Edwards

Journal of Forensic Accounting
1524-5586/Vol.VII(2006), pp. 295-320

An Examination of Audit Responses to Fraud Risk

Mark H. Taylor[*1], **Lori R. Fuller**[2] and **Brad M. Tuttle**[3]

[1] Creighton University, Omaha, NE USA
[2] Widener University, Chester, PA USA
[3] University of South Carolina, Columbia, SC USA

The primary purpose of this study is to examine auditor responses to fraud risk within the framework established by guidance promulgated by the American Institute of Certified Public Accountants (AICPA) through Statement on Auditing Standards (SAS) No. 99, *Consideration of Fraud in a Financial Statement Audit* (AICPA 2002). Although a number of studies examine the extent to which auditors adjust audit plans, particularly budgeted hours and types of tests, no study to date has framed the auditor's responses in terms of the comprehensive framework suggested by the SAS. This has produced an incomplete picture of how auditors react to high levels of management fraud risk. One hundred and nine partners and managers from a cross section of national, regional, and local firms provided responses to a decision case in which are imbedded manipulations of fraud risk to be high or low. Audit risk from non-fraud sources and audit profitability are controlled. The primary results suggest that in response to high fraud risk, auditors respond in a comprehensive manner and would modify multiple aspects of the audit as directed in the SAS.

INTRODUCTION

The aim of the present study is to examine how auditors respond to high levels of management fraud risk. Theoretically, auditors limit audit risk by increasing the quality of the audit (Quadackers, Mock and Maijoor 1996). This behavior is based on the assumptions that (1) higher quality leads to reduced risk and (2) the cost of quality is less than the exposure that high audit risk creates. Regarding the first assumption, auditors can respond to high levels of risk in multiple manners and it is reasonable to believe that some responses are more effective in reducing risk than are other responses. Regarding the second assumption, it is also reasonable that audit responses to risk vary in terms of cost. Together, these assumptions lead to the expectation that differing levels of risk will evoke different audit responses