



International Federation of Accountants

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Agenda Item

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Committee: IAASB
Meeting Location: New York
Meeting Date: May 22-26, 2006

Earlier Application of Standards

Discussion Paper

Objective of Agenda Item

1. To discuss whether the IAASB should introduce a policy on earlier application of standards.

Use of the Earlier Application Phrase

2. Under current IAASB practice, the effective date of each new or revised standard is established in a separate paragraph. Occasionally, a statement on earlier application of the standard is also included in this paragraph. It has been noted, however, that the IAASB has not been consistent in its approach to permit earlier application of new and revised standards.
3. For example, varying approaches have been followed in relation to ISAs 315, 330, 700 (Revised), ISRE 2400 and ISAE 3000.
 - The *Audit Risk Standards* do not refer to earlier application.
 - In the case of ISA 700 (Revised), the IAASB agreed that earlier application was not permissible. The ISA, however, does not include an explicit statement in this regard.
 - ISAE 3000 and ISRE 2410 explicitly permitted/permits earlier application.
4. A brief review of earlier application approaches reveals that this issue may not be confined to the IAASB. The approaches vary across jurisdictions. Some standard setters avoid using an earlier application phrase; however, the possibility is not ruled out. For example, CICA uses an overarching rule for the effective date: "Unless otherwise indicated, Recommendations are effective with respect to financial statements and financial reports relating to years commencing on or after the first of the month noted beside the Recommendation." Other standard setters include a general statements such as, "Earlier application/adoption is encouraged/permissible." Such approach has been used by the IASB. Some standard setters do not use an earlier application phrase at all.
5. It would seem to be important that the IAASB addresses the issue of consistency. Where a statement on earlier application is used selectively, the practice may give rise to uncertainty. For example, where earlier application is explicitly permissible in some standards and no clarification or guidance is provided in other standards, it is not clear whether or not earlier application is permissible in the latter case and views vary.

Options

6. To ensure future consistency, thereby ensuring uniformity of application, the IAASB should develop a clear policy as to whether and under what circumstances earlier application should be permissible. The following options are available:
 - (a) Abandon earlier application altogether and use only the effective date.
 - (b) Permit earlier application in certain circumstances, and:
 - (i) Include a statement only when earlier application is permissible;
 - (ii) Include a statement only when earlier application is not permissible;
 - (iii) Include a statement in all new and revised standards indicating whether or not earlier application is permissible.

Effective Date Only

7. This approach would ensure consistency. It may be argued, however, that the cost of consistency thus obtained may be excessive as the IAASB would discard a tool which, even though not applied frequently, may occasionally be important for the implementation of a standard in that it allows both for a slightly longer implementation period and for improvements to be implemented more quickly.

Earlier Application Permissible Under Certain Circumstances

8. This approach would require the IAASB to consider, on a case by case basis, whether a new or revised ISA could be applied early. Circumstances where earlier application is permissible could be described in a policy statement or the Preface. Such circumstances could include the following:
 - The standard addresses urgent practice issues.
 - Earlier application is preferable because the standard is expected to enhance audit quality significantly.
 - Earlier application is preferable to achieve uniformity of application (for example, where the reason for revision was inconsistent application).
 - Earlier application is not expected to result in conflicts with the requirements of other standards in effect during the period of earlier application.

The possible disadvantages of an approach permitting earlier application are:

- The auditor who does not adopt earlier may be criticized.
- The users of the financial statements and related auditor's report may not know which standards were applied – the relevance of this argument is uncertain because it raises the question whether it is important to the users to know which standards were applied.
- It may result in reporting inconsistencies (for example, the form of the auditor's report, qualification principles, new procedures that may be difficult to achieve, new approaches that require auditor's report wording to be changed, etc.).

Based on the above, it is less likely that a reporting standard will be capable of earlier application.

Earlier Application Statement Included Only When Earlier Application is Permissible

- This approach would work only if there is a general understanding that silence indicates that earlier application is not permissible. Such understanding could be accomplished by explaining the use of the phrase in a policy statement or the Preface.

Earlier Application Statement Included Only When Earlier Application is Not Permissible

- This approach would require a general understanding that silence indicates that earlier application is permissible. Such understanding could be accomplished by explaining the use of the phrase in a policy statement or the Preface.

All New or Revised ISAs Include a Statement on Earlier Application

- This approach would avoid confusion by clearly explaining the earlier application status of each new or revised ISA.

Determination of Effective Dates

9. A consideration of the earlier application issue provides an opportune time for the IAASB to review its approach with regard the determination of the effective dates of standards. To date, the effective dates of reporting ISAs have been linked to the date of the report, and the effective dates of performance ISAs to the starting date of the financial period that is the subject of the engagement.
10. IAASB staff is of the view that the above approach remains appropriate. Linking the effective date to the date of the report for reporting standards eliminates the possibility, even though perhaps theoretical, of two differing reports being issued on the same date. On the other hand, linking the effective date to the starting date of the engagement for performance standards seems appropriate because at the onset of the audit the auditor does not know with certainty when the report will be issued.
11. To date, the effective dates of standards that cover both performance and reporting (for example, ISAE 3000) were linked to the date of the report. However, it seems that the uncertainty about the date of the report may be more significant than the theoretical possibility of two differing reports bearing the same date. The IAASB, therefore, may want to consider linking the effective dates of such standards to the starting date of the engagement.

Staff Recommendation

12. Staff recommends that the earlier application of new or revised standards be considered by the IAASB on a case by case basis, and that an explicit statement as to whether or not earlier application is permissible be included in each new or revised standard.
13. Staff recommends that effective dates be based on the nature of the standard. For reporting standards the effective date should be linked to the date of the report, for performance standards to the starting date of the period that is the subject of the engagement, and for performance and reporting standards to the starting date of the engagement.

The Action Requested

The IAASB is asked to consider whether the options identified by staff include all options available and whether the staff recommendation is appropriate. The IAASB is also asked to consider how the matter should be taken forward.