

Analysis of the Impact of the Business Risk Audit Approach on Enhancing External Audit Quality: A Case Study of a Sample of Statutory Auditors

تحليل تأثير منهج التدقيق القائم على مخاطر الأعمال في تحسين جودة التدقيق الخارجي: دراسة حالة عينة من محافضي الحسابات

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Abstract: This study examines the impact of the risk-based approach on improving the quality of external auditing in the regions of Tlemcen and Sidi Bel Abbès, located in western Algeria. The objective is to evaluate how this approach enhances the reliability and efficiency of auditing processes. Using a qualitative methodology, semi-structured interviews were conducted with twenty auditors. The findings reveal that the risk-based strategy improves audit quality by enabling auditors to accurately identify high-risk areas, thereby increasing the reliability of financial statements and enhancing the effectiveness of audit operations.

keyword: Risk-based audit approach; external audit quality; audit procedures.

JEL classification code : M42, G32

ملخص: تمت دراسة تأثير النهج القائم على المخاطر في تحسين جودة التدقيق الخارجي في منطقتي تلمسان وسيدي بلعباس، غرب الجزائر. هدف البحث هو تقييم مدى تعزيز هذا النهج لموثوقية وكفاءة عمليات التدقيق. باستخدام منهجية نوعية، أجريت مقابلات شبه منظمة مع عشرين مدققاً. أظهرت النتائج أن الاستراتيجية القائمة على المخاطر تحسن جودة التدقيق عبر تمكين المدققين من تحديد المناطق ذات المخاطر العالية بدقة، مما يساهم في زيادة موثوقية البيانات المالية وفعالية عمليات التدقيق.

الكلمات المفتاحية : نهج التدقيق على أساس المخاطر; جودة التدقيق الخارجي; إجراءات التدقيق

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1. Introduction :

The traditional function of auditing in enhancing the credibility of financial statements is one of the primary objectives that auditors strive to achieve. This role is emphasized by numerous researchers, including Pong and Turley in their study titled "The Role of Audit in Corporate Governance," published in the "International Journal of Business in Society." Audit approaches have undergone significant evolution over four generations. The first generation began with a comprehensive definition of auditing focused on the meticulous examination of all records and financial statements. This was followed by the second generation, known as the analytical audit approach, which relied on analytical methods and statistical sampling to reduce the scope and depth of audit procedures. In the third generation, the audit risk approach emerged, coinciding with the development of risk assessment techniques integrated into auditing processes. Finally, the fourth generation centers on the Business Risk Audit (BRA) approach, which is the focus of our current study.

The main problematic of this study lies in determining how the Business Risk Audit approach affects the quality of external auditing. As auditors face increasing challenges, such as heightened transparency and reliability demands, the question remains:

does this approach contribute to enhancing the effectiveness of audit processes and improving the reliability of financial data?

This study hypothesizes that the implementation of the Business Risk Audit approach enhances the quality of external audits, as it helps auditors better identify high-risk areas, thereby improving the efficiency and reliability of audit operations.

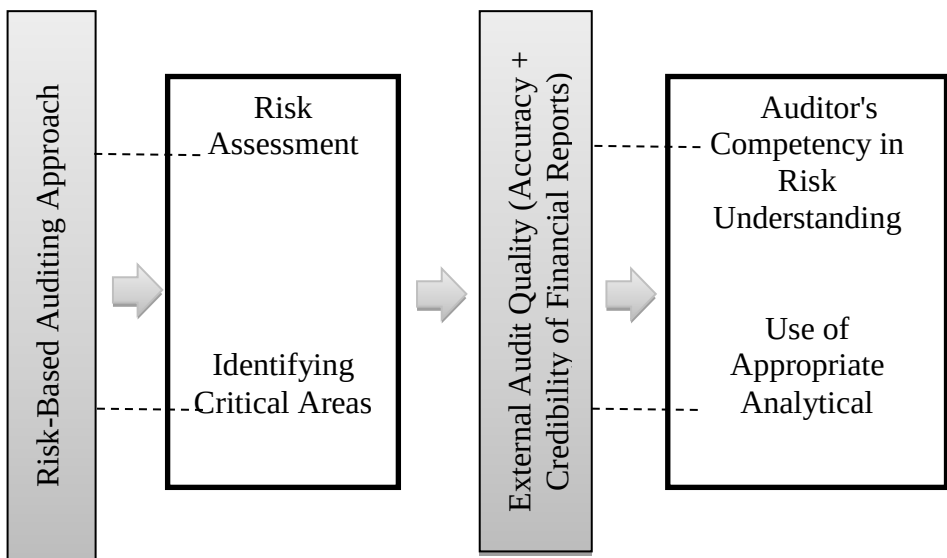
To achieve these objectives, the study will adopt a qualitative methodology that involves conducting semi-structured interviews with a sample of 20 auditors from the western region of Algeria. These interviews will serve as the primary data collection tool,

aiming to provide in-depth insights into auditors' perspectives on the effectiveness of the Business Risk Audit approach. The collected data will be recorded and analyzed qualitatively to identify key themes and trends, contributing to a better understanding of the impact of this approach on the quality of external auditing.

Conceptual Framework:

The conceptual framework represents the theoretical structure of the study and explains the relationship between the basic elements of the study such as the risk-based audit approach and the quality of the external audit. In this context, the conceptual framework can be conceptualized as follows:

Fig.1: Conceptual Framework Diagram for Risk-Based Auditing and External Audit Quality



Source: Prepared by researchers

The Conceptual Framework of the Impact of a Risk-Based Auditing Approach on Enhancing External Audit Quality illustrates the critical interplay between key elements in the auditing process. Central to this framework is risk assessment, which enables auditors to identify and focus on areas most susceptible to material

misstatements. Understanding the client's internal control system is vital for detecting and preventing errors, while auditor competency in risk comprehension and analytical tool utilization further enhances effectiveness.

The framework also emphasizes overcoming challenges such as training gaps and inadequate resources, which are essential for improving the quality of audited financial reports. By addressing these challenges, auditors can foster greater transparency and stakeholder confidence. Overall, the diagram underscores that a risk-based auditing approach not only enhances audit quality but also promotes organizational integrity and accountability.

2. Literature Review:

The history of auditing has undergone significant transformations closely linked to the evolution of accounting, highlighted by the collapses of companies such as Enron and WorldCom, along with the scandal involving Arthur Andersen. These events have underscored the urgent need for enhanced auditing standards.

In the 19th century, auditors relied on clerks to review financial records, shifting in the 1960s to a focus on examining corporate systems rather than individual records. The emergence of large trading houses during the late Middle Ages introduced the concept of profit maximization, leading to a practice of recording only one side of transactions, which in turn facilitated significant embezzlement that was often difficult to trace.

Consequently, there has been an increasing necessity to adopt techniques such as risk assessment, as advancements in computing technology have also significantly impacted the auditing process.

2.1. Adjust terminology:

- **External Audit** is a meticulous and objective process carried out by an independent external auditor, aimed at ensuring the accuracy and integrity of the financial and accounting information presented by an entity. This process involves a comprehensive review of accounting records and financial statements, where the auditor evaluates the extent to which this information complies with applicable accounting standards. At the conclusion of this process, a report is issued that indicates whether the financial statements fairly

and objectively reflect the entity's financial position. (Cohen & Simnett, 2015, pp. 857-858).

- **External audit quality** refers to the effectiveness of the audit process in achieving the required objectives, which include ensuring that the financial information provided accurately reflects the true financial position of the entity. It can be said that external audit quality depends on the auditors' adherence to professional and ethical standards, as well as their skills and competencies. (Iover, Prawitt, & Wilson, 2017, p. 15)

External audit quality also requires auditors to be independent from the entities they audit, which helps minimize conflicts of interest. Overall, external audit quality is a vital element in enhancing trust in financial information, allowing stakeholders, such as investors and shareholders, to make informed decisions based on this information. (Hay, Knechel, & Wong, 2020, p. 10_11)

- **Audit risk** refers to the likelihood that an auditor will issue an inappropriate opinion on financial statements that may contain material misstatements. The concept of audit risk consists of three main components: (ALICIA, 2024)
- **Inherent Risk:** This is the natural risk associated with the nature of the business or transactions before any controls are applied. For example, cash transactions may carry higher inherent risks compared to transactions conducted via checks. (corporate finance institute, 2024)
- **Control Risk:** This indicates the likelihood that the internal controls will fail to prevent or detect a material misstatement. For instance, if there is poor segregation of duties within a company, the level of control risk may be elevated. (CPE, 2024)
- **Detection Risk:** This is the probability that the auditing procedures will not detect a material error or fraud that exists. Detection risk is influenced by the effectiveness of substantive procedures and their correct application by the auditors. (CPE, 2024)

Generally speaking, the following formula can be used to represent audit risk:

Audit Risk (AR) = Inherent Risk (IR) × Detection Risk (DR)
 × Control Risk (CR)

Controlling audit risk is essential for providing a trustworthy and correct opinion on financial accounts, which boosts trust in the company's reports.

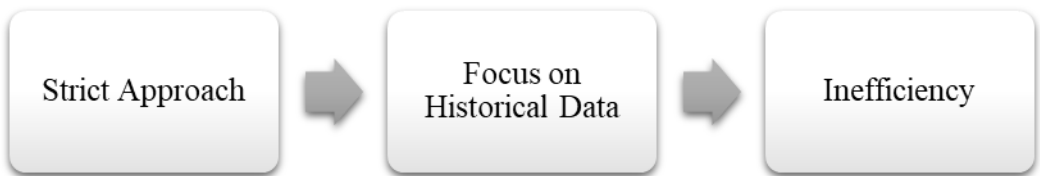
2.2. Traditional audit theories versus risk-based audit approach:

The evolution of auditing practices has led to the emergence of two prominent approaches: traditional auditing theories and the risk-based auditing approach. Understanding the differences between these two methodologies is essential for ensuring high-quality audits that effectively assess financial risks.

2.2.1. Traditional Auditing Theories:

Traditional auditing predominantly emphasizes adherence to established standards and procedures. It relies on the use of checklists and systematic testing of internal controls and financial data. Auditors typically conduct extensive examinations across a wide array of accounts, which may inadvertently lead to overlooking significant inherent risks. (Byrnes, Al-Awadhi, & Gullvist, 2018, pp. 45-50)

Fig. 2: Limitations of Traditional Auditing:



Source: Prepared by researchers (Byrnes, Al-Awadhi, & Gullvist, 2018, p. 55)

The diagram illustrates the limitations of traditional auditing by highlighting three key aspects. Firstly, the strict approach suggests that a focus on measurable procedures can lead to the neglect of significant risks, exposing important accounts to higher levels of danger. Secondly, it emphasizes the reliance on historical data, making this

method less adaptable to rapid changes and emerging risks. Finally, it reveals the inefficiency arising from equal resource allocation across all areas, resulting in ineffective use of the auditor's time and effort, ultimately diminishing the quality of audit outcomes.

This analysis underscores the necessity for developing more flexible and effective auditing methodologies, such as the risk-based auditing approach, which seeks to overcome these limitations through precise and adaptable risk assessment.

2.2.2. The Risk-Based Auditing Approach:

The risk-based auditing approach prioritizes risk assessment within the auditing process. It requires auditors to identify and evaluate risks that could impede the organization's objectives. This proactive methodology allows auditors to tailor their audit plans based on the identified risks, focusing their efforts on areas most vulnerable to material misstatements. By emphasizing risk, this approach enhances audit quality and effectiveness, ensuring that limited resources are allocated efficiently to address the most critical concerns. (Bowlin, 2011, pp. 1231-1233)

Fig. 3: The advantages of the risk-based auditing



Source: Prepared by researchers (Abdalla & Koury, 2023, pp. 345-357)

The diagram reflects the advantages of the risk-based auditing approach through several key elements. Firstly, this methodology offers

a dynamic assessment, allowing auditors to interact more effectively with current risks, thereby enhancing their ability to address fraud and errors. Secondly, the effective allocation of resources directs efforts toward high-risk areas, improving the efficiency and quality of the audit process. Lastly, this approach fosters an improved understanding of the client's operations, leading to more informed decision-making.

The shift from traditional auditing to a risk-based approach indicates an increasing importance of understanding risks in ensuring the accuracy of financial data. This evolution reflects a commitment to enhancing audit quality and increasing the resilience of organizations in facing challenges and uncertainties.

3. A series of interviews with auditors in the provinces of Tlemcen and Sidi Bel Abbes on the impact of the risk-based auditing approach in enhancing external audit quality:

As part of the study titled "Analyzing the Impact of a Risk-Based Audit Approach on Enhancing the Quality of External Auditing," a series of in-depth interviews were conducted with auditors in the provinces of Tlemcen and Sidi Bel Abbès. These interviews aimed to explore the actual role of the risk-based audit approach and how it affects the quality of external audits in organizations. The discussions covered how risks are identified and assessed, as well as the practical procedures followed by auditors to ensure the delivery of high-quality audit reports in compliance with international standards.

3.1. Section 1: Interviews on the impact of the risk-based audit approach

- **Interview 1 :**

Researchers: How do you assess the impact of the risk-based auditing approach on enhancing external audit quality?

Statutory Auditor: The impact relies on the accuracy of risk assessment. When auditors focus on critical points that may affect the financial statements, it improves audit quality. This approach enables

us to allocate efforts to areas that deserve the most attention, thereby reducing errors and increasing the credibility of financial reports.

- **Interview 2 :**

Researchers: What are the main challenges you face when applying the risk-based auditing approach in Tlemcen and Sidi Bel Abbès?

Statutory Auditor: A major challenge is the lack of resources. Implementing this approach requires a qualified team and a deep understanding of the work environment, along with ongoing technological updates. In some cases, audits may rely on incomplete data, complicating accurate risk assessment.

- **Interview 3:**

Researchers: How does the risk-based auditing approach contribute to improving the operational efficiency of the organization?

Statutory Auditor: This approach enhances efficiency by focusing resources on areas with greater risks. This means we do not waste efforts on aspects that have a low probability of errors. Consequently, the time required for auditing decreases, and the quality of final results improves.

3.2. Section 2: Interviews about challenges and practical applications:

- **Interview 1 :**

Researchers: How do environmental factors, such as local laws, affect the application of the risk-based auditing approach?

Statutory Auditor: Local laws significantly impact the process. Sometimes, regulations impose additional requirements that complicate the audit process. However, applying this approach helps us understand the laws more deeply, allowing us to implement financial oversight in accordance with current legislation.

- **Interview 2 :**

Researchers: How are risks identified and assessed in small and medium-sized enterprises using this approach?

Statutory Auditor: In small and medium-sized enterprises, the assessment relies on the management structure and internal control systems. We need to focus on the strength of these systems, especially in organizations where internal controls may be underdeveloped, increasing the risks of financial misstatements.

- **Interview 3:**

Researchers: How does this approach assist in detecting fraud?

Statutory Auditor: The approach helps identify areas susceptible to fraud, such as opaque transactions or a lack of segregation of duties. By focusing on these high-risk areas, we can detect any illegal activities more quickly and effectively.

- **Interview 4:**

Researchers: Is there a need for new technologies to effectively implement the risk-based auditing approach?

Statutory Auditor: Absolutely. This approach requires advanced techniques for data analysis and continuous monitoring of processes. Advanced software enables us to identify unusual patterns that may indicate financial risks.

- **Interview 5:**

Researchers: How does the auditor's experience influence the application of this approach?

Statutory Auditor: Experience plays a significant role. Seasoned auditors can identify risks more easily. They also understand how to allocate resources more effectively and apply efficient strategies to deal with the challenges they encounter.

- **Interview 6:**

Researchers: How compatible is the risk-based auditing approach with international standards?

Statutory Auditor: This approach aligns well with international standards, particularly auditing standards such as ISA 315. The

methodology centers around risk assessment, which conforms to global trends aimed at enhancing effective financial auditing.

3.3. Section 3: Interviews about improving relationships and training:

- **Interview 1 :**

Researchers: How does this approach contribute to improving financial reporting for large companies?

Statutory Auditor: In large companies, this approach helps identify weak points in financial systems. By concentrating on these areas, we ensure that financial reports are more accurate and transparent, thereby enhancing the company's credibility with shareholders.

- **Interview 2 :**

Researchers: Are there any specific challenges that large companies face when applying this approach?

Statutory Auditor: Yes, challenges such as complex financial systems and multiple operations increase the difficulty of accurately identifying risks. Auditing large companies requires greater coordination among audit teams to comprehensively cover all financial aspects.

- **Interview 3 :**

Researchers: How does the dynamic nature of markets affect the implementation of this approach?

Statutory Auditor: The changing market dynamics necessitate continuous updates to potential risks. We need to analyze external factors, such as economic fluctuations and government policies, that may impact the financial status of companies, making this approach more flexible in dealing with such changes.

- **Interview 4 :**

Researchers: How can this approach help improve the relationship between the company and its stakeholders?

Statutory Auditor: The transparency achieved through this approach enhances stakeholder confidence. When financial reports are accurate and reflect the company's true situation, shareholders and regulatory bodies feel assured of the integrity of operations.

- **Interview 5:**

Researchers: What is the role of continuous training in improving the effectiveness of this approach?

Statutory Auditor: Continuous training is essential. Auditors must be knowledgeable about the latest risk assessment techniques and how to apply them. Companies that invest in training their auditors find better and more efficient audit results.

- **Interview 6:**

Researchers: How can the implementation of the risk-based auditing approach be improved in Algeria?

Statutory Auditor: To improve implementation, we need to encourage the adoption of modern accounting systems and develop regulations that support this approach. Collaboration between various financial and professional institutions will also be a key factor in enhancing its effectiveness.

3.4. Section 4 : Interviews on management interaction and risk documentation

- **Interview 1:**

Researchers: How do you evaluate the interaction of top management with the results of risk-based audits?

Statutory Auditor: Top management is usually more receptive to audit findings, especially when they understand the potential benefits for quality improvement. Their positive engagement can significantly enhance the implementation of recommendations derived from audits.

- **Interview 2:**

Researchers: Do you have a specific experience where the audit process was improved as a result of applying this approach?

Statutory Auditor: Yes, in one institution, implementing the risk-based auditing approach led to notable improvements in the accuracy of financial reports and operational efficiency. The focus on risk allowed us to address key issues promptly.

- **Interview 3:**

Researchers: How are identified risks documented during the audit process?

Statutory Auditor: Risks are documented in audit reports, providing details on how they were assessed and the actions taken to address them, ensuring transparency and accountability in the audit process.

- **Interview 4:**

Researchers: What role do internal audit teams play in supporting the implementation of the risk-based approach?

Statutory Auditor: Internal audit teams play a crucial role in identifying risks and monitoring compliance with policies, enhancing the overall effectiveness of the audit process. Their continuous oversight ensures that the risk-based approach is effectively integrated into the organization.

- **Interview 5:**

Researchers: Are there specific tools or techniques you use to enhance the implementation of this approach?

Statutory Auditor: Yes, we utilize advanced data analysis software to quickly identify patterns and uncover risks more accurately. These

tools enhance our ability to assess risks in real-time and facilitate more informed decision-making.

4. Study Methodology :

The impact of the risk-based auditing approach (BRA) on audit quality was investigated in this study using a qualitative methodology. Semi-structured interviews were conducted as part of the methodology with a sample of twenty statutory auditors from Tlemcen and Sidi Bel Abbes. Particularly, between May 22 and July 14, 7 auditors were interviewed in Tlemcen and 13 in Sidi Bel Abbes. The purpose of these interviews was to obtain detailed information on the real-world experiences auditors had while using BRA. To determine how this approach affects audit procedures, risk assessment, and financial reporting, the data that was gathered was examined. The study's main focus was on auditors' opinions of how well BRA improved operational performance, openness, and auditor independence.

5. Study Results :

- By enabling auditors to offer independent financial and administrative advice, the use of BRA increases the value of audit services.
- By asking auditors to exercise additional caution while evaluating high-risk areas, BRA helps to reduce audit risks.
- Financial reports are more accurate as a result of the improved disclosure and transparency of financial information brought about by the strategy.
- By cutting out pointless steps, it frees up auditors to concentrate on important areas.
- BRA supports the bolstering of auditor independence and fortifies quality control procedures in audit operations.
- The method promotes objectivity and competency in auditing procedures.

6. Conclusion :

The study comes to the conclusion that by giving high-risk areas priority, the risk-based auditing strategy (BRA) greatly improves the quality of external audits and fosters more operational effectiveness, transparency, and auditor independence. According to auditors, BRA improves risk management and boosts the accuracy of financial reporting. In order to fully reap the benefits of BRA, auditors must get ongoing training to improve their risk assessment abilities, and adequate funding must be set aside to facilitate its implementation. Furthermore, risk identification can be enhanced by using sophisticated data analysis methods, and compliance can be guaranteed by customizing international standards to the local environment. Encouraging moral behavior by auditors is essential to preserving their impartiality and independence. The quality and efficacy of audits will be further improved by ongoing audit methodology enhancement.

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