Audit Risk

Accounting & Finance

The three components, and the one the auditor controls.

Audit risk is the product of inherent risk, control risk and detection risk.

Audit risk = Inherent × Control × Detection

High inherent and control risk More testing.	**Lower detection risk needed**
Strong controls Less testing.	**More detection risk acceptable**
Target audit risk	**Set low and held constant**

THE COMMON MISTAKE

× Thinking the auditor reduces inherent risk

✓ They assess it and respond

Inherent risk comes from the nature of the business. The auditor cannot change it, only test more heavily in response.

> This is why testing is not uniform. Risky, judgemental balances get far more attention than routine ones.