

## PRACTITIONER SUMMARY

# Improving Fraud Performance with a Different Perspective

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**SUMMARY:** [Chui, Curtis, and Pike \(2022\)](#) find that auditors encouraged to take a forensic specialist's perspective provide a more effective and efficient risk response in varying fraud risk environments than with their traditional mindset. The study provides evidence that auditors can adopt the forensic perspective which focuses on fraud detection, while maintaining their typical audit roles and responsibilities. We summarize their key findings and discuss practical implications and actionable suggestions for audit practitioners. These insights suggest a potential low-cost mechanism to improve auditors' fraud risk assessments and subsequent risk responses.

**Keywords:** fraud risk assessment; risk response; perspective-taking; fraud-related decision-making.

## I. INTRODUCTION

Financial statement audits provide reasonable assurance that financial statements are free of material misstatement, whether derived from error or fraud. Auditors are expected to skeptically evaluate management's assertions as they assess the likelihood of fraud and respond with additional, appropriate audit procedures ([American Institute of Certified Public Accountants \(AICPA\) 2002](#); [Public Company Accounting Oversight Board \(PCAOB\) 2017](#); [Anti-Fraud Collaboration \(AFC\) 2020](#)). Although auditors' fraud risk assessment performance has improved over time, PCAOB inspection reports and academic research find that auditors do not always perform adequate follow-up procedures to address the identified fraud risk ([Beasley, Carcello, Hermanson, and Neal 2013](#);

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Trompeter, Carpenter, Desai, Jones, and Riley 2013; Public Company Accounting Oversight Board (PCAOB) 2020). This has led to calls for greater forensic specialist involvement in the audit (Asare and Wright 2018; Jenkins, Negangard, and Oler 2018). There are, however, concerns over cost and the incremental value of forensic specialists' involvement, casting doubt on the practicality of including them on every audit engagement (Trompeter et al. 2013; Hux 2017).

A recent study, "How Does an Audit or Forensic Perspective Influence Auditors' Fraud-Risk Assessment and Subsequent Risk Response?" (Chui, Curtis, and Pike 2022), examines the impact of perspective-taking on auditors' fraud risk assessment and subsequent risk response performance. Chui et al. (2022) suggest a compromise for the efficiency versus effectiveness concerns regarding fraud detection—that auditors' adoption of a forensic specialists' perspective could improve fraud detection. They designed an experiment with both audit practitioners and forensics specialists, finding that auditors who adopted the forensic perspective while performing an audit task, assessed fraud risk higher and provided more appropriate risk responses than auditors who did not adopt the forensic perspective.

In this article, we summarize the psychology of perspective-taking and the key findings of Chui et al. (2022). Results from that study can assist audit practitioners to develop a possible avenue for improving their fraud detection performance in an audit.

## II. BACKGROUND

Auditors are expected to identify conditions that may suggest the possibility of fraud during an audit and to modify the nature, timing, and extent of procedures to be performed in response to assessed fraud risk (Public Company Accounting Oversight Board (PCAOB) 2016). Nevertheless, as frauds are often well thought out and generally involve collusion and concealment, the signs of fraud can be very subtle and detection may require skills that go beyond the typical approach utilized by auditors to gather and evaluate evidence (Asare, Wright, and Zimbelman 2015; EY 2020). Despite making progress in fraud risk assessment (Trompeter et al. 2013), auditors still struggle to adequately respond to the identified fraud risk (Beasley et al. 2013). Auditors, in some instances, respond with additional procedures that either do not address the identified fraud risk or simply extend existing planned audit procedures (Hammersley, Johnstone, and Kadous 2011).

There is speculation as to whether auditors possess the necessary skills to identify and respond appropriately to fraud conditions (Jenkins et al. 2018); an alternative would be to include forensic specialists on all audits (Asare and Wright 2018), since their approach focuses exclusively on the possibility and identification of fraud (Chui and Pike 2013). Although forensic specialists have the potential to help improve fraud detection, there are also drawbacks to their involvement on all audits, such as expense and a potential lack of sensitivity to varying risk levels, leading to inefficiencies and over-auditing in lower fraud risk environments (Hux 2017). Finally, it is unknown whether forensic specialist expertise is directly transferable and applicable to the audit setting (Boritz, Kochetova, and Robinson 2015). Chui et al. (2022) investigate whether auditors can capitalize on the forensic perspective to improve their fraud detection performance while maintaining their sensitivity to varying risk levels.

Psychology research defines perspective-taking as an intentional process of stimulating a person's thought into considering and accepting the specific aspects of another's point of view (Davis 1983a). It allows individuals to adopt the other person's strategies beyond their typical perspective during their decision-making processes (Davis, Conklin, Smith, and Luce 1996). Perspective-taking has shown to reduce individual judgment biases and enhance empathy as well as conflict resolution ability (Davis 1983b). Several accounting studies find that perspective-taking has the potential to improve auditors' performance in the areas of resolving client disputes, evaluating

clients' reported earnings, and assessing fair value measurements (Church, Peytcheva, Yu, and Singtokul 2015; Hamilton 2016; Joe, Wu, and Zimmerman 2020). Chui et al. (2022) suggest that perspective-taking could serve as a method for improving auditors' fraud detection performance.

Prior literature suggests that the benefits of perspective-taking are most evident when there is a high degree of goal alignment between the perspective-taking target and the individual taking on the targeted perspective (Parker, Atkins, and Axtell 2008). Chui et al. (2022) assert that as both auditors and forensic specialists share the goal of fraud detection, perspective-taking has the theoretical grounding to help improve auditors' fraud detection performance. Although both groups share similar goals in the context of fraud detection, there are some key differences between the audit and forensic perspective.

Chui and Pike (2013) find the attributes of a forensic perspective include the view that fraud can exist regardless of its size and magnitude, even in the presence of strong internal control. One reason this perspective is important is that it is essential to think like a fraudster and how fraud could be perpetrated. Additionally, unlike a typical audit, the work of a forensic specialist is not driven by a budget, as they can generally request more time and resources until they are satisfied with their assessment of whether fraud exists. The auditors' perspective, in contrast, is big picture in nature and is largely guided by materiality and budget efficiency.

Although Chui et al. (2022) are optimistic about the benefits of the forensic specialists' perspective in an audit, they are aware that auditors must be sensitive to the varying risk levels of their clients' operating environments and modify their audit plans accordingly. Being overly sensitive to fraud risk in low-risk environments could result in auditors proposing more work than necessary to arrive at the same audit conclusion, rendering an inefficient audit. Thus, they design their study to examine how the forensic specialists' perspective influences auditors' fraud risk assessment and their subsequent risk response in both high- and low-risk environments.

### III. KEY FINDINGS

In their experiment, Chui et al. (2022) prime senior-level audit practitioners from two Big 4 firms with the forensic specialist's perspective (see Appendix A).<sup>1</sup> Chui et al. (2022) then ask the primed practitioners to assess the fraud risk of a hypothetical company and propose audit-plan modifications in response to their fraud risk assessment. To test the effect of a forensic perspective on varying fraud risk environments, Chui et al. (2022) develop two versions of the company as either a high or low fraud risk environment by seeding fraud risk factors, including management characteristics, managerial compensation, accounting environment, and unresolved audit issues.<sup>2</sup> Chui et al. (2022) then randomly assign the audit practitioners into one of the fraud risk environments. Audit practitioners and forensic specialists, utilizing their typical perspective/approach, also participated in the same experiment to compare and contrast the findings from the auditors primed with the forensic perspective.

<sup>1</sup> Institutional Review Board approval was received for the study prior to any data collection.

<sup>2</sup> The hypothetical company, Lakeview Lumber, is based on the Lindberg (1999) case. Lakeview sells various types of building materials, lawn and garden products, and home improvement supplies to retail customers and contractors. In the high fraud risk environment, Chui et al. (2022) seeded misstatements in Lakeview's bad debt and product warranties expense accounts. They also seeded other fraud risk factors based on SAS No. 99 in the high fraud risk environment to suggest that there is a high likelihood of fraud being perpetrated by Lakeview's management. Fraud risk factors include management's lavish lifestyle, lack of concern of internal controls, cash bonus based on the company's reported net income. In the low fraud risk environment, no misstatements were seeded in Lakeview's bad debt and warranties expense accounts, and there were low fraud risk indicators regarding management characteristics, managerial compensation, and accounting environment.

There are several key findings from the [Chui et al. \(2022\)](#) study. Psychologists find that individuals who adopt the perspective of others are likely to develop a mental representation (understanding and interpretation of a task) similar to the representation developed by those from the adopted perspective ([Davis et al. 1996](#)).<sup>3</sup> Developing a mental picture of the task is an indispensable component of individuals' judgment and decision-making processes ([Greeno 1977](#)). However, when individuals encounter a task in which they have no knowledge or prior perspective, they have the tendency to develop a mental representation that does not correspond with the task and could result in making suboptimal or even erroneous decisions ([Bonner 2007](#)).

Consistent with prior literature, [Chui et al. \(2022\)](#) use an open-ended recall task to assess their experimental participants' mental representation. They find that primed auditors develop a mental representation similar to that of the forensic specialists. In particular, they recall more fraud-related items about the client than the auditors who did not adopt a forensic specialist's perspective (unprimed auditors). Interestingly, both primed and unprimed auditors recall a similar number of audit-related items regarding the client, suggesting that the primed auditors retain their audit-oriented cognitive representation while gaining the forensic-oriented cognitive representation shared by the forensic specialists.

[Chui et al. \(2022\)](#) find that primed auditors, equipped with the forensic-oriented mental representation, make significantly higher fraud risk assessments of the client than unprimed auditors in both high and low fraud risk environments, suggesting a forensic specialist's perspective is effective in heightening auditors' fraud awareness. However, ultimately, the usefulness of adopting a forensic specialist's perspective hinges on the appropriateness of the auditors' risk response. To develop a benchmark to evaluate the appropriateness of the primed and unprimed auditors' risk responses, [Chui et al. \(2022\)](#) consult with a panel of three audit and three forensic experts to select a set of preferred procedures auditors might employ to modify their risk response in the experimental case. Primed and unprimed auditors were then provided a list of possible audit procedures, both expert-preferred and other less effective tests, they could use to respond to their assessed risk.

In the high fraud risk environment, [Chui et al. \(2022\)](#) find that primed auditors exhibit a more appropriate risk response than unprimed auditors through proposing audit plan modifications consistent with the experts' benchmark. The primed auditors' responses are also more comprehensive as they incorporate preferred procedures from both the audit and forensic domains. Interestingly and perhaps most importantly, in the low fraud risk environment, [Chui et al. \(2022\)](#) did not find any discernible difference between primed and unprimed auditors regarding their risk response. This is an important finding as it demonstrates that not only do primed auditors have a heightened fraud awareness and more appropriate response to this heightened awareness, but they also remain sensitive to the variation of fraud risk environments by not over-auditing in low-risk environments.

When comparing primed auditors to forensic specialists performing the same experimental case, [Chui et al. \(2022\)](#) find that primed auditors and forensic specialists make similar fraud risk assessments in both the high and low fraud risk situations. More importantly, primed auditors, as compared to the forensic specialists, make more appropriate overall modifications to the audit plan when the level of fraud risk is high. Confirming the concern of forensic inclusion on all audits, [Chui et al. \(2022\)](#) find forensic specialists appear to lack sensitivity to changes in fraud risk, as their risk responses are similar in both high and low risk client situations.

<sup>3</sup> Psychology researchers on perspective-taking often use students and lay individuals in their experiment. In these experiments, they usually adopt the perspective of their peer group.

## IV. CONCLUSION AND IMPLICATIONS FOR PRACTICE

The Chui et al. (2022) study is a unique investigation into the fraud detection performance of auditors. The adoption of the forensic specialist perspective during risk assessment and response procedures is a low-cost alternative to including forensic specialists on all audit engagements. Their findings indicate an optimal solution to improving auditors' fraud performance by encouraging auditors to take the fraud perspective of forensic specialists. Specifically, primed auditors propose the most appropriate fraud risk response in a high fraud environment, as determined by a panel of audit and forensic experts. At the same time, in a low fraud risk environment, primed auditors demonstrate an efficient response that is consistent with auditors utilizing their typical perspective. Thus, Chui et al. (2022) findings indicate auditors with a forensic perspective adopt a fraud focus, while retaining the typical audit tenets of efficiently identifying and responding to risk, to provide a more appropriate response to fraud, incorporating additional procedures from both the audit and forensic domains.

We encourage practitioners to implement the perspective-taking prompt during stages of fraud risk assessment and brainstorming sessions. We also encourage practitioners to vary the forensic perspective prompt and tailor it to specific client or industry. Firms can consider adding these prompts to their audit program, training practices, and brainstorming sessions. The prime used in Appendix A is a good starting point, and it is not meant to be a static, check-the-box exercise. We recommend practitioners consult with their forensic practice to develop specific perspective-taking prompts and integrate the prompts to their audit program. Chui et al. (2022) acknowledge that there is a lack of longitudinal evidence regarding the duration of the perspective-taking effect. Thus, repeated priming and recalibrations to the prime may be necessary.

It is important to note that Chui et al. (2022) told the primed auditors that they were part of the external audit team and were not taking on the role of a forensic specialist that is assisting with the audit. This distinction is important to ensure the benefits of perspective-taking are achieved in the conduct of a financial statement audit. Practitioners should also be aware that some of the items in the Chui et al. (2022) forensic perspective prompt pertained to differing resource constraints between auditors and forensic specialists (e.g., audit sampling, materiality level, and time resources). This was done based on the guidance of the expert panel utilized by the authors. The study's results, whereby primed auditors demonstrated both an effective and efficient audit response in varying risk environments, provide evidence that the findings are not driven by a perceived difference in available resources. With that said, if the inclusion of resource constraints is a concern to practitioners, those items could be excluded in the implementation of the Chui et al. (2022) proposed forensic perspective prompt.

Finally, we echo Chui et al. (2022) that a forensic perspective prompt is not a replacement for fraud detection knowledge and experience. Auditors participating in the Chui et al. (2022) study had nearly four years of external audit experience. Thus, the benefits of forensic perspective-taking may not be realized with staff with less experience and/or no direct fraud detection knowledge.

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## APPENDIX A

### Key Attributes to Prime Auditors to Think Like a Forensic Specialist

- As a forensic specialist, your primary responsibility is to determine whether fraud exists, regardless of its magnitude. This can be achieved through:
  - examining either a single account or transaction(s) to determine whether fraud exists;
  - examining everything in great depth and generally not relying on audit sampling;<sup>a</sup>
  - being concerned with minor discrepancies in any single account and assessing whether they are indicative of fraud; and
- Evaluating accounting records in terms of the authenticity of the underlying events and considering the possibility of any unreported transactions.
- Materiality is irrelevant to you because fraud often can occur below the materiality level.<sup>a</sup>
- You are not driven by a fixed budget. You examine your work at the end of each phase to assess whether additional work is required. You may request more time and resources until you are satisfied with your assessment of whether fraud exists.<sup>a</sup>
- You should be sensitive to, and on the lookout for, the warning signs of fraud. You can often identify these signs if you are willing to look deeply for them.
- You should keep in mind that things are not always as they appear to be. A visible immaterial misstatement may appear to be inconsequential, but the hidden portion of the misstatement could be substantial.
- You should assume that fraud is possible even in the presence of strong internal controls. Anyone is susceptible to committing fraud, given the means, motive, and opportunity. Thus, you should consider by whom and under what circumstances your client's controls could be compromised.

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<sup>a</sup> Denotes resource-related items that are different between auditors and forensic specialists.