Statutory Audit Requirements:
Legal responsibilities: Directors & Auditors
Audit and its increased regulation

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Areas we will cover

• Responsibilities of the directors under the Companies Act of 2015.
• Responsibilities of the auditor under the Companies Act 2015.
• Auditing in an environment of increased legislation.
Requirement for proper accounting records

• Section 628 of the Companies Act of 2015 requires that every company shall keep proper accounting records.

• Section 629. (1) provides that if a company fails to comply with section 628, the company, and each officer of the company who is in default, commit an offence.
Requirement for proper accounting records

A person who is found guilty of an offence under subsection (1) is liable on conviction. (a) in the case of a body corporate, to a fine not exceeding two million shillings; or (b) in the case of a natural person, to a fine not exceeding one million shillings or to imprisonment for a term not exceeding two years, or to both.
Requirement for proper accounting records

• Section 630 provides that a company shall preserve its accounting records for not less than seven years from and including the date on which they were created.

• If the company is in liquidation, the 7 year rule will be subject to rules in force for companies in liquidation.

• An officer of a company who- (a) fails to take all reasonable steps to ensure that the company complies with section 630(2); or (b) intentionally causes the company to fail to comply with that subsection, commits an offence.
Requirement for proper accounting records

• Section 635 provides the following
• (1) The directors of every company shall prepare a financial statement for the company for each financial year of the company.
• (2) Such a financial statement is referred to in this Part as the company's individual financial statement.
• (3) If the directors of a company fail to prepare for a financial year of the company a financial statement that complies with the relevant requirements of this Part, each of the directors who is in default commits an offence and on conviction is liable to a fine not exceeding one million shillings.
• (4) If, after a director has been convicted of an offence under subsection (3), the directors continue to fail to prepare the requisite financial statement, each of the directors who is in default commits a further offence on each day on which the failure continues and on conviction is liable to a fine not exceeding one hundred thousand shillings for each such offence.
Requirement for audited financial statements

• Section 709 provides that
• (1) The directors of a company shall ensure that the company's annual financial statements for a financial year are audited in accordance with this Part unless the company—(a) is exempt from audit under section 711 or 714; or (b) is exempt from the requirements of this Part under section 716.
Exemption from audit

• 711. (1) A company that complies with the conditions of subsection (2) in respect of a financial year is exempt from the requirements of this Act relating to the audit
• (2) The conditions are:
• (a) that the company qualifies as a small company in relation to that year;
• (b) that its turnover in that year is not more than fifty million shillings; and
• (c) that the value of its net assets specified in its balance sheet as at the end of that year is not more than twenty million shillings.
Exemption from audit

- Section 714. (1) A company is exempt from the requirements of this Act relating to the audit of financial statements in respect of a financial year if-
  - (a) it has been dormant since its formation; or
  - (b) it has been dormant since the end of the previous financial year
- 715. A company is not entitled to the exemption from dormant conferred by section 714 if it was at any time within the relevant financial year a company that was
  - (a) an insurance company, a banking company or an e-money issuer; or
  - (b) a company of any other kind prescribed by regulation
Functions of auditors

• 727. (1) An auditor shall make a report to the members of the company on all annual financial statements of the company

• 727. (2) Identify the financial statements audited and give a scope of his audit including the standards used.

• Give an opinion whether books of account are true and fair.
In summary....What auditors do.....

• Some of the more important auditing procedures include:
  – Inquiring of management and others to gain an understanding of the organization itself, its operations, financial reporting and known fraud or error
  – Evaluating and understanding the internal control system
  – Performing analytical procedures on expected or unexpected variances in account balances or classes of transactions
  – Testing documentation supporting account balances or classes of transactions
  – Observing the physical inventory count
  – Confirming accounts receivable and other accounts with a third party
What auditors shouldn’t do

- Analyze or reconcile accounts
- “Close the books”
- Locate invoices, etc., for testing
- Prepare confirmations for mailing
- Select accounting policies or procedures
- Prepare financial statements or footnote disclosures
- Prepare an entity for audit
- Determine restrictions of assets
- Implement corrective action plans
- Determine estimates included in financial statements
- Establish value of assets and liabilities
- Maintain client permanent records, including loan documents, leases, contracts and other legal documents
- Prepare or maintain minutes of board of directors meetings
- Establish account coding or classifications
- Determine retirement plan contributions
What auditors usually do wrong

• Authorize, execute or consummate transactions on behalf of a client
• Prepare or make changes to source documents
• Assume custody of client assets, including maintenance of bank accounts
• Establish or maintain internal controls, including the performance of ongoing monitoring activities for a client
• Supervise client employees performing normal recurring activities
• Report to the board of directors on behalf of management
• Serve as a client’s stock or escrow agent or general counsel
• Sign payroll tax returns on behalf of a client
• Approve vendor invoices for payment
• Design a client’s financial management system or make modifications to source code underlying that system
• Hire or terminate employees
Need for regulation in financial reporting space

• The need for certain standards to be met by members of the profession or industry.
• To ensure that accounting and accountants serve in the public interest.
• To ensure the right quality and consistency in the quality of accounting services.
• To ensure compliance with ethics, technical and professional standards.
• To protect the public especially investors and creditors.
Characteristics of good Regulation

• Nature and characteristics of the operation of the market are well understood
• Should be subject to regular review.
• Should be proportionate, transparent, non-discriminatory and implemented consistently.
• Should be transparent
• The regulator should be well governed
Some regulators

- Central Bank of Kenya
- Capital Markets Authority
- Insurance Regulatory Authority
- SASRA
- RBA
- ICPAK
Key laws

• Responsibilities of management
• Management are responsible for ensuring the entity they are responsible for complies with relevant laws and regulations, including:
  • Companies Act 2015
  • corporate governance principles
  • Health and safety law;
  • Labour Act 2007
  • Stock exchange rules; and
  • Financial reporting regulations.
• **ISA 250 Scope**

• ISA 250 deals with the auditor’s responsibility to consider laws and regulations in an audit of financial statements.

• ISA 250 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.

• **ISA 250 effective date on and after 15 December 2009.**
Auditing in regulated environment

• ISA 250 distinguishes the auditor’s responsibilities in relation to compliance with two different categories of laws and regulations as follows;

• The provisions of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements such as tax and pension laws and regulations; and

• 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 (for example, compliance with the terms of an operating license, compliance with regulatory solvency requirements, or compliance with environmental regulations); non-compliance with such laws and regulations may therefore have a material effect on the financial statements.
• **ISA 250 Objective**

  • The objective of auditor are;
  • 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;
  • 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
  • To respond appropriately to non-compliance or suspected non-compliance with laws and regulations identified during the audit.
Auditing in regulated environment

- Audit procedures
- **ISA 250** Consideration of Laws and Regulations in an Audit of Financial Statements requires an auditor to perform the following procedures:
  - obtaining a general understanding of the client's legal and regulatory environment;
  - inspecting correspondence with relevant licensing and regulatory authorities;
  - enquiring of management and those charged with governance as to whether the entity is compliant with laws and regulations;
  - remaining alert to possible instances of non-compliance; and
  - obtaining written representations that the directors have disclosed all instances of known and possible non-compliance to the auditor.
• ISA 250 Requirements
• Auditor shall obtain understanding of legal and regulatory framework applicable to the entity and how entity is complying with it.
• Audit shall obtain sufficient and 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.
Audit Procedures When Non-Compliance Is Identified or Suspected

• 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;
  – An understanding of the nature of the act and the circumstances in which it has occurred; and
  – Further information to evaluate the possible effect on the financial statements.
• Seek legal advice if sufficient information not made available on material non-compliance, which auditor suspects.
• If information cannot be obtained consider impact on opinion.
• Consider the impact of non-compliance on auditor’s risk assessment and the reliability of written representations, and take appropriate action.
Reporting of Identified or Suspected Non-Compliance

• Communicate to those charged with governance, unless they themselves are involved.
• If management and those charged with governance are involved consider reporting to next level of authority like audit committee.
• 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.
Reporting Non-Compliance in the Auditor’s Report on the Financial Statements

• If the auditor concludes that the non-compliance has a material effect on the financial statements, and has not been adequately reflected in the financial statements, the auditor shall, express a qualified opinion or an adverse opinion on the financial statements.

• 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.

• 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.
Reporting Non-Compliance to Regulatory and Enforcer Authorities

• Auditor shall consider its responsibility to report.
• Documentation
• The auditor shall include in the audit documentation identified or suspected non-compliance with laws and regulations and the results of discussion with management and, where applicable, those charged with governance and other parties outside the entity.
Responsibilities of the auditor / Summary

• The auditor is responsible for obtaining **reasonable assurance** that the financial statements taken as a whole, are free from material misstatement, whether caused by **fraud** or error (ISA 200).

• Non-compliance with laws and regulations can impact the financial statements because companies in breach of the law may need to make provisions for future legal costs and fines. In the worst case scenario this could affect the ability of the company to continue as a **going concern**.

• In addition the auditor may need to report identified non-compliance with laws and regulations either to management or to a regulatory body, if the issue requires such action. An example of the latter would be when the client is in breach of money laundering regulations.
Responsibilities of the auditor / Summary

• Therefore, in planning an audit of financial statements the auditor must take into account the applicable legal and regulatory framework.
• More specifically the auditor must obtain sufficient, appropriate evidence regarding compliance with those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements.
• The auditor must also perform specified audit procedures to help identify instances of non-compliance with those laws and regulations that may have a material impact on the financial statements. If non-compliance is identified (or suspected) the auditor must then respond appropriately.
Prudent steps to take

• Preach compliance to your clients
• Stay close to the regulators
• Keep in professional touch with the Institute
• Follow (shape) the legislation process
• Develop a keen 6th sense
The End

• Questions ..... 
• Comments ......
• Feedback....
• Lunch
• good bye