

Verification of Compliance by the Audited Entity with the Requirements of Laws and Regulations

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Abstract. *The article is devoted to current issues of compliance by the audited entity with the requirements of laws and regulations related to the organization and the industry. The auditor should get an idea of the subject's compliance with these regulations. Particular attention should be paid to laws and regulations that may affect the organization's activities.*

This study explores the verification of compliance by audited entities with laws and regulations, emphasizing its critical role in financial auditing. Despite existing frameworks such as International Standard on Auditing (ISA) 250, gaps persist in identifying and addressing non-compliance, particularly in industries with complex regulatory requirements. This research adopts a qualitative approach, analyzing audit procedures, risk assessments, and internal controls to evaluate compliance mechanisms. The findings indicate that auditors face inherent limitations in detecting non-compliance due to regulatory complexity, management collusion, and inadequate internal controls. The results highlight the necessity of integrating advanced monitoring systems, improved legal consultations, and stronger regulatory enforcement to mitigate audit risks. The implications suggest that regulatory bodies and audit firms must enhance compliance verification methods, ensuring greater financial transparency and legal adherence. Strengthening audit frameworks will improve corporate governance, reduce financial misstatements, and foster investor confidence in regulatory compliance.

Key words: *risk assessment, compliance with legal requirements, economic entity, monitoring, internal standards, controls, inherent risk.*

Introduction

Recommendations regarding the auditor's responsibility to take into account laws and regulations when auditing financial statements are contained in International Standard 250 "Considering Laws and Regulations in an Audit of Financial Statements". The standard contains the following paragraphs: introduction, management's responsibility for compliance with laws, the auditor's verification of compliance with laws, reporting non-compliance with laws and regulations, and refusal to conduct an audit.

When planning an audit and performing audit procedures, the auditor takes into account the fact that the entity's non-compliance with laws and regulations may have a significant impact on the financial statements. However, not all cases of non-compliance with laws and regulations may be identified during the audit. At the same time, identifying any, even insignificant, cases of non-compliance with laws casts doubt on the honesty of the organization's management and employees. Therefore, it is necessary to analyze the possible consequences of non-compliance with laws for the audit. The term "non-compliance" according to international requirements means intentional and unintentional

actions or inactions of the audited entity that contradict current laws and regulations. Such actions include transactions carried out by the entity itself or on its behalf by management or employees. The term "non-compliance" does not apply to actions by management or employees that are unrelated to the activities of the organization.

Method

Professional training, experience, knowledge of the subject and the industry allow the auditor to determine that individual actions that have attracted his attention contain signs of non-compliance with laws and regulations. However, the auditor's conclusions regarding the determination of facts of non-compliance with legislation are usually formed on the basis of consultation with an experienced and qualified lawyer. The final decision can only be made by the court.

Laws and regulations have different effects on the financial statements of an organization. Some regulations determine the form, content, and procedure for forming financial statement indicators, while others regulate the conditions for conducting the enterprise's activities. These conditions must be observed by the organization's management. The activities of some organizations (e.g. banks, insurance companies) are strictly regulated by law. Other organizations must be guided only by general issues of the functioning of an economic entity (e.g. compliance with labor legislation, safety, etc.). In all cases, non-compliance with laws and regulations entails penalties, lawsuits, and liability of the economic entity and management. In general, the weaker the connection between non-compliance and the events and transactions reflected in the financial statements, the less likely the auditor is to determine the fact of non-compliance with the law.

Result and Discussion

International practice of applying ISA 250 varies. This is due to differences in the regulatory framework in force in different countries. National standards of each country reflect its specifics of determining the impact of laws and regulations on the audit.

This standard is used only for the audit of financial statements. ISA 250 does not apply to a special assignment to verify compliance with laws and regulations, or to the preparation of a separate report.

The standard defines the responsibility of the organization's management for compliance with laws and regulations. The organization's management is responsible for:

- ✓ for the implementation of the entity's activities in accordance with laws and regulations;
- ✓ prevention and detection of cases of non-compliance with legislation.

In order to prevent and identify cases of non-compliance with the law, the management of the organization must:

- monitor changes in legislation and compliance of activities with new requirements;
- ✓ develop internal control systems and evaluate their functioning;
- ✓ develop, publish and comply with the internal regulations of the organization;
- ✓ train employees in the internal regulations of the organization;
- ✓ monitor compliance with the internal regulations and the application of disciplinary measures;
- ✓ involve lawyers to monitor changes in legislation;
- ✓ maintain a register of special laws that must be observed by the entity and complaint books.

Large organizations may assign these responsibilities to an internal audit department or an audit committee. When an auditor checks for compliance with laws and regulations, he or she is not responsible for preventing non-compliance with the law. However, conducting an annual audit helps to prevent such non-compliance. However, an audit carries a risk that some material misstatements in the financial statements will not be detected. The risk is increased if a material misstatement causes non-compliance due to:

- the presence of a number of regulations that affect mainly the activities of the organization. They

do not have a significant impact on financial reporting and are not taken into account by the accounting and internal control systems.

- concealment of facts of non-compliance with the law. For example, the management of the organization may commit collusion, forgery of documents, deliberate failure to reflect transactions in the accounting, deliberate distortion of information;
- the presence of limitations inherent in the accounting and internal control systems, as well as the use of testing.

To identify facts of non-compliance with the law, it is necessary to take into account the rules of ISA 200 "Objective and General Principles of an Audit of Financial Statements", namely: when planning and conducting an audit, it is necessary to adhere to the principle of professional skepticism. The auditor can identify events and transactions that could cast doubt on the subject's compliance with laws and regulations.

When planning an audit, the auditor should review all regulations relevant to the organization and the industry. He or she should also obtain an understanding of the entity's compliance with these regulations. Particular attention should be paid to laws and regulations that may affect the organization's operations. In particular, failure to comply with them may result in the termination of the organization's operations or call into question the continuity of its operations, such as failure to comply with licensing requirements or investment rules.

To have a general understanding of laws and regulations, the auditor needs to:

- use information about the organization's activities and industry;
- learn from management about the organization's policies and actions aimed at compliance with the law;
- learn from management about regulations that may have a significant impact on the organization's activities;
- determine the organization's policies and actions for identifying, assessing and recording lawsuits and sanctions;
- discuss legal requirements with auditors of subsidiaries in other countries.

When checking for non-compliance with legislation, two types of audit procedures are used:

- ✓ aimed at identifying non-compliance with laws and regulations;
- ✓ applied when identifying facts of non-compliance with legislation.

The content of audit procedures is given in Table 1.1.

Table 1.1. Contents of audit procedures when checking facts of non-compliance with legislation

Type of audit procedures	Content of audit procedures
Procedures aimed at identifying non-compliance with laws and regulations	<ul style="list-style-type: none">• Survey of the organization's management on compliance with laws and regulations• Review of correspondence with relevant regulatory and licensing authorities

Type of audit procedures	Content of audit procedures
	<ul style="list-style-type: none">• Inquiring with the organization's management about compliance with those laws and regulations that affect the determination of material amounts and disclosures in the financial statements. These regulations relate to the form and content of financial statements, specific industry requirements, requirements for accounting for transactions under government contracts, accrual and recognition of expenses for income tax

	<p>purposes, or pension costs</p> <ul style="list-style-type: none"> • Reviewing meeting minutes • Inquiring with management and legal counsel about litigation, claims, and sanctions • Obtaining written statements from management that all facts of non-compliance with laws and regulations have been reported to the auditor
Procedures applied when facts of non-compliance with legislation are identified	<ul style="list-style-type: none"> • Obtaining an understanding of the nature of non-compliance with the law and the circumstances in which it occurred • Obtaining information on the impact of non-compliance with the law on the financial statements • Assessing such possible financial consequences as penalties, fines, sanctions, damages, threat of asset confiscation, forced termination of operations, litigation • Assessing the need to disclose possible financial consequences in the financial statements. • Assessing the reliability and objectivity of the organization's financial statements • Documenting the identified facts of non-compliance with the law and discussing them with the organization's management (copies of accounting records or documents, notes of conversations) • Possible consultations with lawyers on the legal consequences of non-compliance with laws and further actions of the auditor • Reviewing the assessment of audit risk and the reliability of the statements of the organization's management in the event that it fails to mention the facts of non-compliance with the law in its statements

The standard provides examples of signs that indicate non-compliance with the law:

- investigations by government departments, fines and penalties;
- payments for services not specified in contracts, loans to consultants, related parties, their employees or government officials;
- significant commissions or brokerage fees;
- purchases at prices significantly above or below market yen;
- unusual cash payments, purchases paid by cashier's checks, transfers to numbered bank accounts;
- unusual transactions with companies registered in tax havens;
- transfers of payments for goods and services to a country other than the country from which the goods and services were supplied;
- existence of an accounting system that does not adequately reflect transactions and provide sufficient evidence for audit;
- business transactions that are not properly recorded;
- comments in the media.

The auditor has the right to report non-compliance with the law to the organization's management, users of the audit report, regulatory authorities and law enforcement agencies. In doing so, he must comply with certain rules.

The auditor reports any identified non-compliance with the law to the audit committee, the board of

directors, and the organization's top management. In minor cases or if there are no consequences, the auditor may not report non-compliance with the law. In addition, the auditor may agree in advance with management on the nature of the issues to be reported. However, if non-compliance with the law is intentional and material, the auditor must immediately report this fact.

If the auditor has information that the management of the organization is involved in the fact of non-compliance with the law (including the board of directors), he is obliged to inform the superior body of the organization, the audit commission or the supervisory board of this superior organization.

Users of financial statements are informed of non-compliance with legislation through the auditor's report. If the auditor has discovered a material fact of non-compliance with legislation, he or she should express a qualified opinion or an adverse opinion. The entity may prevent the auditor from obtaining sufficient and appropriate audit evidence regarding facts of non-compliance with laws and regulations. In this case, the auditor should express a qualified opinion or disclaim an opinion based on the limitation of the scope of the audit.

Conclusion

When conducting an audit, the auditor must comply with the basic ethical principle of confidentiality of information. Following this principle does not allow the auditor to report facts of non-compliance with the law to third parties (regulatory authorities and law enforcement agencies). However, there are circumstances in which the auditor has the right not to comply with the requirement of confidentiality of information. Compliance with confidentiality by the auditor is not mandatory by law or court decision. For example, in some countries, auditors are required to inform regulatory authorities about non-compliance with the law by financial institutions. In such circumstances, the auditor should obtain legal advice.

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