

CONSIDERATION OF LAWS AND REGULATIONS IN AN AUDIT OF FINANCIAL STATEMENTS: CAS 250

- Management is responsible for complying with laws and regulations
- The auditor is not responsible for preventing non-compliance with or to detect non-compliance with laws

The Auditor's Consideration of Compliance with Laws and Regulations

- As part of obtaining an understanding of the entity and its environment obtain a **general understanding of the laws and regulations applicable to the entity and how the entity is complying** with those laws and regulations
 - Use your own knowledge of business and inquire management to figure this out
- Obtain **sufficient appropriate audit evidence** regarding **compliance with laws and regulations** that have a **direct material effect** on the financial statements
 - Examples: compliance with income tax act, non-compliance with laws leading to fines, litigation
- Perform the **following two audit procedures** to help identify instances of non-compliance with laws that have a material impact on the F/S
 1. **Inquiring of management** and those charged with governance, as to whether the entity is in compliance with such laws and regulations; and
 2. **Inspecting correspondence** with regulatory authorities
- During the audit, **remain alert** to the possibility that **other audit procedures** may bring instances of non-compliance; therefore, be alert when:
 - Reading **minutes**;
 - **Inquiring** management and the client's lawyers regarding litigation, claims and assessments
 - Performing substantive tests of details
- Request management and those charged with governance to provide **written representations** that **all known instances of non-compliance or suspected non-compliance** with laws and regulations that affect the F/S have been **disclosed to the auditor**
 - written representations **do not** provide sufficient appropriate audit evidence on their own (you can only use it to corroborate evidence obtained via other procedures)

Audit Procedures When Non-Compliance Is Identified or Suspected

- If the auditor **aware of non-compliance or suspected non-compliance**, the auditor should:
 - Get an understanding of the **nature** of the act and the **circumstances** in which it occurred; and
 - Get further information to **evaluate the effect on the F/S (i.e. financial consequences of non-compliance (fines), required disclosures)**
- Some indications of possible non-compliance include
 - Unauthorized transactions or improperly recorded transactions
 - Unusual transactions with companies registered in tax havens
 - Investigations by regulatory organizations and government departments or payment of fines or penalties
- If the auditor suspects non-compliance, he/she must **discuss with management and those charged with governance**. If mgm't doesn't provide information that demonstrates that they are in fact in compliance, and if the non-compliance will have a material impact on the F/S, the

auditor needs to **get legal advice** on whether a law has been broken, the legal consequences, the possibility of fraud, and how the auditor should proceed

- If sufficient information about suspected non-compliance cannot be obtained, the auditor may have a scope limitation (and may need to provide a disclaimer of opinion or qualified opinion)

Reporting Non-Compliance to Those Charged with Governance

- Communicate with those charged with governance concerning matters involving non-compliance with laws and regulations that come to the auditor's attention (if non-compliance is intentional and material do this ASAP)
- If auditor suspects intentional non-compliance by management or those charged with governance, always **report one level above** (i.e. the audit committee)

Reporting Non-Compliance in the Auditor's Report on the Financial Statements

- If the non-compliance has a **material** effect on the F/S, and has **not been adequately accounted** for in the F/S express a **qualified opinion or an adverse opinion**
- If the auditor is **precluded by management from obtaining sufficient appropriate audit evidence** to evaluate whether non-compliance that may be material to the F/S has occurred, there is a **scope limitation**; therefore, express a qualified opinion or disclaim an opinion on the financial statements

Reporting Non-Compliance to Regulatory and Enforcement Authorities

- Determine whether the auditor has a responsibility to report the identified or suspected non-compliance to parties outside the entity
 - Auditor's professional duty to maintain the **confidentiality** of client information may prevent reporting identified or suspected non-compliance
 - Note that the duty of confidentiality may be **overridden by statute, the law or courts of law**
 - It is best to get **legal advice** to determine the appropriate course of action

Documentation

- The auditor's documentation of findings regarding identified or suspected non-compliance with laws and regulations may include, for example:
 - **Copies of records** or documents
 - **Minutes** of discussions held with management, those charged with governance or parties outside the entity.