IMPACT: International Journal of Research in Business Management (IMPACT: IJRBM)
ISSN (P): 2347-4572; ISSN (E): 2321-886X
Vol. 6, Issue 11, Nov 2018, 1-6

EFFECTIVE WAYS OF THE ASSESSMENT OF AUDIT RISK COMPONENTS

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Received: 24 Oct 2018 **Accepted:** 01 Nov 2018 **Published:** 10 Nov 2018

ABSTRACT

The article describes the approaches how to assess the internal and control risk. Proposed the actions of the auditor in assessing two components of audit risk which can be applied by company. Besides of it analyzed methods of assessment of internal and control risk which can significantly simplify risk assessment and reduce labor costs for its implementation.

KEYWORDS: *Internal Risk, Risk of Control, Methods of Assessment, Interval Estimation, Qualitative and Quantitative Assessment*

INTRODUCTION

The internal risk in the West is often referred to as an inherent risk. Western auditors interpret the concept of internal (on-farm, inherent) risk somewhat more broadly. So, according to SAS 47 the inherent risk is the exposure of any indicator to material distortion, provided that there is no related distortion of rules or procedures within the internal management structure. Inherent risk includes the relative risk of distortion of some indicators, as well as external factors - technological advances or the deterioration of the situation in the industry [1].

And, according to SAS 47, the risk of control is the risk that the occurrence of a material misstatement of a record in any indicator of financial statements will not be prevented or detected in a timely manner using the rules and procedures of internal control [1].

Internal and Control Risk

At the planning stage of an audit, it is rather difficult to assess internal risk with high accuracy, therefore we, as one of the possible options, suggest the following approach - the use of interval risk assessment based on the subjective opinion of the auditor. This approach is formally applicable at all stages of the audit, but it is particularly relevant at the planning stage. For interval estimation, two approaches can be used:

- A simple indication of the interval, for example, IR (0.4... 0.5);
- Using the normal law of distribution.

In practice, a simple indication of the most likely, in the opinion of the auditor, the value of the risk range is sufficient. It is obvious that the smaller the difference between the lower and upperrisk estimates, the higher the auditor's confidence in the accuracy of this assessment. For new customers, as a rule, the difference between the lower and upper estimates should be significant, for example, IR (0,6..1,0), for old clients the range may already be, for example, IR

(0,6.0,7).

The second approach to the assessment of internal risk is the application of a test system (question-answer), to which the auditor himself answers and in which information about the enterprise is laid. Moreover, information can be obtained even before the start of the inspection, for example, during the conduct of a preliminary examination. Such information, in particular, may include indicators of external financial statements, number of personnel (including accountants), applied accounting system, activities of the enterprise, etc.

A feature of this approach is the need for appropriate software to analyze the results of the survey. It would be convenient to use neural network models as such software. Such models have an extremely important feature - the possibility of learning and self-learning. Having trained the neural network on the basis of materials of enterprises where an internal risk assessment has already been carried out, the auditor has the opportunity to assess the internal risk of new enterprises. Using the possibilities of training and self-learning, having information on already proven enterprises, it is possible to determine with high accuracy the internal risk for new, previously untested economic entities.

The question may arise: why did we initially determine the internal risk by introducing an interval estimate? Interval estimation has a difficult application in mathematical models. Indeed, it is not easy to directly use the interval estimate in the model. However, this is not required: interval estimation characterizes the subjective opinion of the auditor on the internal risk of a given client. The second approach we proposed allows us to proceed to a strictly quantitative assessment of internal risk.

Knowing the results of two assessments, the auditor at the final stage takes the specific value of internal risk and uses it in the model. Moreover, the choice is made on the basis of professional judgment with the use of the principle of caution (prudence).

The actions of the auditor in assessing internal risk can be proposed as follows:

- The method of expert assessment (MEO) (subjective assessment), then the decision on the value of internal risk;
- Estimation using the neural network model, the decision on the value of internal risk.

From the point of view of verifying the registration of primary documents, the auditor is faced with one of two options: the document is drawn up correctly or with violations. Execution of a document with violations indicates the ineffectiveness of internal control, but by itself does not allow to assess its measure. To do this, you need to know the number of documents that are aligned as a result of exposure to the control environment. In practice, it is difficult to obtain such information, in most cases document does not differ from the document originally compiled correctly.

When comparing the concepts of internal and control risk, it is impossible not to pay attention to the fact that both these risks are internal for the enterprise and external for the auditor. Indeed, the auditor is not able to directly affect their value. Only in subsequent reporting periods, these risks can be reduced by the recommendations of the auditor. In addition, from the point of view of the possibility of quantitative assessment, their separate determination is difficult, since the auditor encounters with the documentation, which has already passed the correction stage by means of internal control when checking, which is not always possible to accurately assess. Indeed, with corrections, often some documents are simply re-compiled, and incorrect ones (old ones) are destroyed. Under these conditions, it is extremely difficult to accurately assess the effectiveness of the control system.

In addition, it may not be entirely appropriate. Because, in the course of verification, the fact of the presence or absence of significant errors is ultimately important, and not the reason for their presence from the point of view of whether they arose: as a result of the very possibility of errors (intra-business risk) or because not eliminated by internal controls (control risk).

Like internal risk, the risk of control in relation to the client is the internal risk of the client. For the auditor, risk control is an external risk. It is impossible to reduce this risk (at least at the planning stage of the audit), it is important to be able to accurately enough estimate.

The initial judgment of the auditor about the risk of control, as well as about internal risk, cannot be sufficiently accurate. This point of view of the author is also shared by some major audit specialists [2].

Therefore, at the initial stage, it is appropriate to apply an interval estimation. Later, during the process of the audit, this opinion is revised and clarified, the gap between the lower and upper limits of the assessment is narrowed. After testing operations, it is possible to assess the risk of control using statistical methods. At the same time, it is quite possible that it will be necessary to make changes to the audit plan and program, especially if the revised assessment of the risk of control goes beyond the upper limit of the initial (planned) assessment. According to traditional views on the audit technique, the control risk value is clarified, as a rule, in at least two stages: after acquaintance with the organization and production of accounting (as an element of ICS) and with the internal control system itself (first stage) and after detailed tests of ICS (second stage). Each specification of the value of the control risk should be recorded in the working documentation indicating the made (or unproduced) change in the Plan and the Verification Program.

One of the important methods for assessing the control risk is questioning with the subsequent statistical processing of data. It is appropriate to apply the "intellectual" processing of the results of the questionnaire, which includes the analysis of internal contradictions in the answers of the respondents and contradictions in the answers to the same questions by different respondents.

Such an analysis will allow, on the one hand, identifying possible “bottlenecks” in the client’s control system, and, on the other, to prepare special questionnaires for re-interviewing the same people with those questions that did not receive a clear answer on the results of the initial questionnaire. In addition to re-questioning, information can be obtained from oral conversations with the staff of the client. Although the evidentiary value of these evidences is low, they do allow to determine the directions that should be paid special attention during the verification. A particular difficulty is the problem of the numeral assessment of the magnitude of the control risk. To solve this problem, a direct assessment is used based on the subjective opinion of the auditor [3], subjective opinions and correspondence tables [4], and some generally refuse to quantify [5].

Thus, in the current practice of numeral assessment of the control risk, a quantitative assessment is carried out on the basis of a qualitative assessment. In turn, the qualitative assessment is performed at the preliminary stage subjectively, at the subsequent stage using the test system. The tests proposed in the literature allow us to estimate the risk of control qualitatively (as low, medium or high) and are not without subjectivity. [6]. Moreover, the subjectivity in these tests is manifested in two stages:

- Estimation an individual test question (qualitative),
- Making a decision on the results of testing (it is not formalized at all, but is taken on the basis of the subjective opinion of the person who conducted the testing).

How to test the controls with the subsequent numerical evaluation of their effectiveness? The effectiveness of the control environment as an independent element of an enterprise can be reliably assessed only when conducting an audit, starting well before the preparation of annual financial statements. Only in this case, the auditor has the opportunity to at least qualitatively assess the effectiveness of the control system of the inspected subject.

For quantification, an appropriate rating system is required. Formalizing the results of a qualitative assessment based on the available tests is practically impossible.

Evaluation of the effectiveness of the control environment for the segments is carried out simultaneously in two sections: by the number of documents and by the sum equivalent of the operations of these documents. The essence of the assessment is to identify those documents that were initially taken into account and reflected with errors, and then, as a result of the control environment, these errors were corrected.

To do this, it is necessary to identify the documents that were initially reflected incorrectly, which is quite difficult in practice, since corrections are often made, by re-registering the business transaction, which eliminates the possibility of control by auditors. Only some software tools (but not all) allow you to track and record all changes made to the accounting database.

However, it is still possible to obtain some information about the effectiveness of the control environment, for example, information about corrected incorrect assignments of primary documents, corrected incorrect amounts in reports of reporting persons, etc.

The effectiveness of internal control is calculated as the ratio of the number (amount) of documents in which errors are eliminated to the total number (amount) of documents in which errors occurred before the impact of the control environment.

The risk of control is the value of the inverse efficiency of internal control and is estimated as the ratio of the number (amount) of documents in which errors have not been eliminated to the total number (amount) of documents in which errors occurred before the impact of the control environment.

Based on the evaluation results, the following are also automatically calculated indicators:

- Total control risk (average),
- The maximum value (by quantity and amount).

According to the results of comparing the average and maximum values of the risk of control in quantitative (qualitative assessment) and total terms (which is more accurate and correct), the auditor decides on the “decide value” of the risk of control. The advantages of this method of assessment, according to the author, are:

- Clear formatting of both the source data and the results.
- The relative ease of use.

Assessment of control risk by segment is carried out simultaneously in two sections: by the number of documents and by the sum equivalent of the operations of these documents. The essence of the assessment is to identify documents (operations) that contain errors (incorrectly reflected in the account). These documents (operations) are entered in the lines of the form (form) corresponding to the nature of the violation.

According to the results of comparing the average and maximum values of control risk in quantitative and total terms, the auditor makes a decision on the accepted value of the integral indicator of internal risk and risk of control.

The advantages of this method of assessment are:

- Availability of the necessary information base,
- The simplicity of calculations (minimum labor costs),
- High reliability (due to the non-use of the sampling method in the formation of the initial data).

The judgment about the internal (inherent) risk is estimated by us subjectively at the planning stage of the audit and during the audit, as a rule, does not change. The judgment of the risk of control during a review may change more than once.

The risk of undetected can also change, for example, when the sample size changes as a result of a change in the test program. With a constant acceptable risk, the risk of failure to detect may change if you change the judgment of control risk, which will require a change in the sample size.

CONCLUSIONS

Of the two components of audit risk that change during an audit, the risk of control is paramount because of the risk of undetected changes due to a change in the judgment of the risk of control. To use in modeling audit risk, not only the traditional division of it into three components, but also to apply the assessment of the integral indicator of internal risk and control risk. This technique can significantly simplify risk assessment and reduce labor costs for its implementation. To use quantitative methods for assessing audit risk and its components, not limited to the qualitative assessment of "low", "medium" and "high".To proceed, if necessary, due to the content of internal standards, to a qualitative assessment of audit risk based on the results of its quantitative assessment, and not contrariwise. Thus, quantitative risk assessment can be used as a step to move to a qualitative assessment. To fix in the internal standards of audit organizations specific methods and procedures for assessing audit risk applied by this organization.

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