Opening Balances—Initial Audit Engagements, Including Reaudit Engagements

Source: SAS No. 122.

Effective for audits of financial statements for periods ending on or after December 15, 2012.

Introduction

Scope of This Section

.01 This section addresses the auditor’s responsibilities relating to opening balances in an initial audit engagement, including a reaudit 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 comparative financial statements are presented, the relevant requirements and guidance for comparative financial statements in section 700, Forming an Opinion and Reporting on Financial Statements, also apply. Section 300, Planning an Audit, includes additional requirements and guidance regarding activities prior to starting an initial audit. Section 708, Consistency of Financial Statements, also applies with respect to the auditor’s evaluation of the consistency of accounting principles between the periods presented and covered by the auditor’s opinion. Section 210, Terms of Engagement, includes requirements and guidance with respect to communications with a predecessor auditor before accepting an initial audit engagement, including a reaudit engagement.

.02 This section, with respect to predecessor auditors, does not apply if the most recent audited financial statements are more than one year prior to the beginning of the earliest period to be audited.

Effective Date

.03 This section is effective for audits of financial statements for periods ending on or after December 15, 2012.

Objective

.04 The objective of the auditor, in conducting an initial audit engagement, including a reaudit engagement, is to obtain sufficient appropriate audit evidence regarding opening balances about whether (Ref: par. .A1)

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
Audit Evidence

statements or changes thereto are appropriately accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

Definitions

.05 For the purposes of generally accepted auditing standards, the following terms have the meanings attributed as follows:

**Initial audit engagement.** An engagement in which either (a) the financial statements for the prior period were not audited, or (b) the financial statements 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 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.

**Predecessor auditor.** The auditor from a different audit firm who has reported on the most recent audited financial statements or was engaged to perform but did not complete an audit of the financial statements. (Ref: par. .A2)

**Reaudit.** An initial audit engagement to audit financial statements that have been previously audited by a predecessor auditor.

Requirements

Audit Procedures

.06 The auditor should 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, and consistency in the application of accounting policies.

.07 In instances in which the prior period financial statements were audited by a predecessor auditor, the auditor should request management to authorize the predecessor auditor to allow a review of the predecessor auditor's audit documentation and for the predecessor auditor to respond fully to inquiries by the auditor, thereby providing the auditor with information to assist in planning and performing the engagement. (Ref: par. .A3–.A11)

Opening Balances

.08 The auditor should 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. evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances and performing one or both of the following: (Ref: par. A7–A9 and A12–A14)

i. When the prior year financial statements were audited, reviewing the predecessor auditor's audit documentation to obtain evidence regarding the opening balances

ii. Performing specific audit procedures to obtain evidence regarding the opening balances

.09 If the auditor obtains audit evidence that the opening balances contain misstatements that could materially affect the current period's financial statements, the auditor should 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 should communicate the misstatements to the appropriate level of management and those charged with governance, in accordance with section 260, The Auditor's Communication With Those Charged With Governance. If the prior period financial statements were audited by a predecessor auditor, the auditor should also refer to paragraphs .12–.13.

Consistency of Accounting Policies

.10 The auditor should 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 appropriately accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

Relevant Information in the Predecessor Auditor’s Report

.11 If the prior period's financial statements were audited by a predecessor auditor, and a modification was made to the opinion, the auditor should 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 section 315, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement.

Discovery of Possible Material Misstatements in Financial Statements Reported on by a Predecessor Auditor

.12 If the auditor becomes aware of information during the audit that leads the auditor to believe that financial statements reported on by the predecessor auditor may require revision, the auditor should request management to inform the predecessor auditor of the situation and arrange for the three parties to discuss this information and attempt to resolve the matter. The auditor should communicate to the predecessor auditor information that the auditor believes the predecessor auditor may need to consider, in accordance with section 560, Subsequent Events and Subsequently Discovered Facts, which addresses the auditor's responsibilities when facts become known to the auditor after the date of the auditor's report that, had they been known to the auditor at that date, may have caused the auditor to amend the auditor's report. (Ref: par. .A15)

.13 If management refuses to inform the predecessor auditor that the prior period financial statements may need revision or if the auditor is not satisfied with the resolution of the matter, the auditor should evaluate (a) the
implications on the current engagement and (b) whether to withdraw from the engagement or, when withdrawal is not possible under applicable law or regulation, disclaim an opinion on the financial statements. (Ref: par. .A16)

Audit Conclusions and Reporting

.14 The auditor should not make reference to the report or work of the predecessor auditor as the basis, in part, for the auditor's own opinion.

Opening Balances

.15 If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor should express a qualified opinion or disclaim an opinion on the financial statements, as appropriate, in accordance with section 705, Modifications to the Opinion in the Independent Auditor's Report. (Ref: par. .A17)

.16 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 appropriately accounted for or adequately presented or disclosed, the auditor should express a qualified opinion or an adverse opinion, as appropriate, in accordance with section 705.

Consistency of Accounting Policies

.17 If the auditor concludes that

a. the current period's accounting policies are not consistently applied regarding opening balances, in accordance with the applicable financial reporting framework, or

b. a change in accounting policies is not appropriately accounted for or adequately presented or disclosed, in accordance with the applicable financial reporting framework,

the auditor should express a qualified opinion or an adverse opinion, as appropriate, in accordance with section 705.

Modification to the Opinion in the Predecessor Auditor's Report

.18 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 should modify the auditor's opinion on the current period's financial statements, in accordance with section 705. (Ref: par. .A18)

Application and Other Explanatory Material

Objective (Ref: par. .04)

.A1 Audit evidence regarding opening balances and the consistency of accounting principles may include the most recent audited financial statements, the predecessor auditor's report thereon, the results of inquiry of the predecessor auditor, the results of the auditor's review of the predecessor auditor's audit documentation relating to the most recently completed audit, and audit procedures performed on the current period's transactions that may provide evidence about the opening balances or consistency.
Definitions

**Predecessor Auditor (Ref: par. .05)**

.A2 Two predecessor auditors may exist: the auditor who reported on the most recent audited financial statements and the auditor who was engaged to perform, but did not complete, an audit of any subsequent financial statements.

**Audit Procedures (Ref: par. .07)**

.A3 The auditor may initiate communications with management to authorize review of the predecessor auditor's audit documentation and for the predecessor auditor to respond fully to inquiries by the auditor, either before or after accepting the engagement. Relevant ethical and professional requirements guide the auditor's communications with the predecessor auditor.

.A4 The predecessor auditor may request a consent and acknowledgment letter from the entity to document this authorization in an effort to reduce misunderstandings about the scope of the communications being authorized. Exhibit B, "Illustrative Entity Consent and Acknowledgment Letter," contains an illustrative entity consent and acknowledgment letter.

.A5 It is customary for the predecessor auditor to make himself or herself available to the auditor and to make available for review certain audit documentation. The predecessor auditor determines which audit documentation is to be made available for review and which may be copied. The predecessor auditor ordinarily permits the auditor to review audit documentation, including documentation of planning; risk assessment procedures; further audit procedures; audit results; and other matters of continuing accounting and auditing significance, such as the schedule of uncorrected misstatements, working paper analysis of balance sheet accounts, and those relating to contingencies.

.A6 Before permitting access to the audit documentation, the predecessor auditor may request written confirmation of the auditor's agreement regarding the use of the audit documentation. Exhibit C, "Illustrative Successor Auditor Acknowledgment Letter," contains an illustrative successor auditor acknowledgment letter.

.A7 The extent, if any, to which a predecessor auditor permits access to the audit documentation or responds to inquiries from the auditor is a matter of the predecessor auditor's professional judgment. The predecessor auditor's denial or limitation of access may affect the auditor's assessment of risk regarding the opening balances or the nature, timing, and extent of the auditor's procedures with respect to the opening balances and consistency of accounting principles. (Ref: par. .07 and .08c)

.A8 If the predecessor auditor permits access to the audit documentation, the auditor may review the predecessor auditor's audit documentation for information relevant to planning and performing the audit. The auditor's determination whether to use information resulting from such review as part of the auditor's risk assessment procedures or as evidence regarding the opening balances is influenced by the auditor's assessment of the professional competence and independence of the predecessor auditor. Although the predecessor auditor is not a component auditor, as defined in section 600, Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors), the auditor may make inquiries similar to those listed in section 600.
concerning the professional competence and independence of the predecessor auditor. \(^1\) (Ref: par. .07 and .08c)

.A9 The auditor's review of the predecessor auditor's audit documentation may provide audit evidence about the opening balances and consistency of accounting principles. However, the nature, timing, and extent of audit work performed and the conclusions reached are solely the responsibility of the auditor, as required by section 200, \textit{Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards}. (Ref: par. .07 and .08c)

\textbf{Considerations Specific to Governmental Entities (Ref: par. .07)}

.A10 In audits of governmental entities, law or regulation may limit the information that the auditor can obtain from a predecessor auditor. Certain information may be identified as classified or otherwise prohibited from disclosure by federal, state, or local laws or public safety or security concerns. For example, if a governmental entity that has previously been audited by a government audit organization (for example, the U.S. Government Accountability Office, a federal inspector general, an elected or statutorily appointed state auditor general, or other suitably qualified audit organization) engages a public accounting firm, the amount of access to audit documentation or other information that the government audit organization can provide an incoming auditor may be constrained by privacy or confidentiality laws or regulations. In situations when communications with a predecessor auditor are restricted, audit evidence may need to be obtained through other means and, if sufficient appropriate audit evidence cannot be obtained, consideration given to the effect on the auditor's opinion, in accordance with the requirement in paragraph .15.

.A11 If a government audit organization engages a public accounting firm in an agency capacity to perform an audit of a governmental entity and such firm did not audit the financial statements of the governmental entity in the prior period, this is usually regarded as a change in auditors; therefore, this section applies.

\textbf{Opening Balances (Ref: par. .08c)}

.A12 The nature and extent of audit procedures necessary to obtain sufficient appropriate audit evidence regarding opening balances depend on such matters as the following:

- 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

.A13 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

\(^1\) Paragraph .22 of section 600, \textit{Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)}. 
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, such as one or more of the following, may be necessary to obtain 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 cutoff

.A14 For noncurrent 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.

**Discovery of Possible Material Misstatements in Financial Statements Reported on by a Predecessor Auditor**

.A15 Section 560 provides reporting guidance to the predecessor auditor who is requested to reissue a previously issued report on financial statements of a prior period when those financial statements are to be presented on a comparative basis with audited financial statements of a subsequent period. Section 700 provides reporting guidance to the auditor reporting on comparative financial statements when the predecessor auditor is unable or unwilling to reissue the auditor's report on prior period financial statements that have been restated. (Ref: par. .12)

.A16 If management refuses to inform the predecessor auditor that the prior period financial statements may need revision, or if the auditor is not satisfied with the resolution of the matter, the auditor may seek legal advice in determining an appropriate course of action, including evaluating whether to withdraw from the engagement when withdrawal is possible under applicable law or regulation. (Ref: par. .13)

**Audit Conclusions and Reporting**

**Opening Balances (Ref: par. .15)**

.A17 Section 705 addresses 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.

b. An opinion that is qualified or disclaimed, as appropriate, regarding the results of operations and cash flows, when relevant, and

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2 Paragraphs .19–.20 of section 560, *Subsequent Events and Subsequently Discovered Facts*.


Modification to the Opinion in the Predecessor Auditor's Report
(Ref: par. .18)

.A18 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 when, 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.

Circumstances include the following:

- 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 and pervasive to the entity's results of operations and cash flows.\(^1\)
- The financial position at year-end is fairly presented.
- A disclaimer of opinion regarding the results of operations and cash flows and an unmodified opinion regarding financial position is considered appropriate in the circumstances.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Financial Statements\(^2\)

We have audited the accompanying balance sheet of ABC Company as of December 31, 20X1, and were engaged to audit the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with auditing standards generally accepted in the United States of America. Because of the matters described in the Basis for Disclaimer of Opinion on the Results of Operations and Cash Flows paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the results of operations and cash flows.

We conducted our audit of the balance sheet in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the balance sheet is free from material misstatement.

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\(^1\) If the possible effects, in the auditor's professional judgment, are considered to be material but not pervasive to the entity's results of operations and cash flows, the auditor would express a qualified opinion on the results of operations and cash flows.

\(^2\) The subtitle "Report on the Financial Statements" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.
An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.3 Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our unmodified opinion on the financial position.

Basis for Disclaimer of Opinion on the Results of Operations and Cash Flows

We were not engaged as auditors of the Company until after December 31, 20X0, and, therefore, did not observe the counting of physical inventories at the beginning of the year. We were unable to satisfy ourselves by performing other auditing procedures concerning the inventory held at December 31, 20X0. Since opening inventories enter into the determination of net income and cash flows, we were unable to determine whether any adjustments might have been necessary in respect of the profit for the year reported in the income statement and the net cash flows from operating activities reported in the cash flow statement.

Disclaimer of Opinion on the Results of Operations and Cash Flows

Because of the significance of the matter described in the Basis for Disclaimer of Opinion on the Results of Operations and Cash Flows paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the results of operations and cash flows for the year ended December 31, 20X1. Accordingly, we do not express an opinion on the results of operations and cash flows for the year ended December 31, 20X1.

Opinion on the Financial Position

In our opinion, the balance sheet presents fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1, in accordance with accounting principles generally accepted in the United States of America.

Report on Other Legal and Regulatory Requirements

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]

[Auditor's signature]

[Auditor's city and state]

[Date of the auditor's report]

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3 In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances." In addition, the next sentence, "Accordingly, we express no such opinion." would not be included.
Exhibit B—Illustrative Entity Consent and Acknowledgment Letter (Ref: par. .07 and .A4)

Paragraph .07 requires that the auditor request management to authorize the predecessor auditor to allow a review of the predecessor auditor's audit documentation and for the predecessor auditor to respond fully to inquiries by the auditor, thereby providing the auditor with information to assist in planning and performing the engagement. Paragraph .A4 states that the predecessor auditor may request a consent and acknowledgment letter from the entity to document this authorization in an effort to reduce misunderstandings about the scope of the communications being authorized. The following letter is presented for illustrative purposes only and is not required by professional standards.

[Date]
ABC Enterprises
[Address]

You have given your consent to allow [name of successor CPA firm], as independent auditors for ABC Enterprises (ABC), access to our audit documentation for our audit of the December 31, 20X1, financial statements of ABC. You also have given your consent to us to respond fully to [name of successor CPA firm] inquiries. You understand and agree that the review of our audit documentation is undertaken solely for the purpose of obtaining an understanding about ABC and certain information about our audit to assist [name of successor CPA firm] in planning and performing the audit of the December 31, 20X2, financial statements of ABC.

Please confirm your agreement with the foregoing by signing and dating a copy of this letter and returning it to us.

Attached is the form of the letter we will furnish [name of successor CPA firm] regarding the use of the audit documentation.

Very truly yours,
[Predecessor Auditor]
By: ______________________
Accepted:
ABC Enterprises
By: ______________________
Date: ________________
Exhibit C—Illustrative Successor Auditor Acknowledgment Letter (Ref: par. .A6)

Paragraph .A6 states that the predecessor auditor may request that the auditor confirm in writing his or her agreement regarding the use of the predecessor auditor's audit documentation before permitting access to it. The following letter is presented for illustrative purposes only and is not required by professional standards.

[Date]
[Successor Auditor]
[Address]

We have previously audited, in accordance with auditing standards generally accepted in the United States of America, the December 31, 20X1, financial statements of ABC Enterprises (ABC). We rendered a report on those financial statements and have not performed any audit procedures subsequent to the audit report date. In connection with your audit of ABC’s 20X2 financial statements, you have requested access to our audit documentation prepared in connection with that audit. ABC has authorized our firm to allow you to review that audit documentation.

Our audit, and the audit documentation prepared in connection therewith, of ABC's financial statements were not planned or conducted in contemplation of your review. Therefore, items of possible interest to you may not have been specifically addressed. Our use of professional judgment and the assessment of audit risk and materiality for the purpose of our audit mean that matters may have existed that would have been assessed differently by you. We make no representation about the sufficiency or appropriateness of the information in our audit documentation for your purposes.

We understand that the purpose of your review is to obtain information about ABC and our 20X1 audit results to assist you in planning and performing your 20X2 audit of ABC. For that purpose only, we will provide you access to our audit documentation that relates to that objective.

Upon request, we will provide copies of audit documentation that provides factual information about ABC. You agree to subject any such copies or information otherwise derived from our audit documentation to your normal policy for retention of audit documentation and protection of confidential entity information. Furthermore, in the event of a third-party request for access to your audit documentation prepared in connection with your audits of ABC, you agree to obtain our permission before voluntarily allowing any such access to our audit documentation or information otherwise derived from our audit documentation, and to obtain on our behalf any releases that you obtain from such third party. You agree to advise us promptly and provide us a copy of any subpoena, summons, or other court order for access to your audit documentation that include copies of our audit documentation or information otherwise derived therefrom.

Please confirm your agreement with the foregoing by signing and dating a copy of this letter and returning it to us.

Very truly yours,

[Predecessor Auditor]

By: ____________________________
Even with management's consent, access to the predecessor auditor's audit documentation may still be limited. Experience has shown that the predecessor auditor may be willing to grant broader access if given additional assurance concerning the use of the audit documentation. Accordingly, the auditor might consider agreeing to the following additional limitations on the review of the predecessor auditor's audit documentation in order to obtain broader access:

- The auditor will not comment, orally or in writing, to anyone as a result of the review about whether the predecessor auditor's engagement was performed in accordance with generally accepted auditing standards.
- The auditor will not provide expert testimony or litigation support services or otherwise accept an engagement to comment on issues relating to the quality of the predecessor auditor's audit.
- The auditor accepts sole responsibility for the nature, timing, and extent of audit work performed and the conclusions reached in expressing an opinion on the 20X2 financial statements of ABC.

The following paragraph illustrates the previous text:

Because your review of our audit documentation is undertaken solely for the purpose described previously and may not entail a review of all our audit documentation, you agree that (1) the information obtained from the review will not be used by you for any other purpose, (2) you will not comment, orally or in writing, to anyone as a result of that review about whether our audit was performed in accordance with generally accepted auditing standards, (3) you will not provide expert testimony or litigation support services or otherwise accept an engagement to comment on issues relating to the quality of our audit, and (4) you accept sole responsibility for the nature, timing and extent of audit work performed and the conclusions reached in expressing your opinion on the 20X2 financial statements of ABC.