

**OPENING BALANCES – ISSUES PAPER****Introduction**

1. The comment period for the exposure draft of the proposed ISA 510 (Redrafted), “Initial Engagements—Opening Balances,” closed on October 31, 2007. A total of 37 comment letters were received. A list of the respondents is included in Appendix A.
2. Overall, respondents were supportive of the redraft, with many expressing the view that it was an improvement over the extant ISA. Most of the respondents commented positively to the questions in the Explanatory Memorandum (“EM”) regarding the proposed objective and the allocation of requirements and application material. Most of the significant comments focused on specific proposals in the requirements section. There were relatively fewer significant comments on the proposed guidance in the application material.
3. The following summarizes the significant comments received from respondents, including comments received on the significant matter identified in the EM on split opinions (see paragraphs 21 – 27 below), and the task force’s preliminary views and recommendations.

**Significant Comments****A. SCOPE**

4. A few respondents raised questions regarding the scope of the ISA:
  - One respondent (APB) suggested that the scope of ISA 510 be broadened to include consideration of opening balances in all engagements and not just in an initial audit engagement.
  - Another respondent (EC) also noted that the ISA contains requirements that are applicable to both initial and recurring audit engagements, and recommended that the ISA not only identify which requirements apply in both initial and recurring engagements in ISA 510, but also repeat the requirements that are applicable in all circumstances in other ISAs, as relevant.
  - Two respondents (Royal NIVRA and EC) commented that partner rotation should be included in the scope.
  - One respondent (Royal NIVRA) said that initial balances are only one consideration in an initial engagement and recommended that the scope of the ISA be expanded to include all aspects of an initial engagement, such as obtaining an understanding of the entity.

*Preliminary Task Force Views and Recommendations*

5. The task force is of the view that the suggestions for changes in the scope would be substantive changes that are beyond the scope of Clarity redrafting.
6. In particular, including all aspects that need to be considered in an initial audit engagement would significantly expand the scope of the extant ISA, which is focussed quite specifically on the auditor’s considerations of the opening balances. In addition, the task force believes that other ISAs already provide sufficient guidance on other considerations in an initial

audit engagement. For example, ISA 300 (Redrafted) includes specific planning considerations prior to starting an initial audit.<sup>1</sup> In addition, ISA 315 (Redrafted)'s<sup>2</sup> focus on performing the risk assessment procedures *necessary to provide a basis* for the auditor's risk identification and assessment establishes an appropriate frame of reference to guide an incoming auditor's judgments on the understanding of the entity and its environment that needs to be obtained. (See also the discussion of the alignment between proposed ISAs 510 (Redrafted) and 710 (Redrafted)<sup>3</sup> in paragraphs 28 and 29 below.)

7. The task force debated the proposal to extend the scope of the ISA so that it applies to all opening balances. In the task force's view, however, this would confuse more than it would clarify. The work effort defined in the ISA is very clearly focussed on an incoming auditor (described in the Exposure Draft as the "current auditor") and considerable restructuring would be needed to segregate those requirements relevant in all engagements from those directed to incoming engagements only. The task force believes that the guidance for ongoing engagements is best addressed in other standards, such as proposed ISA 710 (Redrafted). If IAASB believes that there are important omissions, the task force proposes that the relevant requirement(s) be repeated in proposed ISA 710 (Redrafted) or other relevant ISAs (such as ISA 315 (Redrafted)), rather than expand the scope of proposed ISA 510 (Redrafted). For example, proposed ISA 710 (Redrafted), which is currently on exposure, could be expanded to include cross-references to relevant requirements in proposed ISA 510 (Redrafted) if considered appropriate and necessary.
8. Finally, the task force discussed the proposal that the scope of the ISA explicitly include partner rotation. The definition of a predecessor auditor proposed in the Exposure Draft made it clear that the ISA applies only when the predecessor auditor is from another firm. In the task force's view this is appropriate because the circumstances are fundamentally different between an incoming auditor, which constitutes a change in the entire engagement team, and partner rotation, which involves a change of the engagement partner only. In rotation, it is only the partner that changes while the continuity of the engagement team remains. The work effort described in the ISA focuses on the audit evidence needed when commencing an audit for the first time and applies to the team as a whole. In addition, other ISAs already provide relevant guidance on partner rotation – for example, [proposed] ISA 220 (Redrafted) paragraph 17 provides guidance to an engagement partner taking over responsibility for an audit on the need to review the work performed prior to the date of change.
9. Therefore, the task force believes that the scope of the ISA as stated currently is appropriate and is not recommending any changes to it.

### Action Requested

The IAASB is asked to consider if the scope is appropriate and if any amendments are needed.

<sup>1</sup> ISA 300 (Redrafted), "Planning an Audit of Financial Statements," paragraphs 12 and A21.

<sup>2</sup> ISA 315 (Redrafted), "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment."

<sup>3</sup> Proposed ISA 710 (Redrafted), "Comparative Information—Corresponding Figures and Comparative Financial Statements."

## B. OBJECTIVE

10. The objective as set out in the Exposure Draft reflected two distinct responsibilities of the auditor with respect to opening balances of initial engagements, as follows:

The objective of the auditor is, in conducting an initial audit engagement, to obtain sufficient appropriate audit evidence about whether:

- (a) Misstatements that materially affect the current period's financial statements arising from the opening balances exist; and
- (b) Appropriate accounting policies have been consistently applied or changes thereto are accounted for properly.

11. There was strong support from the respondents for this approach to the objective. Only one respondent (SAICA) did not agree with the two separate considerations in the objective, arguing that subparagraph (b) is an integral part of being able to conclude on (a).

12. Several respondents, however, offered editorial suggestions for further improvement:

- A number of respondents<sup>4</sup> commented on the wording of the auditor's responsibility to obtain sufficient appropriate audit evidence whether the accounting policies have been consistently applied or changes thereto are accounted for properly. The respondents said that disclosure and presentation are equally important, and asked that reference be made to the applicable financial reporting framework.
- A number of respondents<sup>5</sup> suggested the reordering of the opening sentence and subparagraph (a) to improve readability.
- Three respondents (Royal NIVRA, AUASB and GTI) commented that the focus of the objective should be on opening balances instead of misstatements and suggested the inclusion of the words "Opening balances contain" before misstatements in subparagraph (a).

*Preliminary Task Force Views and Recommendations*

13. The task force believes that the auditor has two distinguishable responsibilities relating to opening balances during an initial engagement, namely (i) to identify and appropriately address any misstatements in the opening balances and (ii) to be satisfied regarding the continuity in accounting policies. However, the task force did believe that a number of the editorial suggestions made by respondents improved the wording of the objective. In particular,

- Amending the introduction to the objective to clarify that the focus is obtaining sufficient appropriate audit evidence regarding the opening balances (i.e., it is not, as suggested by one respondent, on all considerations in an initial audit engagement).
- Reordering the wording of the introduction to refer first to the fact that the objective applies in conducting an initial audit engagement. Although this is a change from the structure of other objectives, the task force agrees with respondents who said that readability is more important than consistency.

<sup>4</sup> ICPA, APB, IRBA, KPMG IFRG Ltd, EC, E&Y, IDW, FEE, AICPA, CNCC and PWC.

<sup>5</sup> BDO, CICA, IRBA, ICAEW, NAO, FEE.

- Reordering the wording of (a) to improve its readability.
  - Elaborating in (b) that the auditor considers the accounting, *presentation* and *disclosure* and including reference to “*in accordance with the applicable financial reporting framework*”.
14. Taking the above respondents’ comments into account, and subject to the IAASB’s further views, the task force proposes that the objective be refined as follows (see paragraph 3<sup>6</sup>):

In conducting an initial audit engagement, the objective of the auditor with respect to opening balances, in conducting an initial audit engagement, 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 have been consistently applied or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

### Action Requested

The IAASB is asked to consider the proposed wording of the objective.

### C. DEFINING THE WORK EFFORT

15. There were a number of comments on the work effort needed to obtain sufficient appropriate audit evidence regarding the opening balances as specified in paragraph 5.
- Three respondents<sup>7</sup> commented that it is subparagraphs (a) and (b) that define what the auditor is trying to achieve and that subparagraph (c) ought to be moved to the application guidance as illustrative procedures to achieve them. A fifth respondent (IDW) suggested a restructuring to paragraph 5 so that it retained the procedures in (c) in the requirement, but positioned them as subsets of (a) and (b).
  - One respondent (PwC) suggested editorial changes to clarify that the auditor shall at least perform one of the procedures in subparagraph (c).

#### *Preliminary Task Force Views and Recommendations*

16. The task force continues to believe that there are three separate steps in obtaining sufficient appropriate audit evidence about whether the opening balances contain misstatements:
- a) Agreeing the opening balances to the closing balances to ensure that they have been appropriately brought forward.
  - b) Ensuring that the appropriate accounting policies were used.

<sup>6</sup> Paragraph numbers refer to the revised draft of the ISA unless otherwise stated.

<sup>7</sup> EC, ICAEW and ACCA

- c) Being satisfied that sufficient appropriate audit evidence has been obtained regarding the amounts reflected in the opening balances (e.g., evidence regarding the rights and obligations, completeness, valuation and existence of account balances, etc.).

The procedures set out in (c) are not simply ways to obtain evidence to be able to conclude on (a) and (b) – indeed, (a) and (b) are relatively straight forward steps and would not require the extent of the procedures described in (c) in order to conclude on them. Rather, in the task force’s view, (c) is needed in addition to (a) and (b) to obtain the sufficient appropriate audit evidence referred to in the introduction to the requirement.

17. For these reasons, the task force retained the structure of paragraph 5 and is recommending only editorial changes to it. Specifically, the task force made changes to (c) to clarify that at least one of the three procedures must be performed.
18. Subject to the IAASB’s further views, the task force proposes that the paragraph be refined as follows (see paragraph 5):

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, have been restated;
- (b) Determining whether the opening balances reflect the application of appropriate accounting policies; and
- (c) Performing one or more, as is necessary in the circumstances, of the following:
- (i) Review the predecessor auditor’s working papers to obtain information relevant to the current period’s financial statements and evaluate whether further audit evidence may need to be obtained in order to obtain sufficient appropriate evidence regarding the current period’s financial statements;
- (ii) Evaluate whether audit procedures performed in the current period provide evidence relevant to the opening balances; or
- (iii) Perform specific audit procedures to obtain evidence regarding the opening balances.

### Action Requested

The IAASB is asked to consider whether the work effort in paragraph 5 is appropriately described.

#### D. PREDECESSOR AUDITOR’S INDEPENDENCE AND COMPETENCE

19. Five respondents (GTI, IDW, FEE, EC and ICJCE) commented that the consideration of the predecessor auditor’s independence and competence is similar to the considerations of the independence and competence of a component auditor in a group audit, and questioned whether either the guidance in paragraph A2, or the requirement in paragraph 5, should be

expanded to include all of the corresponding considerations that are in ISA 600 (Revised and Redrafted).<sup>8</sup>

*Preliminary Task Force Views and Recommendations*

20. The task force has not implemented this proposal. Although some of the respondents argued that this would be a conforming change to align the guidance in the two ISAs, the task force was concerned that significantly expanding the guidance (or introducing a new requirement) would be a substantive change and go beyond the scope of Clarity redrafting. The task force also noted that the IAASB did not identify this as a conforming change when approving ISA 600 (Revised and Redrafted). Furthermore, the task force is not convinced that the situations are necessarily parallel as the incoming auditor is able to obtain some evidence regarding the opening balances from procedures performed on this year's financial statements and, therefore, does not rely as fully on the other auditor's work. For these reasons, the task force concluded that, for purposes of the redraft, the guidance in the Exposure Draft is appropriate.

**Action Requested**

The IAASB is asked to consider whether the guidance on the auditor's consideration of the predecessor auditor's independence and competence in A2 is sufficient for purposes of the redraft.

E. SPLIT OPINION

21. The EM to the Exposure Draft identified as a significant matter the proposal to remove the restriction to the ability to express a split opinion on the financial position and results of operations and cash flows of an entity to circumstances when permitted.
22. Most respondents commented on the proposed change and the majority of them<sup>9</sup> expressed support for the removal of the restriction. The following respondents did not fully support the removal:
- One respondent (IDW) suggested that paragraph A7(c) be amended to clarify that split opinions are acceptable unless explicitly prohibited by the applicable financial reporting framework or law or regulation.
  - Two respondents (JICPA and CNCC) suggested the inclusion of "In those jurisdictions where it is permitted."
  - Another respondent (EC) argued that the issue of "split opinions" should be addressed in ISA proposed 705 (Revised and Redrafted),<sup>10</sup> not proposed ISA 510 (Redrafted), and suggested the removal of the paragraph and appendix in its entirety. They noted that some Member States do not allow such opinions.

<sup>8</sup> ISA 600 (Revised and Redrafted), "Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)."

<sup>9</sup> PwC, CIPFA, CPA, APB, AUASB, ICASAAC, IDW, AIA, BDO.

<sup>10</sup> Proposed ISA 705 (Revised and Redrafted) "Modifications to the Opinion in the Independent Auditor's Report."

23. Three additional respondents (NZICA, NAO and FEE), although supporting the removal of the restriction, noted that:
- Cash flows may not always need to be qualified even though there is insufficient audit evidence regarding financial performance.
  - There may need to be a scope limitation regarding the financial position in the comparative figures even if sufficient appropriate audit evidence can be obtained regarding the closing financial position.

*Preliminary Task Force Views and Recommendations*

24. Both the close-off and proposed clarified versions of ISA 705 explicitly acknowledge the possibility of the expression of an unmodified opinion on the closing financial position but a disclaimer of opinion on the results of operations and cash flows if the auditor has been unable to obtain sufficient appropriate audit evidence concerning the entity's opening balances.<sup>11</sup> Thus, the proposal to amend proposed ISA 510 (Redrafted) is consistent with the principles established in proposed ISA 705 (Revised and Redrafted). For this reason and in light of the significant level of support in the responses, the task force did not amend paragraph A7(c) to narrow its applicability to circumstances when permitted, or when not prohibited. The task force also observes that the overriding principle in the Preface that the ISAs cannot override law or regulation always applies.
25. In response to the specific comments made on the wording of paragraph A7, the task force accepted that it is possible to obtain sufficient appropriate audit evidence regarding cash flows even if sufficient evidence cannot be obtained regarding financial performance, and therefore deleted the reference to cash flows in paragraph A7(c). The task force proposes to keep the reference to cash flows in the illustrative example, however, to show that they can be affected as well.
26. The task force did not expand the guidance to address the impact on comparative financial position as was suggested as the task force thought it would blur the line between the respective scopes of proposed ISAs 510 (Redrafted) and 710 (Redrafted). However, the amendment proposed to paragraph 1 of the scope of the ISA discussed in paragraph 29 below should appropriately direct readers to proposed ISA 710 (Redrafted) for additional requirements and guidance when the financial statements include comparative financial information.
27. Subject to the IAASB's further views, the task force proposes that the split opinion paragraph be refined as follows (see paragraph A6):

[Proposed] ISA 705 (Revised and Redrafted) 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 appropriate in the circumstances; or

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<sup>11</sup> Pproposed ISA 705 (Revised and Redrafted), paragraph A20.

(b) An opinion which is qualified or disclaimed, as appropriate, regarding the results of operations and unqualified regarding financial position. (The Appendix contains an example of an auditor's report with an opinion which is qualified regarding the financial performance and cash flows and unqualified regarding financial position.)

### Action Requested

The IAASB is asked to consider whether the amended paragraph is appropriate and if any further amendments are needed.

#### F. ALIGNMENT OF PROPOSED ISA 510 (REDRAFTED) WITH PROPOSED ISA 710 (REDRAFTED)

28. A number of respondents commented on the need for greater alignment with proposed ISA 710 (Redrafted), in particular in relation to the reporting requirements. For example, one respondent (CNCC) noted that proposed ISA 710 (Redrafted) includes additional requirements for the current auditor regarding comparative figures and suggested that the paragraphs addressing considerations for incoming auditors in proposed ISA 710 (Redrafted) be transferred to proposed ISA 510 (Redrafted), and that appropriate references should be included in proposed ISA 710 (Redrafted) to proposed ISA 510 (Redrafted).

#### *Preliminary Task Force Views and Recommendations*

29. The task force considered the alignment and possibility of overlap between the two ISAs. The task force does not believe that it is necessary to transfer all of the requirements and guidance in proposed ISA 710 (Redrafted) that apply to incoming auditors to proposed ISA 510 (Redrafted). As noted earlier, the latter is focused on the audit of the initial balances and reporting implications thereof. Proposed ISA 710 (Redrafted) comprehensively addresses all audit and reporting considerations related to comparative financial information. As long as there are appropriate cross references from proposed ISA 510 (Redrafted) to proposed ISA 710 (Redrafted) to alert the auditor that there are additional considerations when the financial statements include comparative financial information, the current structure of the two ISAs works. In this regard, the task force reviewed both proposed ISAs to ensure that there is appropriate alignment and proposes the following amendments:
- Clarify in the introductory paragraph that when the financial statements include comparative financial information, the requirements and guidance in proposed ISA 710 (Redrafted) also apply (i.e., there are additional requirements). This wording for the cross reference is now consistent with the approach taken in the cross reference to proposed ISA 510 (Redrafted) in proposed ISA 710 (Redrafted).
  - Introduce a cross reference to proposed ISA 710 (Redrafted) in the requirement in paragraph 12 describing the circumstances when a modification to the auditor's opinion in the predecessor auditor's opinion remains relevant and material to the current period's financial statements.

### Action Requested

The IAASB is asked to consider whether proposed ISA 510 (Redrafted) is sufficiently aligned with proposed ISA 710 (Redrafted).

#### G. ADDITIONAL REQUIREMENTS AND GUIDANCE

30. Some respondents suggested that the following additional guidance be added to the ISA:

- The EC suggested that paragraph 8 should also include a requirement to consider the effect on the auditor's risk assessment when the prior period financial statements were not audited.
- ICJCE suggested additional guidance be included to describe the necessary audit procedures when there is a change in both the accounting framework and auditor.
- ACCA suggested additional guidance on the evaluation of the appropriateness of accounting policies reflected in the opening balances.
- AICPA suggested additional guidance on the audit evidence to be obtained relating to the consistent application of accounting policies. A further suggestion was made to include a sentence to paragraph A2 stating that applying procedures to opening balances does not constitute an audit or re-audit of the opening balances.
- AUASB suggested including guidance on the effect of unadjusted errors brought forward from the prior period in paragraph A2.
- DTT and ICAI suggested including guidance that the predecessor auditor may not provide the working papers to the current auditor.

#### *Preliminary Task Force Views and Recommendations*

31. The task force believes that, in each of the cases noted above, introducing new additional guidance would go beyond a redraft of an ISA. Accordingly, the task force is not proposing introducing new additional guidance.

#### **Action Requested**

The IAASB is asked whether they agree with the task force's view not to include additional guidance as discussed above.

#### H. CONSIDERATIONS SPECIFIC TO PUBLIC SECTOR ENTITIES

32. One respondent (ACAG) commented that legislation governing public sector audit activity often includes privacy and secrecy provisions that limit the ability of the public sector auditor to divulge information to, or provide other assistance to an incoming private sector auditor. This limitation may create problems when a public sector auditor's term of engagement ends, for example when a public sector entity is privatized.
33. Another respondent (IRBA) commented that it is common practice that Auditors General outsource audit assignments to audit firms and requested guidance that would indicate whether there is one auditor (the Auditor General) for the two years (during which a change of auditors occur) or whether there are two auditors (the different audit firms).

*Preliminary Task Force Views and Recommendations*

34. Subject to the IAASB's further views, the task force proposes that the paragraphs relating to Considerations Specific to Public Sector Entities be included as follows (see paragraphs A8 and A9):

In the public sector, there may be legal or regulatory limitations on the information that the current auditor can obtain from the predecessor auditor. For example, if a public sector entity that has previously been audited by the jurisdiction's Supreme Audit Institution (SAI) is privatized, the amount of access to working papers or other information that the SAI can provide an incoming auditor that is in the private sector may be constrained by privacy or secrecy laws or regulation. In situations where such communications are constrained, audit evidence may need to be obtained through other means and, if sufficient appropriate audit evidence cannot be obtained, consideration given to the impact on the auditor's opinion.

The Auditor General may outsource the audit of public sector entities to private sector audit firms. When the Auditor General appoints a different audit firm to the firm that audited the financial statements of the public sector entity in the prior period, this is not usually regarded as a change in auditors, as the Auditor General remains responsible for the audit.

**Action Requested**

The IAASB is asked whether they agree with the proposed inclusion and wording for the paragraphs relating to the Special Considerations in the Audit of Public Sector Entities.

**Appendix A**

**List of Respondents to the Exposure Draft**

<b>Abbreviation</b>	<b>Category</b>
<b>Professional Organizations</b>	
AIA	Association of International Accountants
AICPA	American Institute of Certified Public Accountants
ACCA	The Association of Chartered Certified Accountants
CALCPA	California Society of Certified Public Accountants
CIPFA	Chartered Institute of Public Finance and Accountancy
CNCC	CNCC/CSOEC
FEE	Fédération des Experts Comptables Européens
HKICPA	Hong Kong Institute of Certified Public Accountants
ICAI	Institute of Chartered Accountants in Ireland
ICAP	Institute of Chartered Accountants of Pakistan
ICAS	Institute of Chartered Accountants of Scotland
ICJCE	Instituto de Censores Jurados de Cuentas de España
IDW	Institut der Wirtschaftsprüfer
ICPAS	Institute of Certified Public Accountants of Singapore
ICAEW	The Institute of Chartered Accountants in England and Wales
Ireland CPA	The Institute of Certified Public Accountants in Ireland
JICPA	The Japanese Institute of Certified Public Accountants
NIA	National Institute of Accountants in Australia
Royal NIVRA	Koninklijk Nederlands Instituut van Registeraccountants (Royal NIVRA)
SAICA	The South African Institute of Chartered Accountants
<b>National Auditing Standard Setters</b>	
APB	Auditing Practices Board (United Kingdom)
AUASB	Auditing and Assurance Standards Board, Australian Government
CICA	Auditing and Assurance Standards Board of the Canadian Institute of Chartered Accountants
IRBA	Independent Regulatory Board for Auditors (also a Regulator)
NZICA	Professional Standards Board of the New Zealand Institute of Chartered Accountants
<b>Audit Firms</b>	
BDO	BDO Global Coordination B.V.
DTT	Deloitte Touche Tohmatsu
EY	Ernst & Young Global
GT	Grant Thornton International
KPMG	KPMG
PwC	PricewaterhouseCoopers
<b>Public Sector Organizations</b>	
ACAG	Australasian Council of Auditors-General
NAO	National Audit Office

<b>Abbreviation</b>	<b>Category</b>
Provincial Auditor Saskatchewan	Provincial Auditor Saskatchewan
SNAO	Swedish National Audit Office
<b>Regulators and Oversight Authorities</b>	
EC	European Commission
<b>Individuals and Others</b>	
JM	Joseph Maresca CPA, CISA