

Audit Risk → Meaning

Inappropriate opinion, when financial statements are materially misstated

→ what is not included

- opinion FS are Materially Misstated when they are Not

→ Does Not Refer to Auditor's Business Risk

Such as loss from litigation

COMPONENTS

IR — Susceptibility of A/c Bal or transaction to a MMS
Because of Nature

Assuming NO IC

A/c Bal, transaction Mein MMS Ke changes
Because of their Nature

— Higher for Some A/c Bal, transaction, Disclosure
Example Complex calculation

— Considered while designing TOC/SP

affected by

External

- Change in Law/Regulation
- Tech Development

Internal

Mgt's Misunderstanding
of Complex A/cing guidance

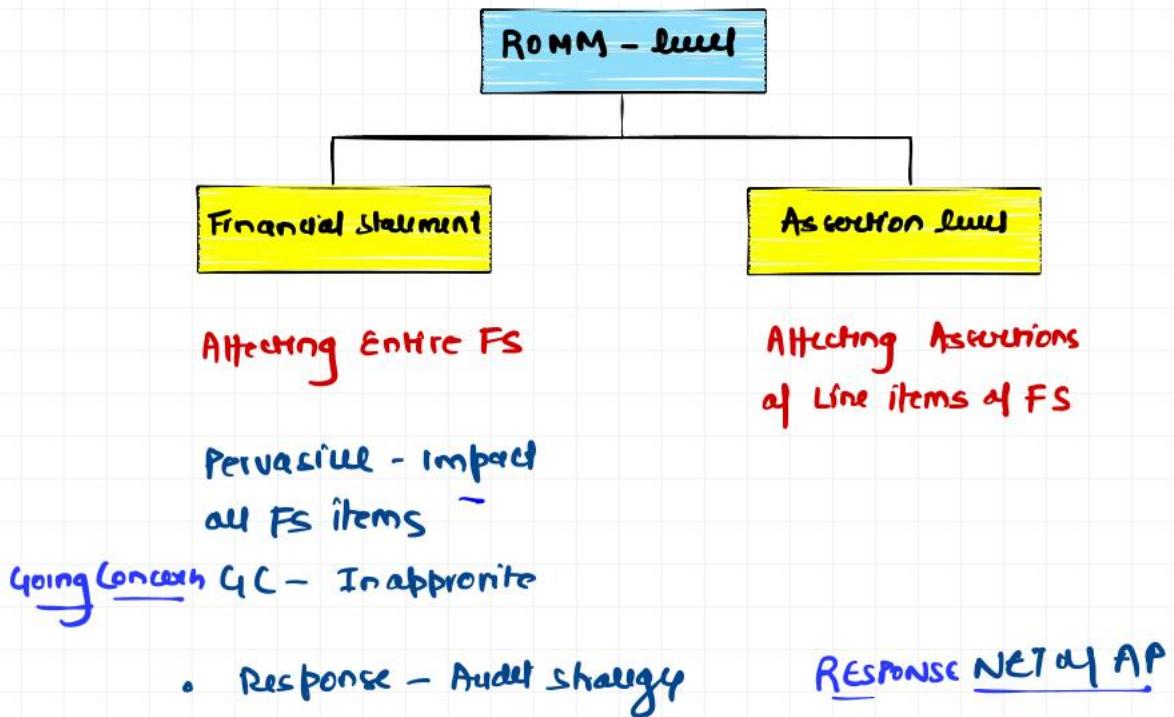
Control Risk — Risk of MMS in Assertion —
 NOT Prevented / Detected / Corrected
 on timely basis by Entity's IC.

- IC Missing
- IC Not operating effectively
- Flaw in Design of IC

Control Risk

CR — Efficiency of IC — Inverse Relationship

- IR CR^{ROMM} — Risk of entity
- exist independently of Audit
- Not influenced by Auditor



Detection Risk

- Risk that Auditor's Procedure will Not be able to detect MMS.

Elements

Sampling

Conclusion Reached based on Sample
MAY BE Different from Conclusion
if Population was tested

Auditor Concludes

- CR Low but Actually High
- MMS does NOT exist
Actually it exist.
- Inapt opinion
- Affects **AUDIT EFFECTIVENESS**

Auditor Concludes

- ②
- CR High, Actually Low
 - MMS exist Actually NO
 - More work - ✓
 - Affects **efficiency**
 - opinion will Not be inapt.

Non-sampling

Factors Not Related to Sampling

- Not adequate understanding of entity.
- Not able to carry out risk assessment properly.
- Inadequate audit strategy.
- Inadequate plan.
- Incompetent audit program.
- Misapplication of audit procedures by the team.
- Miss interpretation of test result.
- Poor quality audit management. **DSIR**

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Can be minimised through proper planning,
assigning appropriate staff, application of
professional judgement, proper direction,
supervision, and review.

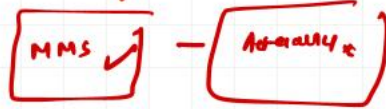
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Sampling Risk

• $\frac{CR \text{ Low}}{\text{Sample}}$ Actually High

• MMS_{xxx} - Actually Exid U

CR High - Actually Low



• OPINION

• EFFECTIVENESS

Opinion will be not to
Incorrect.

Efficiency

Relationship between risk of material misstatement and detection risk

$$\begin{aligned}\text{Audit Risk} &= \text{ROMM} \times \text{DR} \\ &\text{OR} \\ &= \text{IR} \times \text{CR} \times \text{DR}\end{aligned}$$

Assessment of risk is a matter of professional judgement - Rather than a matter capable of precise measurement.

Example: An auditor evaluating the risk of financial misstatements at a conglomerate like Adani Group must use their professional judgment to consider factors such as management practices, industry trends, and regulatory environment, rather than relying solely on numerical data.

Significant risk

- o Risk that require special audit consideration is known as significant risk
- o Auditor shall determine whether any of the risks identified are significant risk
- o He will use his professional judgement for such determination
- o Factors to be considered while exercising judgement to decide which risk are significant risks are as follows.

Fraud

Development

Complexity

Related parties

Subjectivity

Unusual transactions