

**Basis for Conclusions**  
**Prepared by the Staff of the IAASB**  
*October 2016*

*International Standard on Auditing 250 (Revised)*

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# Consideration of Laws and Regulations in an Audit of Financial Statements

## Including Related Conforming Amendments to Other International Standards

**IAASB**

International Auditing  
and Assurance  
Standards Board

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The objective of the IAASB is to serve the public interest by setting high-quality auditing, assurance, and other related services standards and by facilitating the convergence of international and national auditing and assurance standards, thereby enhancing the quality and consistency of practice throughout the world and strengthening public confidence in the global auditing and assurance profession.

The IAASB develops auditing and assurance standards and guidance for use by all professional accountants under a shared standard-setting process involving the Public Interest Oversight Board, which oversees the activities of the IAASB, and the IAASB Consultative Advisory Group, which provides public interest input into the development of the standards and guidance. The structures and processes that support the operations of the IAASB are facilitated by the International Federation of Accountants (IFAC).

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# **BASIS FOR CONCLUSIONS: ISA 250 (REVISED), CONSIDERATION OF LAWS AND REGULATIONS IN AN AUDIT OF FINANCIAL STATEMENTS, INCLUDING RELATED CONFORMING AMENDMENTS TO OTHER INTERNATIONAL STANDARDS<sup>1</sup>**

This Basis for Conclusions has been prepared by Staff of the International Auditing and Assurance Standards Board (IAASB). It relates to, but does not form part of, ISA 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements*, or the related conforming amendments to other International Standards.

ISA 250 (Revised) was approved with the affirmative votes of 16 out of 18 IAASB members present for the vote at the June 2016 meeting.<sup>2</sup> The related conforming amendments to other International Standards were approved with the affirmative votes of 15 out of 18 IAASB members present for the vote at the June 2016 meeting.<sup>3</sup>

## **Background**

1. This project was initiated in response to the need to make amendments to ISA 250 and certain other International Standards as a result of the International Ethics Standards Board for Accountants (IESBA's) project regarding non-compliance with laws and regulations (NOCLAR). The objective of the project was to address actual or perceived inconsistencies of the approach to identifying and dealing with instances of identified or suspected NOCLAR between the International Standards and the IESBA's *Code of Ethics for Professional Accountants* (the IESBA Code), as it is in the public interest that the International Standards and the IESBA Code are able to operate mutually and without confusion.

## **Background to the IESBA NOCLAR Project**

2. In providing a professional service to an entity, a professional accountant (including an auditor or an assurance practitioner)<sup>4</sup> may come across an act or suspected act of NOCLAR committed (or about to be committed) by the entity, by those charged with governance, by management, or by other individuals working for or under the direction of the entity. The IESBA noted that the professional accountant has a prima facie ethical responsibility not to turn a blind eye to the matter and recognized that such a situation could often be difficult and stressful for the professional accountant. Accordingly, the IESBA approved a project in 2010 to develop enhancements to the IESBA Code to help guide professional accountants in dealing with circumstances when NOCLAR is identified or suspected, and in deciding how best to act in the public interest in these circumstances.

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<sup>1</sup> The IAASB's International Standards comprise the International Standards on Auditing (ISAs), the International Standards on Review Engagements (ISREs), the International Standards on Assurance Engagements (ISAEs), and the International Standards on Related Services (ISRSs).

<sup>2</sup> For a full record of the voting on ISA 250 (Revised), including the rationale of the IAASB members who abstained from the vote, see the [minutes of the June 21–24 2016 IAASB meeting](#).

<sup>3</sup> For a full record of the voting on the conforming amendments, including the rationale of the IAASB members who abstained from the vote or voted against the conforming amendments, see the [minutes of the June 21–24 2016 IAASB meeting](#).

<sup>4</sup> Henceforth, the term "auditor" is used within this Basis for Conclusions to include auditors of financial statements and the term "practitioner" is used to include other assurance practitioners.

3. After two exposure drafts (EDs),<sup>5</sup> and after taking into consideration and responding to stakeholder feedback to the IESBA Re-Exposure Draft (IESBA Re-ED), the IESBA [approved](#) changes to the IESBA Code addressing NOCLAR at its April 2016 meeting, with an effective date of July 15, 2017 (i.e., effective for addressing instances of NOCLAR that come to the professional accountant's attention on or after July 15, 2017).
4. The revised IESBA Code sets out a framework for professional accountants to respond to identified or suspected NOCLAR, including consideration as to whether identified or suspected NOCLAR should be disclosed to an appropriate authority. This framework encompasses many other considerations and actions; these include obtaining an understanding of the matter, discussing the matter with management, and, when appropriate, those charged with governance, and assessing the appropriateness of their response, and determining whether further action is needed in the public interest (e.g., reporting to an appropriate authority or withdrawal from the engagement).

### **Background to the IAASB's NOCLAR Project**

5. The IAASB was kept apprised of developments on the IESBA's NOCLAR project through updates and discussions at IAASB meetings as the IESBA's NOCLAR project progressed. The IAASB considered the IESBA's efforts to address NOCLAR and noted that the changes proposed by the IESBA would represent a fundamental change in the approach to confidentiality under the IESBA Code in this area. Furthermore, the IESBA NOCLAR proposals included examples of laws and regulations that were more diverse than those described in extant ISA 250 and specifically referred to NOCLAR that may occur. Accordingly, the IAASB concluded that certain of the International Standards, in particular ISA 250, could be enhanced to give more attention to the additional responsibilities of the auditor or practitioner under the revised IESBA Code when NOCLAR is identified or suspected. The IAASB also thought it would be helpful within the International Standards to highlight the IESBA's view that, when disclosure of identified or suspected NOCLAR to an appropriate authority is an appropriate course of action in the circumstances, this is not considered a breach of the duty of confidentiality under Section 140 of the IESBA Code.
6. Accordingly, in June 2015 the IAASB [approved a project](#) to address actual or perceived inconsistencies of the approach to identifying and dealing with instances of identified or suspected NOCLAR in complying with ISA 250 and other International Standards when the IESBA Code also applies. While the IAASB believed that failing to address such actual or perceived inconsistencies may raise questions among stakeholders regarding the clarity of the interaction between the International Standards and the IESBA Code; the IAASB concluded that only limited amendments to its standards would be necessary. The IAASB accelerated this work so that its ED would be out for public comment at the same time as the IESBA's re-ED, in order for respondents to consider the implications of both proposals concurrently, and so that the respective Boards could finalize their proposals on a similar timeline. To further facilitate the liaison during this time, the IAASB's NOCLAR Task Force included the Chair of the IESBA NOCLAR project, and the IESBA's NOCLAR Task Force included the Chair of the IAASB NOCLAR project.
7. The IAASB's NOCLAR ED, [Responding to Non-Compliance or Suspected Non-Compliance with Laws and Regulations](#) (ED-ISA 250), was released for public exposure in July 2015 and the comment period closed on October 20, 2015. Forty-five (45) comment letters were received from various

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<sup>5</sup> The IESBA released the first ED, *Responding to a Suspected Illegal Act*, in August 2012, and issued a Re-ED, *Responding to Non-Compliance with Laws & Regulations*, in May 2015.

respondents, including regulators and oversight bodies, national auditing standard setters, accounting firms, public sector organizations, IFAC member bodies, representatives of small and medium practices and other professional organizations. Included in the responses were two responses from Monitoring Group members.<sup>6</sup>

8. The IAASB discussed this project with its Consultative Advisory Group (CAG) on three separate occasions. In addition, the IAASB liaised closely with the IESBA in the finalization of the respective projects.
9. This Basis for Conclusions explains the significant issues raised by respondents to ED-ISA 250, and how the IAASB has addressed them.

## Significant Matters

### Public Interest Issues Addressed by This Project

10. The IAASB believes that it is in the public interest that its International Standards and the IESBA Code are able to operate mutually and without confusion due to the many jurisdictions that have adopted both. It is also important that the International Standards acknowledge and do not potentially undermine the enhancements to the IESBA Code in respect of NOCLAR — either through being inconsistent or failing to draw appropriate attention to the revised requirements in the IESBA Code. Equally, it would not be in the public interest for auditors and practitioners to be placed in a situation where the IESBA Code requires a response but the International Standards, either in the requirements or the application material, do not support or recognize that response.

### Nature and Extent of Changes from Extant ISA 250

11. As recommended in the project proposal, the limited amendments to ISA 250 (Revised) were not intended to explicitly duplicate all the specific requirements in the revised IESBA Code. This approach allows for flexibility when ethical codes other than the IESBA Code are applied and minimizes the amount of material that was necessary to incorporate into ISA 250 (Revised) and other International Standards. This approach is consistent with how reference was made in ISA 260 (Revised)<sup>7</sup> to the requirements in the IESBA Code to communicate with those charged with governance about breaches of independence.
12. In summary, the significant changes to ISA 250 (Revised) included in the final pronouncement are intended to:
  - Align aspects of ISA 250 (Revised) to the NOCLAR provisions in the IESBA Code, particularly the definition of non-compliance and the examples of laws and regulations within the scope of ISA 250 (Revised) (see paragraphs 12, A6 and A9–A10 of ISA 250 (Revised)).
  - Clarify the requirement regarding the auditor's determination of whether to report identified or suspected NOCLAR to an appropriate authority outside the entity and the auditor's duty of

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<sup>6</sup> The Monitoring Group comprises the Basel Committee on Banking Supervision (BCBS), the European Commission (EC), the Financial Stability Board (FSB), the International Association of Insurance Supervisors (IAIS), the International Forum of Independent Audit Regulators (IFIAR), the International Organization of Securities Organizations (IOSCO), and the World Bank. IFIAR and IOSCO responded to the IAASB's ED.

<sup>7</sup> ISA 260 (Revised), *Communication with Those Charged with Governance*

confidentiality, in order to recognize the different provisions of laws, regulations, or relevant ethical requirements (see paragraphs 29 and A28–A34 of ISA 250 (Revised)).

- Highlight that the auditor may have additional responsibilities under law, regulation, or relevant ethical requirements regarding identified or suspected NOCLAR. This also includes additional emphasis of the possible documentation requirements contained in law, regulation or relevant ethical requirements (see paragraph 9 of ISA 250 (Revised)).
  - Highlight the implications of identified or suspected NOCLAR on the audit, for example, the reliability of management’s representations, the implications for the auditor’s report, and the consideration of whether to withdraw from the engagement (see paragraphs 22 and A23–A27 of ISA 250 (Revised)).
  - Emphasize the requirements in the IESBA Code relating to the communication of identified or suspected NOCLAR to a group engagement partner or an auditor at a component (see paragraph A8 of ISA 250 (Revised)).
  - Draw attention to the fact that, in certain cases, communication with management or those charged with governance may be restricted or prohibited by law or regulation, for example law or regulation may specifically prohibit a communication, or other action, that might prejudice an investigation by an appropriate authority into an actual, or suspected, illegal act (see paragraphs 20, 23 and A21 of ISA 250 (Revised)).
13. Furthermore, conforming amendments were also made to a number of other International Standards<sup>8</sup> to reflect the matters indicated above or clarify the expected work effort with regard to identified or suspected NOCLAR.
14. For example, new application material has been included in ISA 220 to reflect the communication between predecessor and proposed successor auditors as contemplated in the revised IESBA Code, that is, the requirement that the predecessor auditor, upon request by the proposed successor auditor, will (i) provide known information regarding any facts or circumstances that, in the predecessor auditor’s judgment, the successor auditor needs to be aware of before deciding whether to accept the engagement, and (ii) inform the successor auditor of identified or suspected NOCLAR when the predecessor auditor resigns from the engagement as a result of such NOCLAR.

#### *Summary of Overall Comments Received on Exposure*

15. Overall, many respondents were supportive of the IAASB’s efforts to address actual or perceived inconsistencies in the approach to responding to identified or suspected NOCLAR between the International Standards and the IESBA NOCLAR Re-ED.

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<sup>8</sup> These include ISQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*; ISA 210, *Agreeing the Terms of Audit Engagements*; ISA 220, *Quality Control for an Audit of Financial Statements*; ISA 240, *The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements*, ISA 260 (Revised); ISA 450, *Evaluation of Misstatements Identified during the Audit*, ISA 500, *Audit Evidence*; ISRE 2400 (Revised), *Engagements to Review Historical Financial Statements*; ISAE 3000 (Revised), *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*; ISAE 3402, *Assurance Reports on Controls at a Service Organization*; ISAE 3410, *Assurance Engagements on Greenhouse Gas Statements*; and ISRS 4410 (Revised), *Compilation Engagements*.

## Approach to Changes to the International Standards

### Summary of comments received on exposure

16. A few respondents explicitly expressed support for the IAASB's approach in proposing limited amendments to the International Standards that do not explicitly duplicate in detail all of the specific requirements in the IESBA NOCLAR Re-ED, allowing flexibility when other ethical codes are applied and minimizing the amount of material incorporated into ISA 250 (Revised) and other International Standards. Some respondents requested more alignment between the IESBA NOCLAR Re-ED and the International Standards, for example the inclusion of the work effort requirements from the IESBA NOCLAR Re-ED in the International Standards, or an enhanced link to the IESBA NOCLAR Re-ED. One Monitoring Group member specifically questioned whether the IAASB had concluded that certain aspects of the IESBA proposals that were not addressed in the IAASB's proposals did not need to be addressed in ISA 250 (Revised) because they went beyond what is necessary for an audit of financial statements, and suggested that if this was the case that ISA 250 (Revised) should indicate that the amendments made are those necessary for the purposes of an audit.
17. Some respondents emphasized their concerns and comments previously expressed in response to the IESBA NOCLAR Re-ED or expressed hesitation about the timing of ED-ISA 250 and concerns that the IAASB and IESBA needed to be closely aligned in finalizing their respective proposals. In this regard, the importance of ongoing coordination with the IESBA as it finalized the changes to the IESBA Code was stressed. There were also comments that updating the International Standards for minor amendments requires effort in translation and updates to firms' methodologies, at a time when there are other significant changes to deal with.

### IAASB decisions

18. The IAASB believed that, consistent with the IAASB NOCLAR ED, the intent was not to repeat all the requirements of the IESBA NOCLAR Re-ED in the International Standards, as doing so could place additional requirements on auditors and practitioners who are bound by ethical codes other than the IESBA Code and it could be impracticable for such auditors and practitioners to comply with the International Standards if they included these additional requirements. Furthermore, not all of the procedures contemplated by the IESBA NOCLAR Re-ED are designed for the purpose of providing sufficient appropriate audit evidence to support an opinion on the financial statements and are instead intended to support the auditor or practitioner in fulfilling relevant ethical obligations by responding to NOCLAR that the auditor or practitioner comes across or of which the auditor or practitioner is made aware. The IAASB carefully considered the matters addressed in the final IESBA pronouncement and decided it should continue with the limited approach to amendments to the International Standards, but has highlighted in ISA 250 (Revised) that the auditor may have additional responsibilities under law, regulation, or relevant ethical requirements regarding identified or suspected NOCLAR (see further discussion in paragraphs 27–30 of this Basis for Conclusions).

## **The Auditor's Determination of Whether to Report Identified or Suspected NOCLAR to an Appropriate Authority outside the Entity**

### *Background*

19. Extant ISA 250 includes a requirement that the auditor must determine whether the auditor has a responsibility to report identified or suspected NOCLAR to parties outside the entity.

20. In ED-ISA 250, the IAASB proposed updating this requirement to indicate that the auditor has a responsibility to determine whether the auditor has a legal or ethical duty or right to report identified or suspected NOCLAR. The amendments were proposed in order to more clearly recognize that the auditor may have a responsibility to report under law, regulation or relevant ethical requirements, and the expectations of the auditor may differ, for example, an obligation to report (“a duty”) or a general “right” (but not an obligation) to report.
21. Application material to support this amended requirement was also included in ED-ISA 250 to provide guidance to auditors on the considerations that the auditor may apply in reporting identified or suspected NOCLAR to appropriate authorities, including with respect to the auditor’s duty of confidentiality.

#### *Summary of Comments Received on Exposure*

22. Concerns were raised by respondents with the use of the phrase “legal or ethical duty or right”, as it was believed that this did not reflect the underlying decision-making process and evaluation that would take place before exercising a right, and it did not reflect that, in some cases, it is an ethical requirement or responsibility to report. It was also noted that the IESBA NOCLAR Re-ED did not make use of the term “right”. Other respondents were of the view that the phrase was ambiguous and unclear, particularly where laws or regulations prohibit the breach of confidentiality and the auditor is not able to report identified or suspected NOCLAR outside of the entity.
23. Respondents, including Monitoring Group members, provided various suggestions for improvements to ISA 250 and the conforming amendments in this regard, including the nature and extent of how ISA 250 makes reference to the provisions within the IESBA Code. Notably, there were requests to include, similar to the IESBA NOCLAR Re-ED, discussion of the legal and other risks that the auditor would take into account when determining whether to report identified or suspected NOCLAR to an appropriate authority, as well as reference to the “public interest test” included in the IESBA’s NOCLAR re-ED. Some also recommended more prominence be given in the requirements to the possible preclusion of reporting to an appropriate authority outside the entity, for example, due to confidentiality requirements contained in law or regulation that would override or be in conflict with any ethical requirements.

#### *IAASB Decisions*

24. The IAASB explored various alternatives of how to articulate the auditor’s determination of whether to report identified or suspected NOCLAR to an appropriate authority outside the entity. The IAASB recognized that reporting responsibilities under law, regulation or relevant ethical requirements differ, and it is not possible to encapsulate all of these succinctly in a requirement without making it overly complex. Accordingly, the IAASB agreed to retain a simple requirement that generally covers the possible reporting responsibilities that may exist. The IAASB also believed that it should be clear that the ISAs require the auditor to determine what provisions are contained in law, regulation or relevant ethical requirements regarding reporting of identified or suspected NOCLAR, and that any reporting would be in accordance with such law, regulation or relevant ethical requirements (see paragraph 29 of ISA 250 (Revised)). Further, the IAASB was of the view that it is essential for the requirements to be supported by application material that comprehensively addresses the possible scenarios that may exist (see paragraphs A28–A31 of ISA 250 (Revised)).



25. As the objective of the project was to address actual or perceived inconsistencies with the IESBA Code, the IAASB also considered how best to give appropriate prominence within ISA 250 (Revised) to the requirements in the IESBA Code. The IAASB believed that reference to the IESBA Code would be best placed in the application material as an example, as this achieves the effect of highlighting the specific requirements within the IESBA Code, while recognizing not all who apply the ISAs apply the IESBA Code (see paragraph A30 of ISA 250 (Revised)). This approach is consistent with how the IESBA Code is referred to in other ISAs (e.g., ISA 260 (Revised)).
26. The IAASB also debated whether to explain the considerations relating to the duty of confidentiality in the requirement (i.e., that law, regulation or relevant ethical requirements may in some cases preclude reporting to an appropriate authority). The IAASB concluded that including this reference within the requirement could potentially undermine the objective of the project and inhibit the auditor's consideration of whether to report, and would therefore be best placed in application material (see paragraph A32 of ISA 250 (Revised)). Paragraphs A28–A33 of ISA 250 (Revised) are set out in the manner in which the IAASB believes an auditor would likely consider identified or suspected NOCLAR and determine whether reporting was required or appropriate in the circumstances.

### **Additional Responsibilities under Law, Regulation or Relevant Ethical Requirements Regarding Identified or Suspected NOCLAR, Including with Respect to Documentation**

#### *Background*

27. As noted in paragraph 11, the IAASB's approach was to make limited amendments to the International Standards that do not explicitly duplicate in detail all of the specific requirements in the IESBA NOCLAR Re-ED. Accordingly, in paragraph 8a of ED-ISA 250, the IAASB proposed highlighting that the auditor may have additional responsibilities under ethical requirements regarding identified or suspected NOCLAR, and that complying with those additional responsibilities may provide further information that is relevant to the auditor's work in accordance with ISA 250 and other ISAs.

#### *Summary of Comments Received on Exposure*

28. While respondents generally agreed with the IAASB's approach (see paragraph 16), some respondents specifically requested the inclusion of the documentation requirements contained in the IESBA NOCLAR Re-ED in ISA 250, or suggested other ways to alert the auditor to the fact that additional documentation is required for those auditors subject to the IESBA Code, to give this new requirement in the IESBA Code appropriate prominence.

#### *IAASB Decisions*

29. The IAASB believed that clarifying what some of the additional responsibilities under law, regulation or relevant ethical requirements would entail would be useful, and accordingly incorporated additional material highlighting some of the features of the IESBA Code in the introductory section (see paragraph 9 of ISA 250 (Revised)).
30. The IAASB also agreed with respondents that emphasis of the documentation requirements contained in the IESBA Code would be useful. In reconsidering the documentation requirements of ISA 250, the IAASB believed that the existing requirements in ISA 250 were somewhat limited, and may not appropriately guide the auditor in documenting their significant professional judgments, and the discussion of how management have responded to the identified or suspected NOCLAR.

Accordingly, the IAASB has enhanced the documentation requirements (see paragraph 30 of ISA 250 (Revised)) and has brought emphasis to the additional documentation requirements that may exist in law, regulation or relevant ethical requirements (see paragraphs 9 and A36 of ISA 250 (Revised)).

## Group Audits

### *Background and Summary of Comments Received on Exposure*

31. Consistent with the IESBA NOCLAR Re-ED, the ED-ISA 250 did not propose specific changes related to group audits.
32. In responding to the IESBA NOCLAR Re-ED, respondents, including one member of the Monitoring Group, commented that specific consideration should be given to communication of identified or suspected NOCLAR in a group audit situation. The IESBA accepted that there was a need to enhance the provisions in the IESBA Code regarding communication amongst auditors within a group audit as the guidance provided in the IESBA NOCLAR Re-ED lacked sufficient specificity. The IESBA did not believe that it would be appropriate to rely on ISA 600<sup>9</sup> to provide the necessary direction and guidance in this regard, as the IESBA Code serves different objectives compared with the ISAs. The IESBA also recognized that the IESBA Code and the ISAs are independent of each other and jurisdictions do not necessarily adopt them together. Subsequent to the issuance of ED-ISA 250, the IESBA found it necessary to include more specific provisions dealing with the communication of identified or suspected NOCLAR amongst auditors within a group audit in finalizing the changes to the IESBA Code.

### *IAASB Decisions*

33. The IAASB considered the implications of these amendments to the IESBA Code on the ISAs, and explored various alternatives to alerting auditors to the additional responsibilities in respect of group audit situations. These options included making conforming amendments to ISA 600, inserting additional requirements in ISA 250 addressing group audits, or including additional application material in ISA 250. The IAASB noted that the communication requirements in the revised IESBA Code would apply more widely than to those participating directly in a group audit. For example, there are communication requirements for auditors who are performing work at a component (e.g., a statutory audit) who may not be functioning as a component auditor for the purposes of the audit of the group financial statements.
34. The IAASB has a current initiative addressing group audits,<sup>10</sup> and as part of that initiative is exploring the two-way communications that may be necessary between group engagement teams and component auditors at a holistic level. The IAASB noted that there are existing provisions in ISA 600 that, to some extent, address the issues arising from the amendments in the revised IESBA Code. The IAASB<sup>11</sup> therefore did not believe a conforming amendment to ISA 600 would be appropriate at this time.

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<sup>9</sup> ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

<sup>10</sup> See the [Invitation to Comment, \*Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control and Group Audits\*](#).

<sup>11</sup> The IAASB member who voted against the conforming amendments did so on the basis that, in his view, a conforming amendment to ISA 600 was necessary at this time to give sufficient prominence to the additional communication requirements set out in the IESBA NOCLAR pronouncement.

35. Notwithstanding this view, the IAASB determined that emphasis should be included in ISA 250 regarding the additional responsibilities that may be contained in relevant ethical requirements relating to group audit situations. In order to remain consistent with the IAASB's decisions explained in paragraphs 18 and 29 above, the IAASB agreed to also highlight that the additional responsibilities that may be contained in relevant ethical requirements may include communicating instances of identified or suspected NOCLAR to other auditors (e.g., in an audit of group financial statements) (see paragraph 9 of ISA 250 (Revised)). This has been supported by application material that explains what such communication might entail (see paragraph A8 of ISA 250 (Revised)), with reference to the specific paragraphs in the IESBA Code. This positioning in ISA 250 has the benefit of highlighting the communication requirements in the IESBA Code that may apply in cases where ISA 600 does not apply – for example, to auditors performing statutory audits at a component who are not otherwise involved in the audit of the group financial statements.

### **The Implications of Identified or Suspected NOCLAR on the Audit**

#### *Background*

36. In ED-ISA 250, the IAASB proposed new guidance to clarify how addressing identified or suspected NOCLAR under the IESBA Code may have an effect on the audit being performed under the ISAs. In particular, new introductory material was added to highlight that complying with the additional responsibilities under relevant ethical requirements may provide further information that is relevant to the audit. This was further emphasized in the application material in ED-ISA 250, which explained circumstances that could impact on the reliability of written representations.

#### *Summary of Comments Received on Exposure*

37. Views were expressed that ISA 250 should incorporate more considerations relating to the impact of identified or suspected NOCLAR on the auditor's report, for example key audit matters. Respondents further noted that identified or suspected NOCLAR could qualify as a key audit matter, even if such NOCLAR was completely unrelated to the financial statements. Respondents also indicated that communication of identified or suspected NOCLAR in the auditor's report could be highly sensitive or there may be a circumstance when it should not be communicated as law or regulation may specifically prohibit a communication, or other action that might prejudice an investigation by an appropriate authority into an actual, or suspected, illegal act.
38. It was also observed by respondents that the requirements of ISA 250 regarding withdrawal from the engagement were not aligned to the IESBA NOCLAR Re-ED, in particular that ISA 250 refers to the possibility of withdrawal as being an "exceptional case", and therefore contemplates withdrawal in more limited circumstances than the IESBA NOCLAR Re-ED.

#### *IAASB Decisions*

39. The IAASB reconsidered the application material in ED-ISA 250 addressing the implications for the auditor's report, including the possible withdrawal from the audit (as extant ISA 250 makes reference to an Other Matter paragraph, in the context of the auditor being unable to withdraw from the engagement).
40. The IAASB introduced new application material to clearly set out the variety of circumstances in which identified or suspected NOCLAR may have implications for the auditor's report (including key audit matters). This material acknowledges that the auditor may determine identified or suspected

NOCLAR to be a key audit matter, but also draws reference to relevant material in ISA 701<sup>12</sup> that addresses circumstances in which the auditor determines a matter to be a key audit matter but decides not to communicate the matter in the auditor's report<sup>13</sup> (see paragraph A26 of ISA 250 (Revised)). The application material also highlights that limitations may exist in relation to referring to identified or suspected NOCLAR in the auditor's report, which may affect the auditor's ability to describe the matter in the auditor's report, or in some circumstances, the auditor's ability to issue the auditor's report (see paragraph A27 of ISA 250 (Revised)).

41. The IAASB noted that, throughout the ISAs, the manner in which withdrawal from the engagement is described or required varies due to the circumstances in which withdrawal is contemplated. The IAASB believes that withdrawal "in exceptional circumstances", as indicated in extant ISA 250, may imply that withdrawal is a last resort, which is inconsistent with the intention of the revised IESBA Code. This is because withdrawal may be appropriate in some scenarios even if management has appropriately dealt with the identified or suspected NOCLAR, for example when there are questions about management's integrity. Accordingly, the IAASB agreed to better align the withdrawal provisions in ISA 250 with the revised IESBA Code (see paragraph A25 of ISA 250 (Revised)). However, the IAASB decided not to include the additional guidance in the revised IESBA Code regarding factors to consider in determining whether withdrawal is appropriate within ISA 250 (Revised), as this would be dissimilar to and more prescriptive than the approach taken in other ISAs in relation to withdrawal.

### **Alignment of the Definition of Non-Compliance and the Scope of Laws and Regulations with the IESBA Code**

#### *Background*

42. ED-ISA 250 included proposed changes to ISA 250 that the IAASB believed would significantly clarify the application of the International Standards in light of the IESBA Code. This largely comprised including in ED-ISA 250 the examples of laws and regulations that were indicated in the IESBA NOCLAR Re-ED as being those which the NOCLAR section of the IESBA Code addresses.

#### *Summary of Comments Received on Exposure*

43. Respondents expressed mixed views regarding the inclusion of the examples in ED-ISA 250. Some believed that it would create more confusion as there is no clear separation between the examples that relate to the two different categories<sup>14</sup> of laws and regulations contemplated in paragraph 6 of

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<sup>12</sup> ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

<sup>13</sup> Paragraph 14 of ISA 701 indicates that the auditor shall describe each key audit matter in the auditor's report unless (a) law or regulation precludes public disclosure about the matter; or (b) in extremely rare circumstances, the auditor determines that the matter should not be communicated in the auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

<sup>14</sup> ISA 250 (Revised) 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; 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 (e.g., 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.

ISA 250. Others expressed concern that the examples in the IESBA NOCLAR Re-ED are for a different purpose or application than the ISAs. There was also a view that the examples could increase the expectations gap in terms of how auditors respond in those circumstances versus what the public would expect them to do. Others noted that some of the examples are outside of the auditor's particular expertise, or were included in the IESBA NOCLAR Re-ED for a different purpose, for example to address insider trading.

44. There were suggestions on how to improve the examples, including classifying them between the two categories, combining the examples with other examples referenced in ISA 250, or including appropriate disclaimers to emphasize that the examples are not exhaustive and that the auditor would have to consider what represents relevant laws or regulations in the context of the particular engagement, the entity's industry and the regulatory framework. Respondents also recommended the inclusion of additional examples.
45. Additionally, while no changes were proposed to the definition of non-compliance in ED-ISA 250, respondents highlighted that the definition of non-compliance was not consistent with the IESBA NOCLAR Re-ED, which is explained in paragraph 225.2 of the revised IESBA Code as follows:

Non-compliance with laws and regulations ("non-compliance") comprises acts of omission or commission, intentional or unintentional, committed by a client, or by those charged with governance, by management or by other individuals working for or under the direction of a client which are contrary to the prevailing laws or regulations.

46. There were suggestions that the definition in ISA 250 (Revised) should refer to personal misconduct related to the business activities of the entity, as well as include acts on behalf of the entity by individuals not employed by the entity. However, there was a view from a respondent that the definition in ISA 250 is subtly different from the IESBA NOCLAR Re-ED, in that all instances of personal misconduct are outside the scope of ISA 250.

#### *IAASB Decisions*

47. The IAASB believed that, to the extent possible, the relevant concepts in the ISAs (the scope of laws and regulations, the definition of non-compliance, and the circumstances under which the auditor may withdraw from the engagement) should be aligned to those of the revised IESBA Code, with the recognition that adaptations may be necessary to ensure the provisions remain relevant and appropriate in the context of the an audit of financial statements.

#### *Examples of Laws and Regulations*

48. The IAASB explored the suggestions and recommendations from respondents. While the IAASB acknowledged that it may be helpful to classify the examples between the two categories, the Board thought making a bright line distinction would not be possible, given that the appropriate classification depends on the nature and circumstances of the entity. Instead, the IAASB agreed that additional emphasis should be made in the application material to indicate that the classification of the laws or regulations between the two categories is dependent on the nature and circumstances of the entity (see paragraph A6 of ISA 250 (Revised)).
49. While the IAASB broadly believed that consistency with the revised IESBA Code is important, the Board did not think it necessary in ISA 250 (Revised) to reference the additional examples that were included in the IESBA NOCLAR pronouncement. The IAASB also noted that the examples are not

exhaustive, and therefore would not preclude the additional suggested examples from being within the scope of ISA 250 (Revised).

#### Definition of Non-Compliance

50. In exploring the need for consistency between the ISAs and the IESBA Code, the IAASB debated the meaning of the definition of non-compliance in extant ISA 250 and agreed the following matters:

- The reference to “transactions entered into by, in the name of, or on behalf of the entity” is an example of an act of non-compliance in the context of a financial statement audit.
- Personal misconduct related to the business activities of the entity is, and has always been, included within the scope of ISA 250, since the extant definition only scopes out personal misconduct unrelated to the business activities of the entity.

51. In light of these views, the IAASB evaluated the definition of non-compliance in relation to how non-compliance is described in the revised IESBA Code (see paragraph 225.2 and 225.9 of the revised IESBA Code). The intention of the IESBA was to align the concept of non-compliance with that contained in the ISAs, although the IESBA refined this explanation to ensure the description was relevant in the context of the IESBA Code. The IAASB noted the following key differences between extant ISA 250 and the revised IESBA Code:

- The description in the revised IESBA Code refers to acts committed by “other individuals working for or under the direction of the entity”, in addition to management and those charged with governance. Extant ISA 250 refers to “employees”. The IAASB agreed with how this is described in the revised IESBA Code, since it is possible that others who are not actual employees could be involved with the NOCLAR (such as contractors) and, accordingly, replaced “employees” with “other individuals working for or under the direction of the entity” (see paragraph 12 of ISA 250 (Revised)).
- Extant ISA 250 indicates that “Such acts include transactions entered into by, or in the name of, the entity, or on its behalf, by those charged with governance, management or employees”. The revised IESBA Code does not make reference to this example as the IESBA believed that NOCLAR would not always arise from a transaction, but is rather something that arises from an action or inaction. The IAASB believed that this example should be retained as it is still relevant in the context of the ISAs, but relocated it to the application material supporting the definition (see paragraph A9 of ISA 250 (Revised)).
- The revised IESBA Code explains that the NOCLAR section of the Code does not address personal misconduct unrelated to the business activities of the client; this is located separately (paragraph 225.9 of the Code) from where the Code explains what non-compliance is (paragraph 225.2 of the Code). Extant ISA 250 also indicates that personal misconduct unrelated to the business activities of the entity is not included in the definition of non-compliance. In analyzing the consistency with the revised IESBA Code, the IAASB debated where best this would be placed, i.e., in the definition or in the application material. The IAASB believed that since this is important to the auditor’s understanding of which matters would be excluded from the definition of non-compliance, it should be retained in the definition (see paragraph 12 of ISA 250 (Revised)).
- The IAASB considered, but rejected, including additional explanatory material that was included in the IESBA Code to explain that non-compliance does not include acts committed

by third parties. The IAASB believed the example described in the IESBA Code would be rare, if at all possible, in an audit of financial statements, and concluded that including such a reference purely for consistency may be confusing.

52. The IAASB was further of the view that additional clarity regarding what would constitute personal misconduct related to the business activities would be helpful. Accordingly, an example has been included in the application material (see paragraph A10 of ISA 250 (Revised)).

## **Communication with Management or Those Charged with Governance**

### *Background*

53. New guidance was included in ED-ISA 250 to recognize that laws or regulations may prohibit alerting the entity, for example when the auditor is required to report identified or suspected NOCLAR to an appropriate authority pursuant to money laundering legislation.

### *Summary of Comments Received on Exposure*

54. Respondents raised concern that there is insufficient emphasis in the requirements to alert the auditor to the fact that the auditor may be prohibited from discussing the NOCLAR with management or those charged with governance. It was also noted that it is inconsistently treated within ISA 250 and could be given greater prominence (for example, by adding a statement to the introduction to ISA 250, consistent with paragraph 7 of ISA 260 (Revised)).
55. A Monitoring Group respondent also recommended that paragraphs 40–42 of ISA 240, which address the communication of fraud to management and those charged with governance, should encompass identified or suspected NOCLAR occurring at a component.

### *IAASB Decisions*

56. The IAASB reconsidered how ISA 250 and the conforming amendments address the possible preclusion on communicating with and reporting to management or those charged with governance. The IAASB believed it was important to highlight this possible preclusion in the requirements through the addition of “unless such communication is prohibited by law or regulation” in certain places (see, for example, paragraphs 20 and 23 of ISA 250 (Revised)), supported by an explanation in the application material (see paragraph A21 of ISA 250 (Revised)). The IAASB reviewed ISA 250 and the conforming amendments and included a reference to the preclusion in all cases where communication with management or those charged with governance is indicated.
57. The IAASB noted that both ISA 250 and ISA 240 address communication with management and those charged with governance, and accordingly provisions relating to communicating with group management regarding identified or suspected NOCLAR at a component would need to apply to both. However, as indicated in paragraphs 31–35 above, the IAASB considered revisions to ISA 250 and ISA 600 relating to group audits, and determined that revisions to ISA 600 at this time would not be appropriate, due to the current initiative addressing group audits. Instead, the IAASB has included a general indication that there may be additional responsibilities relating to group audit situations contained in relevant ethical requirements (see paragraphs 9 and A8 of ISA 250 (Revised)).

## **Communication with a Proposed Successor Auditor**

### *Background*

58. The ED proposed a conforming amendment to ISA 220 as application material to highlight a requirement in the IESBA NOCLAR Re-ED that, in the case of an audit of financial statements, an auditor shall request the predecessor auditor to provide known information regarding any facts or circumstances that, in the predecessor auditor's opinion, the auditor needs to be aware of before deciding whether to accept the engagement.

### *Summary of Comments Received on Exposure*

59. There was concern that the predecessor auditor may not be willing to provide the information, or may not have the client's permission to do so, and clarification of this was requested in paragraph A8a of ISA 220. There was also a recommendation to indicate examples of "facts and circumstances" (e.g., identified or suspected NOCLAR), or to reference to the relevant sections of the revised IESBA Code.

### *IAASB Decisions*

60. The IAASB noted that, in finalizing the NOCLAR provisions for the revised IESBA Code, the IESBA made amendments to require that, when withdrawing from the engagement as a result of identified or suspected NOCLAR, the predecessor auditor, on request by the proposed successor auditor, should provide all such facts and other information concerning identified or suspected NOCLAR to the proposed successor auditor that, in the predecessor auditor's opinion, the proposed successor auditor needs to be aware of before deciding whether to accept the audit appointment.
61. The IAASB has accordingly highlighted this requirement of the revised IESBA Code in the application material of ISA 220 (see paragraph A8a of ISA 220).
62. Furthermore, the IAASB agreed that it would be helpful to refer to paragraph 210.14 of the revised IESBA Code in ISA 220 as an example of what may specifically be required by relevant ethical requirements in relation to communications between a predecessor auditor and a proposed successor auditor (see paragraph A8a of ISA 220 (Revised)).

## **Implications for International Standards Other than ISAs**

### *Background*

63. The NOCLAR provisions in the revised IESBA Code apply to all professional accountants, although the responsibilities differ between professional accountants performing audits of financial statements, professional accountants providing professional services other than audits of financial statements and professional accountants in business.
64. In terms of the revised IESBA Code, the laws and regulations to which a professional accountant must respond if the professional accountant is made aware of identified or suspected NOCLAR are the same as the laws and regulations covered by ISA 250 (i.e., laws and regulations that have a direct effect on the determination of material amounts and disclosures in the financial statements or are fundamental to the operating aspects of the entity's business, to its ability to continue as a going concern or to avoid material penalties).
65. In the ED-ISA 250, proposed amendments were only made to ISRE 2400 (Revised), with a minor edit to ISAE 3402.



*Summary of Comments Received on Exposure*

66. Two respondents highlighted that the scope of laws and regulations in the IESBA NOCLAR Re-ED is inconsistent with the scope of the laws and regulations contemplated by certain of the International Standards, specifically ISRE 2400 (Revised) and ISAE 3000 (Revised). There were also concerns about the inconsistency in work effort relating to identified or suspected NOCLAR between these International Standards and the IESBA NOCLAR Re-ED, since the IESBA NOCLAR Re-ED imposes an obligation on a practitioner beyond the requirements of these International Standards.
67. Three respondents questioned whether the conforming amendments to the International Standards were adequate, as no amendments were proposed in the ED to certain of the International Standards, particularly ISAE 3000 (Revised).

*IAASB Decisions*

68. The IAASB noted that the practitioner is, under the revised IESBA Code, expected to respond to NOCLAR when it comes to the practitioner's attention. However, the revised IESBA Code does not require the practitioner to perform procedures to identify instances of NOCLAR. The revised IESBA Code explains the practitioner's expected level of knowledge of laws and regulations, as reflected in paragraph 225.40 of the revised IESBA Code:

The professional accountant is expected to apply knowledge, professional judgment and expertise, but is not expected to have a level of understanding of laws and regulations beyond that which is required for the professional service for which the accountant was engaged. Whether an act constitutes actual non-compliance is ultimately a matter to be determined by a court or other appropriate adjudicative body. Depending on the nature and significance of the matter, the professional accountant may consult on a confidential basis with others within the firm, a network firm or a professional body, or with legal counsel.

69. The IAASB considered whether amendments to the other standards would be appropriate and concluded that:
- It would be appropriate to bring emphasis to the additional responsibilities relating to NOCLAR under the revised IESBA Code in ISAE 3000 (Revised) and ISRS 4410 (Revised).
  - Conforming amendments would not be appropriate for ISRE 2410,<sup>15</sup> as this standard is still in the "pre-clarity" format and has not been recently amended to reflect conforming amendments in respect of other IAASB projects.
  - Conforming amendments would not be appropriate for ISRS 4400,<sup>16</sup> as this standard is the subject of a current IAASB project.

**Jurisdictions that Do Not Adopt, or Plan to Adopt, the IESBA Code**

*Background*

70. In issuing ED-ISA 250, the IAASB proposed limited amendments to the International Standards and did not intend on duplicating all the specific requirements in the revised IESBA Code. This approach recognized that, in some jurisdictions, ethical codes other than the IESBA Code may be applied. The

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<sup>15</sup> ISRE 2410, *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*

<sup>16</sup> ISRS 4400, *Engagements to Perform Agreed-upon Procedures Regarding Financial Information*

IAASB requested respondents to indicate the impact, if any, of the proposed limited amendments in jurisdictions that have not adopted, or do not plan to adopt, the IESBA Code.

#### *Summary of Comments Received on Exposure*

71. Respondents generally indicated that there is no conflict between the proposed amendments to the International Standards and local jurisdictional codes or laws or regulations in jurisdictions that have not adopted, or do not plan to adopt, the IESBA Code. However, a limited number of respondents expressed the view that a possible conflict could arise, or that future compliance with the International Standards may become difficult, due to the requirement in ISA 200<sup>17</sup> that the auditor comply with “relevant ethical requirements” when conducting an audit in accordance with ISAs. There was also a question raised about how ethical codes applied by auditors and practitioners would be measured to determine their equivalency to the IESBA Code, given a perception of the IESBA Code becoming more explicit and detailed.

#### *IAASB Decisions*

72. The IAASB further discussed these matters, including with the IAASB’s National Auditing Standard Setters Liaison Group, in order to obtain a better understanding of how ISA 200 is interpreted and applied by NSS in their jurisdictions. IAASB staff also consulted with IESBA staff to ascertain the implication of the circumstances where the IESBA Code is in conflict with local laws or regulations. The Board concluded that the concern raised does not appear to have broad relevance internationally at this time, and therefore there is no present need to clarify ISA 200. Nonetheless, this may be a matter for monitoring by the IAASB, taking into account any pertinent findings from the post-implementation review the IESBA intends to undertake in the future regarding the NOCLAR provisions in the revised IESBA Code. It was also acknowledged that the determination of how national ethical requirements (when not the IESBA Code), the IESBA Code, and the ISAs interrelate is a matter for local or jurisdictional consideration, although it was recognized that the relevant ethical requirements applied would need to be high quality.

### **Other Issues Raised by Respondents**

#### *Whether a More Fulsome Review of ISA 250 Is Warranted in Due Course*

73. Prior to undertaking this project, in developing its current Strategy and Work Plan, the IAASB had not identified a need for a fulsome review of ISA 250. However, the IAASB recognized that ED-ISA 250 was an opportunity for the IAASB to solicit stakeholders’ views as to whether there is merit in exploring other aspects of ISA 250 where further improvements may need to be considered in due course (i.e., under a future IAASB Work Plan).
74. There were mixed views from respondents regarding the need for a future project to revise ISA 250 or explore its improvement. Respondents in support of a future revision, including a Monitoring Group member, expressed support for some of the specific aspects highlighted in the ED of matters that may warrant consideration in the future. There were also suggestions and recommendations from respondents of matters that could be considered in a future revision of ISA 250. Respondents who did not support a more fulsome review of ISA 250 cited various reasons, including other higher priority

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<sup>17</sup> ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*

projects, a lack of observed problems with the current ISA, and concerns about the scope, responsibilities and expectations of the auditor arising from a revision.

#### *IAASB Decisions*

75. Consistent with the proposals in ED-ISA 250, the IAASB continues to believe that an immediate revision of ISA 250 is not warranted in light of other more urgent priorities that were identified in developing the current Work Plan – which continue to be supported by feedback to the December 2015 Invitation to Comment, *Enhancing Audit Quality in the Public Interest*. However, the question of the relative importance of a fulsome review and accordingly whether this should be considered by the IAASB in its next Work Plan for 2017–2018 was included in IAASB’s July 2016 survey, [Survey Consultation—The IAASB’s Work Plan for 2017–2018 and Continuing Relevance of Its Strategic Objectives](#). The determination of future priorities, including whether to revise ISA 250 more fully in the future, will be made based on feedback from this survey and discussions with the CAG, with oversight from the Public Interest Oversight Board.

#### *Firms’ Systems of Quality Control*

76. A Monitoring Group respondent indicated that the IAASB should establish requirements for firms to establish processes internal to the firm that stipulate how the firm should address those instances in which an auditor or practitioner comes across identified or suspected NOCLAR at an entity. It was suggested this could potentially be done as part of the IAASB’s current project addressing quality control.
77. ISQC 1 contains a general requirement for firms to establish policies and procedures with regards to compliance with relevant ethical requirements. The IAASB agreed that the establishment of appropriate policies and procedures to address the response to identified or suspected NOCLAR is important, and will consider the need for a specific requirement in ISQC 1 in this regard as part of its quality control project.

#### *Other Conforming Amendments*

78. Respondents recommended that paragraph A24 of ISA 210 should address the inclusion in the engagement letter of the auditor’s legal duty or ethical responsibility to report identified or suspected NOCLAR. The IAASB agreed with this suggestion.
79. For the purposes of consistency, respondents suggested revising paragraph A26 of ISA 500 and inserting a new paragraph in ISA 500 (paragraph A33a) to highlight that audit evidence may arise from other sources, such as ethical requirements, and that identified or suspected NOCLAR may provide further information relevant to the audit. The IAASB agreed with the inclusion of this additional guidance.

#### **Effective Date**

80. At the time of exposing ED-ISA 250, the IESBA was targeting approval of the NOCLAR provisions together with the restructured IESBA Code, which was expected to take place by the fourth quarter of 2016. Accordingly, the IAASB anticipated that the effective date of the changes to ISA 250 (Revised) could be aligned with that of the NOCLAR provisions in the revised IESBA Code, and respondents supported this.

81. The IESBA subsequently determined that its NOCLAR provisions should be issued when finalized, instead of waiting for the final restructuring of the IESBA Code, thus moving the timeline for the effective date of the IESBA NOCLAR pronouncement forward. The effective date of the IESBA NOCLAR provisions is July 15, 2017 (i.e., the provisions apply to instances of NOCLAR that come to the professional accountant's attention on or after July 15, 2017).
82. The IAASB debated various options, balancing the aim of trying to achieve alignment with the IESBA's effective date with recognition of the importance of allowing sufficient time for stakeholders to effectively implement ISA 250 (Revised) and the conforming amendments. The IAASB noted that it is not possible to achieve perfect alignment of the effective dates.
83. The IAASB noted that the changes to ISA 250 (Revised) do not change the auditor's work effort, i.e., the auditor's response to identified or suspected NOCLAR would not differ between extant and revised ISA 250. This is because the auditor would still have an obligation in accordance with extant ISA 250 to consider the appropriate action be taken in accordance with the relevant ethical requirements, for example the IESBA Code when this constitutes the relevant ethical requirements. Therefore, the lack of alignment of effective dates would, in practice, not have an effect.
84. Accordingly, the IAASB agreed that the most appropriate effective date is for audits of financial statements for periods beginning on or after December 15, 2017, with early adoption permitted, as this would allow for a sufficient time period for the implementation activities (approximately fifteen months).

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