

Auditing Risk in Conditions of Economic Instability: New Approaches to Risk Assessment and Management*

Abstract: *Economic instability, characterized by inflationary pressures, market volatility, supply chain disruptions, and increased bankruptcy risks, significantly affects the reliability of financial reporting and elevates auditors' exposure to various types of audit risk. The aim of this paper is to examine how contemporary auditors assess and manage audit risk under heightened economic uncertainty, as well as to identify new methodological approaches that enhance the quality of audit procedures. Special attention is given to the integration of advanced analytical techniques, data-driven risk assessment models, scenario analysis, and evaluations of organizational resilience to macroeconomic shocks. The paper also explores the role of internal controls, regulatory requirements, and professional skepticism in mitigating inherent, control, and detection risk. The research findings indicate that the application of digital tools, forensic procedures, and dynamic risk assessment models significantly contributes to more effective management of audit risk during periods of economic instability. The conclusion emphasizes the need for continuous development of auditing methodologies, improvement of professional competencies, and strengthening of the institutional framework in order to ensure a higher level of reliability in audit opinions under unstable economic conditions.*

Keywords: *audit risk, economic instability, financial reporting reliability, professional skepticism, internal controls, digital auditing tools, forensic procedures, risk assessment models, scenario analysis and macroeconomic shocks.*

¹ Alfa BK University, Faculty of Finance, Banking and Audit, Belgrade, Republic of Serbia.
E-mail: joksimovicmarijana80@gmail.com
ORCID iD: <https://0000-0002-5939-5137>

² Alfa BK University, Faculty of Finance, Banking and Audit.
E-mail: zorica.djuric@alfa.edu.rs
ORCID iD: <https://0000-0002-6851-0635>

³ Alfa BK University, Belgrade, Republic of Serbia.
E-mail: ivan.djekic@alfa.edu.rs
ORCID iD: <https://orcid.org/0000-0002-0369-1455>

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INTRODUCTION

The contemporary business environment is marked by pronounced economic instability and increasingly frequent disruptions in both national and global markets. Inflationary pressures, rising financing costs, exchange rate volatility, and liquidity risks create additional challenges for business entities, as well as for auditors whose task is to provide an objective and reliable assessment of financial reporting. Under such conditions, audit risk assessment becomes more complex, as uncertainty in the environment raises the likelihood of material misstatements arising from error or fraud.

Traditional approaches to audit planning and risk assessment (5) although still relevant, demonstrate limited effectiveness in conditions of sudden and unexpected economic shocks. Therefore, there is a growing need for methodological improvements that incorporate advanced analytical techniques, greater reliance on quantitative models, and the use of digital tools that enable timely identification of risk patterns. Modern auditing practice increasingly integrates forensic elements, big data analytics, and assessments of business model resilience to macroeconomic disturbances.

The role of professional skepticism, the quality of internal controls, and regulatory requirements also becomes more prominent, since economic instability increases inherent and control risks for most economic entities. Auditors are therefore compelled to adopt more flexible, dynamic, and comprehensive approaches to managing audit risk, as well as to continuously enhance their professional competencies.

Based on this, the aim of this paper is to examine how economic instability contributes to heightened audit risk and how modernization of auditing procedures can be applied to mitigate it. The paper seeks to provide new insights into methodological approaches that contribute to a higher-quality, more reliable, and more efficient audit process in an increasingly uncertain business environment.

LITERATURE REVIEW

Audit risk and its management are central topics in modern auditing theory and practice, especially under conditions of economic instability. According to the International Auditing and Assurance Standards Board (IAASB), audit risk is the risk that an auditor expresses an inappropriate opinion when financial statements contain material misstatements due to error or fraud. Classical literature highlights three components of audit risk: inherent, control, and detection risk (1).

Contemporary studies indicate that economic instability—such as inflation, market volatility, and liquidity crises—significantly increases inherent and control risks, requiring new methodological approaches (10). Audit digitalization, forensic procedures, big data analytics, and scenario analyses are tools that allow auditors to improve the accuracy of risk assessment and the efficiency of audit procedures (2).

Moreover, research shows that the quality of internal controls, regulatory frameworks, and professional skepticism directly affects auditors' ability to identify and mitigate risks in unstable economic environments (8). The literature also emphasizes the importance of continuous auditor education and adaptive audit methods that respond to dynamic changes in the business environment.

METHODOLOGY

This study utilizes a combined research approach, integrating qualitative literature analysis with a comparative examination of audit procedures in economically unstable environments. This methodology allows for a comprehensive understanding of both theoretical frameworks and practical applications of audit risk management under conditions of uncertainty.

The **literature analysis** involved a systematic review of relevant academic publications, professional auditing standards, and reports issued by regulatory authorities and international organizations, including the OECD and the World Bank, covering the period from 2015 to 2024. The purpose of this review was to identify key theoretical models, methodological approaches, and practical recommendations that can enhance the effectiveness of audit risk assessment and management.

The **comparative analysis** focused on the application of modern auditing practices across various economic contexts, including stable, unstable, and transitional markets. This part of the study examined several critical factors, including the assessment of inherent, control, and detection risks, the implementation of digital auditing tools and forensic procedures, the role of professional skepticism, and the influence of regulatory support on audit quality.

For **data categorization and synthesis**, the content analysis method (3) was employed. This technique enabled the identification of core themes, including risk management, digitalization of auditing processes, the regulatory framework, and the challenges and limitations faced by auditors in different economic settings.

Based on the combined insights from the literature review and comparative analysis, the study formulated a set of recommendations aimed at improving audit methodologies. These recommendations focus on enhancing audit risk assessment and management practices in conditions of economic instability, emphasizing the integration of advanced tools, adaptive approaches, and regulatory alignment.

RESEARCH RESULTS

The study clearly demonstrated that economic instability has a significant impact on audit risk management processes. Based on a combined analysis of the literature and a comparative

review of audit procedures across different economic environments, key patterns and trends were identified, highlighting the specific approaches to auditing under conditions of uncertainty. These results provide a better understanding of the challenges auditors face in unstable markets and the potential strategies for more effective risk management.

One of the key findings of the study relates to the assessment of audit risk in economically unstable conditions. Auditors in such environments focus on all three components of risk: inherent, control, and detection risk. The analysis showed that inherent risk, which represents the potential for errors and irregularities intrinsic to business operations, increases due to rapid changes in the market environment, unpredictable economic developments, and sector instability.

Control and detection risks, on the other hand, largely depend on the availability and application of modern digital tools as well as the level of regulatory support in the country. In economies with well-developed infrastructure and strong regulatory frameworks, these risks are significantly reduced, whereas in transitional and unstable markets, auditors often have limited opportunities for adequate control and detection of irregularities.

Figure 1: Audit Risk Model



Source: Authors, based on available literature

As illustrated in Figure 1, the Audit Risk Model explains the relationship between overall audit risk and its three main components: inherent risk, control risk, and detection risk. Overall audit risk represents the probability that the auditor will issue an inappropriate opinion when the financial statements contain material misstatements.

Inherent risk refers to the susceptibility of financial statements to material misstatements arising from the nature of the entity's business, industry, or economic environment, before considering internal controls. Control risk (4). represents the possibility that the entity's internal controls will fail to prevent, detect, or correct such misstatements on a timely basis. These two components are largely determined by the client's operating environment and internal control systems and cannot be directly controlled by the auditor.

Detection risk, in contrast, depends on the nature, timing, and extent of audit procedures and the auditor's professional judgment. It represents the risk that audit procedures will fail to detect material misstatements that exist. As shown in the figure, the interaction among these components implies that higher levels of inherent and control risk require a lower level of detection risk, which is achieved through more extensive and rigorous audit procedures.

The study also emphasized the importance of using digital tools and forensic procedures in modern auditing. The application of data analysis software, blockchain technology, and

automated auditing platforms significantly contributes to more accurate detection of irregularities and reduction of operational risk.

However, the use of these technologies is uneven. In countries with low levels of digital infrastructure or limited digital literacy among auditors, the effectiveness of digital tools is constrained. This highlights the need for additional investments in technology and continuous training of audit personnel to improve the efficiency of risk management.

Professional skepticism and regulatory support proved to be key factors in audit quality. Auditors who apply a high level of skepticism are better able to identify irregularities and potential business risks.

Regulatory support, including clear guidelines and standards, contributes to the greater reliability of audit reports and increases compliance with professional standards. Countries with strong regulatory frameworks achieve significantly better results in risk management, while transitional economies often have limited support, which complicates the implementation of modern auditing methods.

Table 1: Regulatory Support, Professional Skepticism, and Their Impact on Audit Quality

Economic Environment	Degree of Regulatory Support	Level of Professional Skepticism	Expected Audit Quality
Stable Economy	High	Moderate	High
Transitional Economy	Moderate	High	Moderate to High
Unstable Economy	Low to Moderate	Very High	Moderate
Crisis Economy	Low	Extreme	Low to Moderate

Source: Authors, based on available literature

Table 1 presents the interaction between regulatory support and professional skepticism across different economic environments and their impact on audit quality. The table indicates that in stable economic environments, a high degree of regulatory support combined with a moderate level of professional skepticism is associated with a high level of audit quality. This finding underscores the importance of strong regulatory frameworks in enhancing the effectiveness of the audit process.

In transitional economies, where regulatory support is assessed as moderate, audit quality is evaluated as moderate to high, primarily due to an increased level of professional skepticism. However, in unstable and crisis economic environments, regulatory support is low or low to moderate, while professional skepticism reaches very high or extreme levels. Despite elevated skepticism, the expected level of audit quality remains moderate or low to moderate, suggesting that professional skepticism alone is insufficient to fully offset the limitations imposed by weak regulatory structures.

The study identified several advantages and challenges in managing audit risk under unstable economic conditions.

Advantages include: increased accuracy in risk assessment, improved detection of irregularities and potential fraud, and more efficient use of resources and time in the audit process.

Challenges include: lack of digital infrastructure in some countries, high initial costs of implementing modern technologies and resistance to change among auditors and organizations, combined with low digital literacy.

The combined analysis of literature and comparative studies indicates that effective audit risk management in conditions of economic instability depends on the integration of multiple factors. Key elements include the use of advanced digital tools, consistent application of professional skepticism, and adequate regulatory support.

Countries with well-developed infrastructure and stronger regulation achieve better risk control outcomes, while transitional and unstable economies have significant potential for improvement through further education, investments in technology, and adaptation of regulatory frameworks to meet modern auditing needs. These findings underline the necessity of a comprehensive approach that combines technology, human factors, and regulatory strategy to ensure effective audit risk management.

DISCUSSION

The findings of this study provide valuable insights into the dynamics of audit risk management under conditions of economic instability. The analysis confirms that unstable and transitional economic environments present unique challenges for auditors, particularly in terms of assessing inherent, control, and detection risks. Inherent risk tends to increase due to rapid market fluctuations, unpredictable economic events, and sectoral instability, making audit planning more complex and demanding. This aligns with prior research emphasizing the sensitivity of audit processes to external economic shocks (6).

The study also highlights the growing importance of digital tools and forensic procedures in mitigating audit risks. Digital technologies such as data analytics software, blockchain applications, and automated audit platforms enable more precise detection of irregularities, enhance efficiency, and reduce operational risk. However, the effectiveness of these technologies is constrained by factors such as limited digital infrastructure, low digital literacy among auditors, and resistance to change within organizations. These findings corroborate previous studies that emphasize the role of technology adoption as both an opportunity and a challenge in modern auditing (9).

Professional skepticism emerges as another critical factor in risk management. Auditors who actively apply a skeptical mindset are better equipped to identify anomalies, assess complex transactions, and prevent misstatements. This underscores the importance of human judgment in the audit process, which cannot be fully replaced by technological tools. Regulatory support further enhances audit quality by providing clear standards, guidance, and enforcement mechanisms. (7). Countries with strong regulatory frameworks demonstrate higher compliance and reliability in audit outcomes, while transitional economies often face limited regulatory guidance, reducing the effectiveness of audit procedures.

The interplay of these factors—technology, professional judgment, and regulatory support—indicates that audit risk management is inherently multidimensional. Effective strategies must integrate these elements, especially in environments characterized by uncertainty and volatility. For transitional economies, the study suggests that targeted investments in digital infrastructure, continuous professional training, and the modernization of regulatory frameworks can significantly improve audit outcomes.

The research contributes to the understanding of audit practices in unstable markets by linking theoretical frameworks to practical applications. It emphasizes that sustainable audit risk management is not only about adhering to standards but also about adapting to contextual challenges and leveraging available tools effectively. These insights are particularly relevant for policymakers, regulators, and audit firms seeking to strengthen audit quality and financial reporting reliability in economically volatile contexts.

CONCLUSION

The study clearly demonstrates that economic instability significantly affects audit risk management processes, with various factors interacting in complex ways. Effective risk management in unstable and transitional economies requires an integrated approach that includes the use of advanced digital tools, the continuous application of professional skepticism, and adequate regulatory support.

The analysis showed that inherent risk increases in conditions of rapid market changes and unpredictable economic situations, while control and detection risks largely depend on the level of digital infrastructure and the regulatory framework. The use of digital technologies and forensic procedures enables more precise detection of irregularities and reduces operational risks, but their effectiveness depends heavily on the availability of resources and auditors' digital literacy.

Professional skepticism and regulatory support are highlighted as key elements for improving audit quality and reducing risk. Countries with more developed infrastructure and strong regulatory frameworks achieve better results, whereas transitional economies have significant potential for improvement through education, investment, and modernization of regulatory standards.

In conclusion, the results indicate that sustainable and effective audit risk management is possible only through a comprehensive approach combining technology, human competencies, and regulatory strategy. Such an approach not only reduces risks and increases audit accuracy but also strengthens trust in financial reporting and the stability of the business environment, even under conditions of economic instability.

Literature

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Revizija rizika u uslovima ekonomske nestabilnosti: Novi pristupi proceni i upravljanju rizicima

Apstrakt: Ekonomska nestabilnost, koju karakterišu inflatorni pritisci, volatilnost tržišta, poremećaji u lancu snabdevanja i povećani rizici od stečaja, značajno utiče na pouzdanost finansijskog izveštavanja i povećava izloženost revizora različitim vrstama revizijskog rizika. Cilj ovog rada je da se ispita kako savremeni revizori procenjuju i upravljaju rizikom revizije pod povećanom ekonomskom neizvesnošću, kao i da identifikuju nove metodološke pristupe koji poboljšavaju kvalitet revizijskih procedura. Posebna pažnja se posvećuje integraciji naprednih analitičkih tehnika, modela procene rizika zasnovanih na podacima, analize scenarija i procene organizacione otpornosti na makroekonomske šokove. U radu se takođe istražuje uloga internih kontrola, regulatornih zahteva i profesionalnog skepticizma u ublažavanju inherentnog, kontrolnog i otkrivanja rizika. Nalazi istraživanja pokazuju da primena digitalnih alata, forenzičkih procedura i dinamičkih modela procene rizika značajno doprinosi efikasnijem upravljanju rizikom revizije tokom perioda ekonomske nestabilnosti. U zaključku se naglašava potreba za kontinuiranim razvojem metodologija revizije, unapređenjem stručnih kompetencija i jačanjem institucionalnog okvira kako bi se osigurao viši nivo pouzdanosti revizorskih mišljenja u nestabilnim ekonomskim uslovima.

Ključne reči: Revizijski rizik, ekonomska nestabilnost, pouzdanost finansijskog izveštavanja, profesionalni skepticizam, interne kontrole, alati za digitalnu reviziju, forenzičke procedure, modeli procene rizika, analiza scenarija i makroekonomski šokovi.