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Materiality and Risk in Auditing Financial Statements: Research at Vietnamese Auditing Companies

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Abstract
Materiality and audit risk are two basic and important issues in financial statement auditing. On that basis, auditors need to carefully consider factors when assessing materiality and audit risk before conducting any audit. In particular, it is necessary to consider the relationship between materiality and audit risk to determine the content, scope and time of audit procedures appropriately. The article summarizes the content on audit risk and materiality, analyzes some limitations in assessing audit risk and materiality, and thereby proposes some solutions to improve materiality assessment. Weaknesses and risks in auditing financial statements at auditing companies in Vietnam.

Keywords: Audit Risk, Materiality, Independent Audit

Introduction

Financial statement auditing services are considered the main revenue-generating services for independent auditing companies today. Most independent audit firms in Vietnam still use the traditional approach to evaluating materiality and audit risk. However, the trend of international integration in the field of accounting and auditing requires auditing companies to further improve the quality of audits. And to improve audit quality, it is necessary to have solutions to further improve the assessment of materiality and risk in financial statement audits.

Literature Review

According to International Auditing Guide No. 25 (IAG 25) on "Materiality and risk in auditing" drafted and published by the International Federation of Accountants (IFAC): "Materiality is the concept of scale and the nature of the error (including omission) of individual or grouped financial information which in the context of the information is judged to be inaccurate or misleading".

According to International Standard on Auditing (ISA) No. 320 on "Materiality in auditing", materiality is understood as follows: "Information considered material means the absence of that information or the lack of accuracy. The accuracy of that information will affect the decisions of users of financial statements. The level of materiality depends on the importance and nature of the information or error being assessed in specific circumstances. Materiality is a threshold, a dividing point, not the content of the required information. The materiality of information must be considered both quantitatively and qualitatively.

According to Vietnam Auditing Standard (VSA) No. 320: Materiality is understood as "a term used to express the importance of an information (an accounting data) in the financial statements".

The level of materiality depends on the importance and nature of the information or errors assessed in specific circumstances. Materiality is important for audit planning and audit methodology design. Materiality is considered by auditors when determining the content, timing and scope of audit procedures and assessing the impact of misstatements.

Audit risk is the possibility of the auditor making an inappropriate comment, mainly the auditor concluding that the financial statements are presented in an honest and reasonable manner, while the client still has material errors. These violations materially affect users of information on financial statements.

According to VSA 400, "Audit risk assessment is the determination of high or low levels of audit risk that may occur, including assessment of potential risk, control risk and risk. Ro detected. Audit risks are identified before planning and before performing the audit.

Currently, financial audit services still account for a large proportion of the total revenue of independent audit firms in Vietnam. The quality of the audit depends heavily on the assessment of materiality and audit risk. However, the assessment of materiality and audit risk are professional judgments, so they are influenced by many factors and there are still many inadequacies in implementation practice.

The relationship between materiality and audit risk and notes for auditors

There is a close relationship between materiality and audit risk. If the acceptable level of materiality increases, audit risk will decrease. On the contrary, if the acceptable level of materiality is reduced, audit risk will increase.

This relationship is important in determining the content, scope and timing of audit procedures. Overall audit risk is influenced by inherent risk and overall control risk. These two types of risks always exist during business operations. Auditors can only reduce overall audit risk by reducing item audit risk.

Item audit risk will be reduced by balancing the relationship between inherent risk, control risk and item detection risk. The auditor will reduce audit risk by performing audit procedures until there is sufficient appropriate audit evidence for each assertion of each type of transaction and account balance.

Some limitations in assessing materiality and risk

The assessment of materiality and audit risk at many auditing companies has been more complete than before, contributing to improving the quality of audits at these companies.

However, at some auditing companies, there still exist certain limitations that need to be overcome, otherwise it will have a significant impact on the quality of audits in the future. Some remaining issues in materiality assessment and audit risks at current auditing companies include:

Evaluate the level of materiality

Allocating initial estimates of materiality to items on the financial statements is very necessary (audit evidence is often collected by item and not by the entire financial statement).

However, regarding the allocation of initial estimates of materiality to items on the financial statements, there is no consensus among Vietnam's independent audit firms. There are companies that do not allocate materiality levels for items such as FACOM, Deloite Vietnam, AACC, ACCA, CPA Vietnam... Meanwhile, there are some companies that do allocate materiality such as AASC, A&C, AFC... (But this allocation also depends on the auditor's judgment).

It can be said that the determination and allocation of initial estimates of materiality for items on the financial statements do not have uniform consensus among auditing companies and still depend heavily on judgment experience. Of auditors.

Approach to audit risk assessment

Most independent audit firms in Vietnam still use the traditional approach to evaluating materiality and audit risk. It is mainly based on assessments and conclusions about specific items on the financial statements. Meanwhile, according to the newly issued International Auditing Standards, audit firms should use an audit risk assessment approach based on the client's business risk.

Assess audit risk on balances and detailed operations

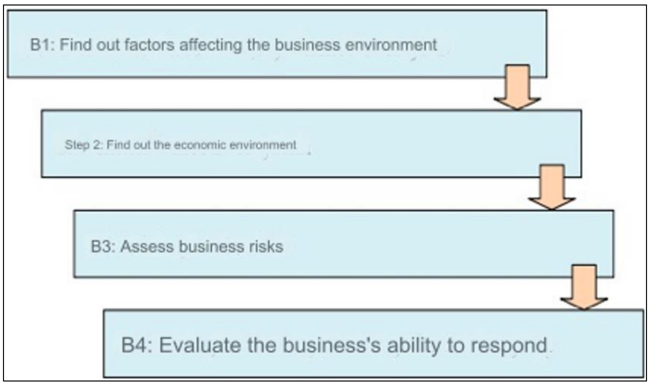
In fact, when assessing potential risks and control risks on account balances and detailed operations, most independent auditing companies in Vietnam have not yet performed assessments for each facility. Reference. While this is extremely necessary, it will help auditors design appropriate audit tests to focus on assertions where errors are more likely to occur.

Assess control risk

In fact, the assessment of control risk of auditing companies currently has two problems.

Firstly, most independent auditing companies conduct an investigation of the client's internal control system, but often do not trust this system, so they always assess the control risk level at the highest level. This makes it no longer meaningful to assess control risk based on companies' internal control systems, leading auditors to mainly use substantive tests, which are often Audits are more expensive than tests of controls.

Second, when understanding the internal control system to assess control risk, auditing companies only mainly prepare questionnaires and reports without focusing on using the Flow Chart method. While using Flow Charts in understanding the internal control system helps auditors get better comments and more easily suggest additional audit procedures.



Source: Compiled by author

Fig 1: Steps in assessing customer business risk

Solutions to Improve Materriality and Risk Assessment in Finacecial Statement Audits at Auditing Companies

The current status of key assessment and audit risks at some auditing companies shows that there are still limitations that affect audit quality. Therefore, solutions to overcome these existing limitations are currently very necessary. Some solutions that auditing companies can apply are as follows:

Complete the assessment of materiality

To overcome the fact that auditing companies have not yet allocated initial estimates of materiality to items, there needs to be specific regulations to uniformly apply the initial estimates of materiality at each point. All auditing companies. Besides, when making the allocation of these estimates, to avoid subjective imposition by the auditor, the allocation level for each item can be made according to size with the following calculation formula:

$$\text{Materiality level temporarily allocated to item X} = \frac{\text{Initial estimate of materiality}}{\sum \text{Balance of allocated items}} \times \text{Balance of item X}$$

Use an audit risk assessment approach according to the client's business risk

Assessing a client's business risks will provide auditors with an important source of data that effectively supports the assessment of risk and materiality on the client's financial statements. In addition, business risk assessment has a significant impact on determining the auditor's level of potential risk or control risk. At the same time, it indirectly helps auditors determine the nature, scope, and implementation time of audit work. Therefore, major auditing companies belonging to the Big 4 group have used this approach to assess audit risk. According to these companies, to assess customers' business risks, auditors should follow the steps shown in Fig 1.

Assess audit risk on account balances and detailed transaction types for each assertion

When assessing audit risk, auditors of auditing firms need to perform risk assessments on account balances and detailed transactions for each assertion, especially in evaluating potential risks and control risks. This will effectively support the design of the audit program because the audit program will be designed in detail for each item or type of transaction. This is what most Vietnamese independent auditing companies need to pay more attention to in the near future.

When assessing potential risks according to the above data bases, to save time, auditors only need to focus on assessing the potential risks of asset items and expenses in a positive manner. Whether the declaration is higher than the actual number and whether debt and revenue items are declared lower than the actual number or not.

Complete Control Risk Assessment

First, the audit firm *needs to perform a control risk assessment based on the assessment of the client's* internal control system. Currently, Vietnamese independent auditing companies, when assessing control risk, often do not trust their clients' internal control systems.

Therefore, the control risk assessment is at the maximum level and the reliability for this system is often 0, leading to the fact that conducting research and testing on the customer's internal control system is no longer meaningful. Meanwhile, in fact, auditors can still rely on clients' internal control systems that have effective systems (to reduce the amount of substantive testing that needs to be used).

In addition, the auditor should prepare a control risk analysis table for each assertion of each item; In particular, clearly indicate for each control objective (corresponding to the data bases), which control procedures the unit has designed and how to operate those procedures. This will help the auditor make an assessment of control risk for each assertion.

Second, increase the use of flow charts in risk assessment control.

The current status of materiality assessment and audit risks in financial statement audits by independent Vietnamese auditing firms shows that the use of Flowcharts to describe the internal control system has not yet been paid attention by auditing companies. There are many different reasons leading to this situation, but the basic cause is still the auditor's fear because they think this method is difficult so they do not want to implement it.

In situations where there is no time or cost pressure, audit firms should encourage their auditors to use Flow Charts to describe the internal control system. The Flow Chart method is advantageous primarily because it can provide an overview of the client's internal control system.

To increase the effectiveness of this method, companies should develop specific instructions on how to implement, conventions and symbols that are used uniformly for the entire company. Because each customer belongs to different fields, auditors need to flexibly apply this method in each specific stage.

First of all, companies need to build a standard symbology system used in the Flow Chart drawing method. In particular, companies can use the proposed symbols provided by the American Auditing Standards Institute.

After building a standard symbol system in the flow chart, it is necessary to guide the auditor on the techniques in drawing the flow chart. For example, use motion lines to indicate the direction of movement and arrow lines should be used whenever it adds clarity. When drawing a flow diagram, the lines of movement should intersect as little as possible. At the same time, the Flow Chart must present separation between responsibilities. In addition, the Flow Chart must include appropriate control processes, comments and explanations; or clearly indicate the origin and place of storage of documents.

Using flow charts in describing the internal control system is very useful, helping auditors easily understand the client in the current year and for the following years, but building a Flow Chart is often difficult. And costs more than using a Narrative Board or Questionnaire (because creating a Flow Chart will take a lot of time). Therefore, auditing companies should apply it to important internal control stages or to the internal control system of some key items or departments of the client, thereby helping to Control risk assessment is performed accurately without being too costly, leading to greater efficiency.

Above are some solutions to improve the ability and efficiency of assessing materiality and risk in auditing financial statements at independent auditing companies today. These solutions will contribute to improving the audit quality of auditing companies in Vietnam in the coming time.

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