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Agenda Item
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Committee: IAASB

Meeting Location: Warsaw

Meeting Date: July 9–13, 2007

Proposed ISA 510 (Redrafted), "Initial Engagements—Opening Balances"

Objective of Agenda Item

1. To approve as an exposure draft proposed ISA 510 (Redrafted), "Initial Engagements—Opening Balances."

ISA 510 Redrafting Task Force Members

2. The Task Force members are:

Diana Hillier (Chair)	IAASB Member
William Kinney	IAASB Member
Josef Ferlings	IAASB Technical Advisor

3. Redrafting support was provided by Bernard Agulhas, Deryck Tindall and Thinus Peyper of the Standards Department of the Independent Regulatory Board for Auditors (IRBA), the secretariat which supports the Committee for Auditing Standards (CFAS) of the IRBA.

Matters for IAASB Consideration

MATTERS THAT RELATE TO THE REDRAFTING OF ISA 510

Proposed objective and structure of the redrafted ISA

4. The Task Force used paragraph 2 of the extant ISA as the basis for the proposed objective. However, the Task Force concluded that there are only two aims in the objective, namely, obtaining sufficient appropriate audit evidence that the opening balances are free of material misstatements, and that the accounting policies are used consistently or that changes are properly accounted for. The Task Force concluded that sub-paragraph 2(b) of the extant ISA 510 should not form a separate consideration in obtaining sufficient appropriate audit evidence as the opening balances will necessarily be misstated if the closing balances are not brought forward correctly (and *vice versa*), which is already covered by paragraph 3(a) in the proposed objective. The need to consider whether the closing balances were appropriately carried forward is reflected in the requirements (paragraph 5) but has not been specifically identified in the objective.

5. To align the requirements with the proposed objective, the requirements that describe the audit procedures were restructured into two sections: Opening Balances and Accounting Policies.

This restructuring demonstrates more clearly how the requirements support the achievement of the objective:

(a) Paragraphs 5 - 9 describe how the auditor obtains sufficient appropriate audit evidence regarding the existence of misstatements in the opening balances (paragraph 3(a)); and

(b) Paragraph 10 describes considerations in obtaining sufficient appropriate audit evidence regarding the accounting policies (paragraph 3 (b)).

Furthermore, the restructuring also provides a closer link between the audit procedures and the reporting requirements. Paragraphs 12 and 13 deals with the audit procedures in paragraphs 5 and 10, respectively.

6. The second sentence in paragraph 9 has been moved forward to the section on Audit Procedures from paragraph 12 in the "Audit Conclusions and Reporting" section of the extant ISA, as it relates to the auditor's work effort. To better explain what the auditor is expected to do if evidence is obtained that there is a misstatement in the opening balances that could affect the current period's financial statements, new wording have been introduced in the first sentence of paragraph 9. This is not a new requirement; however, as it already exists in ISA 710, paragraph 9.

Action Requested

The IAASB is asked whether they agree with the task force's decision on how to present the objective and if the structure of the requirements and application material properly support the objectives.

Reviewing the predecessor auditor's working papers

7. The redrafting of paragraph 6 of the extant ISA 510 (paragraph 6 of ISA 510 (Redrafted)) raised the issue as to whether the ISA should require the auditor to review the predecessor auditor's working papers. The first sentence of paragraph 6 of the extant ISA 510 provides the following guidance for the auditor regarding the audit procedure to review the predecessor auditor's working papers as one of the ways to obtain sufficient appropriate evidence regarding opening balances:

> *"When the prior period's financial statements were audited by another auditor, the current auditor may be able to obtain sufficient appropriate audit evidence regarding opening balances by reviewing the predecessor auditor's working papers."*

8. The Task Force believes that the wording in the extant ISA implies that the auditor would ordinarily attempt to review the predecessor auditor's working papers as this would be the most efficient way to obtain sufficient appropriate audit evidence about the opening balances. Such review may provide sufficient appropriate audit evidence regarding opening balances on its own. However, the Task Force was also aware that in some jurisdictions access to the predecessor auditor's working papers may be restricted by legislation or regulation, resulting in the predecessor auditor not being allowed to or compelled to make the working papers available to the current auditor. The Task Force is of the opinion that, although it would be desirable that a review of the predecessor auditor's working papers be elevated to become a

requirement, the requirement needs a caveat should such impediments arise that prevent the current auditor from being able to conduct a review of the predecessor auditor's working papers. The caveat would then require the current auditor to perform alternative audit procedures in the circumstances.

Action Requested

The IAASB is asked to consider whether the proposed requirement for the current auditor to review the predecessor auditor's working papers is appropriate, and whether the caveat proposed enables the auditor to still comply with the requirements of the proposed redrafted ISA in those situations where access to the predecessor auditor's working papers may be restricted.

Restricting an allowable "piecemeal opinion" to those jurisdictions that permit it

9. Paragraph 11(c) in extant 510 restricted the circumstances when the auditor could express an unmodified opinion on the closing financial position of the entity and a qualified opinion or disclaimer of opinion on the results of operations and cash flows ("split opinion") to jurisdictions permitting it (paragraph 11 (c) in extant ISA 510). The Task Force considered whether the restriction to circumstances when it is permitted remains appropriate. Paragraph 37 of ISA 705 (Close Off) specifically allows the expression of an unmodified opinion on the closing financial position of the entity but a disclaimer of opinion on the results of operations and cash flows without the caveat of restricting it to "jurisdictions" permit that it. Therefore, the Task Force thought it consistent with the revised ISA 705 to redraft paragraph 11 without the reference to "in those jurisdictions where it is permitted".

10. The Task Force also considered the possibility that the auditor, in some jurisdictions, may not be permitted by legislation or regulation to issue such an opinion but concluded that the guidance on such an impediment, if needed, should be dealt with in ISA 705 rather than in ISA 510.

Action Requested

The IAASB is asked to consider whether the Task Force's proposed treatment of the allowable "piecemeal opinion" is appropriate.

Differential work effort

11. The Task Force was mindful of the views of some that the extant ISA 510 is not sufficiently clear on the differential work effort necessary between circumstances when the financial statements were previously audited and circumstances when the financial statements were not previously audited. The Task Force agreed on a wording change to the end of paragraph 8 (*....the auditor shall perform the audit procedures necessary to obtain sufficient appropriate audit evidence*) that it believes helps to clarify the level of work effort required of the auditor. This additional work effort is supported by paragraph A1 which states that the *nature and extent of audit procedures* …depends on such matters as … *whether the prior period's financial statements were audited.*

Action Requested

The IAASB is asked to consider whether the redrafted ISA is sufficiently clear on the level of work effort required of the auditor in the circumstances described above or whether, in the interests of Clarity, additional guidance should be provided.

Reference to contingencies and commitments in the Scope

12. The Task Force was uncertain as to the intention of the following reference contained in the second sentence of paragraph 1 of the extant ISA 510:

    "…This ISA would also be considered when the auditor becomes aware of contingencies and commitments existing at the beginning of the period."

13. The Task Force concluded that the reference was intended to mean, that in addition to **financial statement amounts, opening balances also include** contingencies and commitments existing at the beginning of the period and which were disclosed (or should have been disclosed) in the prior period financial statements. The following proposed rewording of the second sentence of paragraph 1 of the extant ISA 510 was drafted to provide clarity to this uncertainty:

    In addition to financial statement amounts, opening balances include contingencies and commitments requiring disclosure that existed at the beginning of the period.

    We have also decided to add the sentence to the definition of opening balances so that it was clear the objective and requirements should be applied to contingencies and commitments as well as the opening balances in the body of the financial statements themselves.

Action Requested

The IAASB is asked to consider whether the proposed rewording to explain the intended applicability of this ISA to contingencies and commitments existing at the beginning of the period, is correct and whether the ISA provides sufficient clarity of the auditor's responsibilities when the auditor may become aware of contingencies and commitments existing at the beginning of the period.

Material Presented

Agenda Item 3-A (Pages 1629-1638)	Proposed ISA 510 (Redrafted) – Clean
Agenda Item 3-B (Pages 1639-1646)	Proposed ISA 510 (Redrafted) – Mark-up from Extant
Agenda Item 3-C (Pages 1647-1650)	Proposed Disposition of the Present Tense and Other Statements in Proposed ISA 510 (Redrafted)
Agenda Item 3-D (Pages 1651-1658)	Mapping Document – Proposed ISA 510 (Redrafted)

Action Requested

14. The IAASB is asked to consider the matters highlighted above and to approve the proposed ISA 510 (Redrafted) for issue as an Exposure Draft.

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