

The Impact of Forensic Services Supplied by Audit Firms on Audit Quality

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Abstract

Service portfolios of audit firms are increasingly extended by forensic services, i.e., additional consulting services dedicated to the detection, investigation and prevention of fraud. The objective of our analysis is to examine the effect of providing forensic services by audit firms on the audit quality. We analyze the effects in a model of strategic auditing. We first show that detection risk of audit firms, who also offer forensic services, can be decreased because those firms devote c.p. a higher effort to detect fraud in order to gain an additional service contract. Second, we demonstrate that the manager's manipulation probability decreases if the annual auditor offers forensic services. Both effects together should decrease audit risk. However, as our analysis reveals, in equilibrium, the audit effort of both auditor types could be equal. Nevertheless, due to the manager's lower manipulation probability, audit quality is improved if the auditor also supplies forensic services.