

KAEG-I [INTL VERSION 2024]: ISA 250 (Revised) Consideration of Laws and Regulations in an Audit of Financial Statements

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ISA 250 (Revised) Consideration of Laws and Regulations in an Audit of Financial Statements

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ISA 250 (Revised) *Consideration of Laws and Regulations in an Audit of Financial Statements*

(Effective for audits of financial statements for periods beginning on or after December 15, 2017)

Introduction, Objectives, Definition

International Standards on Auditing: ISA 250.01-12

Introduction

Scope of this ISA

1. This International Standard on Auditing (ISA) deals with the auditor's responsibility to consider laws and regulations in an audit of financial statements. This ISA does not apply to other assurance engagements in which the auditor is specifically engaged to test and report separately on compliance with specific laws or regulations.

Effect of Laws and Regulations

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.

Responsibility for Compliance with Laws and Regulations (Ref: Para. A1 - A8)

3. 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 the provisions of laws and regulations, including compliance with the provisions of laws and regulations that determine the reported amounts and disclosures in an entity's financial statements.

Responsibility of the Auditor

4. The requirements in this ISA are designed to assist the auditor in identifying material misstatement of the financial statements due to non-compliance with laws and regulations. However, the auditor is not responsible for preventing non-compliance and cannot be expected to detect non-compliance with all laws and regulations.

5. The auditor is responsible for obtaining reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether due to fraud or error.¹ In conducting an audit of financial statements, the auditor takes into account the applicable legal and regulatory framework. Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements in the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the ISAs.² In the context of laws and regulations, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for such reasons as the following:

There are many laws and regulations, relating principally to the operating aspects of an entity, that typically do not affect the financial statements and are not captured by the entity's information systems relevant to financial reporting.

- Non-compliance may involve conduct designed to conceal it, such as collusion, forgery, deliberate failure to record transactions, management override of controls or intentional misrepresentations being made to the auditor.
- Whether an act constitutes non-compliance is ultimately a matter to be determined by a court or other appropriate adjudicative body.

Ordinarily, the further removed non-compliance is from the events and transactions reflected in the financial statements, the less likely the auditor is to become aware of it or to recognize the non-compliance.

1 ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, paragraph 5

2 ISA 200, paragraphs A53 - A54

6. This ISA distinguishes the auditor's responsibilities in relation to compliance with two different categories of laws and regulations as follows: (Ref: Para. A6, A12 - A13)

(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 14) (Ref: Para. A12); 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 (see paragraph 15) (Ref: Para. A13).

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.

8. The auditor is required by this ISA to remain alert to the possibility that other audit procedures applied for the purpose of forming an opinion on financial statements may bring instances of non-compliance to the auditor's attention. Maintaining professional skepticism throughout the audit, as required by ISA 200,³ is important in this context, given the extent of laws and regulations that affect the entity.

³ ISA 200, paragraph 15

9. The auditor may have additional responsibilities under law, regulation or relevant ethical requirements regarding an entity's non-compliance with laws and regulations, which may differ from or go beyond this ISA, such as: (Ref: Para. A8)

- (a) Responding to identified or suspected non-compliance with laws and regulations, including requirements in relation to specific communications with management and those charged with governance, assessing the appropriateness of their response to non-compliance and determining whether further action is needed;
- (b) Communicating identified or suspected non-compliance with laws and regulations to other auditors (e.g., in an audit of group financial statements); and
- (c) Documentation requirements regarding identified or suspected non-compliance with laws and regulations.

Complying with any additional responsibilities may provide further information that is relevant to the auditor's work in accordance with this and other ISAs (e.g., regarding the integrity of management or, where appropriate, those charged with governance).

Effective Date

10. This ISA is effective for audits of financial statements for periods beginning on or after December 15, 2017.

Objectives

11. 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 identified or suspected non-compliance with laws and regulations identified during the audit.

Definition

12. For the purposes of this ISA, the following term has the meaning attributed below:

Non-compliance - Acts of omission or commission, intentional or unintentional, committed by the entity, or by those charged with governance, by management or by other individuals working for or under the direction of the entity, which are contrary to the prevailing laws or regulations. Non-compliance does not include personal misconduct unrelated to the business activities of the entity. (Ref: Para. A9 - A10)

ISA Application and Other Explanatory Material: ISA 250.A1-A10

Application and Other Explanatory Material

Responsibility for Compliance with Laws and Regulations (Ref: Para. 3 - 9)

A1. 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. Laws and regulations may affect an entity's financial statements in different ways: for example, most directly, they may affect specific disclosures required of the entity in the financial statements or they may prescribe the applicable financial reporting framework. They may also establish certain legal rights and obligations of the entity, some of which will be recognized in the entity's financial statements. In addition, laws and regulations may impose penalties in cases of non-compliance.

A2. The following are examples of the types of policies and procedures an entity may implement to assist in the prevention and detection of non-compliance with laws and regulations:

- Monitoring legal requirements and ensuring that operating procedures are designed to meet these requirements.
- Instituting and operating appropriate systems of internal control.
- Developing, publicizing and following a code of conduct.
- Ensuring employees are properly trained and understand the code of conduct.
- Monitoring compliance with the code of conduct and acting appropriately to discipline employees who fail to comply with it.
- Engaging legal advisors to assist in monitoring legal requirements.
- Maintaining a register of significant laws and regulations with which the entity has to comply within its particular industry and a record of complaints.

In larger entities, these policies and procedures may be supplemented by assigning appropriate responsibilities to the following:

- An internal audit function.
- An audit committee.
- A compliance function.

Responsibility of the Auditor

A3. Non-compliance by the entity with laws and regulations may result in a material misstatement of the financial statements. Detection of non-compliance, regardless of materiality, may affect other aspects of the audit including, for example, the auditor's consideration of the integrity of management, those charged with governance or employees.

A4. Whether an act constitutes non-compliance with laws and regulations is a matter to be determined by a court or other appropriate adjudicative body, which is ordinarily beyond the auditor's professional competence to determine. Nevertheless, the auditor's training, experience and understanding of the

entity and its industry or sector may provide a basis to recognize that some acts, coming to the auditor's attention, may constitute non-compliance with laws and regulations.

A5. In accordance with specific statutory requirements, the auditor may be specifically required to report, as part of the audit of the financial statements, on whether the entity complies with certain provisions of laws or regulations. In these circumstances, ISA 700 (Revised)⁹ or ISA 800 (Revised)¹⁰ deal with how these audit responsibilities are addressed in the auditor's report. Furthermore, where there are specific statutory reporting requirements, it may be necessary for the audit plan to include appropriate tests for compliance with these provisions of the laws and regulations.

9 ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, paragraph 43

10 ISA 800 (Revised), *Special Considerations - Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks*, paragraph 11

Categories of Laws and Regulations (Ref: Para. 6)

A6. The nature and circumstances of the entity may impact whether relevant laws and regulations are within the categories of laws and regulations described in paragraphs 6(a) or 6(b). Examples of laws and regulations that may be included in the categories described in paragraph 6 include those that deal with:

- Fraud, corruption and bribery.
- Money laundering, terrorist financing and proceeds of crime.
- Securities markets and trading.
- Banking and other financial products and services.
- Data protection.
- Tax and pension liabilities and payments.
- Environmental protection.
- Public health and safety.

Considerations Specific to Public Sector Entities

A7. In the public sector, there may be additional audit responsibilities with respect to the consideration of laws and regulations which may relate to the audit of financial statements or may extend to other aspects of the entity's operations.

Additional Responsibilities Established by Law, Regulation or Relevant Ethical Requirements (Ref: Para. 9)

A8. Law, regulation or relevant ethical requirements may require the auditor to perform additional procedures and take further actions. For example, the International Ethics Standards Board for Accountants' *International Code of Ethics for Professional Accountants (including International Independence Standards)* (IESBA Code) requires the auditor to take steps to respond to identified or suspected non-compliance with laws and regulations and determine whether further action is needed. Such steps may include the communication of identified or suspected non-compliance with laws and regulations between auditors within the engagement team or other auditors performing work at entities or business units of a group for purposes other than the audit of the group financial statements.¹¹

11 See, for example, paragraphs R360.16-360.18 A1 of the IESBA Code.

Definition (Ref: Para. 12)

A9. Acts of non-compliance with laws and regulations include transactions entered into by, or in the name of, the entity, or on its behalf, by those charged with governance, by management or by other individuals working for or under the direction of the entity.

A10. Non-compliance also includes personal misconduct related to the business activities of the entity, for example, in circumstances where an individual in a key management position, in a personal capacity, has accepted a bribe from a supplier of the entity and in return secures the appointment of the supplier to provide services or contracts to the entity.

The Auditor's Consideration of Compliance with Laws and Regulations

International Standards on Auditing: ISA 250.13-18 Requirements

The Auditor's Consideration of Compliance with Laws and Regulations

13. As part of obtaining an understanding of the entity and its environment in accordance with ISA 315 (Revised),⁴ the auditor shall obtain a general understanding of:

- (a) The legal and regulatory framework applicable to the entity and the industry or sector in which the entity operates; and
- (b) How the entity is complying with that framework. (Ref: Para. A11)

⁴ ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*, paragraph 11

14. 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. A12)

15. The auditor shall perform the following audit procedures to help identify instances of non-compliance with other laws and regulations that may have a material effect on the financial statements: (Ref: Para. A13 - A14)

- (a) Inquiring of management and, where appropriate, those charged with governance, as to whether the entity is in compliance with such laws and regulations; and
- (b) Inspecting correspondence, if any, with the relevant licensing or regulatory authorities.

16. During the audit, the auditor shall remain alert to the possibility that other audit procedures applied may bring instances of non-compliance or suspected non-compliance with laws and regulations to the auditor's attention. (Ref: Para. A15)

17. The auditor shall request management and, where appropriate, those charged with governance, to provide written representations that all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing financial statements have been disclosed to the auditor. (Ref: Para. A16)

18. In the absence of identified or suspected non-compliance, the auditor is not required to perform audit procedures regarding the entity's compliance with laws and regulations, other than those set out in paragraphs 13 - 17.

ISA Application and Other Explanatory Material: ISA 250.A11-A16

The Auditor's Consideration of Compliance with Laws and Regulations

Obtaining an Understanding of the Legal and Regulatory Framework (Ref: Para. 13)

A11. To obtain a general understanding of the legal and regulatory framework, and how the entity complies with that framework, the auditor may, for example:

- Use the auditor's existing understanding of the entity's industry, regulatory and other external factors;
- Update the understanding of those laws and regulations that directly determine the reported amounts and disclosures in the financial statements;
- Inquire of management as to other laws or regulations that may be expected to have a fundamental effect on the operations of the entity;
- Inquire of management concerning the entity's policies and procedures regarding compliance with laws and regulations; and
- Inquire of management regarding the policies or procedures adopted for identifying, evaluating and accounting for litigation claims.

Laws and Regulations Generally Recognized to Have a Direct Effect on the Determination of Material Amounts and Disclosures in the Financial Statements (Ref: Para. 6 and 14)

A12. 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 provisions in those laws and regulations may be directly relevant to specific assertions in the financial statements (e.g., the completeness of income tax provisions), while others may be directly relevant to the financial statements as a whole (e.g., the required statements constituting a complete set

of financial statements). The aim of the requirement in paragraph 14 is for the auditor to obtain sufficient appropriate audit evidence regarding the determination of amounts and disclosures in the financial statements in compliance with 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).

Procedures to Identify Instances of Non-Compliance - Other Laws and Regulations (Ref: Para. 6 and 15)

A13. Certain other laws and regulations may need particular attention by the auditor because they have a fundamental effect on the operations of the entity (as described in paragraph 6(b)). Non-compliance with laws and regulations that have a fundamental effect on the operations of the entity may cause the entity to cease operations, or call into question the entity's continuance as a going concern.¹² For example, non-compliance with the requirements of the entity's license or other entitlement to perform its operations could have such an impact (e.g., for a bank, non-compliance with capital or investment requirements). There are also many laws and regulations relating principally to the operating aspects of the entity that typically do not affect the financial statements and are not captured by the entity's information systems relevant to financial reporting.

¹² See ISA 570 (Revised), *Going Concern*.

A14. As the financial reporting consequences of other laws and regulations can vary depending on the entity's operations, the audit procedures required by paragraph 15 are directed to bringing to the auditor's attention instances of non-compliance with laws and regulations that may have a material effect on the financial statements.

Non-Compliance Brought to the Auditor's Attention by Other Audit Procedures (Ref: Para. 16)

A15. Audit procedures applied to form an opinion on the financial statements may bring instances of non-compliance or suspected non-compliance with laws and regulations to the auditor's attention. For example, such audit procedures may include:

- Reading minutes;
- Inquiring of the entity's management and in-house legal counsel or external legal counsel concerning litigation, claims and assessments; and
- Performing substantive tests of details of classes of transactions, account balances or disclosures.

Written Representations (Ref: Para. 17)

A16. Because the effect on financial statements of laws and regulations can vary considerably, written representations provide necessary audit evidence about management's knowledge of identified or suspected non-compliance with laws and regulations, whose effects may have a material effect on the financial statements. However, written representations do not provide sufficient appropriate audit

evidence on their own and, accordingly, do not affect the nature and extent of other audit evidence that is to be obtained by the auditor.¹³

13 ISA 580, *Written Representations*, paragraph 4

How do we comply with the Standards?

[ISA | KAEGHDWC]

1 Understand the applicable legal and regulatory framework [ISA | 3791]

What do we do?

Obtain an understanding of the legal and regulatory framework applicable to the entity and the industry or sector in which it operates.

Why do we do this?

As auditors, we have a responsibility to design our audit to identify material misstatements in the financial statements due to non-compliance with relevant laws and regulations. To enable us to fulfil this responsibility, we first understand the relevant laws and regulations applicable to the entity. As we perform our risk assessment, our understanding of the relevant laws and regulations, enables us to identify and assess risks of material misstatement (RMMs) and to design and execute our audit responses.

Execute the Audit

[How do we obtain an understanding of the entity's legal and regulatory framework? \[ISA | 3791.6382\]](#)

We obtain a general understanding of the entity's legal and regulatory framework through risk assessment procedures such as inquiry and inspection.

[What sources of information are available to help us understand the legal and regulatory framework of the entity? \[ISA | 3791.1400\]](#)

The following sources could be helpful in understanding the legal and regulatory framework of the entity:

- our existing understanding of the entity's legal and regulatory framework, including their past history of non-compliance with laws and regulations, including illegal acts
- our knowledge from working with similar entities within the industry or sector and the relevant legal and regulatory frameworks in which they operate
- inquiries of management (including those with knowledge of compliance matters such as general counsel or internal audit) as to the laws and regulations most applicable to the entity
- inquiries of management as to other laws and regulations that may be expected to have a fundamental effect on the operations of the entity, such as laws relating to bribery and corruption,

compliance with operating permits, health, safety, environmental and security risks, infringement of intellectual property of others, etc.

- inquiries of management regarding the policies or procedures adopted for identifying, evaluating and accounting for litigation, claims and assessments, as these procedures may identify further relevant laws and regulations
- information provided by the entity to those charged with governance related to applicable laws and regulations - for example, board minutes,
- laws and regulations identified in the entity's financial statements
- correspondence with regulators or licensing bodies
- reported amounts and disclosures in the financial statements that are driven by specific laws and regulations - for example, income taxes

Which laws and regulations do we understand regarding the entity's legal and regulatory framework? [ISA | 3791.1300]

We obtain a general understanding of the entity's legal and regulatory framework by understanding:

- the laws and regulations that may impact the financial reporting and disclosures the entity is subject to, for example:
 - the form and content of the financial statements, such as statutorily mandated requirements
 - industry-specific financial reporting issues
 - accounting for transactions under government contracts, for example, the laws or regulations that may impact the amount of revenue to be accrued
 - accrual or recognition of expenses for income tax or pension costs
- the laws and regulations that may be expected to have a fundamental impact on the operations of the entity

Do some laws and regulations have a more direct effect on the entity's financial statements than others? [ISA | 3791.13010]

Typically, yes. Some laws and regulations have provisions that directly affect the determination of amounts and disclosures in the financial statements. These are known as 'direct' laws and regulations and may include:

Type of 'direct' law or regulation	Examples of how they may impact the financial statements
Industry specific financial reporting issues	<ul style="list-style-type: none"> • Form and content of the financial statements • Statutory or other reporting requirements, such as banking or insurance statutory reporting requirements
Tax or legislative requirements	<ul style="list-style-type: none"> • Accrual or recognition of expenses for income tax or pension costs • Complex tax laws that apply to the entity in multiple jurisdictions • Legislative requirements around pension costs

Governmental legislation	<ul style="list-style-type: none"> Accounting for government contracts, for example laws or regulations that affect the amount of revenue that can be recorded Foreign exchange controls, fiscal tariffs or trade restrictions that apply to the entity
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[What is our responsibility regarding laws and regulations that have a direct impact on the financial statements?](#) [ISA | 3791.13011]

Our responsibility is to [obtain sufficient appropriate audit evidence](#) that the amounts and disclosures determined by those laws and regulations having a direct effect are not materially misstated.

[Are there laws and regulations that do not have a direct impact on the financial statements?](#) [ISA | 3791.13012]

There may be other laws and regulations which do not directly relate to the recognition and measurement of amounts or disclosures in the financial statements. These are known as 'indirect' laws and regulations.

Generally, these indirect laws and regulations relate more to an entity's operations rather than to its accounting and financial reporting, and their financial statement effect is more 'indirect'.

While indirect laws and regulations do not relate directly to the recognition of amounts or disclosures in the financial statements, non-compliance with certain indirect laws and regulations may impact the operations of the business, the entity's ability to continue its business and/or result in material penalties or fines.

[What are examples of laws and regulations that may have an indirect impact on the financial statements?](#) [ISA | 3791.13013]

Laws and regulations that may have an indirect effect may include:

- Fraud, corruption and bribery, such as the US Foreign Corrupt Practices Act (FCPA) or UK Bribery Act 2010, or similar local requirements
- Money laundering, terrorist financing and proceeds of crime regulations
- Data protection regulations
- Environmental protection regulations
- Public health and safety regulations

[What is our responsibility regarding indirect laws and regulations?](#) [ISA | 3791.13014]

Our responsibility is limited to undertaking certain procedures to help identify non-compliance with those laws and regulations, including illegal acts, that may have a material effect on the financial statements. While we do not have a responsibility to identify all non-compliance with indirect laws and regulations, when we encounter information that provides evidence of the existence of possible non-compliance with indirect laws and regulations, including illegal acts, we understand the nature of the non-compliance, the circumstances in which it occurred and enough other information to allow us to evaluate the possible effect on the financial statements.

[What procedures do we perform as it relates to indirect laws and regulations?](#) [ISA | 3791.13015]

With respect to indirect laws and regulations, we perform procedures to understand the entity's applicable legal and regulatory framework and how it complies with it along with other procedures that include inquiries, reading correspondence from relevant licensing or regulatory bodies and reports provided to those charged with governance regarding actual or suspected non-compliance, if any.

What mindset do we have while obtaining an understanding of the applicable legal and regulatory framework? [ISA | 3791.1500]

We focus on the information that could impact our identification and assessment of risks of material misstatements. Some information obtained about the legal and regulatory framework may reveal RMMs directly. Other information may give us insights about the entity that help us assess risks, and plan and execute the audit.

We also maintain a mindset of professional skepticism regarding the identification of actual or suspected non-compliance with indirect laws and regulations.

As we perform the procedures to obtain an understanding of the applicable legal and regulatory framework, it is helpful to ask:

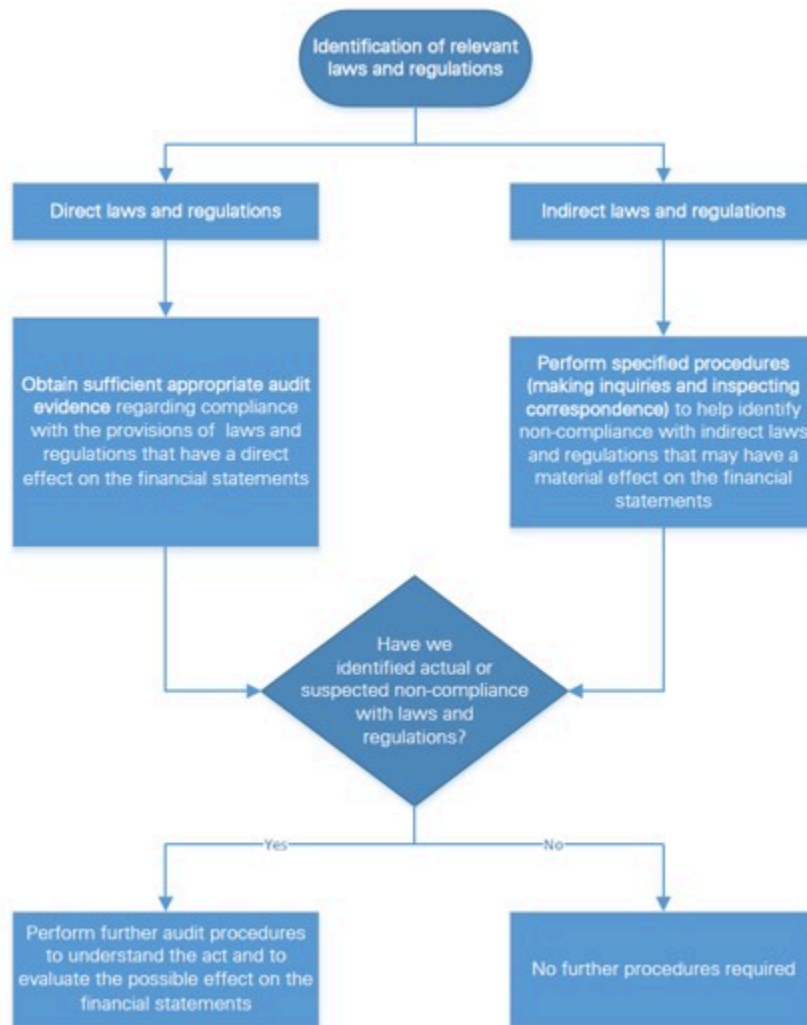
- What could this information tell me about the entity that might be useful?
- Does this relate to a law or regulation that has a direct impact to the financial statements?
- Does this relate to a law or regulation that has an indirect impact?
- Does this information highlight a risk that might cause a material misstatement?

How extensive is our understanding of the legal and regulatory environment? [ISA | 3791.1600]

Although it is judgmental, our main consideration is whether our understanding of the legal and regulatory framework is sufficient to identify and assess the RMMs.

What is the difference between our approach for relevant direct versus indirect laws and regulations? [ISA | 3791.13016]

The differences in our approach can be summarized as in the below flowchart. For either type, we remain alert to the possibility that other audit procedures applied may bring instances of actual or suspected non-compliance with laws and regulations.



2 Understand and inquire concerning compliance with laws and regulations [ISA | 3792]

What do we do?

Obtain an understanding and inquire of management and those charged with governance concerning compliance with laws and regulations, knowledge of violation of laws and regulations and policies to prevent illegal acts.

Obtain an understanding and inquire of management concerning compliance with laws and regulations and their knowledge of violation of laws and regulations.

Why do we do this?

We obtain an understanding of how the entity complies with its legal and regulatory framework and inquire regarding whether there are any known violations of that framework. We do this in order to help us identify and assess risks of material misstatement (RMM) and plan our audit.

Execute the Audit

How do we obtain an understanding of how the entity complies with its legal and regulatory framework?

[ISA | 3792.6384]

We obtain an understanding of how the entity complies with its legal and regulatory framework through risk assessment procedures such as inquiry and inspection.

Enhanced | What inquiries do we make regarding an entity's compliance with the applicable legal and regulatory framework? [ISA | 3792.6385]

We inquire about the following topics related to compliance with the applicable legal and regulatory framework:

Inquiry topic	Inquiry
Compliance with laws and regulations	<p>What are the entity's policies relative to the prevention of non-compliance with laws and regulations, including illegal acts?</p> <p>Does the entity use directives or periodic representations from management concerning compliance with laws and regulations?</p>
Knowledge of violations or possible violations of laws and regulations	<p>Have there been any instances of actual or possible violations of laws and regulations, including illegal acts (irrespective of materiality threshold)?</p> <p>For example, actual or possible non-compliance with anti-bribery laws (e.g., Foreign Corrupt Practices Act (FCPA), UK Anti-Bribery Laws)</p>

Core and Less Complex | What inquiries do we make regarding an entity's compliance with the applicable legal and regulatory framework? [ISA | 3792.6385]

When we inquire about the entity's compliance with the applicable legal and regulatory framework, we inquire whether there have been any instances of actual or possible violations of laws and regulations, including illegal acts (irrespective materiality)? For example, actual or possible non-compliance with anti-bribery laws (e.g., Foreign Corrupt Practices Act (FCPA), UK Anti-Bribery Laws).

What is an "illegal act"? [ISA | 3792.13024]

An "illegal act" is an act or omission that violates any law, or any rule or regulation having the force of law. Whether an act is, in fact, illegal is normally beyond our professional competence. Depending on the facts and circumstances, we may need to consult within the firm (specifically professionals that are qualified to practice law) to help us in evaluating whether an act is illegal.

Enhanced | Who do we inquire of regarding compliance with the applicable legal and regulatory framework? [ISA | 3792.6386]

We inquire of management and those charged with governance (e.g. the audit committee). Within management, this may include those who we normally interact with, such as the CFO, controller, financial reporting personnel, etc. Our inquiries also include those more familiar with compliance related activities, such as general counsel (or other legal personnel), the compliance officer, or internal audit.

We include those within management that we believe have knowledge about the entity's compliance with applicable laws and regulations.

Core and Less Complex | Who do we inquire of regarding compliance with the applicable legal and regulatory framework? [ISA | 3792.6386]

We inquire of management and, where appropriate, those charged with governance. Within management, this may include those who we normally interact with, such as the CFO, controller, financial reporting personnel, etc. Where relevant to the entity, our inquiries also include those more familiar with compliance related activities, such as general counsel (or other legal personnel), the compliance officer, or internal audit.

We include those within management that we believe have knowledge about the entity's compliance with applicable laws and regulations.

Who performs inquiries regarding compliance with the applicable legal and regulatory framework? [ISA | 3792.1500]

The engagement partner and/or engagement manager may be the appropriate person(s) to perform inquiries regarding compliance with the applicable legal and regulatory framework given their higher level of experience and increased level of knowledge and expertise regarding non-compliance with laws and regulations, including illegal acts.

When do we perform inquiries regarding compliance with the applicable legal and regulatory framework? [ISA | 3792.1600]

We perform these inquiries early in the audit, usually in conjunction with other risk assessment inquiries.

Do we update our inquiries regarding compliance with the applicable legal and regulatory framework throughout the audit? [ISA | 3792.13029]

Yes. We update our inquiries to reflect any changes to illegal acts or non-compliance with laws and regulations during the course of the audit, including at the end of the audit

What do we do when actual or possible non-compliance with laws and regulations, including illegal acts, is identified? [ISA | 3792.1700]

We evaluate the possible effect of actual or suspected non-compliance, including illegal acts.

What type of policies and procedures may an entity have in place to prevent or detect illegal acts? [ISA | 3792.1900]

An entity may have the following policies and procedures to prevent or detect non-compliance with laws and regulations, including illegal acts:

Prevention	Detection
Developing, publicizing and following a code of ethics or code of conduct	Monitoring compliance with the code of ethics or code of conduct Direct interaction and oversight of management
Ensuring employees are trained and understand the code of ethics or code of conduct	Internal audits or other compliance function audits Whistle-blower or other compliance/ethics hotlines and/or reporting
Legal function who monitor legal requirements and correspond with relevant licensing and regulatory bodies	Inquiries or questionnaires to those responsible for maintaining compliance with laws and regulations
Maintaining and communicating a register of significant laws and regulations which the entity has to comply with in its particular industry	Reconciliations of relevant information to supporting documentation

What is the impact on our risk assessment when an entity does not have formal policies and procedures in place? [ISA | 3792.13030]

A lack of formal policies and procedures does not automatically mean there is a higher risk of possible non-compliance with laws and regulations, including illegal acts. It may be acceptable for smaller or less complex entities to have more informal policies and procedures. Our inquiries may identify informal ways the entity communicates the importance of and monitors compliance with laws and regulations.

Enhanced | What is a directive concerning compliance with applicable laws and regulations? [ISA | 3792.13032]

A directive concerning compliance with applicable laws and regulations is a pronouncement on a policy or procedure, which encourages or discourages some activity.

Enhanced | What types of directives might an entity issue concerning compliance with applicable laws and regulations? [ISA | 3792.13033]

The entity may have directives concerning compliance with applicable laws and regulations, such as:

- Code of ethics or code of conduct, which outline employee duties for compliance with laws and regulations,
- Informal directives from management or those charged with governance on compliance with laws and regulations, including illegal acts.

Enhanced | What are periodic representations from management concerning compliance with applicable laws and regulations? [ISA | 3792.13034]

Periodic representations concerning compliance are written or oral representations from management to higher levels at the entity.

Enhanced | What form might periodic representations from management take concerning compliance with applicable laws and regulations? [ISA | 3792.13035]

Some entities may have internal questionnaires from those within the company to obtain representations regarding compliance with laws and regulations.

In larger entities, the entity may obtain questionnaires from its directors and officers (D&O questionnaires), which also typically contain questions about an individual's compliance with, or knowledge of actual or suspected non-compliance with, laws and regulations.

Enhanced | What is the appropriate level of management to make periodic representations concerning compliance with applicable laws and regulations? [ISA | 3792.13036]

The appropriate level of management to make periodic representations are those responsible for compliance with laws and regulations, including illegal acts. In this context, this typically includes those members of management responsible for the financial statements, including the accounting and finance personnel, and members of the legal department. In larger entities, this may include those charged with governance. Often this is done through completion of director and officer questionnaires.

3 Inspect correspondence with relevant licensing or regulatory bodies [ISA | 3793]

What do we do?

Inspect correspondence, if any, with the entity's relevant licensing or regulatory bodies

Why do we do this?

We review correspondence with licensing and regulatory bodies because such communications may inform our understanding of the relevant laws and regulations, or inform us of instances of illegal acts or non-compliance with laws and regulations.

Execute the Audit

What correspondence from licensing authorities and regulatory bodies do we inspect? [ISA | 3793.1300]

Correspondence from licensing authorities or regulatory bodies may take many forms, including:

- Publicly available information from the relevant regulatory body, for example, SEC Comment Letters
- Private correspondence from the relevant licensing authority or regulatory body, such as governmental agency inquiries or notices of investigation

How do we obtain correspondence from licensing authorities or regulatory bodies? [ISA | 3793.1400]

We inquire of management and those charged with governance as to there being any correspondence with licensing authorities or regulatory bodies, whether written or verbal. We also may inspect public information from the licensing authority or regulatory body relating to the entity.

[What procedures do we follow to review correspondence from regulators or licensing authorities?](#) [ISA | 3793.1500]

If there is such correspondence, then we obtain it, read it and understand its contents to determine whether it relates to possible illegal acts or non-compliance with laws and regulations.

[What are examples of licensing authorities or regulatory bodies the entity may have received correspondence from?](#)

Examples of licensing authorities or regulatory bodies the entity may have received correspondence include:

- U.S. Securities and Exchange Commission
- U.S. Food & Drug Administration
- U.K. Financial Conduct Authority
- Australian Securities and Investments Commission

There are many federal, local and industry regulators, depending on jurisdiction, each of which may have relevant laws and regulations applicable to the entity.

[When do we inspect correspondence from licensing authorities and regulatory bodies?](#) [ISA | 3793.1600]

We inspect the correspondence when we become aware of it.

[Is the volume of correspondence with licensing authorities or regulatory bodies indicative of the level of risk of misstatement?](#) [ISA | 3793.1700]

Some entity's correspondence with licensing or regulatory authorities is voluminous. This may not necessarily mean there is a risk of misstatement related to non-compliance with laws and regulations, including illegal acts.

[What do we do if correspondence with licensing authorities or regulators is voluminous?](#) [ISA | 3793.1800]

We use professional judgment in such circumstances to determine the extent of inspection that may identify instances of non-compliance.

For example, we consider:

- The nature of the entity
- The nature and type of correspondence received from the licensing or regulatory authority

We may consider other factors, for example:

- Areas of compliance or regulation that are more significant
- Areas of compliance or regulation where the entity has a history of non-compliance

We may also seek to obtain summaries of regulatory correspondence, if it exists, or inquire of management and others at the entity as to the substance of correspondence from regulators.

4 Obtain an understanding of how management is made aware of actual or suspected non-compliance [ISA | 3794]

What do we do?

Obtain an understanding of how management is made aware of actual or suspected non-compliance, including how information is collected, actioned and reported on

Why do we do this?

Understanding how management is made aware of actual or suspected non-compliance, such as a complaints process, informs our understanding of the entity's compliance with laws and regulations, including how they collect, action and report on this information. It also informs our assessment of risk of material misstatement.

Execute the Audit

How might management be made aware of actual or suspected non-compliance? [ISA | 3794.1300]

Depending on their size, nature, and complexity, management may be made aware of actual or suspected non-compliance in a variety of ways. Communication channels may include:

- A complaints or other similar process - e.g.:
 - Whistleblower hotline
 - Compliance or ethics hotline
 - Breach/ incident reporting process
- Other processes or mechanisms - e.g.:
 - Formal or informal feedback process where employees may raise concerns up to management (upward feedback process)
 - Direct interaction and oversight of management in the activities of the entity

What is a complaints process? [ISA | 3794.13019]

A complaints process is a communication channel that allows someone to voice concerns or provide information about a non-compliance matter.

For example, a whistleblower hotline may allow employees to raise complaints anonymously to management and/or those charged with governance. It may be a telephone line or e-mail mailbox or other form of communication channel.

What matters or complaints may be raised via a whistleblower hotline? [ISA | 3794.13020]

A whistleblower hotline allows an entity's employees, or other personnel, to alert the entity to and help to reduce the possibility of inappropriate or illegal actions.

Whistleblower hotlines can also serve as a method of reporting concerns when an issue has been brought up with a superior, but the person does not believe appropriate actions have been taken to resolve the problem.

SEC registrants listed on a US exchange are required by the Sarbanes-Oxley Act to establish procedures for employees to file confidential, anonymous internal whistleblower complaints.

What do we do to obtain an understanding of how management is made aware of actual or suspected non-compliance? [ISA | 3794.1400]

We obtain an understanding of how management is made aware of actual or suspect non-compliance, including how the information is collected, actioned and reported on through risk assessment procedures, including inquiry and inspection. For example, we may inspect examples of documents or summaries that are a part of the processes, if any, to understand how the communication flows and the information reported on.

When we obtain reports of matters reported to those charged with governance, if any, we may inquire to understand how those reports were produced. For example, do the non-compliance matters presented in the report include a complete listing of all matters, or is there a process to 'filter' those matters of importance to those charged with governance?

Matters that may be relevant to our understanding also, include:

- whether there is a defined structure for the reporting of non-compliance matters, for example, through a third party provider who routes the complaint to a delegated member of management or those charged with governance; or
- how non-compliance matters are identified, assessed, prioritized, investigated, actioned and reported on.

Who might we inquire of to obtain an understanding of how management is made aware of actual or suspected non-compliance? [ISA | 3794.13021]

We may inquire of management and/or those charged with governance regarding how management is made aware of actual or suspected non-compliance and how they collect, action and report that information. When we inquire of management, we inquire of those who are made aware of the actual or suspected non-compliance, which may vary depending on the size and complexity of the entity and its legal and regulatory framework. For some entities, this may be the CEO or financial controller and for others, this may be general counsel (or other legal personnel), a compliance officer, or internal audit director.

Do we obtain an understanding of complaints or other similar processes? [ISA | 3794.6388]

Not always. When we make inquiries regarding how management is made aware of actual or suspected non-compliance, we may determine that the entity does not use a complaints or other similar process. Management may primarily use other informal processes or mechanisms. We obtain an understanding of these processes or mechanisms to inform our knowledge of the entity's compliance with laws and regulations and consider their appropriateness for the size, nature, and complexity of the entity to inform our risk assessment.

5 Obtain reports from complaints or other similar processes, including hotlines, if applicable [ISA | 3795]

What do we do?

Obtain reports, if any, of matters reported to those charged with governance from the entity's complaints or other similar processes, including hotlines.

Why do we do this?

Obtaining and reading reports provided to those charged with governance may identify instances of actual or suspected non-compliance with laws and regulations or possible illegal acts that impact our risk assessment or the financial statements directly.

Execute the Audit

What information do we obtain from an entity's complaints or other similar processes, including hotlines?

[ISA | 3795.1300]

When the entity has implemented a complaints process or other similar process (e.g. whistle blower hotline or compliance/ethical hotline or reporting process), we obtain the information or reports provided to those charged with governance from those processes.

These reports may include information regarding actual or suspected non-compliance with laws and regulations or possible illegal acts as well as other matters that may not have a financial reporting consequence (e.g. HR or other interim policy violations).

Management (e.g. internal legal counsel, compliance or internal audit functions) and/or a third-party provider may provide these reports on a periodic basis to those charged with governance or the audit committee.

For smaller or less complex entities, there may not be any reporting to those charged with governance to obtain.

Do we obtain reports or other information from the entity's complaints or other similar processes that are not provided to those charged with governance? [ISA | 3795.13042]

We may, but not always. Our ultimate goal is to obtain a general understanding of non-compliance matters in order to appropriately inform our risk assessment and to understand how actual or suspected non-compliance may materially impact the financial statements. Obtaining and reading the reporting provided to those charged with governance may be sufficient for this purpose. However, we may determine it appropriate to also review other reporting not provided to those charged with governance to enhance our general understanding or to inform certain risks of material misstatement (e.g. the entity's history of non-compliance in a certain area).

What do we do with the reports from an entity's complaints processes? [ISA | 3795.1400]

We read them and look for instances of actual or suspected non-compliance with laws and regulations or possible illegal acts that could impact the audit.

[When do we obtain information from an entity's complaints processes?](#) [ISA | 3795.1500]

We obtain information and reports from the complaints processes throughout the audit, when it becomes available. For example, we may obtain reports during quarterly audit committee meetings.

We seek to obtain this information in a timely manner, so we can evaluate any implications to the audit on a timely basis, including any interim reviews, if applicable.

6 Obtain audit evidence when compliance with laws and regulations has a direct and material impact [ISA | 3799]

What do we do?

Obtain sufficient and appropriate audit evidence when compliance with laws and regulations has a direct and material impact on the determination of financial statement amounts and disclosures.

Why do we do this?

Certain laws and regulations have a direct effect on financial statement amounts and disclosures. For example, tax laws that affect accruals and the amount recognized as expense in the current period, or pension laws and regulations.

As auditor, our responsibility to detect and report misstatements resulting from non-compliance with laws and regulations, including illegal acts, having a direct effect on the determination of material amounts and disclosures in the financial statements is the same as for any misstatement. We respond by obtaining sufficient appropriate audit evidence that relates to those laws and regulations having a direct effect on the financial statements.

Execute the Audit

[How do we obtain sufficient appropriate audit evidence relating to laws and regulations that have a direct material impact on the determination of financial statement amounts and disclosures?](#) [ISA | 3799.1300]

Where RMMs have been identified related to a law or regulation, we [perform procedures to respond to those RMMs](#). Similar to the audit response to any other RMM, we obtain sufficient, appropriate audit evidence to address the risk of material misstatement.

7 Ascertain whether non-compliance with laws and regulations, including illegal acts, has occurred [ISA |

3800]

What do we do?

IF specific information comes to our attention concerning an instance of actual or suspected non-compliance with laws and regulations, including a possible illegal act, that could have a material effect on the financial statements, THEN perform audit procedures to ascertain whether such an act has occurred and if so, the nature of the act and the effect on the financial statements.

Why do we do this?

We apply due professional care throughout the audit, which includes being alert as to the possibility of non-compliance or suspected non-compliance with laws and regulations, including illegal acts.

Normally, an audit does not include audit procedures specifically designed to detect such matters. However, procedures performed throughout the audit, including inquiry, inspection of documents or other procedures may bring them to our attention.

When we become aware of the existence of non-compliance or suspected non-compliance with laws and regulations, including illegal acts, we perform audit procedures to ascertain if an illegal act has occurred and consider the impact on our audit, specifically the identification of risks of material misstatement.

Execute the Audit

How might we identify possible non-compliance with laws and regulations, including illegal acts? [ISA | 3800.1300]

We remain aware throughout the audit as to the possibility of non-compliance with laws and regulations, including illegal acts. As we respond to the risks of material misstatement throughout the audit, we may become aware of actual or suspected non-compliance or illegal acts. For example, we may identify such matters through reading minutes or whistleblower reports, through inquiries of management, or through external sources.

How do we remain aware of the possibility that non-compliance with laws and regulations including illegal acts may have occurred? [ISA | 3800.13040]

Throughout our audit, when we receive information, make inquiries and perform procedures, we apply professional skepticism. This means we keep in mind the possibility that non-compliance with laws and regulations, including illegal acts, may have occurred.

What is each engagement team member's responsibility with regards to being aware that non-compliance with laws and regulations, including illegal acts, may have occurred? [ISA | 3800.13039]

Each individual involved in the engagement is responsible for being aware of the possibility that non-compliance with laws and regulations, including illegal acts, may have occurred.

The engagement partner is responsible for setting an appropriate tone that promotes maintaining a questioning mind throughout the audit and exercising professional skepticism in gathering and evaluating audit evidence.

What procedures do we perform if specific information comes to our attention concerning the existence of possible non-compliance with laws and regulations, including an illegal act, that could have a material effect on the financial statements? [ISA | 3800.1400]

If specific information comes to our attention concerning the existence of possible non-compliance with laws and regulations, including illegal acts, that could have a material effect on the financial statements, we perform the following procedures to ascertain whether the act has occurred.

Procedure	Examples of relevant questions about the possible non-compliance with laws and regulations, including illegal acts
Inquire of management regarding the nature of the act, the circumstances in which it occurred and other information related to the act.	<ul style="list-style-type: none"> • What happened? • How did it happen? • Who was involved? • Who within the entity had knowledge of it? • When did it occur? • How long has it been happening? • Is it continuing?
Obtain sufficient other information to evaluate the effect on the financial statements.	<ul style="list-style-type: none"> • What is the actual or potential monetary impact? • What accounts are impacted? • What are the financial consequences of non-compliance, or the illegal act, on the financial statements? • Are there any governmental agencies involved or need to be involved? • Are there any fines, penalties, damages, threats of litigation, expropriation of assets, enforced discontinuation of operations, etc?
Inquire of management regarding their responses to the illegal act and the need for investigation	<ul style="list-style-type: none"> • Does management believe an investigation is warranted? • If not, why not? • What remedial actions have been taken or are planned?

Who do we inquire of concerning the existence of possible non-compliance with laws and regulations, including illegal acts? [ISA | 3800.1500]

We inquire of an appropriate level of management, but at least one level above the person(s) involved.

What do we do if we suspect non-compliance with laws or regulations has occurred? [ISA | 3800.1600]

If we suspect there may be non-compliance, we discuss the entity's approach for further investigation and what those charged with governance have concluded regarding the need for an investigation. These discussions are held with the appropriate level of management and, when appropriate, those charged with governance.

What do we do if prohibited by law from inquiring of management concerning their response to suspected non-compliance? [ISA | 3800.1700]

We consult with the risk management partner within the firm to determine our approach to the matter.

When do we make inquiries regarding possible non-compliance with laws and regulations including illegal acts? [ISA | 3800.1800]

As soon as practicable once we become aware of the existence of a possible non-compliance with laws and regulations, including illegal acts.

If management does not provide satisfactory information that there has been no act of non-compliance, what do we do? [ISA | 3800.1900]

We perform additional procedures to determine whether there has been an act of non-compliance or illegal act.

What do we do if there are no actual or suspected non-compliance matters? [ISA | 3800.13038]

In the absence of any actual or suspected non-compliance matters, no further procedures are necessary beyond those performed to understand the entity and its environment, to identify actual or suspected non-compliance, and requesting written representations from management regarding the entity's compliance with laws and regulations.

8 Obtain written representations regarding instances of actual or suspected non-compliance with laws and regulations [ISA | 7907]

What do we do?

Obtain written representations regarding instances of actual or suspected non-compliance with laws and regulations.

Why do we do this?

Because the effect on financial statements of laws and regulations can vary considerably, written representations provide necessary audit evidence about management's knowledge of identified or suspected non-compliance with laws and regulations, including illegal acts, whose effects may have a material effect on the financial statements.

Execute the audit

Who and when do we request written representations from in relation to instances of actual or suspected non-compliance, including illegal acts? [ISA | 7907.9290]

We always request written representations from management.

We may also request written representations from those charged with governance, if it is appropriate in the circumstances, such as:

- When those charged with governance have not commissioned an investigation into non-compliance and they have concluded that further investigation is not considered necessary;
- When those charged with governance have commissioned an investigation into non-compliance and the investigation team is reporting directly to those charged with governance.

What written representations do we request from management regarding instances of actual or suspected non-compliance? [ISA | 7907.9292]

We obtain written representation from management that all known instances of actual or suspected non-compliance with laws and regulations, including illegal acts, whose effects are necessary to be considered when preparing financial statements have been disclosed to us.

We use our member firm's example management representation letter templates, if available, or the example management representation letter templates in Alex.

Audit Procedures When Non-Compliance Is Identified or Suspected

International Standards on Auditing: ISA 250.19-22

Audit Procedures When Non-Compliance Is Identified or Suspected

19. If the auditor becomes aware of information concerning an instance of non-compliance or suspected non-compliance with laws and regulations, the auditor shall obtain: (Ref: Para. A17 - A18)

- (a) An understanding of the nature of the act and the circumstances in which it has occurred; and
- (b) Further information to evaluate the possible effect on the financial statements. (Ref: Para. A19)

20. If the auditor suspects there may be non-compliance, the auditor shall discuss the matter, unless prohibited by law or regulation, with the appropriate level of management and, where appropriate, those charged with governance. If management or, as appropriate, those charged with governance do not provide sufficient information that supports that the entity is in compliance with laws and regulations and, in the auditor's judgment, the effect of the suspected non-compliance may be material to the financial statements, the auditor shall consider the need to obtain legal advice. (Ref: Para. A20 - A22)

21. If sufficient information about suspected non-compliance cannot be obtained, the auditor shall evaluate the effect of the lack of sufficient appropriate audit evidence on the auditor's opinion.

22. The auditor shall evaluate the implications of identified or suspected non-compliance in relation to other aspects of the audit, including the auditor's risk assessment and the reliability of written representations, and take appropriate action. (Ref: Para. A23 - A25)

ISA Application and Other Explanatory Material: ISA 250.A17-A25

Audit Procedures When Non-Compliance Is Identified or Suspected

Indications of Non-Compliance with Laws and Regulations (Ref: Para. 19)

A17. The auditor may become aware of information concerning an instance of non-compliance with laws and regulations other than as a result of performing the procedures in paragraphs 13 - 17 (e.g., when the auditor is alerted to non-compliance by a whistle blower).

A18. The following matters may be an indication of non-compliance with laws and regulations:

- Investigations by regulatory organizations and government departments or payment of fines or penalties.
- Payments for unspecified services or loans to consultants, related parties, employees or government employees.
- Sales commissions or agent's fees that appear excessive in relation to those ordinarily paid by the entity or in its industry or to the services actually received.
- Purchasing at prices significantly above or below market price.
- Unusual payments in cash, purchases in the form of cashiers' checks payable to bearer or transfers to numbered bank accounts.
- Unusual transactions with companies registered in tax havens.
- Payments for goods or services made other than to the country from which the goods or services originated.
- Payments without proper exchange control documentation.
- Existence of an information system which fails, whether by design or by accident, to provide an adequate audit trail or sufficient evidence.
- Unauthorized transactions or improperly recorded transactions.
- Adverse media comment.

Matters Relevant to the Auditor's Evaluation (Ref: Para. 19(b))

A19. Matters relevant to the auditor's evaluation of the possible effect on the financial statements include:

- The potential financial consequences of identified or suspected non-compliance with laws and regulations on the financial statements including, for example, the imposition of fines, penalties, damages, threat of expropriation of assets, enforced discontinuation of operations, and litigation.
- Whether the potential financial consequences require disclosure.
- Whether the potential financial consequences are so serious as to call into question the fair presentation of the financial statements, or otherwise make the financial statements misleading.

Audit Procedures and Communicating Identified or Suspected Non-Compliance with Management and Those Charged with Governance (Ref: Para. 20)

A20. The auditor is required to discuss the suspected non-compliance with the appropriate level of management and, where appropriate, those charged with governance, as they may be able to provide additional audit evidence. For example, the auditor may confirm that management and, where appropriate, those charged with governance have the same understanding of the facts and circumstances relevant to transactions or events that have led to the suspected non-compliance with laws and regulations.

A21. However, in some jurisdictions, law or regulation may restrict the auditor's communication of certain matters with management and those charged with governance. 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, including alerting the entity, for example, when the auditor is required to report the identified or suspected non-compliance to an appropriate authority pursuant to anti-money laundering legislation. In these circumstances, the issues considered by the auditor may be complex and the auditor may consider it appropriate to obtain legal advice.

A22. If management or, as appropriate, those charged with governance do not provide sufficient information to the auditor that the entity is in fact in compliance with laws and regulations, the auditor may consider it appropriate to consult with the entity's in-house or external legal counsel about the application of the laws and regulations to the circumstances, including the possibility of fraud, and the possible effects on the financial statements. If it is not considered appropriate to consult with the entity's legal counsel or if the auditor is not satisfied with the legal counsel's opinion, the auditor may consider it appropriate to consult on a confidential basis with others within the firm, a network firm, a professional body, or with the auditor's legal counsel as to whether a contravention of a law or regulation is involved, including the possibility of fraud, the possible legal consequences, and what further action, if any, the auditor would take.

Evaluating the Implications of Identified or Suspected Non-Compliance (Ref: Para. 22)

A23. As required by paragraph 22, the auditor evaluates the implications of identified or suspected non-compliance in relation to other aspects of the audit, including the auditor's risk assessment and the reliability of written representations. The implications of particular identified or suspected non-compliance will depend on the relationship of the perpetration and concealment, if any, of the act to specific controls and the level of management or individuals working for, or under the direction of, the entity involved, especially implications arising from the involvement of the highest authority within the entity. As noted in paragraph 9, the auditor's compliance with law, regulation or relevant ethical requirements may provide further information that is relevant to the auditor's responsibilities in accordance with paragraph 22.

A24. Examples of circumstances that may cause the auditor to evaluate the implications of identified or suspected non-compliance on the reliability of written representations received from management and, where applicable, those charged with governance include when:

- The auditor suspects or has evidence of the involvement or intended involvement of management and, where applicable, those charged with governance in any identified or suspected non-compliance.
- The auditor is aware that management and, where applicable, those charged with governance have knowledge of such non-compliance and, contrary to legal or regulatory requirements, have not reported, or authorized reporting of, the matter to an appropriate authority within a reasonable period.

A25. In certain circumstances, the auditor may consider withdrawing from the engagement, where permitted by law or regulation, for example when management or those charged with governance do not take the remedial action that the auditor considers appropriate in the circumstances or the identified or suspected non-compliance raises questions regarding the integrity of management or those charged with governance, even when the non-compliance is not material to the financial statements. The auditor may consider it appropriate to obtain legal advice to determine whether withdrawal from the engagement is appropriate. When the auditor determines that withdrawing from the engagement would be appropriate, doing so would not be a substitute for complying with other responsibilities under

law, regulation or relevant ethical requirements to respond to identified or suspected non-compliance. Furthermore, paragraph A55 of ISA 220 (Revised)¹⁴ indicates that some ethical requirements may require the predecessor auditor, upon request by the proposed successor auditor, to provide information regarding non-compliance with laws and regulations to the successor auditor.

14 ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*

How do we comply with the Standards? [ISA | KAEGHDWC]

1 Ascertain whether non-compliance with laws and regulations, including illegal acts, has occurred [ISA |

3800]

What do we do?

IF specific information comes to our attention concerning an instance of actual or suspected non-compliance with laws and regulations, including a possible illegal act, that could have a material effect on the financial statements, THEN perform audit procedures to ascertain whether such an act has occurred and if so, the nature of the act and the effect on the financial statements.

Why do we do this?

We apply due professional care throughout the audit, which includes being alert as to the possibility of non-compliance or suspected non-compliance with laws and regulations, including illegal acts.

Normally, an audit does not include audit procedures specifically designed to detect such matters. However, procedures performed throughout the audit, including inquiry, inspection of documents or other procedures may bring them to our attention.

When we become aware of the existence of non-compliance or suspected non-compliance with laws and regulations, including illegal acts, we perform audit procedures to ascertain if an illegal act has occurred and consider the impact on our audit, specifically the identification of risks of material misstatement.

Execute the Audit

How might we identify possible non-compliance with laws and regulations, including illegal acts? [ISA | 3800.1300]

We remain aware throughout the audit as to the possibility of non-compliance with laws and regulations, including illegal acts. As we respond to the risks of material misstatement throughout the audit, we may become aware of actual or suspected non-compliance or illegal acts. For example, we may identify such matters through reading minutes or whistleblower reports, through inquiries of management, or through external sources.

How do we remain aware of the possibility that non-compliance with laws and regulations including illegal acts may have occurred? [ISA | 3800.13040]

Throughout our audit, when we receive information, make inquiries and perform procedures, we apply professional skepticism. This means we keep in mind the possibility that non-compliance with laws and regulations, including illegal acts, may have occurred.

What is each engagement team member's responsibility with regards to being aware that non-compliance with laws and regulations, including illegal acts, may have occurred? [ISA | 3800.13039]

Each individual involved in the engagement is responsible for being aware of the possibility that non-compliance with laws and regulations, including illegal acts, may have occurred.

The engagement partner is responsible for setting an appropriate tone that promotes maintaining a questioning mind throughout the audit and exercising professional skepticism in gathering and evaluating audit evidence.

What procedures do we perform if specific information comes to our attention concerning the existence of possible non-compliance with laws and regulations, including an illegal act, that could have a material effect on the financial statements? [ISA | 3800.1400]

If specific information comes to our attention concerning the existence of possible non-compliance with laws and regulations, including illegal acts, that could have a material effect on the financial statements, we perform the following procedures to ascertain whether the act has occurred.

Procedure	Examples of relevant questions about the possible non-compliance with laws and regulations, including illegal acts
Inquire of management regarding the nature of the act, the circumstances in which it occurred and other information related to the act.	<ul style="list-style-type: none"> • What happened? • How did it happen? • Who was involved? • Who within the entity had knowledge of it? • When did it occur? • How long has it been happening? • Is it continuing?
Obtain sufficient other information to evaluate the effect on the financial statements.	<ul style="list-style-type: none"> • What is the actual or potential monetary impact? • What accounts are impacted? • What are the financial consequences of non-compliance, or the illegal act, on the financial statements? • Are there any governmental agencies involved or need to be involved? • Are there any fines, penalties, damages, threats of litigation, expropriation of assets, enforced discontinuation of operations, etc?

Inquire of management regarding their responses to the illegal act and the need for investigation	<ul style="list-style-type: none"> • Does management believe an investigation is warranted? • If not, why not? • What remedial actions have been taken or are planned?
---	---

Who do we inquire of concerning the existence of possible non-compliance with laws and regulations, including illegal acts? [ISA | 3800.1500]

We inquire of an appropriate level of management, but at least one level above the person(s) involved.

What do we do if we suspect non-compliance with laws or regulations has occurred? [ISA | 3800.1600]

If we suspect there may be non-compliance, we discuss the entity's approach for further investigation and what those charged with governance have concluded regarding the need for an investigation. These discussions are held with the appropriate level of management and, when appropriate, those charged with governance.

What do we do if prohibited by law from inquiring of management concerning their response to suspected non-compliance? [ISA | 3800.1700]

We consult with the risk management partner within the firm to determine our approach to the matter.

When do we make inquiries regarding possible non-compliance with laws and regulations including illegal acts? [ISA | 3800.1800]

As soon as practicable once we become aware of the existence of a possible non-compliance with laws and regulations, including illegal acts.

If management does not provide satisfactory information that there has been no act of non-compliance, what do we do? [ISA | 3800.1900]

We perform additional procedures to determine whether there has been an act of non-compliance or illegal act.

What do we do if there are no actual or suspected non-compliance matters? [ISA | 3800.13038]

In the absence of any actual or suspected non-compliance matters, no further procedures are necessary beyond those performed to understand the entity and its environment, to identify actual or suspected non-compliance, and requesting written representations from management regarding the entity's compliance with laws and regulations.

2 Perform additional procedures if satisfactory information is not provided [ISA | 3801]

What do we do?

IF management does not provide satisfactory information that there has not been an illegal act, THEN consult with client's legal counsel or other management's specialist and perform additional procedures.

Why do we do this?

When management does not provide satisfactory information that there has been no illegal act, we perform additional procedures to determine the impact on the audit.

Execute the Audit

What procedures do we perform when management does not provide satisfactory information that there has been no non-compliance with laws and regulations, including illegal acts? [ISA | 3801.1300]

If management does not provide satisfactory information that there has been no act of non-compliance, then perform the following procedures:

- [Consult with the client's legal counsel and other professionals about the application of relevant laws and regulations to the possible act and the possible effects on the financial statements](#)
- [If necessary, apply additional procedures to obtain further understanding of the nature of the acts](#)

2.1 Consult with the client's legal counsel and other professionals [ISA | 3802]

What do we do?

Consult with the client's legal counsel and other professionals about the application of relevant laws and regulations to the possible instance of non-compliance and the possible effects on the financial statements.

Why do we do this?

We consult with the entity's legal counsel to understand how the possible instance of non-compliance, including an illegal act, deviates from the laws and regulations governing the entity.

Whether an act is, in fact, illegal or an instance of non-compliance is a determination that is normally beyond the auditor's professional competence. Although our training, experience and understanding of the client may give us an understanding of the possible implications arising from an act of non-compliance, we obtain an understanding from those qualified to make a legal analysis.

Execute the Audit

In what circumstances do we consult with the client's legal counsel concerning possible non-compliance with laws and regulations including an illegal act? [ISA | 3802.1300]

We consult if management does not provide satisfactory information that there has been no instance of actual or suspected non-compliance with laws and regulations, including an illegal act.

How do we consult with the client's legal counsel concerning possible non-compliance with laws and regulations including an illegal act? [ISA | 3802.1400]

The audit client arranges the discussion between the engagement team and their legal counsel, which may be internal or external.

We may obtain written or verbal information from the client's legal counsel.

[Is an entity's legal counsel that we consult considered to be a specialist?](#) [ISA | 3802.13043]

Generally yes. If the legal counsel has assisted the entity in the determination of amounts or disclosures in the financial statements in relation to an actual or suspected non-compliance matter that is not clearly inconsequential, and the legal counsel's evaluation is used as audit evidence, we evaluate the legal counsel in accordance with activity '[Evaluate the work of a management's specialist](#)'

[Who else may we consult with concerning possible non-compliance with laws and regulations including an illegal act?](#) [ISA | 3802.1500]

Depending on the facts and circumstances of the possible non-compliance with laws or regulations, including illegal act, we may need to consult with others who have specific knowledge at the entity. Beyond the client's legal counsel, others may include:

- environmental professionals,
- those with statutory or regulatory expertise,
- actuaries or those with other financial expertise, and
- others with subject matter expertise relevant to the underlying laws and regulations.

2.2 Apply additional procedures to further our understanding [ISA | 3803]

What do we do?

IF necessary, THEN apply additional procedures to obtain further understanding of the nature of the possible non-compliance with laws and regulations including illegal acts.

Why do we do this?

Further procedures including examining supporting documents or confirming information with intermediaries may provide additional information regarding a potential non-compliance matter or illegal act.

Execute the Audit

[When do we perform additional procedures concerning possible non-compliance with laws and regulations including illegal acts?](#) [ISA | 3803.1300]

We perform additional procedures when management or its legal counsel has not provided sufficient information that there has been no instance of non-compliance.

[What additional procedures might we perform concerning possible non-compliance with laws and regulations including illegal acts?](#) [ISA | 3803.1400]

Our additional procedures could include:

- discussing with the entity's in-house or external legal counsel the application of the laws and regulations to the circumstances, including the possibility of fraud

- examining supporting documents (e.g. invoices, cancelled checks, agreements) and comparing with accounting records
- confirming significant information with the other party to the transaction or with intermediaries
- determining whether the transaction has been properly authorized
- considering whether other similar transactions may have occurred and applying procedures to identify them

What procedures may we perform to confirm information regarding possible non-compliance, including illegal acts? [ISA | 3803.13055]

We may perform the following to confirm information regarding a possible instance of non-compliance, including illegal acts:

Who we confirm information with	What information we might confirm
<p>Examples of parties that we may confirm significant information with include:</p> <ul style="list-style-type: none"> • Intermediaries • Banks • Customers • Lawyers 	<p>Examples of information that could be confirmed include:</p> <p>Terms of contracts, such as:</p> <ul style="list-style-type: none"> • existence of the contract, • accuracy of the parties involved, • effective date, • quantities of goods sold, • receivable or payable amounts.

Why do we determine whether a suspicious transaction has been authorized and approved in accordance with the entity's established policies and procedures? [ISA | 3803.13058]

A transaction giving rise to suspicion of non-compliance with laws and regulations, including illegal acts, that has not been authorized and approved in accordance with the entity's established policies and procedures may be an indicator that the transaction is indicative of non-compliance. Further, where these transactions have not been authorized and approved in accordance with the entity's established policies, this may be an indicator that the transaction may have been entered into to engage in fraud or other deceptive behavior.

How do we determine whether the suspicious transaction was properly authorized? [ISA | 3803.13059]

We inspect the supporting documentation for the transaction for evidence of authorization, in line with the entity's established policies and procedures. We may also inquire of those personnel involved in the transaction, and management, including the entity's legal counsel.

What do we do if the suspicious transaction was not properly authorized? [ISA | 3803.13060]

We consider how this impacts the determination of whether the transaction was an illegal act or evidence of possible non-compliance with laws and regulations.

What types of procedures could we perform to identify other similar suspicious transactions? [ISA | 3803.13061]

We may perform the following types of procedures:

- Inquiries of management or others at the entity (for example, Accounting or Finance personnel, Internal Audit or In-house Counsel)
- Data analysis, for example, searching for transactions initiated or approved by an individual, or transactions with a similar customer with other similar characteristics
- Involve forensic specific team member(s) to assist us in identifying similar transactions at the entity

[What do we do if we identify other similar suspicious transactions?](#) [ISA | 3803.13062]

We consider the impact of these other transactions, including whether they are also indicative of other illegal acts or non-compliance with laws and regulations.

[What do we do with the results of these additional procedures regarding a possible instance of non-compliance including an illegal act?](#) [ISA | 3803.1500]

We consider the results in our understanding of whether non-compliance, including illegal acts, has occurred. Further, we use the results of these additional procedures in determining the impact to the audit.

[What do we do if, after additional procedures are performed, we are not able to determine whether an illegal act has occurred?](#) [ISA | 3803.1600]

We [consult with the appropriate parties](#) within the firm to determine our approach to the matter.

3 Evaluate the possible effect of actual or suspected non-compliance, including illegal acts [ISA |

3804]

What do we do?

IF we determine an act of non-compliance, including an illegal act, has or is likely to have occurred, THEN perform additional procedures.

Why do we do this?

Where we determine an instance of non-compliance, including an illegal act, has or is likely to have occurred, we perform additional procedures to consider the impact of the act on the financial statements. We do this because the instance of non-compliance or illegal act may result in the financial statements being materially misstated and, consequently, impact our audit opinion.

Execute the Audit

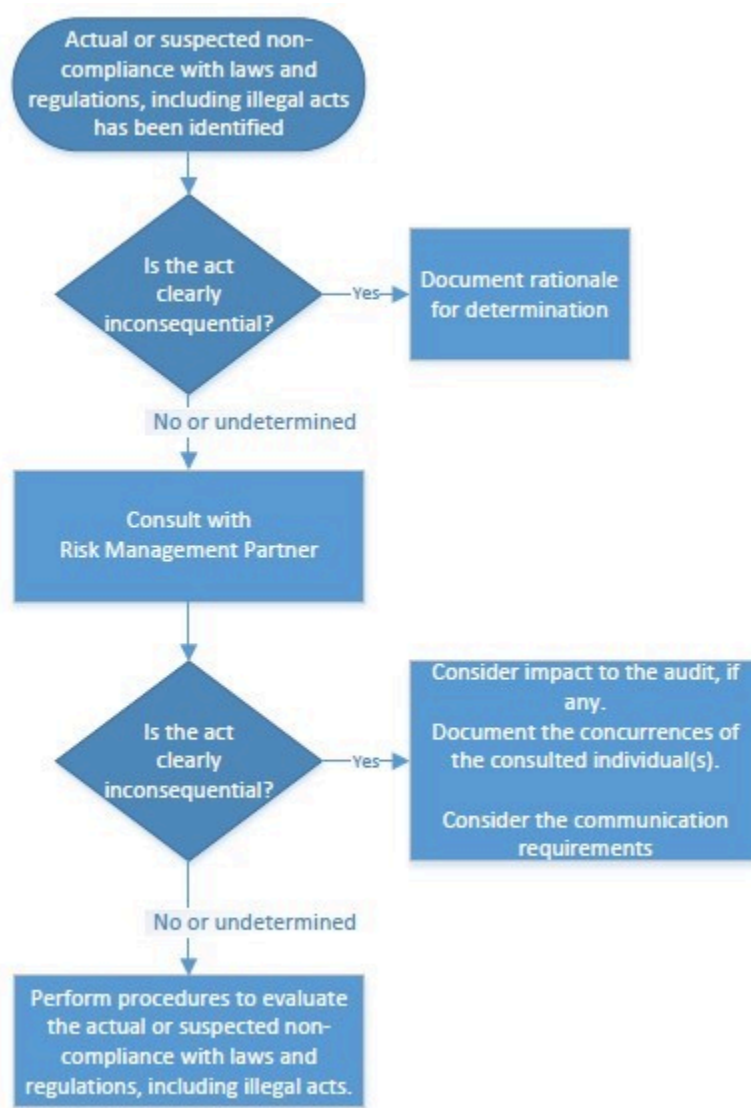
[What additional procedures do we perform when we determine an instance of non-compliance, including an illegal act, has or is likely to have occurred?](#) [ISA | 3804.1300]

If we determine an instance of non-compliance, including an illegal act, has or is likely to have occurred, we:

- [Consider the effect on the financial statements](#), including adequacy of relevant disclosures

- [Assess the significance of the matter](#)
- [Consider the implications on other aspects of the audit](#)

Our considerations and procedures as it relates to our evaluation of identified instances of actual or suspected non-compliance with laws and regulations, including illegal acts, can be summarized as follows:



3.1 Consider the effect of non-compliance, including illegal acts, on the financial statements [ISA |

3805]

What do we do?

Consider the effect of the non-compliance, including illegal acts, on the amounts presented in the financial statements and the adequacy of the relevant disclosures.

Why do we do this?

We consider the effect of an instance of non-compliance, including illegal acts, on the amounts and disclosures in the financial statements in determining the significance of the matter. Disclosures can be relevant because, illegal acts or non-compliance with laws and regulations may impact material revenue transactions or earnings streams, such as a significant business relationship, which may require disclosure.

Execute the Audit

What are the potential effects of an instance of non-compliance, including an illegal act, on the financial statements? [ISA | 3805.1300]

Illegal acts can affect the amounts presented in the financial statements, as well as disclosures in the financial statements of the potential effects of the illegal act.

Potential financial consequences from non-compliance with laws and regulations, including illegal acts, may include:

- Fines, penalties, damages, taxes
- Forced closure or jurisdictional sanction
- Litigation, including contingencies

How do we consider the effect of an instance of non-compliance, including an illegal act, on the financial statements? [ISA | 3805.1400]

We think about what implications the act of non-compliance could have for the entity, including the possible effects of any fines, penalties, etc. This could include impacts to the entity's ability to operate their business, obtain new customers, etc.

In considering the effects, we think about what this means with respect to the amounts presented in the financial statements (e.g. contingent liabilities), as well as the adequacy of the disclosures.

How do we consider the materiality of the impact of the instance of non-compliance, including an illegal act, on the financial statements? [ISA | 3805.13044]

We consider both the quantitative and the qualitative impact of materiality when evaluating the impact of the act on the financial statements. We also consider whether the non-compliance, including illegal acts, is a public interest matter.

Could the effect be qualitatively material even if it is not quantitatively material? [ISA | 3805.13045]

Yes. While we may consider the amount to be not quantitatively material, there may be other qualitative factors that suggest it is still material.

Examples of qualitative matters include:

- misstatements involving fraud, or intentional acts of non-compliance with laws and regulations, including illegal acts;
- the potential effect of a misstatement on:
 - the compliance with loan covenants;
 - management's compensation - e.g., bonuses;
 - key metrics or KPIs - e.g., earnings per share;

- matters requiring communication to those charged with governance;
- whether it relates to a public interest matter; and
- misstatements that change a loss into income or vice versa.

The presence of one or more of these qualitative matters may be an indicator that the non-compliance, including illegal acts, is not clearly inconsequential.

[In what circumstances is an instance of non-compliance, including an illegal act, deemed to be a public interest matter?](#) [ISA | 3805.13046]

A public interest matter is one that involves acts whose effects are not necessarily quantitatively material, but because of the serious nature of the activity, actual or potential substantial harm might be caused to investors, creditors, employees or the general public.

Examples of public interest matters may include fraud resulting in substantial financial harm to investors, breaches of environmental laws and regulations endangering the health and safety of employees or the public, or products that are harmful to public health or safety if likely to be sold by the entity.

[What if we are aware of a misstatement in the financial statements related to the non-compliance, including illegal acts?](#) [ISA | 3805.13047]

When a misstatement is identified, we start [accumulating, communicating and evaluating](#) it.

[What else do we evaluate?](#) [ISA | 3805.1500]

We also evaluate whether the potential financial consequences are so serious as to call into question the fair presentation of the financial statements, or otherwise make the financial statements misleading.

[How do we evaluate the adequacy of disclosure of the potential effects of the instance of non-compliance, including an illegal act, on the entity's operations?](#) [ISA | 3805.1600]

We think about what may impact the financial statements related to the illegal act or non-compliance with laws and regulations. Depending on our procedures to obtain an understanding of the illegal act, or non-compliance, we may be aware of certain implications that the entity should disclose.

For example, through inquiries with the company's legal counsel, we may become aware of the fact that due to non-compliance with regulations, the entity has lost the ability to export goods to a certain country. This could mean the loss of business to a significant customer or revenue stream. Given the significance of this to the entity's operations, the engagement team may determine the matter should be disclosed in the financial statements.

If the illegal act creates significant unusual risks associated with material revenue or earnings, such as loss of a significant business relationship, that information is considered for disclosure.

[What happens if management fails to disclose information relevant to an instance of non-compliance, including an illegal act, in the financial statements?](#) [ISA | 3805.13049]

If we are aware of relevant information related to an instance of non-compliance, including illegal acts, the entity should disclose, we request the entity to disclose such information. If management fails

to disclose the relevant information in the financial statements, it constitutes a misstatement. If the uncorrected misstatement is material to the financial statements, we consider whether to express a qualified or adverse opinion, depending on the pervasiveness of the matter.

3.2 Assess the significance of the instance of actual or suspected non-compliance, including illegal acts [ISA | 3806]

What do we do?

IF an instance of actual or suspected non-compliance, including an illegal act, has occurred THEN assess the significance, including by consultation with relevant parties.

Why do we do this?

If we determine that an illegal act or an instance of actual or suspected non-compliance with laws and regulations, has occurred, then the engagement partner forms an assessment of the significance of the matter, including consultations where appropriate.

We consult to involve those with significant experience in such matters to determine the best course of action.

Execute the Audit

Who assesses the significance of the instance of actual or suspected non-compliance or illegal act? [ISA | 3806.13080]

The engagement partner forms an initial assessment of whether the matter is clearly inconsequential.

What are some considerations in determining the significance of the instance of actual or suspected non-compliance, including illegal acts, to the audit? [ISA | 3806.13082]

Where the amounts involved, or the potential amounts involved, are material to the financial statements, the matter is of significance to the audit and is not clearly inconsequential.

Alternatively, an act may be of significance to the audit and therefore not clearly consequential due to its nature even though the amounts involved are not quantitatively material, for example non-compliance with laws and regulations by senior management or intentional acts.

Are there any indicators that an instance of actual or suspected non-compliance, including an illegal act, may be 'clearly inconsequential'? [ISA | 3806.9401]

An act may be "clearly inconsequential" to the audit if:

- it involves non-management personnel, and
- the entity has properly addressed the matter(s) in the ordinary course of business.

If an act does not result in any implications to our audit, it may also be an indication that the act is "clearly inconsequential" to the audit.

Examples of actual or suspected non-compliance with laws and regulations, including illegal acts, that may be considered "clearly inconsequential" include cash or product misappropriation by non-management personnel.

If the instance of actual or suspected non-compliance is clearly inconsequential, what are the next steps?

[ISA | 3806.1500]

We:

- (1) document the rationale for the matter being clearly inconsequential, and
- (2) consider communication with those charged with governance. We are not required to communicate matters determined to be clearly inconsequential; however, we still may wish to inform those charged with governance if the circumstances warrant.

After completing these steps, no further action is required.

What if an instance of actual or suspected non-compliance or illegal act is not clearly inconsequential, or we can't make a determination? [ISA | 3806.1600]

We consult with DPP and the risk management partner and [perform additional steps](#) to further evaluate the actual or suspected non-compliance with laws and regulations, including illegal acts.

In addition, as part of our consultation, due to the sensitivity of the matter(s), the engagement partner, in coordination (i.e., in discussion and with concurrence) with the Risk Management Partner, performs the requirements set out in [14.2.6](#) <https://www.gqrrm-prod.kworld.kpmg.com/G/0/Content/233> of the GQ&RRM.

What if we become aware of an instance of actual or suspected non-compliance including an illegal act that causes potential substantial harm to investors, creditors, employees or the general public that have not been publicly disclosed or reported to the appropriate authorities? [ISA | 3806.1700]

We consult with the Risk Management Partner when we become aware of matters that are public interest matters. This includes those acts which are not quantitatively material to or do not directly affect the financial statements, but because of the serious nature of the activity, might cause actual or potential substantial harm to investors, creditors, employees, or the general public.

What does 'substantial harm' mean in the context of an instance of actual or suspected non-compliance or illegal act? [ISA | 3806.13077]

Substantial harm, in this context, refers to a judgmental determination of whether we believe the matter is of public interest. Remember that at this point, we are considering whether we consult with others within the firm to determine the appropriate course of action.

Group Audit | What about non-compliance or illegal acts at the component level in a group audit? [ISA | 3806.13087]

When evaluating acts identified in a group audit, we evaluate the act in the context of the entity where the matter arises, not only for the group as a whole. Component auditors communicate to the group auditor information on instances of actual or suspected non-compliance with laws or regulations, including illegal acts.

The Clearance Memorandum includes information regarding instances of actual or suspected non-compliance with laws and regulations, including illegal acts. As group auditors, we may communicate further information to the component auditor related to an instance of actual or suspected non-compliance with laws and regulations, including illegal acts, such as who is responsible

for evaluating the matter (as it may be investigated at the group or component level depending on the circumstances), the level of involvement between the component and group auditor, and any specific procedures to be performed related to the instance.

3.3 Consider the implications of the instance of non-compliance, including illegal acts [ISA | 3807]

What do we do?

Consider the implications of the instance of non-compliance, including illegal acts, on other aspects of the audit, including risk assessment and client continuance.

Why do we do this?

If we become aware of an illegal act or non-compliance with laws and regulations, there may be implications to the audit. For example, there may be impacts to our risk assessment activities or the reliability of management's representations. We consider those potential impacts to the audit.

During an audit, management makes many representations to us, both oral and written. These representations are part of the audit evidence we obtain (although they are not a substitute for auditing procedures).

If management's representations are contradicted by other audit evidence, for example if management was aware of an illegal act and concealed it from us, we consider the impact to other representations we obtained from management.

Execute the Audit

[What implications to our audit do we consider related to identified actual or suspected non-compliance with laws and regulations, including illegal acts?](#) [ISA | 3807.1300]

We consider the implications on our audit in four primary areas, including:

- the implications to our risk assessment
- the implications on the reliability of representations of management
- whether circumstances or conditions indicate possible collusion involving employees, management or third parties
- whether it is necessary to conduct a formal re-evaluation of client continuance, in consultation with the appropriate parties defined in ['Who do we consult with if we determine a formal re-evaluation is necessary?'](#)

[How do identified instances of non-compliance, including illegal acts, impact our risk assessment?](#) [ISA | 3807.1400]

There may be many implications to our risk assessment resulting from identified actual or suspected non-compliance with laws and regulations, including illegal acts. We may think about the implications in two broad categories: pervasive impacts and specific impacts (as shown in the table).

Pervasive impacts	Specific impacts
<p>May include considerations surrounding:</p> <ul style="list-style-type: none"> the control environment questions regarding management's integrity potential additional or changed fraud risk factors or fraud risks fundamental effect on operations of the entity, including calling into question the entity's continuance as a going concern 	<p>May include:</p> <ul style="list-style-type: none"> new or modified risk of misstatement (RMs) or risks of material misstatement (RMMs) in a particular account/disclosure or set of accounts/disclosures that are based on the identification of actual or suspected non-compliance with laws and regulations, including illegal acts

[What do we do after considering the impact of instances of non-compliance, including illegal acts, on our risk assessment?](#) [ISA | 3807.13071]

We consider whether there are additional or changed RMs stemming from an illegal act or instance of non-compliance. For example, there may be new RMs related to revenue recognition or debt compliance, depending on the nature of the illegal act or non-compliance.

Additional or changed RMs from instances of non-compliance, including illegal acts, may be assessed as RMMs, calling for an audit response.

[Could instances of non-compliance, including illegal acts, be indicative of a control deficiency?](#) [ISA | 3807.1500]

Possibly. When we identify instances of non-compliance, including illegal acts, we consider if they are indicative of [control deficiencies that we evaluate](#).

When considering the severity of control deficiencies related to instances of non-compliance, including illegal acts, we take into account the nature of the issue, which could influence our evaluation of the severity.

[In what circumstances do we consider the implications of an instance of non-compliance, including an illegal act, on the reliability of management's representations?](#) [ISA | 3807.1600]

Examples of circumstances that may cause us to evaluate the reliability of management's representations include:

- We suspect or have evidence of the involvement or intended involvement of management, or those charged with governance, in identified or suspected illegal acts or non-compliance, including whether there was collusion among these parties.
- We are aware that management, or those charged with governance, have knowledge of non-compliance, and they have not reported it to us and/or an appropriate authority within a reasonable period.

[In considering the reliability of management's representations in an instance of non-compliance, including an illegal act, what implications do we think about?](#) [ISA | 3807.13072]

We consider whether other representations obtained from management are reliable. This involves more than just the representation letter(s) obtained at the completion of the audit. We consider other representations, including whether:

- Other illegal acts or instances of actual or suspected non-compliance with laws and regulations may be present
- Other information obtained from management during the audit is reliable
- Other assertions and responses to inquiries made during the audit are reliable

[How might identified collusion affect the audit?](#) [ISA | 3807.13076]

Collusion may impact to whom we communicate the identified or suspected non-compliance, including illegal acts, given the relevant parties we typically communicate to may be involved in the matter. Further, collusion may impact the reliability of representations and evidence obtained throughout our audit

[How do we determine whether it is necessary to conduct a formal re-evaluation of client acceptance following an instance of non-compliance including an illegal act?](#) [ISA | 3807.1700]

We follow the firm's Global Quality & Risk Management Manual (GQ&RMM) process relating to client continuance. The GQ&RMM can be found here:

[International \(specific country views available\) - Section 9.3.1 of GQ&RMM](https://www.gqrrmm-prod.kworld.kpmg.com/) <https://www.gqrrmm-prod.kworld.kpmg.com/>

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[Who determines whether we conduct a formal re-evaluation of the client acceptance following an instance of non-compliance including an illegal act?](#) [ISA | 3807.1800]

The engagement partner determines whether we formally re-evaluate client acceptance.

[What do we do when we conduct a formal re-evaluation of the client acceptance following an instance of non-compliance including an illegal act?](#) [ISA | 3807.13095]

See the question '[When do we revisit or update our continuance evaluation?](#)' for more information on conducting a formal re-evaluation

[Who do we consult with if we have determined a formal re-evaluation is necessary following an instance of non-compliance including an illegal act?](#) [ISA | 3807.9274]

We consult with the Risk Management Partner.

4 Evaluate the entity's response to the non-compliance, including illegal acts [ISA | 3811]

What do we do?

Evaluate the entity's response and document the identified or suspected non-compliance

Why do we do this?

We consider the adequacy of both the entity's investigation, if one is performed, into the non-compliance, including illegal acts, and the remedial action taken given the potential communication requirements and other impacts to the audit, including impacts to risk assessment and our audit opinion.

Execute the Audit

[How do we assess the adequacy of the investigation into an instance of non-compliance including an illegal act?](#) [ISA | 3811.13090]

The audit team, in coordination with the Risk Management Partner, perform procedures that may include:

- Meet with the investigation team to obtain an understanding of the scope of the planned investigation and results of the investigation, including:
 - The nature of the actual or suspected non-compliance with laws and regulations, including illegal acts, to be investigated and the scope of the investigation
 - The members of management or others at the entity that may have information and whether they will be interviewed and results
 - The documents, transactions and accounts subject to investigation
 - Whether there are any limitations imposed on the investigation
 - Whether there are any limitations imposed on our access to the results of the procedures conducted
 - The independence/objectivity and expertise of those involved in the investigation

When the investigation is complete, we consider the findings of the investigation and consider whether the planned procedures were performed and the results.

[What if management's planned investigation of the non-compliance, including illegal acts, is inadequate, insufficient, or inconsistent?](#) [ISA | 3811.13091]

We consult with the Risk Management Partner and inform those charged with governance.

[What if the entity placed scope limitations on the investigation into the instance of non-compliance including an illegal act?](#) [ISA | 3811.13092]

We consider whether any scope limitations or exceptions were put in place initially or after the investigation was planned, and also whether any instances of obstruction were identified by the investigation team. Scope limitations may limit the investigation's ability to identify all relevant aspects of the non-compliance or illegal act.

[What if the investigation team indicates attorney-client privilege may limit access to the investigation team's work?](#) [ISA | 3811.13093]

If the investigation team indicates that attorney-client privilege (or legal professional privilege) may limit access to the investigation team's work, we consult with DPP and the Risk Management Partner to discuss the impact on the limitation on the audit. This includes limitations on our access to documents, information (e.g., updates from the entity or the investigation team throughout the investigation) or the investigation team's final report.

[What is attorney-client privilege \(legal professional privilege\)?](#) [ISA | 3811.13094]

Attorney-client privilege, or legal professional privilege, is a legal term, and can have different meanings or interpretations in different jurisdictions. Typically, attorney-client privilege, or legal professional privilege, refers to a client's privilege to refuse to disclose communications between the client and the attorney.

What documentation may be included to evidence the audit procedures performed, the significant professional judgments made and the conclusions reached? [ISA | 3811.1500]

Our documentation of findings regarding identified or suspected non-compliance with laws and regulations, including illegal acts, may include, for example:

- copies of records or documents
- minutes of discussions held with management, those charged with governance or parties outside the entity

Are there any documentation requirements that may arise from law, regulation or ethical requirements?

[ISA | 3811.1600]

Yes. Law, regulation or ethical requirements may also set out additional documentation requirements related to non-compliance with laws and regulations, including illegal acts.

For example, the IESBA Code requires us to document how management and, where applicable, those charged with governance have responded to the matter, the courses of action we considered, the judgments made and the decisions that were taken, having regard to the reasonable and informed third party perspective, and how we have fulfilled our responsibilities in the public interest.

5 Perform procedures when unable to determine whether non-compliance, including an illegal act, has occurred [ISA | 3819]

What do we do?

IF we are unable to determine whether an act is illegal because of limitations imposed by circumstance and not by the client, THEN consult the relevant parties and consider the effect on the auditor's report.

Why do we do this?

When circumstances, not imposed by the client, do not allow us to determine whether non-compliance, including illegal acts, has occurred, we consider the impact, given the potential implications to the audit.

Execute the Audit

In what circumstances, not imposed by the client, might we be unable to determine whether non-compliance, including illegal acts, have occurred? [ISA | 3819.1300]

Examples of circumstances, not imposed by the client, where we might not be able to determine whether non-compliance, including illegal acts, have occurred include:

- where insufficient evidence exists to determine
- where investigations or legal determinations are pending

What is 'sufficient evidence' when determining whether non-compliance including illegal acts may have occurred? [ISA | 3819.13144]

Sufficient evidence, in this context, refers to the entity's ability to determine whether non-compliance, including illegal acts, may have occurred. For example, at a point in time, there may be insufficient evidence to determine whether or not such an instance of non-compliance, including illegal acts, has occurred.

The identification of evidence may take significant time due to other circumstances.

What could the potential effects of a pending investigation into an instance of non-compliance be on our auditors' report? [ISA | 3819.13145]

Potential effects of the pending investigation include:

- Delay of the audit opinion until we obtain sufficient appropriate audit evidence,
- Qualification of the audit report,
- Disclaimer of an opinion,
- Withdrawal from the engagement, where permitted.

However, there are also cases where we conclude that we are still able to issue our report or consent or conclude our review.

What procedures do we perform if we are unable to determine whether non-compliance has occurred or an act is illegal because of limitation imposed by the circumstances, and not by the client? [ISA | 3819.1400]

We consult with the appropriate parties and consider the effect of the pending investigation on the auditors' report.

Location	Type of audit	Consulting parties
U.S.	PCAOB audits	<ul style="list-style-type: none"> • Regional Professional Practice Partner • DPP • OGC
	Global accounts	
	Audits where U.S. firm is participating, and U.S. firm is not group auditor/lead team	

	All others	<ul style="list-style-type: none"> • Business Unit Professional Practice Partner • DPP • OGC
International	All audits	<ul style="list-style-type: none"> • DPP • Risk Management Partner

Communicating and Reporting Identified or Suspected Non-Compliance

International Standards on Auditing: ISA 250.23-29

Communicating and Reporting Identified or Suspected Non-Compliance

Communicating Identified or Suspected Non-Compliance with Those Charged with Governance

23. Unless all of those charged with governance are involved in management of the entity, and therefore are aware of matters involving identified or suspected non-compliance already communicated by the auditor,⁵ the auditor shall communicate, unless prohibited by law or regulation, with those charged with governance matters involving non-compliance with laws and regulations that come to the auditor's attention during the course of the audit, other than when the matters are clearly inconsequential.

⁵ ISA 260 (Revised), *Communication with Those Charged with Governance*, paragraph 13

24. If, in the auditor's judgment, the non-compliance referred to in paragraph 23 is believed to be intentional and material, the auditor shall communicate the matter with those charged with governance as soon as practicable.

25. If the auditor suspects that management or those charged with governance are involved in non-compliance, the auditor shall communicate the matter to the next higher level of authority at the entity, if it exists, such as an audit committee or supervisory board. Where no higher authority exists, or if the auditor believes that the communication may not be acted upon or is unsure as to the person to whom to report, the auditor shall consider the need to obtain legal advice.

Potential Implications of Identified or Suspected Non-Compliance for the Auditor's Report (Ref: Para. A26 - A27)

26. If the auditor concludes that the identified or suspected non-compliance has a material effect on the financial statements, and has not been adequately reflected in the financial statements, the auditor shall,

in accordance with ISA 705 (Revised), express a qualified opinion or an adverse opinion on the financial statements.⁶

6 ISA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report*, paragraphs 7 - 8

27. If the auditor is precluded by management or those charged with governance from obtaining sufficient appropriate audit evidence to evaluate whether non-compliance that may be material to the financial statements has, or is likely to have, occurred, the auditor shall express a qualified opinion or disclaim an opinion on the financial statements on the basis of a limitation on the scope of the audit in accordance with ISA 705 (Revised).⁷

7 ISA 705 (Revised), paragraphs 7 and 9

28. If the auditor is unable to determine whether non-compliance has occurred because of limitations imposed by the circumstances rather than by management or those charged with governance, the auditor shall evaluate the effect on the auditor's opinion in accordance with ISA 705 (Revised).

Reporting Identified or Suspected Non-Compliance to an Appropriate Authority outside the Entity

29. If the auditor has identified or suspects non-compliance with laws and regulations, the auditor shall determine whether law, regulation or relevant ethical requirements: (Ref: Para. A28 - A34)

- (a) Require the auditor to report to an appropriate authority outside the entity.
- (b) Establish responsibilities under which reporting to an appropriate authority outside the entity may be appropriate in the circumstances.

ISA Application and Other Explanatory Material: ISA 250.A26-A34

Communicating and Reporting Identified or Suspected Non-Compliance

Potential Implications of Identified or Suspected Non-Compliance for the Auditor's Report (Ref: Para. 26 - 28)

A26. Identified or suspected non-compliance with laws and regulation is communicated in the auditor's report when the auditor modifies the opinion in accordance with paragraphs 26 - 28. In certain other circumstances, the auditor may communicate identified or suspected non-compliance in the auditor's report, for example:

- When the auditor has other reporting responsibilities, in addition to the auditor's responsibilities under the ISAs, as contemplated by paragraph 43 of ISA 700 (Revised);
- When the auditor determines that the identified or suspected non-compliance is a key audit matter and accordingly communicates the matter in accordance with ISA 701,¹⁵ unless paragraph 14 of that ISA applies; or

- In exceptional cases when management or those charged with governance do not take the remedial action that the auditor considers appropriate in the circumstances and withdrawal from the engagement is not possible (see paragraph A25), the auditor may consider describing the identified or suspected non-compliance in an Other Matter paragraph in accordance with ISA 706 (Revised).¹⁶

¹⁵ ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

¹⁶ ISA 706 (Revised), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*

A27. Law or regulation may preclude public disclosure by either management, those charged with governance or the auditor about a specific matter. 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, including a prohibition on alerting the entity. When the auditor intends to communicate identified or suspected non-compliance in the auditor's report under the circumstances set out in paragraph A26 or otherwise, such law or regulation may have implications for the auditor's ability to describe the matter in the auditor's report, or in some circumstances to issue the auditor's report. In such cases, the auditor may consider obtaining legal advice to determine the appropriate course of action.

Reporting Identified or Suspected Non-Compliance to an Appropriate Authority outside the Entity (Ref: Para. 29)

A28. Reporting identified or suspected non-compliance with laws and regulations to an appropriate authority outside the entity may be required or appropriate in the circumstances because:

- (a) Law, regulation or relevant ethical requirements require the auditor to report (see paragraph A29);
- (b) The auditor has determined reporting is an appropriate action to respond to identified or suspected non-compliance in accordance with relevant ethical requirements (see paragraph A30); or
- (c) Law, regulation or relevant ethical requirements provide the auditor with the right to do so (see paragraph A31).

A29. In some jurisdictions, the auditor may be required by law, regulation or relevant ethical requirements to report identified or suspected non-compliance with laws and regulations to an appropriate authority outside the entity. For example, in some jurisdictions, statutory requirements exist for the auditor of a financial institution to report the occurrence, or suspected occurrence, of non-compliance with laws and regulations to a supervisory authority. Also, misstatements may arise from non-compliance with laws or regulations and, in some jurisdictions, the auditor may be required to report misstatements to an appropriate authority in cases where management or those charged with governance fail to take corrective action.

A30. In other cases, the relevant ethical requirements may require the auditor to determine whether reporting identified or suspected non-compliance with laws and regulations to an appropriate authority outside the entity is an appropriate action in the circumstances. For example, the IESBA Code requires the auditor to take steps to respond to identified or suspected non-compliance with laws and regulations and determine whether further action is needed, which may include reporting to an appropriate authority

outside the entity.¹⁷ The IESBA Code explains that such reporting would not be considered a breach of the duty of confidentiality under the IESBA Code.¹⁸

¹⁷ See, for example, paragraphs 360.21 A1 and 360.25 A1-R360.27 of the IESBA Code.

¹⁸ See, for example, paragraphs R114.1-114.1 A1 and R360.26 of the IESBA Code.

A31. Even if law, regulation or relevant ethical requirements do not include requirements that address reporting identified or suspected non-compliance, they may provide the auditor with the right to report identified or suspected non-compliance to an appropriate authority outside the entity. For example, when auditing the financial statements of financial institutions, the auditor may have the right under law or regulation to discuss matters such as identified or suspected non-compliance with laws and regulations with a supervisory authority.

A32. In other circumstances, the reporting of identified or suspected non-compliance with laws and regulations to an appropriate authority outside the entity may be precluded by the auditor's duty of confidentiality under law, regulation or relevant ethical requirements.

A33. The determination required by paragraph 29 may involve complex considerations and professional judgments. Accordingly the auditor may consider consulting internally (e.g., within the firm or a network firm) or on a confidential basis with a regulator or professional body (unless doing so is prohibited by law or regulation or would breach the duty of confidentiality). The auditor may also consider obtaining legal advice to understand the auditor's options and the professional or legal implications of taking any particular course of action.

Considerations Specific to Public Sector Entities

A34. A public sector auditor may be obliged to report on identified or suspected non-compliance to the legislature or other governing body or to report them in the auditor's report.

How do we comply with the Standards? [ISA | KAEGHDWC]

1 Communicate the actual, or suspected, instance of non-compliance, including an illegal act [ISA | 3813]

What do we do?

IF we determine non-compliance, including illegal acts, has or is likely to have occurred, THEN communicate with the relevant parties.

Why do we do this?

Instances of non-compliance with laws and regulations, including illegal acts can have significant legal, regulatory and / or criminal consequences for the entity. Consequently, as auditor, it is our duty to promptly communicate actual or suspected acts of non-compliance including illegal acts to management and those charged with governance.

Execute the Audit

What procedures do we follow regarding communication if we determine an illegal act has or is likely to have occurred? [ISA | 3813.1400]

If we determine an illegal act has or is likely to have occurred, perform the following:

- [Communicate non-compliance, including illegal acts, to appropriate parties](#)
- [Communicate non-compliance, including illegal acts, to external parties as required](#)

1.1 Communicate non-compliance, including illegal acts, to appropriate parties [ISA | 3814]

What do we do?

Determine whom we inform of an instance of non-compliance, including illegal acts, then make the communication.

Why do we do this?





We communicate actual and suspected non-compliance, including illegal acts, to those charged with governance to better enable them to effectively fulfill their oversight responsibilities regarding the financial reporting process. If those charged with governance are involved in the actual or suspected non-compliance, we follow a clear escalation process for our reporting.

Execute the Audit

Who do we communicate to regarding non-compliance, including illegal acts (actual and suspected)? [ISA | 3814.1300]

We communicate the non-compliance, including illegal acts, to management and those charged with governance, unless the matter is clearly inconsequential.

If we believe that certain person(s) or groups are involved in the matter of non-compliance, including illegal acts, we communicate in accordance with the following:

Senior management are involved 	Sub-group of those charged with governance are involved 	All those charged with governance are involved 
Communicate with Audit Committee or similar body	Communicate to members of those charged with governance e.g. Board of Directors	Communicate to next higher authority if one exists 

		No higher authority  exists
		Discuss with RMP and consider whether we obtain legal advice.

When we perform our communications, we take care not to inadvertently tip off person(s) involved with an act of non-compliance.

When do we communicate instances of non-compliance, including illegal acts? [ISA | 3814.1400]

We communicate instances of non-compliance, including illegal acts, at appropriate times throughout the audit. If, however, we believe the non-compliance, including illegal acts, is believed to be intentional and material, we communicate the matter as soon as possible.

What do we communicate to those charged with governance regarding an instance of non-compliance including an illegal act? [ISA | 3814.1600]

Our communication to those charged with governance regarding identified or suspected non-compliance with laws and regulations, including illegal acts, include:

- a description of the identified or suspected non-compliance with laws and regulations, including illegal acts
- the circumstances of its occurrence
- the effect on the financial statements
- the possible consequences of the non-compliance with laws and regulations, including illegal acts
- the recommended course of action to be followed, when appropriate.

How do we communicate an instance of non-compliance including an illegal act to those charged with governance? [ISA | 3814.13188]

We communicate identified or suspected non-compliance with laws and regulations, including illegal acts, either orally or in writing. If we communicate orally, we document our communication and include the information in the audit files.

When do we communicate an instance of non-compliance to those charged with governance? [ISA | 3814.13189]

We communicate as soon as possible.

Do we communicate if we do not know all the circumstances regarding an instance of suspected non-compliance or illegal acts? [ISA | 3814.13190]

When suspected or actual non-compliance with laws and regulations, including illegal acts, is identified, we do not wait until an investigation is completed to communicate the matter to those charged with governance. We communicate the matter to those charged with governance, including the known facts surrounding the entity's investigation into the matter, to inform those charged with governance.

Is it appropriate to discuss with management certain matters relating to an instance of actual or suspected non-compliance including illegal acts before communicating with those charged with governance? [ISA |

3814.1700]

We may decide to discuss with management (or other parties, such as the entity's general counsel or internal auditors) certain matters before communicating with those charged with governance. This not only fosters a good professional relationship with management, but also recognizes management's responsibility for the preparation and fair presentation of the financial statements. In addition, these initial discussions may clarify facts and issues and give management an opportunity to provide further information and explanations.

However, if we believe that management were involved in the non-compliance with laws and regulations, including illegal acts, we may choose to instead communicate directly with those charged with governance.

Do we communicate instances of non-compliance including illegal acts already communicated by management? [ISA | 3814.1800]

Yes, we still make our communications about non-compliance with laws and regulations that come to our attention. Management's communications to those charged with governance of matters do not relieve us of our responsibility. Equally, our communications do not relieve management of their responsibilities.

However, management's communication of these matters may affect the form or timing of our communication with those charged with governance. We still inform those charged with governance about the matters involving non-compliance with laws and regulations; however, we may not repeat specific details about the matters that were already communicated by management provided we were present.

For example, we may attend meetings where management inform those charged with governance of instances of non-compliance with laws and regulations, including illegal acts. Our communication to those charged with governance, in this instance, may be to communicate to those charged with governance any additional information that we are aware regarding the matter, or communicate that we are not aware of any further information regarding the matter.

What type of information may we include to evidence our communications regarding an instance of non-compliance including illegal acts with those charged with governance? [ISA | 3814.1900]

Even though we document our communications with those charged with governance regardless of the form of communication, the documentation varies depending on whether we communicate orally or in writing.

Communication type	How we evidence the communications?
Written communications	When we communicate in writing, we include a copy of the written communication in the audit documentation.
Oral communications	What we document

	<ul style="list-style-type: none"> • what was communicated • when it was communicated and • to whom we communicated (in an audit conducted in accordance with the PCAOB standards this is the audit committee).
	<p>Types of documentation (examples, not all inclusive)</p> <ul style="list-style-type: none"> • memorandum, • PowerPoint presentations, • bullet point agenda. For example, we may document just the areas discussed when efforts to capture the details of oral communication in writing may be incomplete and subject to varying interpretations. • copy of audit committee-meeting minutes prepared by the entity in appropriate detail. However, inconsistencies between the minutes prepared by the entity and what we communicated may cause us to perform an additional communication with the audit committee, to the extent considered necessary in the circumstances.
	<p>How much we document</p> <p>We include sufficient information in the audit documentation to enable an experienced auditor, having no previous connection with the engagement, to understand the communications made.</p>

What if we believe the communication regarding an instance of non-compliance including illegal acts may not be acted upon or are unsure as to whom to report? [ISA | 3814.2000]

We consult with the following parties, based on the type of engagement:

Location	Type of audit	Consulting parties
U.S.	PCAOB audits	<ul style="list-style-type: none"> • Regional Professional Practice Partner • DPP • OGC
	Global accounts	
	Audits where U.S. firm is participating, and U.S. firm is not group auditor/lead team	

	All others	<ul style="list-style-type: none"> • Business Unit Professional Practice Partner • DPP • OGC
International	All audits	<ul style="list-style-type: none"> • Risk Management Partner (including discussion on whether to obtain legal advice)

1.2 Communicate non-compliance, including illegal acts, to external parties as required [ISA | 3815]

What do we do?

Determine whether we have a responsibility to communicate an instance of non-compliance, including illegal acts, to external parties and, if so, inform those parties.

Why do we do this?

Certain laws or regulations may require KPMG to communicate illegal acts to parties outside the entity. Before we communicate illegal acts to parties outside the entity, we consult with the appropriate parties to determine the appropriate course of action.

Execute the Audit

[In what circumstances may we have a legal responsibility to communicate actual or suspected non-compliance including illegal acts to parties outside the entity?](#) [ISA | 3815.1300]

We may have a legal responsibility that overrides our client confidentiality responsibilities to communicate to parties outside the entity in response to a subpoena or in response to local laws, regulations or relevant ethical requirements.

[What is client confidentiality?](#)

Firm personnel maintain confidentiality of client and former client information, as well as information of non-clients that is known to be confidential.

Typically, knowledge of actual or suspected non-compliance with laws and regulations, including illegal acts, is confidential information.

[What is confidential information?](#)

Confidential information is any non-public information that comes to an individual's attention as a result of the individual's association with the firm. This non-public information may relate to current clients, former clients or non-clients and may include personally identifiable information.

[What do we do if a legal, regulatory or ethical responsibility to communicate non-compliance including illegal acts overrides our responsibility to maintain client confidentiality?](#) [ISA | 3815.1500]

We will make the communications in accordance with our legal, regulatory or ethical responsibilities so that we do not violate a law.

[How do we know if a legal, regulatory or ethical responsibility overrides our responsibility to maintain client confidentiality?](#)

As auditors, we are not typically capable of determining the legality of a matter. We consult with the appropriate parties to determine whether or not we have a legal, regulatory or ethical responsibility to communicate illegal acts to parties outside the entity.

[When determining our communication responsibilities regarding non-compliance including illegal acts, what constitutes a party outside the entity?](#)

Parties outside the entity include any person, entity, group, government agency, etc. not affiliated with the entity. Typically, in this context, an outside party refers to anyone or any group apart from those within the entity.

[Who do we consult with prior to communicating non-compliance including illegal acts to a party outside the entity?](#)

We consult with the following parties, based on the type of engagement:

Location	Type of audit	Consulting parties
U.S.	PCAOB audits	<ul style="list-style-type: none"> Regional Professional Practice Partner DPP OGC
U.S.	Global accounts	<ul style="list-style-type: none"> Regional Professional Practice Partner DPP OGC
U.S.	Audits where U.S. firm is participating, and U.S. firm is not group auditor/lead team	<ul style="list-style-type: none"> Regional Professional Practice Partner DPP OGC
U.S.	All others	<ul style="list-style-type: none"> Business Unit Professional Practice Partner DPP OGC
International	All audits	<ul style="list-style-type: none"> Risk Management Partner

2 Consider the effect on the auditor's report when non-compliance, including an illegal act, has or is likely to have occurred [ISA | 3817]

What do we do?

IF we determine non-compliance, including an illegal act, has or is likely to have occurred, THEN consult appropriate parties and consider the effect on the auditor's report.

Why do we do this?

An illegal act with a material impact that has not been accounted for or disclosed means the financial statements are not free of material misstatement. As such, we cannot express a 'clean' opinion on those financial statements.

Similarly, if we are precluded by the client from obtaining sufficient appropriate evidence to evaluate whether an illegal act that could be material has occurred, then we may be unable to conclude that the financial statements are free of material misstatement.

Execute the Audit

How do we determine that non-compliance, including illegal acts, with a material effect on the financial statements have been properly accounted for or disclosed in the financial statements? [ISA | 3817.1300]

After determining the impact of the non-compliance, including illegal acts, we inspect the financial statements to determine whether the applicable impact has been included within the accounts and financial statements, or whether the impact has been disclosed.

What guidance do we follow if we conclude non-compliance, including illegal acts, has a material effect on the financial statements and has not been properly accounted for or disclosed? [ISA | 3817.1400]

See the chapter on modifications to the opinion ([ISA 705](#), [AU-C 705](#), [AS 3101](#)) for more information.

In what circumstances might we issue a qualified as opposed to an adverse opinion?

The following table outlines example scenarios of qualified and adverse opinions.

Type of opinion	Example scenario
Qualified	If there is a lack of sufficient appropriate audit evidence or there are restrictions on the scope of the audit that have led us to conclude that we cannot express an unqualified opinion, we may issue a qualified opinion.
Adverse	If the departure from the applicable accounting principles is so important and affects the financial statements to a degree that we do not believe a qualification to our audit report is adequate to disclose the misleading or

	incomplete nature of the financial statements, we may issue an adverse opinion.
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See the chapter on modifications to the opinion ([ISA 705](#), [AU-C 705](#), [AS 3101](#)) for more information on qualified and adverse opinions.

What procedures do we perform if we are precluded by the client from obtaining sufficient appropriate evidence to evaluate whether non-compliance including an illegal act that could be material has occurred? [ISA | 3817.1500]

We consult with the following parties, based on the type of engagement:

Location	Type of audit	Consulting parties
U.S.	PCAOB audits	<ul style="list-style-type: none"> • Regional Professional Practice Partner • DPP • OGC
U.S.	Global accounts	<ul style="list-style-type: none"> • Regional Professional Practice Partner • DPP • OGC
U.S.	Audits where U.S. firm is participating, and U.S. firm is not group auditor/lead team	<ul style="list-style-type: none"> • Regional Professional Practice Partner • DPP • OGC
U.S.	All others	<ul style="list-style-type: none"> • Business Unit Professional Practice Partner • DPP • OGC
International	All audits	<ul style="list-style-type: none"> • Risk Management Partner

In what ways might we be precluded from obtaining sufficient appropriate evidential matter to evaluate whether non-compliance including an illegal act that could be material has occurred? [ISA | 3817.1600]

We may be precluded by management by:

- Management not allowing access to the investigation team
- Management not allowing access to the results of the investigation (for example, where the entity asserts legal privilege)

What procedures do we perform after consulting with the appropriate parties when precluded from obtaining sufficient appropriate evidence concerning non-compliance including an illegal act? [ISA |

3817.1700]

We consider whether it is appropriate to disclaim or qualify an opinion on the financial statements.

What does it mean to disclaim an opinion on the financial statements?

A disclaimer of opinion states that we do not express an opinion on the financial statements. A disclaimer of opinion is appropriate when we have not performed an audit sufficient in scope to enable us to form an opinion on the financial statements.

What is included in a disclaimer of opinion?

We include the substantive reasons for the disclaimer. For example, the reasons why we were not able to perform an audit sufficient to enable us to form an opinion on the financial statements, such as a preclusion by the entity from obtaining sufficient evidential matter related to a possible illegal act.

3 Perform procedures when unable to determine whether non-compliance, including an illegal act, has occurred [ISA | 3819]

What do we do?

IF we are unable to determine whether an act is illegal because of limitations imposed by circumstance and not by the client, THEN consult the relevant parties and consider the effect on the auditor's report.

Why do we do this?

When circumstances, not imposed by the client, do not allow us to determine whether non-compliance, including illegal acts, has occurred, we consider the impact, given the potential implications to the audit.

Execute the Audit

In what circumstances, not imposed by the client, might we be unable to determine whether non-compliance, including illegal acts, have occurred? [ISA | 3819.1300]

Examples of circumstances, not imposed by the client, where we might not be able to determine whether non-compliance, including illegal acts, have occurred include:

- where insufficient evidence exists to determine
- where investigations or legal determinations are pending

What is 'sufficient evidence' when determining whether non-compliance including illegal acts may have occurred? [ISA | 3819.13144]

Sufficient evidence, in this context, refers to the entity's ability to determine whether non-compliance, including illegal acts, may have occurred. For example, at a point in time, there may be insufficient evidence to determine whether or not such an instance of non-compliance, including illegal acts, has occurred.

The identification of evidence may take significant time due to other circumstances.

What could the potential effects of a pending investigation into an instance of non-compliance be on our auditors' report? [ISA | 3819.13145]

Potential effects of the pending investigation include:

- Delay of the audit opinion until we obtain sufficient appropriate audit evidence,
- Qualification of the audit report,
- Disclaimer of an opinion,
- Withdrawal from the engagement, where permitted.

However, there are also cases where we conclude that we are still able to issue our report or consent or conclude our review.

What procedures do we perform if we are unable to determine whether non-compliance has occurred or an act is illegal because of limitation imposed by the circumstances, and not by the client? [ISA | 3819.1400]

We consult with the appropriate parties and consider the effect of the pending investigation on the auditors' report.

Location	Type of audit	Consulting parties
U.S.	PCAOB audits	<ul style="list-style-type: none"> • Regional Professional Practice Partner • DPP • OGC
	Global accounts	
	Audits where U.S. firm is participating, and U.S. firm is not group auditor/lead team	
	All others	<ul style="list-style-type: none"> • Business Unit Professional Practice Partner • DPP • OGC
International	All audits	<ul style="list-style-type: none"> • DPP • Risk Management Partner

Documentation

International Standards on Auditing: ISA 250.30

Documentation

30. The auditor shall include in the audit documentation⁸ identified or suspected non-compliance with laws and regulations and: (Ref: Para. A35 - A36)

- (a) The audit procedures performed, the significant professional judgments made and the conclusions reached thereon; and
- (b) The discussions of significant matters related to the non-compliance with management, those charged with governance and others, including how management and, where applicable, those charged with governance have responded to the matter.

⁸ ISA 230, *Audit Documentation*, paragraphs 8 - 11, and A6

ISA Application and Other Explanatory Material: ISA 250.A35-A36

Documentation (Ref: Para. 30)

A35. 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.

A36. Law, regulation or relevant ethical requirements may also set out additional documentation requirements regarding identified or suspected non-compliance with laws and regulations.¹⁹

¹⁹ See, for example, paragraph R360.28 of the IESBA Code.

How do we comply with the Standards? [ISA | KAEGHDWC]

1 Evaluate the entity's response to the non-compliance, including illegal acts [ISA | 3811]

What do we do?

Evaluate the entity's response and document the identified or suspected non-compliance

Why do we do this?

We consider the adequacy of both the entity's investigation, if one is performed, into the non-compliance, including illegal acts, and the remedial action taken given the potential communication requirements and other impacts to the audit, including impacts to risk assessment and our audit opinion.

Execute the Audit

How do we assess the adequacy of the investigation into an instance of non-compliance including an illegal act? [ISA | 3811.13090]

The audit team, in coordination with the Risk Management Partner, perform procedures that may include:

- Meet with the investigation team to obtain an understanding of the scope of the planned investigation and results of the investigation, including:
 - The nature of the actual or suspected non-compliance with laws and regulations, including illegal acts, to be investigated and the scope of the investigation
 - The members of management or others at the entity that may have information and whether they will be interviewed and results
 - The documents, transactions and accounts subject to investigation
 - Whether there are any limitations imposed on the investigation
 - Whether there are any limitations imposed on our access to the results of the procedures conducted
 - The independence/objectivity and expertise of those involved in the investigation

When the investigation is complete, we consider the findings of the investigation and consider whether the planned procedures were performed and the results.

What if management's planned investigation of the non-compliance, including illegal acts, is inadequate, insufficient, or inconsistent? [ISA | 3811.13091]

We consult with the Risk Management Partner and inform those charged with governance.

What if the entity placed scope limitations on the investigation into the instance of non-compliance including an illegal act? [ISA | 3811.13092]

We consider whether any scope limitations or exceptions were put in place initially or after the investigation was planned, and also whether any instances of obstruction were identified by the investigation team. Scope limitations may limit the investigation's ability to identify all relevant aspects of the non-compliance or illegal act.

What if the investigation team indicates attorney-client privilege may limit access to the investigation team's work? [ISA | 3811.13093]

If the investigation team indicates that attorney-client privilege (or legal professional privilege) may limit access to the investigation team's work, we consult with DPP and the Risk Management Partner to discuss the impact on the limitation on the audit. This includes limitations on our access to documents, information (e.g., updates from the entity or the investigation team throughout the investigation) or the investigation team's final report.

What is attorney-client privilege (legal professional privilege)? [ISA | 3811.13094]

Attorney-client privilege, or legal professional privilege, is a legal term, and can have different meanings or interpretations in different jurisdictions. Typically, attorney-client privilege, or legal professional privilege, refers to a client's privilege to refuse to disclose communications between the client and the attorney.

What documentation may be included to evidence the audit procedures performed, the significant professional judgments made and the conclusions reached? [ISA | 3811.1500]

Our documentation of findings regarding identified or suspected non-compliance with laws and regulations, including illegal acts, may include, for example:

- copies of records or documents
- minutes of discussions held with management, those charged with governance or parties outside the entity

Are there any documentation requirements that may arise from law, regulation or ethical requirements?

[ISA | 3811.1600]

Yes. Law, regulation or ethical requirements may also set out additional documentation requirements related to non-compliance with laws and regulations, including illegal acts.

For example, the IESBA Code requires us to document how management and, where applicable, those charged with governance have responded to the matter, the courses of action we considered, the judgments made and the decisions that were taken, having regard to the reasonable and informed third party perspective, and how we have fulfilled our responsibilities in the public interest.

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