



International Federation of Accountants

545 Fifth Avenue, 14th Floor, New York, NY 10017 USA
Tel +1 (212) 286-9344 Fax +1 (212) 286-9570 www.ifac.org

Agenda Item

11

Committee: IAASB
Meeting Location: Brussels
Meeting Date: December 8-11, 2008

Proposal to Amend Guidance Material in ISA 250 (Redrafted), “Consideration of Laws and Regulations in an Audit of Financial Statements”

Objective of Agenda Item

1. To approve a proposal to amend guidance material in ISA 250 (Redrafted).

Matter for Consideration

2. It has been drawn to the attention of the IAASB Steering Committee that there is a possible ambiguity in one of the requirements of ISA 250 (Redrafted), specifically paragraph 13 which states:

The auditor shall obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements.
3. The concern raised relates to the possibility that the requirement might be misinterpreted as requiring the auditor to obtain sufficient appropriate audit evidence regarding compliance with all provisions of a direct-effect law or regulation, even when some of those provisions do not in fact have a direct effect on the determination of material amounts and disclosures in the financial statements. The possibility of such an interpretation arises in jurisdictions where the term ‘compliance’ carries a particular connotation, especially where audits of compliance with laws and regulations are required and additional requirements in an audit of financial statements related to compliance with laws and regulations exist, such as for audits of private sector entities that receive government assistance and governmental entities.
4. The Steering Committee agreed that such an interpretation would be inconsistent with the intent of the IAASB. Much of the IAASB’s discussion in redrafting the extant ISA 250 has been on clarifying that the auditor’s focus is on obtaining sufficient appropriate audit evidence about whether material amounts and disclosures determined by direct-effect provisions of laws and regulations are properly stated in the financial statements.
5. The Steering Committee discussed and rejected the possibility of proposing to amend the relevant requirement. The general view was that the wording was not so ambiguous as to require this course of action. Further, there has been no other similar concern raised since the ISA was approved. However, the Steering Committee accepts that there is a possibility that the requirement in paragraph 13 of ISA 250 (Redrafted) might be misinterpreted, and

therefore believes that some clarifying amendment to the application material in the ISA would be appropriate to avoid any possible misunderstanding.

PROPOSAL

6. It is proposed that the application material in support of the requirement in paragraph 13 of ISA 250 (Redrafted) be amended to put beyond doubt the correct interpretation of the requirement as intended by the IAASB at the time the ISA was approved.
7. The following amendment to ISA 250 (Redrafted) is proposed: (The proposed amendment is shown in marked text in paragraph A8 below. Other relevant text of ISA 250 (Redrafted) has been reproduced for context but does not require amendment.)

Introduction

2. The effect on financial statements of laws and regulations varies considerably. Those laws and regulations to which an entity is subject constitute the legal and regulatory framework. The provisions of some laws or regulations have a direct effect on the financial statements in that they determine the reported amounts and disclosures in an entity's financial statements. Other laws or regulations are to be complied with by management or set the provisions under which the entity is allowed to conduct its business but do not have a direct effect on an entity's financial statements. Some entities operate in heavily regulated industries (such as banks and chemical companies). Others are subject only to the many laws and regulations that relate generally to the operating aspects of the business (such as those related to occupational safety and health, and equal employment opportunity). Non-compliance with laws and regulations may result in fines, litigation or other consequences for the entity that may have a material effect on the financial statements.

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6. This ISA distinguishes the auditor's responsibilities in relation to compliance with two different categories of laws and regulations as follows:
 - (a) The provisions of 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 tax and pension laws and regulations (see paragraph 13); and
 - (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 14).

7. In this ISA, differing requirements are specified for each of the above categories of laws and regulations. For the category referred to in paragraph 6(a), the auditor's responsibility is to obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations. For the category referred to in paragraph 6(b), the auditor's responsibility is limited to undertaking specified audit procedures to help identify non-compliance with those laws and regulations that may have a material effect on the financial statements.

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Objectives

10. The objectives of the auditor are:
 - (a) To obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements;
 - (b) To perform specified audit procedures to help identify instances of non-compliance with other laws and regulations that may have a material effect on the financial statements; and
 - (c) To respond appropriately to non-compliance or suspected non-compliance with laws and regulations identified during the audit.

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Requirements

13. The auditor shall obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements. (Ref: Para. A8)

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Application and Other Explanatory Material

Laws and Regulations Generally Recognized to Have a Direct Effect on the Determination of Material Amounts and Disclosures in the Financial Statements

(Ref: Para. 13)

- A8. Certain laws and regulations are well-established, known to the entity and within the entity's industry or sector, and relevant to the entity's financial statements (as described in paragraph 6(a)). They could include those that relate to, for example:
 - The form and content of financial statements;
 - Industry-specific financial reporting issues;

- Accounting for transactions under government contracts; or
- The accrual or recognition of expenses for income tax or pension costs.

Some ~~matters~~ provisions in those laws and regulations may be directly relevant to specific assertions in the financial statements (for example, the completeness of income tax provisions), while others may be directly relevant to the financial statements as a whole (for example, the required statements constituting a complete set of financial statements). The aim of the requirement in paragraph 13 is for the auditor to obtain sufficient appropriate audit evidence regarding amounts and disclosures in the financial statements that are determined by the relevant provisions of those laws and regulations.

Non-compliance with other provisions of such laws and regulations and other laws and regulations may result in fines, litigation or other consequences for the entity, the costs of which may need to be provided for in the financial statements, but are not considered to have a direct effect on the financial statements as described in paragraph 6(a).

Action Requested

8. Since the proposed amendment is intended to ensure that the intent of the IAASB is more clearly reflected in the standard, the Steering Committee does not believe that it needs to be exposed for public comment.
9. The IAASB is asked to approve the proposed amendment.