

Assessing Materiality and Risk Simulation

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The Assessing Materiality and Risk simulation identifies risks and important components of the auditing process. Some accounts must be audited 100%, whereas some are sampled. Other accounts require a combination of details and components to achieve precise results. Three risks that make up audit risk are interrelated.

Risks

The three interrelated risks are inherent risk (IR), control risk (CR), and detection risk (DR). This interrelation is perceived when the organization is sensible to material misstatement (undetected in a poor control environment) propelling inherent risk to a high level and consequently causing higher control risk and higher detection risk. Classifying the risks accordingly helps prepare for audits.

Audits

Certain accounts such as the line of credit, cash, and intangibles must be audited 100%, so users can trust that information and thus make sound decisions for investment. These accounts are relevant to an organization as it represents the entity. Investors and management appreciate accounts audited accordingly and materiality accounts that are allocated correctly.

Sampled Accounts

Considering the assurance required materiality is allocated to choose the required sample size (extent of audit). The main aim of auditing financial statement is for the auditor to express an opinion if the preparation of the financial statement “with respect to all materials” is in accordance with the provided reporting financial. Usually auditors mandated the task of determining the level of acceptable materiality to detect material misstatement quantitatively. Items that can affect the judgment of a reasonable individual are thus sampled to verify purposes

and materiality allocated only for the sampled accounts (Rittenberg, Johnstone, Gramling, & Schweiger, 2009, p. 130). This minimizes audit risks.

Audit Risk

Audit risks are in control of the auditor because the level of audit risk is subjective. The auditor predicts where errors occur and change the IR level. In addition the auditor may set CR assertion levels. Consequently, DR is different from IR and CR in that the auditor can change the level of DR, whereas the auditor can only change the assessments with IR and CR.

Conclusion

Assessing materiality and risk are important parts of the auditing process. Auditors plan for time in determining whether to audit an account 100% or to sample an account. The misstatement is projected on to sampled accounts and the tolerable misstatement is a function of materiality. When accounts are audited 100% there is no need to estimate the amount of error. The auditor controls detection risk by the amount of evidence collected by the auditor, whereas inherent risk and control risk are a function of the client.