

Internet Fraud Auditing: A Simulated Health Care Industry Case Study

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Forensic audits are investigative audits that aim at detecting the likelihood, magnitude and risk of irregularities in financial statements. In contrast with the traditional audit of financial statements, this study focuses on auditing statements posted on Internet web sites. Since most publicly traded companies are moving towards posting their financials on the Internet, this method of auditing may become more and more popular, as well as cost effective. Even if a publicly traded company does not post its own financial statements on the web, other companies are providing this service, as well as the Securities and Exchange Commission. The forensic auditor can provide effective expert witness testimony and computer litigation support regarding overstated revenue sales fraud.

This study describes a software based fraud detection expert system (ES) using a simulated case study of the hospital and medical service plan industry. Typically, this system will run on the Internet, scans the audited company's financial statements and analyzes the differences between trends of the company's annual reports (for about 10 years). It also identifies red flags that substantially differ from the norms in the industry. When it detects such deviations, it points out the suspicious accounts, such as the Net Sales account. Furthermore, it highlights the direction of the deviations, such as an over statement rate of 10% and the corresponding offsetting accounts.

This study describes how the system can be validated in a classroom simulation of "cops and robbers." The robbers perpetrate a fraud on a company, and the cops try to spot it and explain it. The ultimate use of such a system will be to continuously run it on the Internet and e-mail alerts to the forensic auditor any time it detects red flags.

Due to space constraints, additional appendices, tables, charts, program code listings and screen shots are not included in this paper. Such materials are available upon written request to the authors.