

**LAWS AND REGULATIONS – ISSUES PAPER****Introduction**

1. The comment period for the exposure draft (ED) of the proposed ISA 250 (Redrafted), “The Auditor’s Responsibilities Relating to Laws and Regulations in an Audit of Financial Statements,” closed on July 31, 2007. A total of 48 comment letters were received. A list of the respondents is included in Appendix A.<sup>1</sup>
2. Respondents were overall supportive<sup>2</sup> of ED 250, with many expressing the view that it was an improvement over the previous ISA 250. Most of the respondents addressed the two specific questions posed in the explanatory memorandum (“EM”) regarding the appropriateness of the objectives and the appropriateness of the criteria (responses are summarised in Appendix B). Most of the significant comments focused on specific proposals in the requirements section. There were relatively fewer significant comments on the proposed guidance in the application material.
3. There was general support,<sup>3</sup> including specific comments by FEE, Deloitte and GTI, for the clearer distinction of categories of laws and regulations made in paragraph 6 compared to the distinction made in extant paragraphs 18 and 19.
4. The following section summarises the significant comments received from respondents and task force views and recommendations.

**Significant Comments on ED-ISA 250 and Task Force Recommendations****A. RISK-BASED APPROACH VERSUS A PROCEDURAL APPROACH**

5. Three respondents<sup>4</sup> expressed concern that the ISA could or should subsequently be updated to be more aligned with the risk-based approach to audit. CEBS’ comments, in this context, referred to the risk-based approach followed in ISAs 315 and 330. In addition to this, the EC questioned how “the auditor’s consideration of compliance” and having “audit procedures when non-compliance is identified or suspected” conforms with the audit model of identifying and assessing the risks of material misstatements and responding to assessed risks. IOSCO overall thought that a good job had been done of redrafting the extant ISA but also encouraged the IAASB to update the standard to “incorporate the risk based approach by making reference to considering the risk that material effects that non-compliance with all types of laws and regulations (including indirect effect laws and regulations) could have on the financial statements”.

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<sup>1</sup> Respondent’s letters can be accessed on the IAASB website at <http://www.ifac.org/Guidance/EXD-Comments.php?EDID=0081&Group=All+Responses>.

<sup>2</sup> APB, CFAS, CIPFA, CNCC & CSOEC, DTT, EYG, FEE, GTI, HKICPA, ICAEW, ICAP, ICAS, ICAI, ICJCE, IDW, IOSCO, IRBA, IRE Belgium, KPMG -South Africa, NAO, NZICA, PA Saskatchewan and Russian Audit

<sup>3</sup> DTT, FEE, GTI, ICAS, and IRE Belgium

<sup>4</sup> CEBS, EC and IOSCO.

*Task Force Views and Recommendations*

6. In developing the ED of proposed ISA 250 (Redrafted), the IAASB recognized that there were some parts of the extant ISA that were procedurally oriented, particularly in relation to the auditor's responsibility to identify instances of non-compliance with "other" laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the financial statements.
7. To go some way in addressing the concerns expressed and suggestions made, the task force has revised the objectives and requirements to be more outcome-oriented (see paragraphs 8(b) and 12). To fully address the comments made would require a revision of the ISA, in the view of the task force.

**Matter for IAASB Consideration**

Does the IAASB agree with the extent of the changes proposed to better align ISA 250 (Redrafted) to a risk-based approach, recognizing that this is not a revision project?

**B. OBJECTIVES**

8. Related to the above comments about alignment with IAASB's risk-based ISAs, a number of respondents<sup>5</sup> were concerned that the objective referred to in paragraph 8(b) focused on "audit procedures" and should be re-worded to identify the objective/desired outcomes of performing specified procedures referred to in that paragraph.
9. In addition, two respondents (ACCA and APB) were concerned with the "open-ended" nature of objective 8(b), particularly through the use of the word "help". While the ACCA assumed that the word "help" was used to make it clear that the specified procedures could not guarantee to identify all instances of non-compliance, other interpretations were possible and therefore the word should be withdrawn to eliminate any suggestion that specified procedures alone are sufficient to achieve the objective.

*Task Force Views and Recommendations*

10. The task force agrees with the concerns of the respondents noted above and as a consequence has amended paragraph 8(b) to achieve an outcome focus.
11. In addition, the word "help" was removed from paragraph 8(b) and the words "that are known to the entity" added so as to signal to auditors that this particular objective was not so broad as to expect auditors to identify instances of non-compliance not known to the entity. The "open-ended" concerns of the ACCA and APB were thus addressed and the re-worded paragraph 8(b) now reads:

*To identify instances of non-compliance with other laws and regulations that are known to the entity and that may have a material effect on the financial statements*

12. Further, three respondents (ACCA, ICAEW and IOSCO) considered that it would be better to restrict the objective noted in paragraph 8(c) to those laws and regulations scoped by

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<sup>5</sup> APB, Basel, BDO, BusinessEurope, CEBS, CIPFA, FEE, ICAEW, ICAI (Ireland), IOSCO, JICPA and NZICA

paragraphs 8(a) and 8(b) rather than for it to include all identified or suspected instances of non-compliance.

#### *Task Force Views and Recommendations*

13. The task force's view is that paragraph 8(c) should remain largely unchanged as it is designed to cover any identified or suspected non-compliance regardless of its nature (other than when the matters are clearly inconsequential). In other words, auditors should not "turn a blind eye" and must respond appropriately, regardless of whether or not identified or suspected non-compliance affects the financial statements – this is consistent with the extant standard. Paragraph 8(c) has been modified, however, to make it clear that the auditors objectives is "to respond appropriately to identified or suspected non-compliance with laws and regulations that have come to the auditor's attention during the course of the audit.

#### **Matter for IAASB Consideration**

Does the IAASB agree that paragraphs 8(b) and 8(c) now appropriately describe the objectives/desired outcomes?

#### **C. LINK BETWEEN INTRODUCTION AND REQUIREMENTS**

14. Although some respondents commented favorably about the linkage between the Introduction and the Requirements, three respondents (AICPA, CNCC & CSOEC, and GTI) expressed concern that paragraphs 11-14 do not properly link with paragraphs 6(a) and 6(b) because of the use of the word "direct," and therefore by implication, "indirect."
15. As the impact of laws and regulation on the financial statements can vary considerably, ISA 250 distinguishes two categories – see paragraph 6(a) and 6(b) which, in the ED, read:
  - 6(a) *Those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements such as income tax and pension laws and regulations (see paragraph 11); and*
  - 6(b) *Other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the financial statements, but compliance with which may be fundamental to the operating aspects of the business, to an entity's ability to continue its business, or to avoid material penalties (for example, compliance with the terms of an operating license, compliance with regulatory solvency requirements, or compliance with environmental regulations); non-compliance with such laws and regulations may therefore have a material effect on the financial statements, (see paragraph 12).*
16. The auditor's responsibilities in respect of paragraphs 6(a) and 6(b) categories are described in paragraphs 11, 12, 13 and 14 in the section entitled "The Auditor's Consideration of Compliance with Laws and Regulations." The above mentioned respondents indicated that it was unclear in the ED whether paragraphs 11, 12, 13 and 14 apply to both 6(a) and 6(b) or whether there was some distinction.

*Task Force Views and Recommendations*

17. The task force agrees that the link between the paragraphs 6(a), 6(b) and paragraphs 11 and 12 should be made more explicit. Accordingly, the following changes were made:
  - inserted the words ...“*as described in paragraph 6(a)*” within paragraph 11;
  - inserted the words ...“*as described in paragraph 6(b)*” within paragraph 12;
18. The task force did not consider that it was appropriate to link the requirements contained in paragraph 13 with the laws and regulations described in paragraph 6. The intention is for the auditor to be alert to non-compliance with laws and regulations and that this requirement is not restricted to the categorization in paragraph 6. Furthermore, under paragraph 21, the auditor is required to communicate any matters involving non-compliance (other than those that are clearly inconsequential).
19. Further, the task force did not consider that it was appropriate to link the requirements contained in paragraph 14 to paragraphs 6(a) and 6(b) because the requirements of ISA 580 are not restrictive.

**Matter for IAASB Consideration**

Does the IAASB agree with the more explicit linkages between “Introductory” paragraph 6 and “Requirement” paragraphs 11 and 12, and that no explicit linkages be introduced to paragraphs 13 and 14?

- D. JURISDICTIONAL REQUIREMENTS TO SPECIFICALLY REPORT NON-COMPLIANCE WITH CERTAIN LAWS AND REGULATIONS
20. Two respondents (Royal NIVRA and Mazars) noted that there are jurisdictions that require the auditor to inform regulators (as soon as possible) of instances where an entity has not complied with specific laws or regulations (e.g., non compliance with the Dutch Pension Act, or non-compliance with the various regulatory requirements of financial institutions). The respondents were concerned that acknowledgement of these specific requirements is not adequately covered in the proposed ISA. In respect of requirements imposed by specific laws and regulations, the ACCA made the point that no “double-jeopardy” should be created by an auditing standard imposing itself on a matter dealt with by a law or regulation.

*Task Force Views and Recommendations*

21. The task force is of the view that the above mentioned jurisdictional concerns are adequately covered by paragraph A5 which points to ISA 700 and ISA 800 dealing with how reporting responsibilities are addressed in the auditor’s report. In addition, the task force considers paragraph A20 is sufficient guidance with regard to reporting non-compliance to regulatory and enforcement authorities. The task force considered that it was not appropriate to include other reporting requirements of the auditor in ISA 250 as it would be inconsistent with the stated objectives of the auditor (i.e., ISA 250 focuses on an *entity’s* compliance, not an *auditor’s* compliance).

**Matter for IAASB Consideration**

Does the IAASB agree that paragraphs A5 and A20 adequately address the issue where the auditor is required to inform regulators of instances where an entity has not complied with specific laws and regulations?

- E. RESPONSIBILITY OF MANAGEMENT FOR DETECTING NON-COMPLIANCE WITH LAWS AND REGULATIONS
22. Three respondents (APB, BusinessEurope and EALIC) expressed concern that the reference in paragraphs 3 and A2 regarding management’s responsibility for the “the detection” of non-compliance with laws and regulations was too onerous, since it implies detecting *all* instances of non-compliance with laws and regulation which, it was argued, would be impracticable.

*Task Force Views and Recommendations*

23. The task force agrees with the above mentioned concern and as a consequence has inserted the words “systems designed to” in the last sentence of paragraph 3. The task force did not adjust paragraph A2 as many of the bullet points would be regarded as being components of a system designed to prevent, or detect and correct, non-compliance with laws and regulations. The reworded paragraph 3 now reads:

*“It is the responsibility of management, with the oversight of those charged with governance, to ensure that the entity’s operations are conducted in accordance with laws and regulations, including compliance with laws and regulations that determine the form or content of the entity’s financial statements. This includes responsibility for systems designed to prevent, or detect and correct, non-compliance with laws and regulations. (Ref: Para. A1-A2)”*

**Matter for IAASB Consideration**

Does the IAASB agree that the addition of the words “systems designed to” etc. adequately addresses the concerns of the above-mentioned respondents?

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**Appendix A**

**List of Respondents to the Exposure Draft**

<b>Abbreviation</b>	<b>Category</b>
<b>Professional Organizations</b>	
AICPA	American Institute of Certified Public Accountants
ACCA	The Association of Chartered Certified Accountants
CIPFA	Chartered Institute of Public Finance and Accountancy
CNCC	Compagnie Nationale des Commissaires aux Comptes, and Conseil Supérieur de l'Ordre des Experts-Comptables
FAR SRS	FAR SRS
FEE	Fédération des Experts Comptables Européens
FICPA	Florida Institute of Certified Public Accountants
HKICPA	Hong Kong Institute of Certified Public Accountants
IDW	Institut der Wirtschaftsprüfer
IRE	Institut des Réviseurs d'Entreprises/ Instituut der Bedrijfsrevisoren
ICPAI	The Institute of Certified Public Accountants in Ireland
ICPAS	Institute of Certified Public Accountants of Singapore
ICAEW	Institute of Chartered Accountants in England and Wales
ICAI	Institute of Chartered Accountants India
ICAI	Institute of Chartered Accountants in Ireland
ICAP	Institute of Chartered Accountants of Pakistan
ICAS	Institute of Chartered Accountants of Scotland
ICMAP	Institute of Cost & Management Accountants of Pakistan
IPAC	Institute of Public Accountants Cyprus
ICJCE	Instituto de Censores Jurados de Cuentas de España
JICPA	The Japanese Institute of Certified Public Accountants
NIVRA	Koninklijk Nederlands Instituut van Registeraccountants (Royal NIVRA)
<b>National Auditing Standard Setters</b>	
APB	Auditing Practices Board (United Kingdom)
CICA	Auditing and Assurance Standards Board of the Canadian Institute of Chartered Accountants
IRBA	Independent Regulatory Board for Auditors (also a Regulator)
NZICA	Professional Standards Board of the New Zealand Institute of Chartered Accountants
<b>Audit Firms</b>	
Russia Audit	Baker Tilly Russaudit
BDO	BDO Global Coordination B.V.
DTT	Deloitte Touche Tohmatsu
EY	Ernst & Young Global
GT	Grant Thornton International
KPMG	KPMG
KPMG – SA	KPMG South Africa

<b>Abbreviation</b>	<b>Category</b>
Mazars	Mazars
<b>Public Sector Organizations</b>	
ACAG	Australasian Council of Auditors-General
NAO	National Audit Office
PA Saskatchewan	Provincial Auditor Saskatchewan
SNAO	Swedish National Audit Office
WAO	Wales Audit Office
<b>Regulators and Oversight Authorities</b>	
Basel	Basel Committee on Banking Supervision
CEBS	Committee of European Banking Supervisors
EC	European Commission
IOSCO	International Organization of Securities Commissions
<b>Individuals and Others</b>	
BusinessEurope	BusinessEurope
EALIC's	European Association of Listed Companies
IEC	IEC
Jianhua Tang	Jianhua Tang
WY	West Yates

## Appendix B

### Responses to Exposure Draft Questions 1 and 2

#### Question 1

*Are the objectives to be achieved by the auditor, stated in the proposed redrafted ISA appropriate?*

Yes	Generally Agree	Reservations	No	No Comment	Total Responses
25	15	1	3	4	48
52%	31%	2%	6.5%	8.5%	100%

#### Question 2

*Have the criteria identified by the IAASB for determining whether a requirement should be specified been applied appropriately and consistently, such that the resulting requirements promote consistency in performance and the use of professional judgement by auditors?*

Yes	Generally Agree	Reservations	No	No Comment	Total Responses
21	18	1		8	48
44%	38%	2%		16%	100%