Edwards

Journal of Forensic Accounting
1524-5586/Vol.VII(2006), pp. 439-462

An Analysis of Auditor-Selection Decisions: The Case of Ex-Andersen Clients

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Auditors, by lending credibility to financial statements, reduce the information asymmetry between management and shareholders. When the quality of the audit is challenged, its value will be diminished. This paper reports the results of a survey conducted on a sample of ex-Andersen clients regarding the timing of, process surrounding, criteria used, and decisions made to engage a new auditor due to Andersen's demise in 2002. Evidence is provided as to the importance of various factors in the audit firm selection process for Andersen audit clients defecting from Andersen as of June 15, 2002. Results show that (1) over 40 percent of respondents initiated their auditor-replacement process prior to Andersen's indictment and over 95 percent of respondents initiated the process prior to its ultimate conviction; (2) a majority of respondents reported that the audit committee was most influential in selecting the new audit firm; and (3) factors such as reputation of the new audit firms, being a Big 4 audit firm, perception of the quality of audits provided, and specific industry experience played important roles in the selection.

INTRODUCTION

Auditors, by lending credibility to financial statements, reduce the information asymmetry between management and shareholders. When the quality of the audit is challenged, its value will be diminished. For almost nine decades, Arthur Andersen (Andersen) was considered one of the most reputable, prestigious auditing firms in the industry, but since its conviction of obstruction of justice, it has been prohibited from auditing public clients. Before its conviction, Andersen had over 100,000 audit clients in 81 countries throughout the world. Although accounting firms have failed before (e.g., Laventhol & Horwath, the seventh-largest accounting firm in the United States, in November 1990), the collapse of Andersen is the largest audit-firm failure in United States history. With approximately 1,400 companies publicly traded in the United States seeking a new auditor, other accounting firms have been given an unprecedented opportunity to expand their client base and increase