CONSIDERATION OF LAWS AND REGULATIONS IN AN AUDIT OF FINANCIAL STATEMENTS ISA 250

Non compliance

Non-compliance refers to acts of omission or commission by the entity, either intentional or unintentional which are contrary to the prevailing laws or regulations.

Companies are subject to many laws and regulations for example:

- Company law
- Employment law
- Income tax law
- Labour law
- Environmental Protection law etc.

Responsibilities of Management and Auditors regarding laws and regulation

Management

Management is responsible for the prevention, detection and correction of non-compliance with laws and regulations.

The following policies and procedures may be implemented by the management in order to prevent and detect non-compliance with laws and regulations:

1. Maintain a register of significant laws with which the entity has to comply.
2. Engage legal advisors to assist in monitoring legal requirement.
3. Institute and operate appropriate system of internal controls.
4. Develop, publicize and follow a code of conduct.

Auditor

As with fraud, the auditors are not, and cannot be held responsible for preventing non-compliance but they should aim to be aware of those that could materially affect the Financial Statements. There is unavoidable risk that some material misstatements in the financial statements go undetected even though the audit is properly planned and performed.

INTERNAL AUDIT

Internal audit is the function in an organization that ensures that the system in operation runs smoothly. Specifically, the internal audit ensures there is compliance with the system of internal control of the organization. In addition, it ensures there is compliance with the regulatory laws that affect the operations of the entity.

Advantages of internal audit

- Discovery of errors thereby improving the integrity of financial reporting.
- Reduces incidence of frauds.
- Ensures the staff work towards achievement of company's strategy.

Issues with internal audit

- Internal audit Personnel may not be appropriately qualified.
- Internal audit Personnel are recruited by management and therefore are not independent. This makes internal audit report not accepted by the shareholders.

Outsourcing of internal audit

This refers to contracting of internal audit function to experienced and independent external providers

Impact of outsourcing of internal audit on external audit

- The external auditor may be prevented from having easy access to information of the client. This is important as the external auditor need to test the system of internal controls to determine the audit strategy.
- It may lead to improved internal control as the external are likely to be expert and independent. This would improve the reliance external auditor places on the work of internal auditors which may reduce the audit fee charged as less work would be performed.
- External providers are going to be more objective as they are independent. This would improve the reliance that external auditor place on the work of internal audit. As a result, audit evidence may be readily available which reduces audit work and costs.
- Improved internal control. Since internal audit is carried out by an independent expert, the internal control would be strengthened which reduce the risk of material

AMOUNT TO BE RECOGNISED IN THE STATEMENT OF FINANCIAL POSITION REGARDING LONG TERM CONTRACT

Current asset

contract work in progress; this represent amount by which contract cost to date exceed the contract cost recognised in statement of profit or loss as cost of sales

Trade receivables; this represent the amount by which contract revenue recognised in the statement of profit or loss exceeds the cash received from the contract.

Current liability

Deferred income; this represent the amount by which the cash received is more than the revenue recognized in the statement of profit or loss.

Current provision; the provision recognized against the loss to be incurred on onerous contract.

Non-current asset

PPE used for the contract is recognized at carrying amount minus accumulated depreciation.

AUDIT PROCEDURES RELATING TO CONSTRUCTION CONTRACTS

- Total contract cost should be agreed to the contract agreement (documentation).
- Total contract price should be agreed to contract documentation.
- Review the element that make up the total contract cost to ensure no irrecoverable cost is included.
- Review costs recognized in the accounting period and ensure any irrecoverable costs (rectification costs) incurred in the period has been included.
- Agree cost incurred to date to invoice to ensure accuracy.
- Recalculate the depreciation on the PPE used in the contract to ensure the carrying amounts of PPE are correctly valued.
- Agree the cash received to bank statement to ensure contract's current asset or liability is correctly valued.