

FRAUD SPECIFIC AUDITING

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Fraud specific auditing involves two distinct fraud auditing disciplines, each requiring completely different detection skills and detection methodologies and each functioning in different sectors of the fraud universe. These disciplines are proactive fraud auditing and reactive fraud auditing. Some argue that there is a third fraud auditing discipline which involves independent auditors discharging their avowed responsibilities to discover financial statement balance fraud. A better understanding of these auditing disciplines is best accomplished in the context of the fraud universe.

The Fraud Universe

There are three prime sectors in the fraud universe:

- Sector 1. Fraud that has been or is being prosecuted;
- Sector 2. Fraud that has been detected but which has not been prosecuted; and
- Sector 3. Fraud which has not been detected.

Empirical studies of the fraud universe are reasonably consistent in their observations that 75 to 80 percent of all fraud is discovered accidentally, due to incompetent, greedy, and/or careless perpetrators. This research has led to a generally held perception and complacency that, given time, most fraud cases will eventually “self-destruct” and the fraud will be discovered.

Any complacency based upon this research, however, is faulted since the conclusions do not represent the entire fraud universe. At best the conclusions apply only to Sector 1 fraud since Sectors 2 and 3 fraud cannot be examined. Victims never knowingly release details of Sector 2 fraud situations, because any capricious release of case particulars – disclosure for any purpose other than prosecution may be considered to be capricious – would risk defaming suspects whose identity might be revealed. Sector 3 cases can never be examined for obvious reasons. Thus, fraud examined in any empirical studies made in the 1900s could only involve Sector 1 fraud – which was available to be examined – and any conclusions which found that most perpetrators were careless, greedy, and otherwise inept, could only be true of Sector 1 fraud.

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