Abstract:

The largest CPA firms have been regarded as quality-differentiated auditors. This has been a prominent assumption of empirical research in accounting and auditing. Yet, prior research has only tested whether the largest CPA firms, in the aggregate, are quality-differentiated auditors. This paper contributes to the audit quality literature by individually examining each of the largest CPA firms. This new approach is timely, given the questions that have been raised concerning Arthur Andersen.

Each Big Six CPA firm was compared to the non-Big Six CPA firms, using post-Private Securities Litigation Reform Act of 1995 data. The outcomes of auditors in civil and criminal litigation and administrative proceedings were analyzed using a taxonomy based on the corporate misconduct and economic analysis of legal process literatures. With the exception of Arthur Andersen, each of the Big Six CPA firms was individually found to be a higher quality auditor than the non-Big Six. The null hypothesis of no difference between the outcomes of each of the Big Six firms (except Arthur Andersen) and the non-Big Six was rejected at p<.05. Since the lawsuits, filed in 1996-1998, were based on allegedly misstated 1995-1997 financial statements, this suggests that a deterioration in the audit quality of Arthur Andersen occurred no later than the mid-1990’s. It is empirical evidence of a precursor of the eventual failure of the firm. The research results thus suggest that the Enron audit document destruction obstruction of justice conviction in June 2002 was the culmination of a gradual, firm-wide deterioration that was the cause of the destruction of Arthur Andersen.