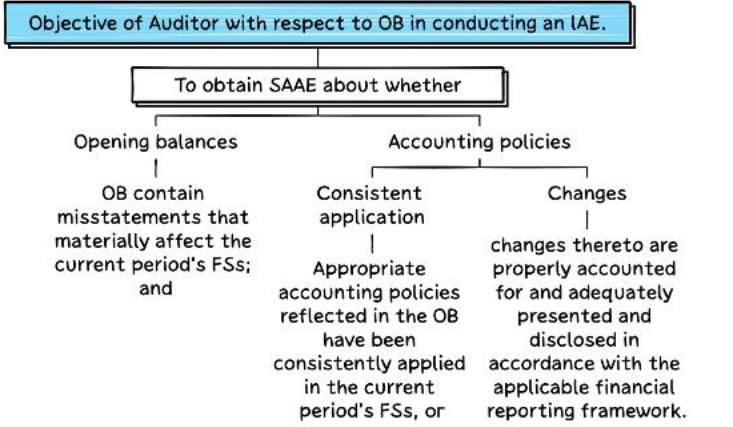


SA 510 Initial Audit Engagements – Opening Balances



| Definitions | |
|--------------------------|--|
| Initial Audit Engagement | An engagement in which either: The FSs for the prior period were not audited; or The FSs for the prior period were audited by a predecessor auditor. |
| Opening balances | Those account balances that exist at the beginning of the period. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments. |
| Predecessor auditor | The auditor from a different audit firm, who audited the FSs of an entity in the prior period and who has been replaced by the current auditor. |

Account Balances at Period Beginning

- Example: On April 1, 2024 (the first day of the financial year), ABC Ltd has cash of ₹1,25,00,000, inventory worth ₹2,75,00,000, and equipment valued at ₹4,50,00,000. These amounts represent the opening balances for the 2024-25 financial year.

Also Include Matters Requiring Disclosure

- Example: As of April 1, 2024, XYZ Corp had a pending legal case with a potential liability of ₹75,00,000. Though not on the balance sheet, this contingent liability must be disclosed and is part of the opening balances.

Include Contingencies

- Example: PQR Enterprises begins its fiscal year with a tax dispute of ₹1,80,00,000 that might result in additional payments. This contingency exists at the beginning of the period and forms part of the opening balances.

Include Commitments

- Example: On January 1, 2024, LMN Manufacturing had signed contracts to purchase machinery worth ₹3,50,00,000 in the coming year. This commitment existed at the beginning of the period and is considered part of the opening balances for disclosure purposes.

Example of Accounting Policy

How a company values inventory (e.g., FIFO, LIFO, weighted average), how it depreciates assets, or how it recognizes revenue.

Audit Procedures regarding Opening Balances

Read Recent FS and Audit Report

The auditor shall read the most recent FSs, if any, and the predecessor auditor's report thereon, if any, for information relevant to opening balances, including disclosures.

Obtain SAAE Whether OB Contains MS Having Material Affect on FS

The auditor shall obtain SAAE about whether the opening balances contain misstatements that materially affect the current period's FSs by

Correct Brought Forward and Disclosure of adjustment

- Determining whether the **prior period's closing balances** have been **correctly brought forward** to the current period or,
- any **adjustments** have been **disclosed** as prior period items in the current year's Statement of Profit and Loss.

Appropriate Accounting Policies

Determining whether the **opening balances** reflect the **application of appropriate accounting policies**; and

Performing one or more of the following

- Careful reading of Audited FS and other Docs**
Where the prior year FSs were audited, **perusing** the copies of the audited FSs including the other relevant documents relating to the prior period FSs;
- Evaluate Audit Procedures**
Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or
- Specific Audit Procedures**
Performing specific audit procedures to obtain evidence regarding the opening balances. (Example: The auditor of LMN Enterprises performs a bank confirmation specifically requesting information about loan balances as of the beginning of the period, confirming the ₹7,50,00,000 opening loan balance.)

DPQ – The newly appointed auditor of BTN Limited wants to obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements. What audit procedures should he perform for this purpose? (SA, May 2022, 3 Marks) (MTP2, May 2023, 3 marks) (RTP, May 2024, NA)

Misstatement in Opening Balance

- If auditor obtains evidence that opening balances contain misstatements that could materially affect current period's FSs
- Auditor shall perform such additional audit procedures as appropriate to determine effect on current period's FSs

Example: If the auditor discovers ABC Ltd.'s opening inventory was overstated by ₹50 Lakhs, they perform additional procedures like analyzing inventory movements to determine the impact on current year's cost of goods sold and profit.

Misstatement in Current period's FS

If the auditor **concludes** that such **misstatements exist** in the current period's FSs, the auditor shall communicate the misstatements with the appropriate level of management and TCWG in accordance with SA 450.

Nature and extent of Audit Procedures

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. Accounting policy-audit must have knowledge of the accounting policy so that he can obtain sufficient and appropriate audit evidence. accounting policy used by the client will have an impact on the audit procedure, for example, different audit procedures will be needed if the client is using weighted average method versus the FIFO method for inventory evaluation
- The **nature** of the account balances, classes of transactions and disclosures and the ROMM in the current period's FSs.
- The **significance** of the opening balances relative to the current period's FSs. (Gupta Pharmaceuticals has trade receivables with opening balance of ₹2.25 crore, representing 40% of current assets.)
- Whether the prior period's FSs were audited and, if so, whether the predecessor auditor's opinion was **modified**. - Kumar Manufacturing's auditor gave a qualified opinion on ₹1.8 crore inventory due to inadequate documentation of slow-moving items. The new auditor must verify inventory extensively, review aging reports, test net realizable value, and assess provision adequacy.

If the prior period's FSs were audited by a predecessor auditor

- Auditors can get evidence on opening balances from the predecessor's audited financials and supporting schedules.
- **Ordinarily**, the current auditor can place **reliance** on the closing balances contained in the FSs 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.

Example: If the predecessor determined accounts receivable was ₹75,00,000 at year-end, the new auditor typically accepts this as the opening balance.

During an audit of Sunrise Exports, the new auditor discovers emails suggesting management pressured the previous auditor to accept questionable revenue recognition practices. This raises concerns about the reliability of the ₹3,50,00,000 accounts receivable opening balance.

Example - The closing inventory of the company as on 31.3.2023 amounting to ₹ 100 lacs continued as it is and became closing inventory as on 31.3.2024

For current assets and liabilities

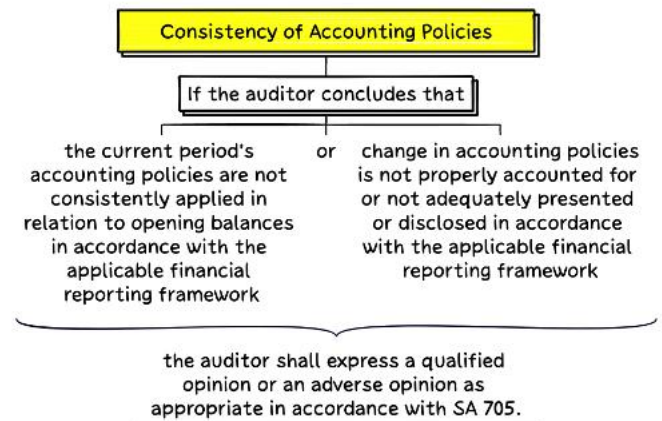
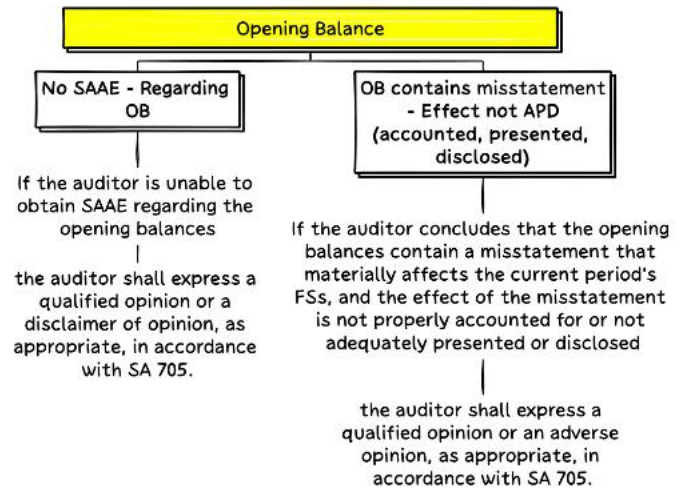
- Audit evidence for opening balances of current assets and liabilities may come from current audit procedures.

- Collecting (paying) opening receivables (payables) in the current period gives evidence of their initial existence, rights, obligations, and value.
- For inventories, the current audit on closing balance offers limited evidence on opening inventory, necessitating additional procedures.
 - 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.

For non-current assets and liabilities

For non-current assets like property and long-term liabilities, evidence comes from accounting records and, sometimes, third-party confirmations. In other cases, the auditor may need to carry out additional audit procedures.

Audit Conclusions and Reporting



Example: At Premier Manufacturing, the auditor cannot verify opening fixed assets of ₹1,20,00,000 (material but not pervasive). The auditor issues a qualified opinion.

Example: At Mega Enterprises, the auditor cannot verify multiple significant opening balances including inventory (₹5,50,00,000), accounts receivable (₹8,75,00,000), and fixed assets (₹12,25,00,000). Because these

represent most of the company's assets, the auditor issues a disclaimer of opinion

Example: If last year's closing inventory was overstated and the company does not adjust it, the auditor may give an adverse opinion.

Example: If last year's revenue was recognized on a cash basis but this year on an accrual basis without proper restatement, consistency is violated.

Example: If the company switches from FIFO to Weighted Average for inventory valuation but does not disclose the impact, it may mislead stakeholders.