Summary of Paper: Auditor Use of Benchmarks to Assess Fraud Risk: The Case for Industry Data

What is this Study About?

This study investigates how auditors use benchmarks during preliminary analytical procedures to detect fraud, especially revenue fraud. Specifically, it examines whether industry data, nonfinancial measures, or cash flows are more effective fraud indicators than traditional client-specific data like prior-year balances.

What are the major findings of the study?

Auditors typically rely heavily on a client's prior-year financial data. However, the study finds that using industry data—such as comparing a company's revenue growth against its industry's average—is a much stronger indicator of fraud. Fraud firms had an average revenue growth 17.2% higher than their industry peers, compared to only 4.8% for non-fraud firms. The difference between revenue growth and employee growth (3.7%) and between revenue growth and cash flow growth (6.6%) were also significant fraud indicators.

Why is the study important?

Auditors often default to benchmarks that management can easily manipulate, potentially missing fraud risks. This study shows that industry benchmarks are less susceptible to manipulation and provide more reliable fraud risk indicators, prompting a re-evaluation of auditing strategies. Only 40% of the surveyed auditors reported using industry data during preliminary analytical procedures, suggesting a significant opportunity for improvement in practice.

What is the impact on professional practice and society at large?

Incorporating industry data in fraud risk assessments can improve audit quality, reduce undetected financial fraud, and protect investors and stakeholders. Ultimately, shifting to more reliable benchmarks strengthens public trust in financial reporting.