Academic research on the auditor and fraud detection/deterrence

Greg Trompeter
Dixon School of Accounting

Three things we know

Fraud risk cues → Quality of fraud risk assessment → Quality of audit procedures

Three things we know

Fraud risk cues → Quality of fraud risk assessment → Quality of audit procedures

Number 1: The association between fraud risk cues and the quality of fraud risk assessment

Three things we know

Number 1: The association between fraud risk cues and the quality of fraud risk assessment:

- Overall auditors' risk assessments are not always sensitive to fraud risk cues
  - *Experimental research:*
    - *Environment changes*
    - *Perceptions of management integrity*
  - *Field research: Knowledge, training and experience deficiency*
- However research has shown that some things help
  - *Experimental research: Disaggregated risk assessments*
  - *Experimental and field research: Involvement of specialists*
  - *Education and training*

Three things we know

Fraud risk cues

Quality of fraud risk assessment

Quality of audit procedures

Number 2: The association between the quality of fraud risk assessment and the quality of audit procedures

Three things we know

Number 2: The association between the quality of fraud risk assessment and the quality of audit procedures:

- Auditors do not always modify the audit program to include more diagnostic testing
  - *Overuse of sample size as a remedy*
- However research has shown that some things help
  - *Brainstorming increases salience of fraud potential and improves fraud detection in the lab IF:*
    - *Not performed as a “box checking exercise”*
    - *Led by a forensic specialist or engagement partner*
    - *Involving the entire engagement team*
  - *Forensic specialists typically suggest more diagnostic testing which improves detection*

Three things we know

Number 3: Skepticism? It’s complicated:

- Exposure matters
  - *Prior hands-on experience with a fraud is associated with increased skepticism (learning-based salience)*
- So do incentives
  - *PCAOB inspection, litigation*
  - *Emphasis of the engagement partner can increase–OR DECREASE–skepticism*
  - *Budgets and experience*
    - *It’s a problem if the extra work does not detect a problem*
  - *Engagement profitability concerns*
    - *Pressure for profitability can overwhelm tone at the top*

Four ~~Three~~ things we don't know

Number 1: Internal firm incentives to detect fraud.

- What are they and do they work?

Number 2: Global issues.

- Uniform application of processes and cultural differences.

Number 3: Cost/benefit of involving forensic specialists.

- When to bring into an audit engagement?
- Incentives to bring in?
- More cost-effective to bring in forensic specialists or train financial auditors?
    - What knowledge do auditors need to be in a good position to detect fraud?

Number 4: What is the best way to train auditors to detect fraud?

- Lecture?
- Case study?
- Simulation techniques to fill experience gap?
- Social media?