

## **A Study of the Abilities of Accounting and Auditing Professionals in Recognizing Red Flags of Fraud**

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Essential to the duties of auditors under SAS 99 is the identification of and reaction to fraud risk factors. Previously, Apostolou et al (2000) and Hansen and Klamm (2004) focused on proper classification of factors as motivation or opportunity. Hansen and Klamm (2004) acknowledge the need to recognize fraud risk factors within the context of a scenario. This 2004 study evaluates the performance of professionals in recognizing fraud risk factors and fraud symptoms in four scenarios; professionals are stratified by level of auditing experience and knowledge of SAS 99. Overall, professionals performed fairly well; however, with three of four scenarios, we observed little difference in stratified performance.

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### **INTRODUCTION**

The purpose of this study is to examine the abilities of accounting and auditing professionals in identifying red flags of fraud, as demonstrated by their performance with analyzing and evaluating scenarios. Ramos (2003) notes the need to use “intuition, judgment, and experience to look for patterns in the identified fraud risks.” Statement on Auditing Standards No. 99 (SAS 99), *Consideration of Fraud in a Financial Statement Audit* (AICPA 2002), urges auditors to “use professional judgment in determining whether a risk factor is present and should be considered in identifying and assessing the risks of material misstatement due to fraud.” Hansen and Klamm (2004) point out the need to recognize fraud risk factors within the context of a scenario.

While intuition and judgment defy quantification, how does one know if an accounting and auditing professional possesses the level and type of these contemplated by SAS 99 and other relevant literature? How are these obtained? Are they gained by experience? If so, does this occur more with experience in auditing than with other experience in the accounting profession? Also, does SAS 99 assist in the recognition of fraud risk factors; does knowledge of the pronouncement better enable professionals to accomplish this task?