

Hello. It looks like you're using an ad blocker that may prevent our website from working properly. To receive the best experience possible, please make sure any blockers are switched off and refresh the page.

If you have any questions or need help you can email us

but are you correctly applying it to your engagements?

May. 13, 2019



The audit risk model is the foundation of any audit. This might seem like CPA 101, but are you correctly applying it to your engagements?

In doing so, your first consideration is your client's risks of material misstatement (RMM), which is made up of inherent risk and control risk. As a reminder, inherent risk is the risk of material misstatement assuming no related controls, while control risk is the risk that your client's controls won't prevent or detect and correct a material misstatement. So how do you apply this to your audit?

Understand your client and its environment

Hello. It looks like you're using an ad blocker that may prevent our website from working properly. To receive the best experience possible, please make sure any blockers are switched off and refresh the page.

If you have any questions or need help you can email us

enter? What are its revenue characteristics? How quickly do products change?

- Organization strategies – How does your client address these external factors?
- Financial Performance – Consider your client's financial performance, including key ratios and operating statistics; key performance indicators; employee performance measures and incentive compensation policies; trends, forecasts, budgets, variance analysis, and competitor analysis; and period-on-period financial performance (revenue growth, profitability, and leverage).

With each of these areas, make sure to document the steps you took to gain an understanding, any changes to your understanding of the client from previous years as well as risks identified and whether they are significant.

Understand your client's internal control

Your next step in applying the audit risk model is to obtain an understanding of your client's internal control. You'll want to know what controls (either individually or in combination) are in place, if they are designed properly to meet their objective, and if they have been implemented. Make sure to consider the following:

- Control environment: What are management's attitudes and actions related to internal control? How much emphasis do they put on achieving reliable financial reporting?
- Control activities: For all material classes of transactions, account balances, and disclosures, you'll need to identify the relevant assertion(s), control objective, key controls, whether the control's design is effective or ineffective, and whether the control is properly implemented.
- Your client's risk assessment, information and communication, and monitoring: While smaller entities may not have well-documented controls or procedures in these areas, they likely still have some controls in place. For example, does the owner review financial results on a monthly basis?

Again, you'll want to document your understanding of your client's internal control,

Hello. It looks like you're using an ad blocker that may prevent our website from working properly. To receive the best experience possible, please make sure any blockers are switched off and refresh the page.

If you have any questions or need help you can email us

details). On the other hand, if your client's inherent and control risks are moderate to high, you would plan more rigorous substantive tests in order to obtain more persuasive audit evidence about the assertion as part of your audit.

The key for using RMM to drive detection risk is to remember that the nature, timing, and extent of further audit procedures planned needs to be responsive to the RMM identified.

The audit risk model is the basis for any audit. For a step-by-step guide to help you apply it to your engagements, download our free [Audit Risk Assessment Tool](#), listen to the [latest podcast episode](#) from the Small Firm Philosophies series on risk assessment, and check out other resources on the AICPA [risk assessment resources page](#).

=====

This blog post first appeared on the [AICPA's website](#). It is the third in a series on risk assessment, a significant audit quality issue. View the first blog post [here](#) and the second [here](#).

Bob Dohrer, CPA, is Chief Auditor at the [AICPA](#). Bob previously served as the Global Leader – Quality & Risk for RSM between 2012 and 2018 where he had overall responsibility for the network's audit and other attest services policies, procedures and guidance. He was also responsible for overseeing RSM's global quality inspection programs in accordance with International Standards on Quality Control.

Hello. It looks like you're using an ad blocker that may prevent our website from working properly. To receive the best experience possible, please make sure any blockers are switched off and refresh the page.

If you have any questions or need help you can email us