit evidence regarding the opening balances of inventory.
- The possible effects of the inability to obtain sufficient appropriate audit evidence regarding opening balances of inventory are deemed to be material but not pervasive to the entity's results of operations and cash flows.⁷
- The State of Affairs at year end gives a true and fair view.
- In this particular jurisdiction, law and regulation prohibit the auditor from giving an opinion which is qualified regarding the results of operations and cash flows and unmodified regarding State of Affairs.
- The relevant ethical requirements that apply to the audit are the Code of Ethics issued by ICAI⁸.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may

⁷ If the possible effects, in the auditor's judgment, are considered to be material and pervasive to the entity's results of operations and cash flows, the auditor would disclaim an opinion on the results of operations and cash flows.

⁸ Specify any applicable ethical requirements under the relevant laws or regulations applicable to the entity.

cast significant doubt on the entity's ability to continue as a going concern in accordance with SA 570 (Revised)⁹.

- The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with SA 701¹⁰.
- Corresponding figures are presented, and the prior period's financial statements were audited by a predecessor auditor. The auditor is not prohibited by law or regulation from referring to the predecessor auditor's report on the corresponding figures and has decided to do so.
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- The auditor has no other reporting responsibilities required under local law.
- The auditor elects to refer to the description of the auditor's responsibility included on a website of an appropriate authority.

INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

Qualified Opinion

We have audited the financial statements of ABC & Associates (the entity), which comprise the balance sheet as at March 31, 20X1, and the Statement of Profit and Loss, and the cash flow statement for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, except for the possible effects of the matter described in the "Basis for Qualified Opinion" section of our report, the accompanying financial statements give a true and fair view of the State of Affairs of the entity as at March 31, 20X1, and of its Results of Operations and its Cash Flows for the year then ended in accordance with the Accounting Standards issued by ICAI.

Basis for Qualified Opinion

We were appointed as auditors of the entity on June 30, 20X0 and thus did not observe the counting of the physical inventories at the beginning of the year. We were unable to satisfy ourselves by alternative means concerning inventory quantities held at March 31, 20X0. Since opening inventories enter into the determination of the results of operations and cash flows, we were unable to

⁹ SA 570(Revised), Going Concern.

¹⁰ SA 701, Communicating Key Audit Matters in the Independent Auditor's Report.

determine whether adjustments might have been necessary in respect of the profit for the year reported in the Statement of Profit and Loss and the net cash flows from operating activities reported in the Cash Flow Statement.

We conducted our audit in accordance with the Standards on Auditing (SAs) issued by ICAI. Our responsibilities under those standards are further described in the “Auditor’s Responsibilities for the Audit of the Financial Statements” section of our report. We are independent of the entity in accordance with the Code of Ethics issued by ICAI and we have fulfilled our other ethical responsibilities in accordance with the Code of Ethics. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified opinion.

Other Matter

The financial statements of the entity for the year ended March 31, 20X0, were audited by another auditor who expressed an unmodified opinion on those statements on June 30, 20X0.

Responsibilities of Management and Those Charged with Governance for the Financial Statements¹¹

[Reporting in accordance with SA 700(Revised) – see illustration 4 in SA 700(Revised)]

Auditor’s Responsibilities for the Audit of the Financial Statements

[Reporting in accordance with SA 700(Revised) – see illustration 4 in SA 700(Revised)]

For XYZ and Co.
Chartered Accountants
Firm’s Registration Number

Signature
(Name of the Member Signing the Audit Report)
(Designation¹²)
(Membership Number)

Place of Signature
Date

¹¹ Or other terms that are appropriate in the context of the legal framework of the particular entity.

¹² Partner or Proprietor, as the case may be.

Illustration 2:

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of financial statements of a non-corporate entity using a fair presentation framework. The audit is not a group audit (i.e., SA 600 does not apply).
- The financial statements are prepared by management of the entity in accordance with the Accounting Standards issued by ICAI.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in SA 210.
- The auditor did not observe the counting of the physical inventory at the beginning of the current period and was unable to obtain sufficient appropriate audit evidence regarding the opening balances of inventory.
- The possible effects of the inability to obtain sufficient appropriate audit evidence regarding opening balances of inventory are deemed to be material but not pervasive to the entity's results of operations and cash flows.¹³
- The State of Affairs at year end gives a true and fair view.
- An opinion that is qualified regarding the results of operations and cash flows and unmodified regarding State of Affairs is considered appropriate in the circumstances.
- The relevant ethical requirements that apply to the audit are the Code of Ethics issued by ICAI¹⁴.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with SA 570 (Revised).
- The auditor is not required, and has otherwise not decided, to communicate

¹³ If the possible effects, in the auditor's judgment, are considered to be material and pervasive to the entity's results of operations and cash flows, the auditor would disclaim the opinion on the results of operations and cash flows.

¹⁴ Specify any applicable ethical requirements under the relevant laws or regulations applicable to the entity.

key audit matters in accordance with SA 701.

- Corresponding figures are presented, and the prior period's financial statements were audited by a predecessor auditor. The auditor is not prohibited by law or regulation from referring to the predecessor auditor's report on the corresponding figures and has decided to do so.
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- The auditor has no other reporting responsibilities required under local law.
- The auditor elects to refer to the description of the auditor's responsibility included on a website of an appropriate authority.

INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

Opinions

We have audited the financial statements of ABC & Associates (the entity), which comprise the balance sheet as at March 31, 20X1, and the Statement of Profit and Loss, and the cash flow statement for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

Qualified Opinion on the Results of Operations and Cash Flows

In our opinion, except for the possible effects of the matter described in the 'Basis for Qualified Opinion' section of our report, the accompanying Statement of Profit and Loss and Cash Flow Statement give a true and fair view of the results of operations and cash flows of the entity for the year ended March 31, 20X1 in accordance with the Accounting Standards issued by ICAI.

Opinion on the State of Affairs

In our opinion, the accompanying balance sheet gives a true and fair view of the State of Affairs of the entity as at March 31, 20X1 in accordance with the Accounting Standards issued by ICAI.

Basis for Opinions, including Basis for Qualified Opinion on the results of operations and Cash Flows

We were appointed as auditors of the entity on June 30, 20X0 and thus did not observe the counting of the physical inventories at the beginning of the year. We were unable to satisfy ourselves by alternative means concerning inventory quantities held at March 31, 20X0. Since opening inventories enter into the

Handbook of Auditing Pronouncements-I.A

determination of the results of operations and cash flows, we were unable to determine whether adjustments might have been necessary in respect of the profit for the year reported in the Statement of Profit and Loss and the net cash flows from operating activities reported in the Cash Flow Statement.

We conducted our audit in accordance with the Standards on Auditing (SAs) issued by ICAI. Our responsibilities under those standards are further described in the “Auditor’s Responsibilities for the Audit of the Financial Statements” section of our report. We are independent of the entity in accordance with the Code of Ethics issued by ICAI and we have fulfilled our other ethical responsibilities in accordance with the Code of Ethics. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our unmodified opinion on the state of affairs and our qualified opinion on the results of operations and cash flows.

Other Matter

The financial statements of the entity for the year ended March 31, 20X0, were audited by another auditor who expressed an unmodified opinion on those statements on June 30, 20X0.

Responsibilities of Management and Those Charged with Governance for the Financial Statements¹⁵

[Reporting in accordance with SA 700(Revised) – see illustration 4 in SA 700(Revised)]

Auditor’s Responsibilities for the Audit of the Financial Statements

[Reporting in accordance with SA 700(Revised) – see illustration 4 in SA 700(Revised)]

For XYZ and Co.
Chartered Accountants
Firm’s Registration Number

Signature
(Name of the Member Signing the Audit Report)
(Designation¹⁶)
(Membership Number)

Place of Signature

Date

¹⁵ Or other terms that are appropriate in the context of the legal framework of the particular entity.

¹⁶ Partner or Proprietor, as the case may be.

