LARGE AUDIT FIRM CLIENTELES: 1981 TO 1997

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Abstract
This paper examines Big Six US clienteles and client financial characteristics during 1981-1997. This period was marked by an explosion in audit-litigation activity and damage awards, significant changes in auditor incorporation and liability rules and increasing competitive pressure: while the number of large audit firm clients grew by about two-thirds, real accounting and audit revenues remained virtually flat. Regulators and critics of large audit firms argue that in response to the more relaxed liability rules and increased pressure on profitability, large audit firms have pursued a growth-at-any-cost strategy, used audits as loss leaders and endangered the overall quality of audits and audit firm clienteles. The firms and their defenders counter-argue that given the highly litigious legal environment, auditors’ incentives to manage their practices judiciously remain strong and there has been no overall decline in audit standards or client quality. Our study provides systematic evidence on this debate by examining the relative financial health of US audit firm clienteles. We find no systematic evidence of a deterioration in the quality of Big Six audit clienteles. While Big Six firms have grown by adding small, rapidly growing clients, they also appear to be shedding smaller, slower-growing, less-profitable clients. We also find that Big Six firms’ practice growth during the 1990s does not appear to have resulted from acquiring a disproportionately large slice of weak and risky clients.

Key Words: Audit firm clienteles, Client Quality, Financial Health, Financial Ratios.

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