NSA 21

NEPAL STANDARDS ON AUDITING
INITIAL ENGAGEMENTS—OPENING BALANCES

CONTENTS

This NSA is applicable in all material respects to Public Sector also.

Introduction

1. The purpose of this Nepal Standards on Auditing (NSA) is to establish standards and provide guidance regarding opening balances when the financial statements are audited for the first time or when the financial statements for the prior period were audited by another auditor. This NSA would also be considered so the auditor may become aware of contingencies and commitments existing at the beginning of the period.

2. This NSA is to be read in conjunction with the Preface to Nepal Standards on Auditing.

3. This NSA contains the basic principles and essential procedures (identified in bold type black lettering) together with related guidance in the form of explanatory and other material.

4. This NSA needs only be applied to material matters.

5. **For initial audit engagements, the auditor should obtain sufficient appropriate audit evidence that:**

   (a) **the opening balances do not contain misstatements that materially affect the current period's financial statements;**

   (b) **the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, have been restated; and**

(c) **appropriate accounting policies are consistently applied or changes in accounting policies have been properly accounted for and adequately disclosed.**

6. "Opening balances" means those account balances which exist at the beginning of the period. Opening balances are based upon the closing balances of the prior period and reflect the effects of:

(a) transactions of prior periods; and

(b) accounting policies applied in the prior period.

In an initial audit engagement, the auditor will not have previously obtained audit evidence supporting such opening balances.

Audit Procedures

7. The sufficiency and appropriateness of the audit evidence the auditor will need to obtain regarding opening balances depends on such matters as:

- the accounting policies followed by the entity,
- whether the prior period's financial statements were audited, and if so whether the auditor's report was modified,
- the nature of the accounts and the risk of misstatement in the current period's financial statements, and
- the materiality of the opening balances relative to the current period's financial statements.

8. The auditor will need to consider whether opening balances reflect the application of appropriate accounting policies and that those policies are consistently applied in the current period's financial statements. When there are any changes in the accounting policies or application thereof, the auditor would consider whether they are appropriate and properly accounted for and adequately disclosed.

9. 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. In these circumstances, the current auditor would also consider the professional competence and independence of the predecessor auditor. If the prior period's auditor's report was modified, the auditor would pay particular attention in the current period to the matter which resulted in the modification.

10. Prior to communicating with the predecessor auditor, the current auditor will need to consider the *Code of Ethics for Professional Accountants* issued by The Institute of Chartered Accountants of Nepal.

11. When the prior period's financial statements were not audited or when the auditor is not able to be satisfied by using the procedures described in paragraph ~~6~~ 9, the auditor will need to perform other procedures such as those discussed in paragraphs 12 and 13.

12. For current assets and liabilities some audit evidence can ordinarily 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, it is more difficult for the auditor to be satisfied as to inventory on hand at the beginning of the period. Therefore, additional procedures are ordinarily necessary such as observing a current physical inventory taking and reconciling it back to the opening inventory quantities, testing the valuation of the opening inventory items, and testing gross profit and cutoff. A combination of these procedures may provide sufficient appropriate audit evidence.

13. For noncurrent assets and liabilities, such as fixed assets, investments and long-term debt, the auditor will ordinarily examine the records underlying the opening balances. In certain cases, the auditor may be able to obtain confirmation of opening balances 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

14. **If, after performing procedures including those set out above, the auditor is unable to obtain sufficient appropriate audit evidence concerning opening balances, the auditor's report should include:**

(a) **a qualified opinion,** for example:

"We did not observe the counting of the physical inventory stated at Rs. ... as at Ashad 3X, 20XX, since that date was prior to our appointment as auditors. We were unable to satisfy ourselves as to the inventory quantities at that date by other audit procedures.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to observe the counting of physical inventory and satisfy ourselves as to the opening balance of inventory, the financial statements give a true and fair view of (are presented fairly, in all material respects,) the financial position of

ABC Company as at Ashad 3X, 20XX and the results of its operations and its cash flows for the year then ended in accordance with Nepal Accounting Standards or relevant practices and comply with (Quote the relevant statute or law)... (For example: Company Act, 2053 / Commercial Bank Act, 2031 etc.)"

(b) **a disclaimer of opinion; or**

(c) **in those jurisdictions where it is permitted, an opinion which is qualified or disclaimed regarding the results of operations and unqualified regarding financial position,** for example:

"We did not observe the counting of the physical inventory stated at Rs. ... as at Ashad 3X, 20XX, since that date was prior to our appointment as auditors. We were unable to satisfy ourselves as to the inventory quantities at that date by other audit procedures.

Because of the significance of the above matter in relation to the results of the Company's operations for the year ended on Ashad 3X, 20XX, we are not in a position to, and do not, express an opinion on the results of its operations and its cash flows for the year then ended.

In our opinion, the balance sheet gives a true and fair view of (or 'are presented fairly in all material respects,') the financial position of the Company as at Ashad 3X, 20XX, in accordance with Nepal Accounting Standards or relevant practices and comply with (Quote the relevant statute or law)... (For example: Company Act, 2053 / Commercial Bank Act, 2031 etc.)"

15. If the opening balances contain misstatements which could materially affect the current period's financial statements, the auditor would inform management and, after having obtained management's authorisation, the predecessor auditor, if any. **If the effect of the misstatement is not properly accounted for and adequately disclosed, the auditor should express a qualified opinion or an adverse opinion, as appropriate.**

16. **If the current period's accounting policies have not been consistently applied in relation to opening balances and if the change has not been properly accounted for and adequately disclosed, the auditor should express a qualified opinion or an adverse opinion as appropriate.**

17. If the entity's prior period auditor's report was modified, the auditor would consider the effect thereof on the current period's financial statements. For example, if there was a scope limitation, such as one due to the inability to determine opening inventory in the prior period, the auditor may not need to qualify or disclaim the current period's audit opinion. **However, if a**

modification regarding the prior period's financial statements remains relevant and material to the current period's financial statements, the auditor should modify the current auditor's report accordingly.

Compliance with International Standards on Auditing

18. Compliance with this NSA ensures compliance in all material respects with ISA 510 (Initial Engagements-Opening Balances).

Effective Date

19. This Nepal Standards on Auditing becomes operative for the audit commencing on or after 01 Magh 2061 corresponding to 14 January 2005. Earlier application is encouraged.