

The Auditor's Report on Financial Statements Effective Date

Background

In Tokyo, IAASB did not have an opportunity to debate the proposed effective date of the ISA.

In preparing the Exposure Draft, the Task Force asked the IAASB Technical Director and technical staff for advice on the appropriate effective dates for ISA 700 and related conforming amendments.

The effective dates for most ISAs are based on the date on which the engagement commences (e.g., *"This ISA is effective for audits of financial statements for periods ending on or after December 31, 2000"*). This makes sense when the ISAs specific engagement performance requirements, as the new requirements can be taken into account from the beginning of the engagement. It may, however, not be the most appropriate approach for an ISA that will change the wording of the auditor's report. The downside of relating the effective date to the beginning of the engagement for new wording of the auditor's report is that it would result in two styles of reports being in the marketplace simultaneously (as engagements will begin at different dates and may cover different periods of time). For this reason, it may be preferable to have all audit reports change at a particular point in time so that the transition from one style of report to the other is clean and quick.

For these reasons, as a general rule, national auditing standards tend to use different approaches to effective dates for standards influencing engagement performance and standards influencing the report.

The following discussion represents the views of IFAC Technical Staff on the approach that should be adopted in the revision to ISA 700:

The main interest must be to limit confusion in the public eye caused by having two styles of reports in the marketplace simultaneously.

There are two options:

ISA 700 to be applied for all financial statements beginning on or after a defined date

The Audit Risk ISAs will be proposing that those standards be effective for financial periods beginning on or after December 15, 2004 with earlier application either permitted or encouraged. (To be determined by the IAASB).

If this ISA is applied for reports on financial periods beginning on or after December 15, 2004 then all reports would be related to audits done in accordance with the new risk standards and the "understanding" of the entity referred to in the report would be the same as that acquired in accordance with the risk standards. Thus performance and reporting would be in sync.

There are, however, two problems. First, the marketplace would be confused by an audit firm which might issue two audit reports on the same day – say February 2006. One would be on the financial statements of a client with a November 30, 2005 yearend and be in the "old" style and the other on a client with a December 31, 2005 year end and be in the "new" style. Second, an

auditor auditing financial statements for the year ended November 30, 2005 may choose to apply the new risk standards. Does that require the “new” style report or the “old” style report? In our view issuing the old report is not wrong – even if the wording of the new report is clearer.

ISA 700 to be applicable for audit reports dated on or after December 15 (or 31) 2005.

This option should be linked with a prohibition from earlier application.

This would have the benefit of ensuring that all reports of 2005 annual statements would be accompanied by the “new” report.

There are, however, two potential problems. First, audits of periods ending before December 15, 2005 (e.g. September 30, 2005) might be done in accordance with the “new” risk standards and receive an old style report if dated before December 15, 2005. Second, audits for September 30, 2005 might be done in accordance with the “old” risk standards but the report not completed or dated until January 2006 – whereupon the new form of report would need to be applied even if the audit had followed the “old” standards.

We see no problem in issuing an old style report even if the audit has been conducted in accordance with new standards. The report is not wrong!

The downside risk under this option is that auditors need to aware that annual audits for periods ending in September – December 14, 2005 might not be completed by December 31, 2005 and therefore would need to be planned using the new risk standards. A particular risk arises if an audit was properly planned to be completed by December 15, 2005 but due to unforeseen circumstances the report cannot be dated before January 2006. One way of limiting this problem is to advance the application date to March 2006. This reduces the risk of this situation problem arising but on the other hand would result in many December 31, 2005 audits which would have reports issued in January, February or March 2006 having to follow the old style report. Further, we think the EU would find it unacceptable to have an implementation date so far in the future.

Staff Recommendation

We therefore recommend that the ED proposes that the new standard should be effective for audit reports dated on or after December 31, 2005 and that earlier application not be permitted. We would further propose that the application of the conforming amendments to ISA 560 and 580 should similarly be linked to the audit report date.

Finally we recommend that the Preface to the ED contains a specific question to respondents seeking views on the application date.