

AUDIT RISK MANAGEMENT AND ITS AFFECT ON THE AUDIT OF THE FINANCIAL STATEMENT

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INTRODUCTION

The audit risk is one of the most complex categories of the audit, which determines the auditor's opinion regarding the reliability of reporting. The assessment of the audit risk is one of the mandatory requirements of the International Standards on Auditing (Nadezhda Kvatashidze, 2016). It is commonly agreed that only in case of the acceptable value of the overall risk can an auditor decide whether the financial statement of the audited entity is reliable.

The scholarly views on the nature of the audit risk and its determinants vary significantly (AHMAD KHATEEB, 2015).

The scholarly research resulted in the formation of the audit risk model implying interaction and mutual influence of the three determinants: the inherent risk, controls risk and risk of invisibility (Levan Sabauri, 2017). The research also led to the development of the qualitative and quantitative risk assessment methods.

As against a wide range of approaches to the audit risk assessment, there is a general scholarly consensus regarding its management. From the very beginning, the auditors recognized uncontrollability of the overall audit risk elements, such as the inherent and controls risks as against the risk of invisibility relatively controllable by the auditor which may be reduced through a number of means (Sabauri, Levan; Kvatashidze, Nadezhda, 2016).

Largely due to the above-mentioned prevalent view, the audit risk management tasks were not defined. No attempt was made at developing the risk management methodology either.

Therefore, the present status of the audit risk assessment and management does not comply with the increasingly stringent requirements regarding the quality of the audit, which adds up to the urgency of this study (Sabauri, Levan; Kvatashidze, Nadezhda, 2018).

The objective of the study is the development of the comprehensive approach to the audit risk management and its testing at the audit firms.

The Object and Methods of the Study

The object of the study is the audit risk as the probability of the auditor's error which may occur in the verification of reliability of the financial statement.

Also, the object of the study is the systematic audit risk

management. The research is based on the dialectic method. We also applied the systematic, process approaches, as well as the applicable and special methods.

The practice of the audit and an in-depth analysis of the audit risk model may make the generally accepted approach to the audit risk management somewhat questionable for the reasons below:

Firstly, the probability of significant reduction of the inherent and controls risks in the repeated audit performed by the audit firm regularly engaged by a commercial entity is quite high (Levan Sabauri, 2016). The fact is that if the attitude of the Management of an entity to the audit is adequate, its accounts office and the internal control units will take preventive measures regarding the system and methodological errors and try to comply with the recommendations provided in the audit report.

Secondly, in the stage-by-stage auditing of a reporting period performed as a part of the customer service, the auditor may also influence the inherent and controls risks, which reduce as the audit progresses.

Thirdly, management of the overall audit risk by "the traditional method" of the invisibility risk reduction is impossible without monitoring the "risk explosion" during the audit and the efficient, regularly adjusted risk prevention measures envisaged by the audit program.

Finally, the material inaccuracies of the risk assessment can be eliminated by means of due analysis of the inherent risk management in terms of completeness, adequacy and actual performance of the accounting policy.

Also, we believe that the reduction measures of the invisibility risk, which may be considered as the only one to be possibly influenced by the auditor, call for a larger scope and more complex audit procedures, which understandingly increase the costs and take longer. Both these factors make it harder to achieve the objective of the audit due to the issues below:

- the higher the prime cost of the audit, the smaller its cost efficiency;
- prolongation of the audit period may result in the delayed information supply to the users of financial statements;
- the longer the audit, the costlier the service, which

may result in the refusal of the Management of a company to revise the contract value;

- because of the lack of time and money, the auditor may refuse to provide his opinion and thus make the audit a failure as its objective of diminishing the information risk was not achieved.

Therefore, it seems necessary for the auditor to put forward a hypothesis as to the influence on all the determinants of the audit risk (the invisibility, controls and inherent risks) and its possible management (Michael Gibbins, Steven Salterio, Alan Webb, 2001).

THE RESULTS AND REVIEW

In order to vindicate the hypothesis and its practicability, the author suggests his comprehensive approach to the audit risk management.

The approach is based on the positioning of the rolling audit repeated by the audit risk management procedures and stages, which makes it possible to put together the proposals in terms of feasibility and the information supply. In the development of the audit risk management approach, special attention should be paid to the ways of direct influence on all the risk determinants and their involvement in its management (Levan Sabauri, 2015).

The suggested approach implies that the first-stage audit during which the auditor thoroughly familiarizes himself with the activities of the audited entity should rely on the results of analysis in terms of completeness, adequacy and actual implementation of the entity’s accounting policies. The additions and relevant changes to the accounting policy of the audited entity make it possible to reduce the inherent risk even before the audit has been planned. The information on how much the inherent risk has been reduced is applied for adjustment of the initial planning parameters of the audit (stage 2). The repeated rolling audit method and the

“risk explosion” monitoring and balancing are applied in the third-stage material audit. The method implies a repeated audit of an entity by the regularly engaged audit firm. It is also employed in the customer service for a stage-by-stage an audit in a reporting period. The repeated rolling audit influences the inherent and controls risks. The risk monitoring results and the balancing measures affect reduction of the invisibility risk. By means of the feedback, the amount of reduction of all the risks is to be taken into account in updating the audit program.

After the third-stage audit, the information concerning the detected material deflections and errors together with the actual value of the audit risk is to be analyzed for the purpose of the assumptions underlying the audit opinion on the reliability of the financial statement verified in the final-stage audit (Taylan Altıntaş, 2010).

The procedures and methodological solutions of the approach demonstrate the potential of the audit risk management by influencing all rather than the invisibility risk solely which makes the comprehensive management of the overall audit risk possible. By employing the comprehensive approach, the audit firms can significantly reduce the audit risk.

In order to check the above approach, we conducted a set of tests implying the auditor’s influence on the status and dynamics of the audit risk determinants during a mandatory audit. The approach was applied in auditing the 2015 financial statements of some of the industrial, commercial and service entities. Below, there are the results of employment of the repeated rolling audit method, a part of the aforementioned comprehensive approach.

The assessment results of the internal control system (ICS) in the reporting year may be set out in the auditor’s summary working paper showing how much the value of the controls risk changed in the investigated period (Fig. 1).

Fig. 1. The Controls Risk Dynamics in the Employment of the Repeated Rolling Audit Method

The investigated (audited) factor	Assessment of Reliability of the Internal Control System; Points				Decision on the effect on the auditor’s assumption regarding the materiality of the omissions and reliability of the financial statement
	1 quarter	2 quarter	3 quarter	4 quarter	
The Management’s signatures on all the economic contracts	5	7	8	8	Recommendations Fulfilled
The management style and principles	6	6	6	7	Insignificant affect
Organizational Set-up	Uninvestigated	2	3	3	Action taken

Distribution of Powers and Responsibilities	4	5	6	6	Action taken
Staffing policy	3	3	4	4	No affect on the reliability
Management accounting	0	3	4	5	Action Taken
Compliance of the economic activities with the legal requirements	5	6	7	8	Action Taken
Availability of the audit commission, auditors, internal auditors	4	4	7	7	Action Taken
Compliance of the accounting policy with the legal requirements	6	8	8	8	Action Taken
Accounting office set-up	3	4	4	4	Action Taken
Availability of the document flow schedule and meeting it	0	4	6	7	Action Taken
Distribution of Powers and Responsibilities among the accounting office staff	2	4	4	4	Action Taken
The way of accounting the economic transactions	2	3	4	4	Omissions eliminated
Preparation of the financial statements	4	6	6	6	Action Taken and omissions eliminated
Accounting automation degree	3	4	5	6	Action taken
Critical areas of accounting	3	4	5	6	Action Taken and omissions eliminated
Staff accountability	2	4	4	4	No affect on the reliability
Omissions in the internal control system disregarded by the Management	3	4	5	6	Action taken
Sale of the material part of the assets	2	3	3	3	No affect on the reliability
Changes to the information systems	2	3	3	3	No affect on the reliability
The unusual, rare transactions in the audited period	3	3	3	3	Undetected
Too many adjustments in the financial statement at the end of the reporting period	3	3	3	3	No affect on the reliability
Punitive measures against those breaching Laws and the internal regulatory documents	2	3	5	6	Action taken
Material gap between the stock-taking results and accounting data	3	5	7	7	Insignificant inadequacy
Consideration of the previous audits	2	4	5	6	Action Taken and omissions eliminated
Assessment of experience and competence of the accounting office staff	3	3	4	4	The Management should pay attention to skill-sharing
Professional development of the accounting office staff	0	1	1	1	The accountants' training needed

Status of the Budget and counterparty settlement	1	1	1	1	No affect on the reliability of the financial statement
The owner and management support to the accounting policy	2	3	4	5	Action Taken and omissions eliminated
Retention of the assets	4	5	6	7	Action Taken and omissions eliminated
Possibility of unauthorized access to the computer system	3	5	6	6	Omissions eliminated
The Management ready to correct errors	Inapplicable	5	6	6	The Management ready to correct errors
Introduction of the performance standards and control over the fulfillment	Inapplicable	3	4	4	No affect on the reliability
Analysis of the reasons behind the gap between the standard and actual indicators	Inapplicable	–	–	1	No affect on the reliability
Snap stock-taking	3	5	6	7	Insignificant influence
Value of the controls risk	52 %	30 %	19 %	12 %	–

As shown in table 1, the cooperation between the auditor and the accounting office staff of the audited entity resulted in the reduction of the controls risk to the acceptable level which makes the auditor's opinion regarding the reliability of the financial statement trustworthy. The summary paper is fairly informative in terms of dynamics of the controls risk. The situation in question makes it clear that employment of the repeated rolling audit techniques makes it possible to avoid most of the omissions detected in the reporting year.

The uneliminated omissions: the minor gap between the stock-taking results and accounting data; insufficient professional development and skill-sharing among the accounting office staff; irregular snap stock-taking (David Hay, W Robert Knechel, Helen Ling, 2008). It should be said though that the omissions have but minor affect on the reliability of the financial statement. However, that does not mean that the auditor's opinion should not be taken into account.

The figure below shows the controls risk dynamics in the audited enterprises, where the comprehensive approach comprising the repeated rolling audit techniques was tested.

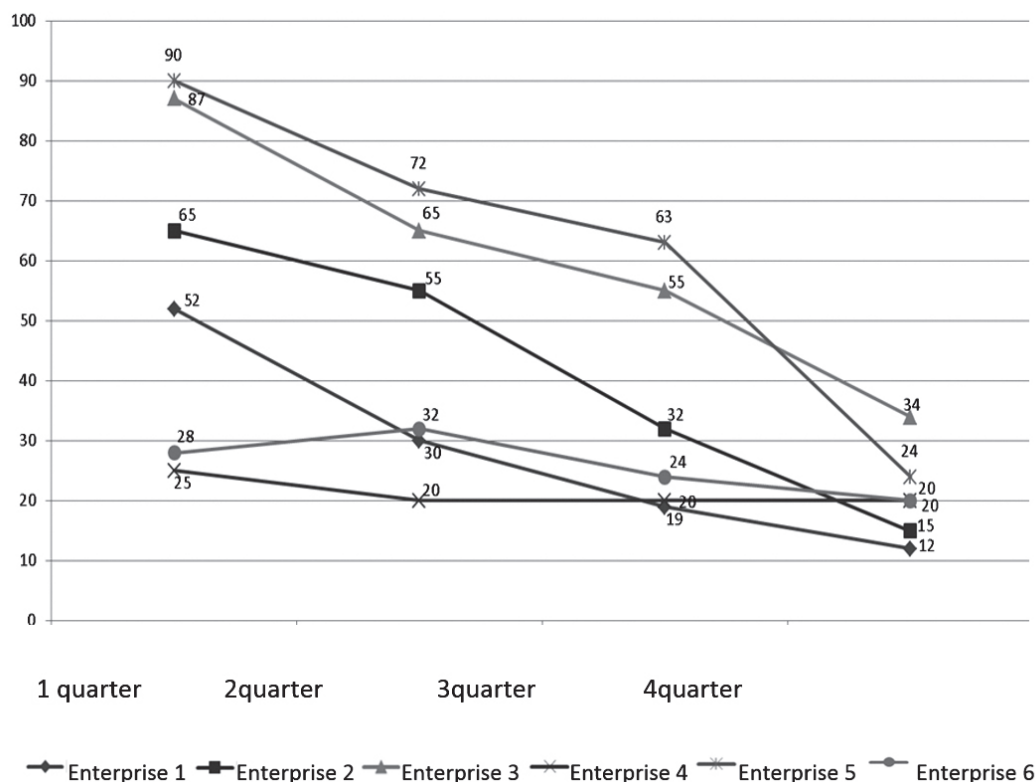
Obviously, employment repeated rolling audit

techniques made it possible to significantly reduce the controls risk of all the companies where the comprehensive approach was tested. The tests also confirmed 10% cut of the audit costs, which is another evidence of its efficiency in terms of the audit risk management.

CONCLUSIONS

1. The auditor and the enterprise can affect the material inaccuracies' risk.
2. The audit risk management tools: the rolling audit technique, use of the research analysis results, adequacy of the accounting policy and its actual pursuance, the ongoing monitoring and balancing the inherent and controls risk "explosion" by affecting the invisibility risk.
3. The auditor plays a key role in the audit risk management.
4. The auditor-enterprise work may bring down the audit risk to the acceptable level, cut the audit time and upgrade its quality.
5. Application of the suggested comprehensive approach in the audit confirms the hypothesis of the auditor's potential influence on each and every determinant of the audit risk.

Fig 2. The controls risk dynamics where the repeated rolling audit technique is employed.



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SUMMARY

The paper describes the problems concerning assessment of the audit risk and its management on the initial planning and further stages of audit. It also deals with a comprehensive approach to the audit risk, which makes it possible

to manage it by influencing all its determinants and the way the audit firms apply it for the sake of time-saving in the measurement of the control risk. We also developed the audit risk management logic chart.