

A Brief Discussion of Audit Risks and Their Causes

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Abstract: As a crucial supervisory department overseeing economic operations, the audit department plays a pivotal role in safeguarding the healthy development of the country's economy, exposing corruption, and effectively maintaining social and economic peace and stability. The work of auditing involves detecting existing issues, providing remedies, and consistently contributing to national governance. However, as the market economic environment undergoes continuous changes, legal systems advance, and the audit environment becomes more complex, audit risks have gradually gained prominence. The prevention of audit risks has increasingly captured the attention of audit agencies at all levels. This necessitates audit institutions to continually adapt to new challenges, comprehend risks, and exert effective control over them. This article delves into the causes of audit risks, exploring ways to effectively identify and respond to these risks within a complex and ever-changing environment. The objective is to ensure the objectivity and accuracy of audit reports, allowing the audit function to truly serve as an "immune" system, protecting public interests.

Keywords: Audit risk; Reasons; Audit environment

Online publication: December 22, 2023

1. Introduction

In China's economic and social development, auditing emerges as a vital component in maintaining social and economic peace and stability, functioning as an independent supervision mechanism. Given the continuous changes in the market economic environment, effective prevention of audit risks has progressively become the focal point of both audit practice and research. Therefore, delving into audit risks and their underlying causes holds significant practical importance for enhancing the quality of audit work and ensuring the fairness and accuracy of audit results^[1].

2. Audit risk concept

National audit risk encompasses various risks that may arise due to actions or inactions of the audit agency and auditors during the audit process, influencing the healthy development of the audit industry. In simpler terms, it pertains to the financial revenue and expenditure of the audited unit, with a potential for significant errors and frauds escaping auditor detection, leading to inappropriate audit conclusions. At the core of this concept lies

the inherent uncertainty in audit work, highlighting the possibility that, even when adhering to audit standards and procedures, not all financial errors may be uncovered. The presence of audit risks necessitates auditors to exercise professional judgment in performing their duties and adopt suitable audit strategies to diminish the likelihood of errors in audit opinions, ensuring the reliability of audit quality ^[2].

3. The composition and main characteristics of audit risk

3.1. Inherent risks

Inherent risk encompasses the likelihood that specific account balances or transaction types may be inaccurately presented, even within an effective internal control environment. This risk arises from the inherent nature of the audited unit, the operational context, and the intricacy of financial reporting itself. It is distinct from the design and implementation of the unit's internal control system, instead being influenced by external factors and the unit's attributes. For instance, in the case of public institutions, units relying on operating income may face higher inherent risks compared to those relying solely on fiscal appropriation income, given their more complex economic and financial systems. Additionally, units receiving significant special funds at various levels may incur greater inherent risks. When evaluating inherent risks, auditors must consider multiple dimensions, such as unit characteristics, operating conditions, and the unit's financial status, to identify areas with higher risks and adjust the audit plan accordingly ^[3].

3.2. Control risks

Control risk represents the likelihood that an entity's internal control system will fail to prevent, promptly detect, and correct misstatements in financial reports. This risk indicates that, despite the presence of internal controls, they may be ineffective due to poor design or implementation. For example, a unit might have established an attendance system with a time clock machine, but internal control failure may occur if employees manipulate clock-in entries through various methods, indicating a failure in adherence to internal control procedures due to inadequate supervision or resource allocation. Control risks encompass improper failures, such as insufficient workforce in key audit links and defects in technical systems ^[4].

3.3. Inspection risks

Inspection risk pertains to the risk that the auditor's audit procedures may fail to uncover material misstatements, even if such misstatements exist in the financial statements. This risk is connected to the auditor's selection and execution of audit procedures. The magnitude of inspection risk is influenced by the appropriateness and effectiveness of the audit procedures, including whether they are designed to capture potential misstatements and whether auditors can execute these procedures effectively. To mitigate inspection risks, auditors must design appropriate audit methods to ensure the adequacy and appropriateness of audit evidence ^[5].

3.4. Objectivity and controllability of risks

Audit risks are objective, and auditors cannot completely eliminate them. However, auditors can employ various measures and methods to strictly adhere to audit procedures, continually enhance audit methods, and strive to minimize audit risks and potential losses. This implies that, while risks are inherent, they are also controllable through proactive audit practices ^[6].

4. Causes of Audit Risks

4.1. Limitations of audit information

There exists an asymmetry of information between the audit agency and the audited unit. The audit agency typically possesses less relevant economic information than the audited unit, and the information it acquires is relatively limited. Auditors often conduct reviews based on the information provided by the audited unit, making necessary extensions before rendering audit judgments. However, these materials may not fully represent the entirety of the reviewed matters, and some might have been tampered with. Auditors, lacking expertise in discerning truth from forgery, may form audit conclusions that carry inherent audit risks.

4.2. Restrictions on auditing methods

Modern auditing methods highlight the delicate balance between audit costs and risks. The adopted audit procedures allow for the presence of certain audit risks. Auditors must navigate the challenges of heavy workloads, limited personnel, and tight deadlines. Most audits resort to sampling methods, inherently prone to errors due to their nature of inferring population characteristics based on samples. Regardless of the chosen sampling method and size, there are always certain errors, introducing audit risks to varying extents. Unlike departments such as the Discipline Inspection Commission and Public Security, auditors are constrained in employing strong measures when scrutinizing key matters. The limitations of auditing methods create a challenging situation, exposing audit work to the risk of insufficient scrutiny and incomplete discovery ^[7].

4.3. Inadequacy of laws and regulations

The legal environment constitutes a crucial component of audit risk, regulating the financial and auditing conduct of audited units through the formulation and implementation of laws, regulations, standards, and policies. However, with the continuous evolution of the economy and society, relevant laws and regulations often lag behind and lack comprehensive coverage. Consequently, certain economic matters lack clear regulatory guidance. Auditors find themselves unable to resolve specific issues based solely on existing laws and regulations, relying instead on professional judgment. This, to a certain extent, heightens the difficulty of auditing and introduces audit risks ^[8].

4.4. Imperfect quality control of audit institutions

The internal quality control system of an audit institution is pivotal for ensuring the quality of audit work and minimizing risks. This system encompasses the standardization of audit processes and methods, and the supervision and evaluation of audit results. If an audit institution fails to establish an effective quality control system or if the system is flawed, the audit work may struggle to adapt to the complex and dynamic audit environment, thereby increasing audit risks. For instance, a lack of appropriate supervision mechanisms may lead the audit team to adopt inadequate audit methods or overlook key audit evidence, ultimately resulting in errors in audit opinions ^[9].

4.5. Low quality of the auditors

The professional quality and personal ethics of auditors significantly influence the control of audit risks. The strength of auditors' judgment directly impacts the quality of their work, necessitating comprehensive qualities such as professional ability, ethics, and prudence. For example, a low overall quality of auditors during the sample selection process can lead to errors such as missing items and audit inaccuracies, posing risks. Simultaneously, if auditors lack sufficient professional caution, it may result in deviations in audit behavior,

influencing the final audit results and introducing unnecessary audit risks. The risk becomes critical if auditors compromise their professional ethics and engage in private dealings with the audited unit on major issues.

5. Audit risk prevention and control

5.1. Actively create a favorable audit environment

To prevent and control audit risks, it is imperative to actively construct and maintain a conducive audit environment. Firstly, there is a need to foster broader oversight by enhancing public awareness of audit reports and the significance of audits. Social scrutiny can compel audited units and audit institutions to adhere to higher standards, reducing the likelihood of corruption and errors. Secondly, by promoting legal literacy, the public's accurate understanding of auditing work is heightened, creating societal pressure for the expectation and standardization of auditing work ^[10]. Furthermore, collaborative efforts to promote and supervise the development of industry standards through oversight and guidance from higher-level agencies, along with disciplinary inspection linkages, are crucial aspects of cultivating a positive audit environment. These measures cultivate an environment that is more tolerant, understanding, and supportive of audit work, consequently mitigating audit risks.

5.2. Establish and improve internal operating mechanisms

For audit institutions, the establishment and enhancement of internal operating mechanisms serve as the bedrock for preventing and controlling audit risks. This necessitates the design and implementation of internal control measures to ensure the quality and efficiency of audit work. In this process, the development of a rigorous quality management system is essential, encompassing various aspects such as the formulation of audit plans, the collection and evaluation of audit evidence, and the preparation and review of audit reports. Regular internal quality reviews should be conducted by audit institutions to ensure alignment with professional standards and regulatory requirements, promptly identifying and rectifying any issues that may compromise audit quality.

5.3. Risk prevention and control during the audit process

5.3.1. Planning stage

As Benjamin Franklin once said, "By failing to prepare, you are preparing to fail." A well-crafted audit plan can significantly reduce audit risks. The planning stage of the audit requires a deep understanding of the audited unit's business environment, internal control system, and historical financial information, with the identification of potential audit risk points. In this phase, the institution should use professional judgment to formulate audit and implementation plans, determining resource allocation, key audit areas, and specific matters requiring attention. Simultaneously, to enhance the effectiveness of risk prevention and control, the audit plan should assess the nature, timing, and scope of audit evidence. Through meticulous audit planning, we ensure that the focus of the audit work aligns with the most critical risk areas, thereby improving the relevance and effectiveness of risk prevention and control.

5.3.2. Implementation stage

During the audit implementation stage, auditors rigorously execute audit procedures and carry out specific tasks in line with the audit plan. This includes collecting and analyzing audit evidence, testing the effectiveness of internal controls, and conducting substantive audit procedures. Risk prevention and control in the audit implementation phase require auditors to maintain a high level of professional skepticism, assess the reliability and sufficiency of evidence, and thoroughly investigate any anomalies or inconsistencies discovered. Auditors

should utilize appropriate audit techniques and tools to ensure the accuracy and completeness of audit evidence. Simultaneously, effective communication among audit teams and the appropriate peer review of significant judgments and estimates are necessary to enhance audit quality.

5.3.3. Audit report stage

At this stage, the auditor needs to form an audit opinion based on the collected audit evidence and completed audit work. To ensure the accuracy and fairness of the audit opinion, auditors should conduct a comprehensive evaluation of the audit evidence, confirming the adequacy and appropriateness of the evidence supporting the audit opinion. When drafting an audit report, the conclusions should be expressed clearly and accurately to prevent misunderstandings and ensure the objectivity and validity of problem descriptions. Additionally, the audit institution should implement a structured audit report review process to guarantee that all significant audit findings are appropriately reflected, thereby preventing and controlling risks arising from omissions or misstatements of information.

5.4. Comprehensively improve the comprehensive quality of auditors

Firstly, strengthening the study of professional knowledge forms the foundation. Audit institutions can regularly organize internal training to update auditors on the latest auditing standards, audit reporting standards, and innovative auditing technology methods. Simultaneously, auditors are encouraged to participate in external seminars and engage in “review instead of training,” fostering increased communication with audit leaders to glean insights into cutting-edge auditing technologies and methods.

Secondly, to enhance auditors’ practical ability, simulated audit cases can be incorporated, allowing auditors to engage in practical exercises in a simulated environment. This approach fortifies their capability to navigate complex audit situations, fostering adaptability and judgment. Beyond cultivating professional skills, emphasizing professional ethics education is crucial. Audit institutions should conduct regular ethics training to bolster auditors’ professional ethics and adherence to independence principles. Through case analysis, auditors can grasp the pivotal role of professional ethics in audit work and the severe consequences stemming from professional misconduct.

Finally, audit institutions should establish a supportive learning culture, motivating auditors to continually improve themselves. Providing auditors with learning resources such as online courses, professional books, and the latest research reports further contributes to a culture of continuous improvement.

6. Conclusion

In summary, effective management of audit risks is the linchpin for ensuring the quality and reliability of audit results. A thorough analysis of the causes of audit risk reveals a diverse set of factors that are interrelated and mutually influential. Consequently, audit institutions and auditors must establish a comprehensive and systematic risk management system. This should begin with optimizing the audit environment, assessing the risks associated with the audited unit, rigorously implementing audit procedures, and ultimately improving the overall quality of auditors. This multifaceted approach ensures the effective identification, assessment, and control of audit risks.

Disclosure statement

The author declares no conflict of interest.

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