Original Article

Perceptions of preparers, users and auditors regarding financial statement audits conducted by Big 4 accounting firms

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ABSTRACT **This study includes the most diverse stakeholder population integrated into one research study regarding perceptions of financial statement audits conducted by Big 4 accounting firms. Whereas prior studies almost exclusively used either archival data or experiments to *implicitly* derive the stakeholders' perceptions, this study employed focus groups with financial statement (1) preparers; (2) users consisting of bankers, financial analysts and non-professional investors; and (3) auditors to *explicitly* solicit perceptions regarding the financial statement audits conducted by Big 4 accounting firms. Some stakeholders opined that Big 4 audit quality has decreased because of the rush to hire staff because of increased Sarbanes–Oxley (SOX) work. However, stakeholders generally agreed that for organizations that are some combination of large, complex and/or multinational, the Big 4 accounting firms will be superior. For other organizations, second- and third-tier accounting firms will provide the same quality audit as the Big 4 firms. One factor as to why there are fewer differences between the firms is that many of the non-Big 4 auditors are Big 4 firm alumni. Regardless of whether a Big 4 audit is actually superior, the stakeholders generally agreed that the Big 4 audit has a cachet that has a monetary value in the financial marketplaces. In terms of differences between the Big 4 firms, the auditors believe there is little difference in how they interpret GAAP or GAAS because there is open communication between the Big 4 firms. Alternatively, the preparers have witnessed differences, particularly, in GAAP interpretations. However, both the auditors and the preparers generally agreed that interpretation differences are wider between Big 4 and non-Big 4 firms.**
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INTRODUCTION

Historically, the Big X (Big 8, Big 6 and now the Big 4) accounting firms have had a mixed public image. In surveys published in business

magazines, they are highly rated in terms of places to work and to start your career. For example, *BusinessWeek* (Gerdes, 2009) ranked Deloitte & Touche, Ernst & Young, PricewaterhouseCoopers and KPMG no. 1 through no. 4 on a list of 50 public and governmental organizations as the best places for college graduates to launch their careers.[1] In contrast, because the Big 4 firms provide financial audit services to the vast majority of large public companies, as well as large private, not-for-profit and government organizations, the Big 4 firms are associated with every major financial scandal, usually with the rhetorical question: Where were the auditors? The most significant example of this association was the complete collapse of Arthur Andersen in 2002 because it was the auditor for Enron and was accused of many professional violations.

The objective of our study was to explore the perceptions regarding the financial statement audits conducted by Big 4 accounting firms by a board range of stakeholders related to audited financial statements, including: (1) financial statement preparers; (2) financial statement users consisting of bankers, financial analysts and non-professional investors; and (3) financial statement auditors.[2] A search of literature did not identify any prior research that included all of these stakeholders in a single study. In fact, almost all of the studies mentioned in the literature review either use archival data – in many cases publicly available data – (for example, Krishnan, 2003; Francis *et al*, 2005; Knechel *et al*, 2007; Krishnan *et al*, 2008; Huang *et al*, 2009) or use experiments to test hypotheses. In the experimental settings, the subjects are typically auditors (for example, Solomon *et al*, 1999). However, the vast majority of the studies are empirical studies with publicly available data. Conceptually, these studies reverse engineer the perceptions of the specific stakeholder group of the research. That is, there is no direct communications with the stakeholders, instead the historical data are analyzed and the statistical results *imply* some hypothesized actions (for example, set a higher price for an initial public offering (IPO)) of the stakeholders, which in turn *implies* something about the subjects' perceptions (for example, must have had more confidence in the auditors) that lead them to take the hypothesized action. Our research *explicitly* solicits perceptions from stakeholders, which we then compare to the implied perceptions in prior studies. To collect a broad range of perceptions, a series of structure focus groups were conducted with groups of these stakeholders.

Thus, we contribute to the literature in at least two ways. First, by directly addressing the research questions to stakeholders, we obtain their *explicit* perceptions. Second, our study includes a broader range of stakeholders than any prior study, which typically focuses on just one stakeholder group. Therefore, we are able to highlight different perceptions within and between diverse stakeholder groups regarding the financial statement audits conducted by Big 4 accounting firms, which has not been done in prior research. Many of the findings of prior literature are confirmed by the focus groups. The focus group discussion also shows that some of the facts identified by prior empirical research are actually of interest for a broad range of stakeholders. However, the focus group discussions also raise questions not investigated by researchers so far, for example, investigating the impact of Big 4 alumni in smaller accounting firms.

The remainder of this article is organized as follows. The next section provides a literature review of research regarding a variety of aspects of Big 4 accounting firms. The next section provides an overview of our research method that used focus groups to explicitly collect perceptions regarding the financial statement audits conducted by Big 4 firms around six broad research questions from the stakeholders. The next section provides a synopsis of the focus group discussions. The final section presents our conclusions and suggestions for future research.

LITERATURE REVIEW

Differential audit quality, accounting firm size and demand for audit quality

A large body research examines differential audit quality. As audit quality is multidimensional and inherently unobservable – except for proven audit failures – differential audit quality must be inferred. DeAngelo (1981a, b) develops a demand and supply rationale for audit quality and defines audit quality as the joint probability that an auditor will both discover a breach in the accounting system and report the breach. On the supply side, DeAngelo posits that auditors specialize in providing differing magnitudes of audit quality to audit clients, and concludes that larger accounting firms have incentives to supply higher-quality audits. The key assumption underlying this argument is that the incumbent auditor can earn client-specific quasi rents, which amount to the cost advantage of incumbency owing to saved auditor start-up and switching costs. Given that Big X auditors have larger reputation capital to protect compared to their non-Big X competitors, and therefore the potential impairment to an auditor's independence driven by fee dependence is less likely for Big X auditors, auditor size proxies for audit quality.

Turning to the demand side, information asymmetry between a company's managers and owners leads to management shirking, or lack of alignment between the incentives of management and owners, which can be reduced by auditing (Jensen and Meckling, 1976). The extent of the resulting agency conflicts affects the audit quality level demanded by clients. In particular, the greater the extent of the agency conflicts, the higher the quality of auditing needed to make management credible to current and potential investors (DeFond, 1992). Results in prior literature support the linkage between agency costs and the demand for quality-differentiated audits. Francis and Wilson (1988) and DeFond (1992), for instance, find that demand for Big X audits is increasing in agency costs. Owing to their presumed product differentiation (DeAngelo, 1981a, b), Big X auditors therefore receive (or are able to charge) a fee premium relative to their non-Big X competitors. This argument is consistent with prior literature that finds evidence of a Big X fee premium for the US audit market (Palmrose, 1986; Francis and Simon, 1987; Simon and Francis, 1988; Turpen, 1990).

There are two explanations for the hypothesized positive relation between auditor size and audit quality. First, DeAngelo (1981b) argues that large auditors have more incentives to deliver higher-quality audits because an inaccurate report may lead to a loss of client-specific rents. We term this the reputation hypothesis. Second, Dye (1993) argues that large auditors will deliver more accurate audits because they have greater wealth exposed to risk in the case of any litigation. This is the so-called deep pockets hypothesis. Lennox (1999) provides evidence on the relationship between auditor size and litigation, and finds greater support for the latter hypothesis. Nevertheless, the findings in prior literature are also in line with the reputation hypothesis (see, for example, paragraph 'Auditor industry specialization').

Another important factor affecting the demand for auditing is the IPO market. Prior work shows that an inverse relation exists between the size of an IPO's auditor and the initial return earned by an investor. Beatty (1989) and Willenborg (1999), for example, report that IPOs with larger auditors have less IPO underpricing.

Evidence from audit outcomes

Audit outcomes are observable. Therefore, prior literature examines audit outcomes such as audited financial statements and audit reports in order to investigate whether different accounting firms are different in quality or are perceived to be different in quality. In the following, the prior literature findings of financial statements audited by Big 4 auditors and of audit reports of Big 4, as well as of national, second-tier accounting firms, are presented.

Financial statements audited by Big 4 auditors

Simunic (1980) argues that the accounting services provided by different accounting firms are perceived by investors to be different in quality, with brand name auditors (currently Big 4 auditors) perceived as being more credible than others. In line with this argument, Becker *et al* (1998) and Francis *et al* (1999) posit that owing to their superior knowledge and reputation capital, brand name auditors conduct higher-quality audits. They find that clients of brand name auditors have lower discretionary accruals relative to their competitors. Teoh and Wong (1993) similarly find evidence of a positive association between auditor brand name and a client's earnings response coefficient. This result indicates that an earnings surprise connected with a brand name auditor is valued more highly in the stock market.

Audit reports of Big 4 auditors (and national, second-tier accounting firms)

Weber and Willenborg (2003) examine a context in which the opinions of brand name auditors are often the only reliable source of information available to individuals for making investment decisions. In particular, the authors investigate whether brand name auditors' opinions are more informative to microcap IPO investors with respect to future stock delisting and returns. Their findings suggest that larger accounting firms (in their case, Big 6 and national, second-tier auditors) are more informative in the sense that their pre-IPO opinions are more predictive of both post-IPO stock performance and pre-IPO distress. Interestingly, the opinions of the national, second-tier firms are comparably predictive to those of the Big 6 firms using a model that econometrically accounts for differences in the clients that hire these national firms (for example, issuers that retain national firms are both smaller and more risky than issuers that retain Big 6 firms). In terms of differences in the informativeness of audit opinions within the Big 6 firms, the authors find that all of the Big 6 firms are better at predicting negative delistings than the local firms, but no significant differences are evident in the informativeness of the audit opinions within the Big 6 firms.

Focusing on the reporting behavior of auditors, Francis and Krishnan (1999) provide evidence that only Big 6 auditors (currently Big 4 auditors) report conservatively. Their finding supports the argument that Big X auditors have larger reputation capital to protect, and hence greater incentives to report conservatively relative to other auditors. This finding is in line with DeAngelo's (1981b) reputation hypothesis. Francis and Krishnan (1999) hypothesize that high-accruals firms are more likely to receive a modified audit report, a strategy of the auditor to deal with the inherent uncertainty and potential estimation error associated with accruals, and call such reporting conservatism. By reporting conservatively, the auditor tries to compensate for his inability to assess the accuracy of reported accruals, and the potential accrual's impact on asset realization and going-concern problems.

A study issued by the General Accounting Office (GAO) of the United States corroborates the essential aspects in terms of Big 4 audit outcome. The Big 4 audit opinion serves as an effective quality label, whereas most of the second-tier firms are not able to bid successfully for large accounts because of a lack of industry knowledge, geographic pressure and reputation (Frieswick, 2003). The GAO argues that a Big 4 audit report is characterized by a distinctive quality label, and therefore contains credible and high quality information.

Auditor industry specialization

In addition to brand name reputation, industry knowledge is also an important component of audit quality (Shockley and Holt, 1983). Indeed, the importance of auditors understanding their client's industry is underscored by regulatory authorities in guidance such as SAS No. 47 (1983), SAS No. 53 (1988) and SAS No. 55 (1988). The importance of

industry knowledge in performing a financial statement audit has increased in recent years because of changes in the global economy (Bell *et al,* 1997). Thus, industry specialization has offered accounting firms an avenue for differentiating their services (Knechel *et al*, 2007). Consistent with this view, brand name auditors are generally structured along industry lines (Emerson, 1993). Industry experts tend to have more experience and make better audit judgments (Solomon *et al*, 1999; Low, 2004), and thus financial statement outcomes reflect higher-quality audits by Big X industry specialists. For instance, auditors' industry expertise can mitigate earnings management, positively influencing audit quality (Balsam *et al*, 2003; Krishnan, 2003). In addition, Balsam *et al* (2003) show that clients of industry specialists have higher valuations in the event of earnings surprises, which suggests that specialist auditors increase the markets' perception of earnings quality. Furthermore, industry specialists are less likely to be associated with financial fraud (Carcello and Nagy, 2004). O'Keefe *et al* (1994), for instance, show that specialist auditors comply to a greater extent with auditing standards (GAAS) than non-specialist auditors. This finding is consistent with the reputation hypothesis of DeAngelo (1981b), which posits that industry specialist Big X auditors have both the expertise to detect earnings management and the incentives to report it (Krishnan, 2003), as they have more to lose in terms of reputation costs than do non-Big X auditors. Findings from audit fee research also suggest that industry specialist auditors may earn a fee premium, although this evidence is mixed (for example, Ettredge and Greenberg, 1990; Ferguson and Stokes, 2002). For instance, Craswell *et al* (1995) show that specialist Big 8 auditors earn a 34 per cent fee premium over non-specialist Big 8 auditors, but this premium may vary across markets, firms or time periods (Hay *et al*, 2006).

A question that arises in the context of industry expertise at Big X firms is whether such expertise is observed firm-wide (at the national level), at specific offices (at the city level) or a combination of both? The findings of Francis *et al* (2005) suggest that an auditor's reputation for industry expertise is priced in the US audit market if the then Big 5 firm is both the national industry leader and the city-specific industry leader in the city where the client is headquartered lending support to the view that national and city-specific industry leadership jointly affect auditor reputation and pricing. This finding is consistent with the argument that an auditor's expertise can be transferred across offices, as there is an effect of national leadership on the audit fee premium. In contrast, the result that auditors that are solely national industry leaders without also being city-specific industry leaders do not earn a fee premium does not support this argument. Given these conflictive findings, the authors conclude that auditor reputation for industry expertise is neither strictly national nor strictly local in character.

Another way to capture the role of auditor expertise is to proxy for expertise or experience using office size. In recent research on the relation between Big 4 office size and audit quality, Francis and Yu (2009) show that larger Big 4 offices are more likely to issue a going-concern report. In addition, large Big 4 offices' going-concern reports are more informative in the sense that they better predict next-period client bankruptcy, and clients in larger Big 4 offices evidence less aggressive earnings management behavior. These results indicate that audit outcomes vary significantly across Big 4 offices, and hence that the local office's perspective is of vital importance in audit research. This evidence is consistent with larger Big 4 offices providing higher-quality audits owing to greater in-house experience.

Implications of auditor change

Accounting policymakers have long had an interest in the phenomenon of companies changing auditors (SEC, 1971). The primary concern about the termination of a client–auditor

relationship is that it may be the result of 'opinion shopping', where the company searches for favorable treatment from the auditor. For instance, companies with bad financial conditions may switch to a new auditor if they are unable to pressure their incumbent auditor to issue an unqualified audit opinion (Chow and Rice, 1982). Thus, changing auditors may be a loophole to suppress negative information or to avoid going-concern opinions (Fried and Schiff, 1981; Chow and Rice, 1982; Eichenseher and Shields, 1983; Kluger and Shields, 1989). Notwithstanding these arguments, prior research on market reactions following an auditor change is mixed. Eichenseher *et al* (1989) find a negative market reaction, whereas other studies find no evidence of any market reaction (Johnson and Lys, 1990). This suggests that there may be other reasons for changing auditors aside from opinion shopping. For example, a company may change to a higher-quality auditor because the company believes that a higher-quality auditor (the new auditor) will provide more credible guidance to investors and creditors (Schwartz and Menon, 1985). Numerous prior studies show that, indeed, auditor switching to (from) a brand name auditor leads to positive (negative) market reaction owing to brand name auditors' better monitoring capabilities (for example, Fried and Schiff, 1981; Nichols and Smith, 1983; Eichenseher *et al*, 1989; Klock, 1994; Dunn *et al*, 1999).

Auditor independence

Given the public attention to the issue of auditor independence prior research investigates whether auditor independence may be impaired by certain factors. First, accounting firm size may have an impact on auditor independence. Second, accounting firm alumni may have the potential to impair auditor independence. In the following, prior literature findings with respect to accounting firm size and accounting firm alumni and their potential impact on auditor independence are reported.

Big 4 accounting firms versus smaller accounting firms

Given that larger accounting firms have a larger portfolio of clients, they are less dependent on a specific client than smaller accounting firms, as the fees earned from this one client usually constitute a smaller proportion of the accounting firm's total revenues (Mautz and Sharaf, 1961). Smaller accounting firms' independence may be further impaired by the tendency of smaller accounting firms to offer a more personal mode of service (Shockley, 1981). It is thus often argued that smaller accounting firms are less able to resist clients' pressure. Financial statement users, for example, banks and analysts, therefore prefer that their client firms be audited by a large accounting firm (currently Big 4 firm) (Goldman and Barlev, 1974).

Accounting firm alumni

Another line of research investigates whether accounting firm 'alumni' that depart the accounting firm to work in senior management positions of audit clients can impair auditor independence. Alumni of accounting firms have a good understanding of the audit methodology of their former employer. Moreover, auditors may have a cozy relationship with their former colleagues, the alumni. As a result, there are some concerns that audit opinions are more generous for clients with high-placed alumni of the firm. Accordingly, SOX placed restrictions on the so-called 'revolving door' or outplacement of accounting firm personnel to clients (Francis, 2004). Research in this area suggests, however, that while auditor leniency is more likely for clients with high-placed alumni (Menon and Williams, 2004; Lennox, 2005), outplacement appears to occur less often than is perceived (Lennox, 2005).

Post-SOX period

In today's auditing market, the Big 4 firms dominate the market. However, in recent years, second-tier auditors such as Grant Thornton and BDO Seidman have been successful in recruiting clients away from their Big 4

competitors. For instance, the Big 4 firms experienced a net loss of 400 clients in 2004 compared to 201 in 2003, while the second-tier auditors acquired 117 clients in 2004 compared to 30 in 2003 (Glass Lewis & Co, 2005). Gullapalli (2005) argues that in the post-SOX environment, as the Big 4 firms have been terminating their riskier or problematic clients, and second-tier auditors, such as BDO Seidman, have been picking these clients up. Some of the reasons given for the auditor change were a need for better service and/or cost considerations. Consistent with these explanations, the results of recent (post-SOX) literature show that second-tier auditors have become more conservative in the sense that, although in the pre-SOX period they tolerated earnings management to a greater extent by clients that switched from a Big 4 auditor, in the post-SOX period they are associated with lower earnings management (Krishnan *et al*, 2008). The findings of Huang *et al* (2009), however, suggest that Big 4 firms have also become more conservative in the post-SOX period with respect to both their new client acceptance and their pricing decisions (for example, the Big 4 firms are much less likely to serve as a successor following a client's dismissal of the predecessor in the post-SOX period than in the pre-SOX period, and they now earn an initial fee premium instead of the initial fee discount observed in the pre-SOX period).

GAAS interpretations

The objective of an audit and, by implication, the auditor's responsibilities and standards of due care in conducting an audit are set out by a set of standards known as generally accepted auditing standards (GAAS). Furthermore, GAAS provides guidance on how to plan, implement and report on audit outcomes. However, owing to the broad nature of the standards set forth by GAAS, its implementation by accounting firms involves a fair degree of latitude. This means that there is not just one correct approach to gathering and interpreting the evidence that culminates in an audit report (DeFond and Francis, 2005).

RESEARCH METHOD

To elicit information regarding the stakeholder's perceptions regarding the financial statement audits conducted by Big 4 accounting firms, a series of focus groups were conducted with volunteers, including: (1) financial statement preparers (the Chief Financial Officers, CFOs); (2) financial statement users consisting of bankers, financial analysts and non-professional analysts; and (3) financial statement auditors.[3] A total of 53 individuals participated in the focus groups, and each category of stakeholders met separately. The auditor focus groups were scheduled after the other focus groups to solicit the auditors' reactions to the comments of the other stakeholders.

The overarching objective of this article was to explore the perceptions regarding the Big 4 accounting firms by a diverse range of stakeholders related to audited financial statements. Before conducting the focus groups, a script was developed to ensure that the different stakeholder groups are addressing the same basic research questions (RQs) including:

RQ1: What are the general perceptions regarding Big 4 audits?

RQ2: What contributes to superior auditing?

RQ3: Does the relative sizes of the accounting firm size versus the client size impact perceptions about audit quality?

RQ4: What are specific perceptions regarding non-Big 4 accounting firms?

RQ5: Do US accounting firms interpret GAAP and GAAS differently?

RQ6: When do third parties require Big 4 audits?

At the beginning of each focus group, the facilitator introduced himself and explained

the objective of the study. Participants were told that the discussions would be synthesized and no quotes will be associated with a specific person or company.

Conducting a focus group requires a careful mix formality and informality to provide structure, spontaneity and interaction. As an initial icebreaker, the participants were asked to briefly introduce themselves in a round-robin fashion. Then, as the discussion of each new research question started, the first round of responses was again conducted in a round-robin fashion. That is, the participant to the immediate left of the facilitator was asked to respond first, then the participant to that person's left responded next, and the process continued clockwise until all the participants responded. (For the next question, the process moved counter-clockwise.) However, a critical aspect of the focus groups is obtaining reactions from other participants to a specific participant's comments. As such, as each participant finished his or her turn providing initial comments, the facilitator asked the group whether they had any responses to those initial comments before proceeding to the next participant.

RESEARCH FINDING

The following is a synopsis of the focus group discussions. Focus groups are a form of qualitative research, and, as such, detailed statistics (for example, 18.5 per cent believe that …) were not collected. Those kinds of numbers have little meaning for very small, self-selected, non-random samples in focus groups. The purpose of focus groups is to identify beliefs, opinions, issues, perceptions and concerns related to a topic. With that said, using terms or phrases such as *most*, *generally*, *the majority* or *a general consensus* in the following synopsis implies that more than 50 per cent of the participants agreed on a particular point; terms such as *few* or *some* means less than 50 per cent (usually just one to three participants in a focus group); and the term *all* is reserved for those very rare instances where it was clear that all participants agreed on a point (Mock *et al*, 2009). As we discuss later, future research can build on the beliefs, opinions, issues, perceptions and concerns identified in the focus groups to conduct quantitative research.

The synopsis starts with the most general questions regarding general perceptions of financial statement audits conducted by Big 4 accounting firms followed by questions that address more specific aspects of the Big 4 accounting firms. As there can be differences in the beliefs people state and the actions they actually take, the final question explores the *actions* of banker, analysts and other third parties in terms of requiring Big 4 audits or asking/requiring companies to change auditors.

There are only a couple of quotes or statements from the non-professional investors in the focus group synopsis. We were very surprised to learn, as we did not uncover a similar finding in the literature, that these non-professional investors never looked at the auditor's report. In fact, they never look at the company-produced financial statements (neither the annual report nor the Securities and Exchange Commission (SEC) filings) when making their investment decisions. They rely on third-party materials such as *The Value Line Investment Survey* published by Value Line and information posted on the Motley Fool and similar web sites.[4] This reliance on secondary sources was not a naïve decision on their part. They belong to the National Association of Investment Clubs (NAIC), which is an association of investment clubs.[5] In NAIC guidelines for operating investment clubs, they recommend using secondary sources. The club members' depth of knowledge regarding the Big 4 accounting firms varied. One member worked in the finance department of a large company, two other members worked in businesses, and the remaining members were non-business professionals. With that said, they generally knew of the Big 4 accounting firms and they knew the Big 4 firms were somehow different from the other accounting firms, but most members probably could not name all four firms. Therefore, contrary to the findings

in Weber and Willenborg (2003), having a Big 4 auditor is *not* a reliable source of information available to individuals for making investment decisions, at least not this investment club – and maybe not for other NAIC investment clubs.

RQ1: What are the general perceptions regarding Big 4 audits?

At the beginning of the focus groups, we asked participants to give us their general impressions of Big 4 accounting firms. Specifically, we concentrated on the perceptions regarding financial statement audits performed by those firms.

Superior audits

When asked whether they believed that financial statement audits performed by Big 4 firms were generally superior to audits performed by non-Big 4 firms, the majority of participants in the different stakeholder groups indicated that the answer to that question was a function of client size and complexity. For very large clients, clients with complex accounting situations, and/or multinational operations, the Big 4 accounting firms, with their wider and deeper resources, will be able to be more responsive to those kinds of clients. These comments are in line with the findings of Francis and Wilson (1988) and DeFond (1992), showing that demand for Big X audits is increasing in agency costs.

The bankers opined that the quality of Big 4 audits *may* be better than smaller accounting firms. One banker said that, knowing the structure of accounting firms, he presumes that the bigger firms have a bigger budget, more time and adhere to different internal standards. The bankers also recognized that there can be variations within any of the firms. This does not mean that the smaller firms do not do excellent work; however, the bankers feel that they have more knowledge as to what the standards are in the bigger accounting firms. The bankers believe that smaller firms with smaller budgets and more economic pressures to retain clients, because they are not auditing public companies, do not have quite the same requirements or standards and 'might be willing to look at things a little more loosely'. A banker went on to say that accounting firms that audit many public companies develop a certain discipline that may not be seen in smaller firms that do not audit public companies.

An analyst said that up until about 2 years ago when they received financial statements – of which two thirds come from the outside of the United States – they believed that they were all audited at essentially the same level of quality. As such, they gave little thought to the accounting firm's name on the auditor's report. However, in the past 2 years, they have compiled a list of accounting firms that they can refer to when analyzing a set of financial statements. Similar to other analyst opinions, her company is also more comfortable with Big 4 audits. She also added that when looking at the financial statements and the auditor's report, they check to see whether the company has changed auditors since the last report. They will follow up with those companies to determine why the prior auditors left, suggesting that the termination of a auditor–client relationship as a result of 'opinion shopping' is a concern of financial statement users.

Countervailing view

Although there was a general agreement among the CFOs regarding the Big 4 audit quality, not every CFO praised the Big 4 accounting firms. For example, one CFO said that he has witnessed a serious deterioration in the technical skills (both audit skills and, particularly, accounting technical skills) at the Big 4 firms over the past several years. He believed this was because the firms could not hire people during the dot-com boom, and therefore there is now a shortage of people at the manager and senior levels in the firms. As a consequence, the partners are working harder now, implying that the partners may be spreading themselves more thinly. The CFO went on to say that the firms' more recent hiring standards have also

fallen because they need people to fill positions in response to the demands of SOX activities. Another CFO complained that no one on the audit of his organization had skills in his particular industry, and that they could not provide any technical advice or guidance to his company.

One analyst said that she felt that the Big 4 firms were overrated. She gave an example of a bank where she worked and all the external auditors were very junior and had no banking experience. Some of her clients use accounting firms that are specialized in specific industries and she has also had good experiences with the level of service provided by large regional accounting firms. She went on to say, 'The big ones screw up as much as the little ones'. However, she does believe that firm size has to be appropriate for the company being audited. She said she looks at what percent of the accounting firm's billings are from her specific client and she becomes concerned as that percentage increases.

Except for a few negative comments above, the various stakeholders expressed their beliefs that the Big 4 firms provide quality audits that are generally (but not always) superior to those provided by non-Big 4 firms. These beliefs support the logic presented in DeAngelo (1981a, b), which concluded that larger accounting firms have incentives to supply higher-quality audits. These perceptions also indicate that Simunic's (1980) argument 30 years ago still stands that investors perceive that Big 4 auditors are more credible than others. The stakeholders' belief in the superiority of Big 4 firms reached a stronger consensus when the client was some combination of large, complex and/or multinational. All other things being equal, these kinds of companies would increase agency demands, which in turn would increase the demands for the highest quality auditors, as argued in Francis and Wilson (1988) and DeFond (1992). In addition, the comments of the stakeholders in terms of the informativeness and the credibility of Big 4 auditor's report are in line with the view of GAO, which argues that a Big 4 auditor's report ensures, owing to a distinctive quality, that a consistently high level of knowledge, presence and reputation has been applied to the audit (Frieswick, 2003).

Strong Big 4 accounting firms cachet

Whether or not Big 4 audits are actually superior, there was a strong consensus among the stakeholders that the Big 4 firms definitely have more cachet, and that it does communicate something positive to the reader of financial statements if they are audited by a Big 4 firm. Probably the most consistent comment we heard in all the preparer (CFO) and user (bankers, analysts and investors) groups was that when they receive a set of audited financial statements, the first thing they do is turn to the auditor's report, look at the opinion paragraph, and see who signed the report, and whether it is signed by a Big 4 firm, that is the last time they think about the auditors and the report. The whole process takes a couple of seconds. On the other hand, if it is not signed by a Big 4 firm, then they stop and have to consider the ramifications of who did sign the report. They might check an in-house list of 'approved' accounting firms, they might check to see whether the accounting firm is at least registered with the Public Company Accounting Oversight Board (PCAOB), or they might check with colleagues to see whether they know the firm.

The participants believed that cachet does have some monetary value in the marketplace in terms of lower interest rate on a loan, a higher price for common stock, the ease of raising venture capital or issuing an IPO. For example, one CFO said the first thing he does with financial statements is check who signed the auditor's report and '[it] carries more weight if it is signed by a Big 4 firm'. An auditor mentioned that underwriters prefer having Big 4 auditors associated with a company that is preparing to go public. These comments support Beatty (1989) and Willenborg (1999) who reported that IPOs with larger auditors have less IPO underpricing.

Echoing this point, another CFO made the observation that boards know that they could obtain a quality audit from a non-Big 4 firm, but yet they continue to support the ongoing engagement of a Big 4 firm because they believe that having a Big 4 auditor looks better in the financial marketplace. Another CFO indicated that it definitely sends a negative signal to the marketplace when a company switches from a Big 4 firm to a third-tier accounting firm. This observation is supported by numerous prior studies that found auditor switching to (from) a Big 4 auditor leads to positive (negative) market reaction owing to Big 4 auditors' better monitoring capabilities (for exemple, Fried and Schiff, 1981; Nichols and Smith, 1983; Eichenseher *et al*, 1989; Klock, 1994; Dunn *et al*, 1999).

RQ2: What contributes to superior auditing?

The participants were then asked what characteristics of the Big 4 firms contributed to any perceived superiority of those firms.

Better training

One CFO said that the Big 4 accounting firms are more consistent in terms of resources, including people, products, training and other resources. Regarding training in particular, most of the CFOs had prior experience working in public accounting, and some of them indicated that one of the reasons why the Big 4 firms were better is because of their extensive training programs. Some CFOs described the intensive training that they had when they worked for the major accounting firms. One CFO described how the partners and managers at the Big 4 firm where he worked loved to write audit points, which described errors (for example, not signing and dating an audit schedule) that were made during the audit. The partners and managers seemed to enjoy 'ripping you apart'. As such, the auditors were highly motivated to perform quality work to avoid having audit points written about their work. One CFO, whose company used a smaller accounting firm, added that their accounting firm sends their employees to Ernst & Young training programs.

Deep pockets

An analyst said that there might be a bias favoring the Big 4 firms because they have deeper pockets to share the liability, which agrees with the so-called deep pockets hypothesis presented in Dye (1993) and Lennox (1999).

Known quantity

An analyst said that they recommend Big 4 firms because they increase their comfort level, as the Big 4 firms are a known quantity, and provide the same standard worldwide. However, the findings of recent audit quality research may go counter to that analyst's belief because the research suggests that larger Big 4 offices provide higher-quality audits owing to greater in-house experience, and therefore the office size has impact on audit quality of Big 4 accounting firms (Francis and Yu, 2009). The analyst went on to say that when a company is not using a Big 4 firm, they check to see whether the firm is at least registered with the PCAOB because that will provide a minimum level of assurance that it is a quality accounting firm.

Extensive client bases

One CFO said that the Big 4 firms, because of their extensive client bases, are able to provide more comprehensive information on how other clients in their client base are addressing some particular GAAP issue. The auditors are not giving advice *per se* here, which may be considered an independence conflict; instead, the firms are acting as a conduit and telling clients what other companies in their client base have done when faced with a particular issue.

RQ3: Does the relative sizes of the accounting firm size versus the client size impact perceptions about audit quality?

In earlier discussions, stakeholders generally agreed that Big 4 firms would be the best choice

for large, complex and/or multinational companies. We revisited this discussion by exploring two related questions: (1) Can large accounting firms provide superior audit work to smaller clients? (2) Can small accounting firms provide quality audits to larger clients? Regarding the first question, according to the bankers, to a great extent, the discussion of Big 4 firms versus smaller accounting firms is somewhat irrelevant for private companies, particularly smaller private companies, because these companies rarely have a Big 4 audit because the Big 4 firms are concentrating on audits under SOX for large public companies. One banker said that the Big 4 accounting firms have pulled out of the smaller private company domain because of recent legislation to focus their scarce resources on the bigger public companies. The second-tier and regional accounting firms are auditing the smaller public companies and the smaller accounting firms are auditing smaller private companies.

Regarding the second question, there was a concern expressed by some stakeholders that larger clients could put undue pressure on the auditors from smaller firms. In the ensuing discussion among the analysts, there was some debate about the benefits and concerns of having a big company audited by a relatively small accounting firm. On the one hand, because the company is a major client of the firm, the company will probably receive more partner-level attention. However, on the other hand, some analysts were concerned that because of the smaller accounting firms' fear of losing a major client, the smaller accounting firms may be more flexible in acquiescing to the client's demands. This is not a new concern; it was brought up in early research, such as Mautz and Sharaf (1961), Goldman and Barlev (1974) and Shockley (1981).

RQ4: What are specific perceptions regarding non-Big 4 accounting firms?

In earlier discussions, general comments were made about the relative quality of Big 4 versus non-Big 4 audits, but in this section we take a closer look at perceptions regarding the non-Big 4 firms. On the basis of their prior experiences, the CFOs generally agreed that the skills of the auditors at the second-tier firms, in particular, are as good as those at the Big 4 firms, and, with the non-Big 4 firms, a client gets 'more bang for the buck'. Specifically, regarding the next two firms, there were mixed opinions among some CFOs on whether the next two firms (Grant Thornton and BDO) were similar to the Big 4 firms, talent-wise and reputation-wise. One CFO indicated that, depending on the purpose of the audit, there is a distinction between the top *six* firms and all the other firms. If a company is preparing to make an acquisition, particularly if they are buying a business outside the United States, the company would feel much more comfortable if one of the six larger accounting firms was conducting the audit of the target company as opposed to a small local accounting firm. Another CFO stated that based on his narrow experiences there are significant differences between the Big 4 firms and even the second-tier firms. He has seen a difference in the 'pitch' (the accounting firm's proposal) and in the due diligences performed by the Big 4 firms and the second-tier firms. He felt that the Big 4 firms are more rigorous. Another CFO added that when his organization went from a third-tier firm to a Big 4 firm, he noticed that the Big 4 firm paid significantly more attention to footnotes and disclosures compared to their original auditors and the Big 4 firm 'dug deeper into the details'. Another CFO stated that the Big 4 firms are better at identifying areas where the risks are the greatest, and then devote more time to those areas. One of the bankers indicated that in the past 10 years he has seen increased strength and quality in the regional accounting firms.

There is a body of literature (for example, Menon and Williams, 2004; Lennox, 2005) that explores issues of alumni of the accounting firms working for clients, but there appears to be no literature on the impact of Big 4 auditors moving to non-Big 4 accounting firms.

According to one CFO, decades ago there were differences between the Big 4 firms (or Big 8 firms in those days) and smaller firms, but he does not believe there are significant differences today because there are so many alumni from the Big 4 firms in the smaller and regional firms, all the firms are very similar in terms of auditing. He went on to say that sometimes the small, regional firms might even have better quality. Building on that last point, another CFO agreed that sometimes the smaller firms actually provide better service. He said that when he was at another company, they switched from a Big 4 firm to a large regional firm, and that the new auditors put in more hours and the total fees were less. He went on to say that, in general, 'if you are a single-location company, you might receive better services from a small regional accounting firm. On the other hand, if you have many offices around the United States or you are an international company then you will need a larger firm to provide auditing services'. This quote again reflects that the demand for Big 4 audits is increasing with agency costs, and confirms the findings of Francis and Wilson (1988) and DeFond (1992).

RQ5: Do US accounting firms interpret GAAP and GAAS differently?

Up to this point, we discussed Big 4 firms as one homogenous group. In following paragraphs, we explore whether the stakeholders believe there are differences between the Big 4 firms. One auditor stated that he thought there might be a relatively narrow band of differences between the Big 4 firms, particularly, how their national offices might interpret some specific accounting (GAAP) or auditing (GAAS) question. However, he went on to say that the band of differences would be much wider for the top 100 accounting firms.

One CFO said there might be slight variations between the firms. However, he went on to say that 'the firms all have their "books" that outline in detail how they approach audits and the firms share those books with each other. The firms meet – it's like a cartel – and they share a lot of information and develop plans to incorporate or respond to new GAAS and GAAP pronouncements'. Supporting the CFO's view, in a later focus group, an auditor pointed out that there are frequent conversations between representatives of the different Big 4 firms that results in a convergence of their interpretations. For example, when some new accounting or auditing issue arises, that will prompt discussions between the firms. She went on to say that the firms are fairly open in discussing their audit methodologies, so that the methodologies used by the firms are constantly evolving over time.

A CFO pointed out that in recent years there has been a paradigm shift in the relationships between the auditors, the board and management. In the past, it was easier to push the auditor to go along with management's interpretation of an accounting rule, but now the auditors are much stricter in their interpretations of GAAP and GAAS. On the other hand, another CFO argued that, based on his experiences, if you can show the auditor in the pronouncements where the auditor's interpretation was incorrect, the auditors will back off, which is another indication of the shortage of technical skills in the accounting firms that was raised in the earlier Big 4 firm discussions.

Some CFOs had an opposing view and argued that the GAAP and GAAS differences were wider than those stated by the other CFOs. For example, one CFO said that the firms do seem to have different interpretations based on the fact that they have different audit methodologies and practices, and how they analyze the information they collect. For example, for public companies, significant differences are seen in the way the firms handle Section 404 – some are more conservative and rigid, and others are looser in their approach. Those wider differences were echoed by another CFO who said that, based on his experiences of working for different Big 8 firms in the past, he was

surprised at the differences in their approaches. For some firms, the interpretations were very strict and for other firms the interpretations were very loose. 'It was an eye opener for me'.

A CFO from the health-care industry indicated that he saw differences between the accounting firms in his industry because some of the firms have a better understanding of government regulations compared to the other firms. Another CFO believed that there were more distinct differences between the firms before SOX when some of the firms were more willing to push the envelope on their interpretations of GAAP and GAAS.

Some CFOs believed that there, probably, are some differences between how different Big 4 firms interpret GAAP and GAAS, but generally that belief is hard to test as most organizations stay with one accounting firm for many years and do not have first-hand experiences working with more than one firm. With that said, a couple CFOs did mention that when their companies changed auditors, sometimes the new auditors had negative comments on some of the interpretations made by the prior auditors. Generally, those comments were more related to GAAP than GAAS.

One CFO made the point that it is not so much the interpretation of GAAS, as most of the firms have well-developed audit plans based on GAAS, but instead it is varying levels of quality control at the firms or at offices within the firms. In other words, according to this CFO, it is the rigor of the quality control that seems to vary from firm to firm.

One CFO said that some firms are more creative than others in interpreting GAAP. Building on this point, another CFO indicated that where GAAP has strict guidelines, firms generally follow those guidelines, but where there is room for different interpretations the firms may come up with different interpretations. In addition, accounting is becoming more complex, particularly with the Internet and electronic commerce, which raises issues as to when to recognize revenue. Some firms also have more expertise in particular areas that may impact how they interpret GAAP.

Another CFO pointed out that these interpretation differences are frequently seen when a company makes an acquisition and acquiring company's auditors disagree with some of the accounting method used by the acquired company even though that method met with the approval of the acquired company's auditors. Another CFO echoed the prior comment and said that GAAP, by its very nature, is open to interpretation and it is more complex now.

Reflecting this complexity, one CFO indicated that even within one accounting firm, different GAAP interpretations are received from different partners. In addition, when the local partner is asked a complex question, frequently they will contact their national office for an answer.

One CFO summarized his view by stating that the common denominator in all of this (interpreting GAAS and GAAP) is how much the auditors are willing to let management manage income. On a year-to-year basis, there is a certain amount of give and take in this area. Picking up this comment, the findings of Becker *et al* (1998) and Francis *et al* (1999) show that clients audited by the Big 4 accounting firms have lower discretionary accruals relative to their competitors.

One CFO said that the difference in interpretation of GAAP was not so much a firm issue, but more of who was the audience for the audited financial statements. For private companies, interpretations are 'looser and flexible'. For public companies, for the interpretations of GAAP, 'the intensity and scrutiny ratchets up exponentially'. Another CFO expressed an opinion that smaller accounting firms might also be more flexible in their interpretation of GAAP because of the fear of losing the client.

One analyst said that her company has seen some differences mostly in that some accounting firms are more conservative than others. This comes to the analysts' attention because they will ask an issuer why they are doing something on their financial statements that seems

relatively negative, such as taking a large write-off. The issuer will say it is because their auditors are making them do that. Her point was that there are flags to indicate when an accounting firm is being more conservative, but there are no similar flags to tell when an accounting firm is being more liberal.

RQ6: When do third parties require Big 4 audits?

The prior discussion centered on the stakeholders' perceptions and beliefs. This last focus group discussion explores how those beliefs turn into action. Specifically, this section explores whether those stakeholder who can influence auditor selection ever insist on the use of a Big 4 firm or under what circumstances would they insist on a Big 4 firm. According to some CFOs, some banks and other organizations that require audited financial statements frequently insist that the audit must be conducted by a Big 4 firm. One CFO from a very large company said that his organization requires that all 'SAS 70 reports' submitted to them must be prepared by Big 4 firms.[6] When asked how much pushback his company receives owing to this requirement, he indicated that it has not been an issue, and that currently all the SAS 70 reports they receive are prepared by Big 4 firms.

Another CFO indicated that he believed that the requirement for Big 4 audits is a little less frequent today than it was in the past, which is primarily due to the fact that now there are only four large accounting firms and there is a limit to the number of new audit clients that they can accept. One CFO put it rather bluntly when he said that if you are a small company planning on going public and you call any of the Big 4 accounting firms asking for a proposal to conduct an audit, you will be waiting a long time for them to return your phone call. In fact, regarding the Big 4 firm perspective, post-SOX literature shows that Big 4 firms are much less likely to serve as a successor following a client's dismissal of the predecessor in the post-SOX period than in the pre-SOX period, suggesting that Big 4 firms have become more conservative with respect to their new clients' acceptance (Huang *et al*, 2009). Therefore, the clients' acceptance of the Big 4 accounting firms has changed over time.

The bankers indicated that their requirements would not be that specific to insist on a Big 4 audit, instead, the letter from the bank to the borrower would use a phrase such as: '… an accounting firm acceptable to the bank'. The bankers said that requiring audits and the scrutiny of the borrower's accounting firm depends a lot on the perceived risk associated with the loan. For a relatively small company that is an Internet start-up or media company, the risk is perceived to be relatively high, and thus even for a relatively small loan the bank may insist on an audit. On the other hand, if the borrower has a long relationship with the bank and has pledged hard assets, the size of the loan could be relatively larger before the audit requirement would be imposed.

A banker said that another factor that might motivate closer scrutiny of the selected accounting firm would be industry specialization, which supports research in this area such as Solomon *et al* (1999) and Low (2004). That is, certain accounting firms are known to have specialists in specific industries and sometimes, on an informal basis, the banker may mention this need to engage one of these firms (that have the appropriate specialists) to their customer. For example, the banker may mention to the customer that they might receive better tax advice from a specific accounting firm. One banker mentioned that their customer sometime initiates the discussion and will ask them to recommend an accounting firm when they are moving from the requirement of having reviewed financial statements to audited financial statements. In response to that request, the banker said that he would provide the customer with a list of some firms that he is familiar with, but he would not insist on a specific firm because of the 'checks and balances'. But, on the other hand, the banker would try to get a good match between the customer and

the accounting firm. This reflects the typical close one-on-one relationship between bankers and their customers for commercial loans.

The bankers were asked whether they had run into the situation where they recommended to a customer that they needed to think about changing accounting firms (in general, not specifically to Big 4 firms). Although they did not put an exact number or percentage of their answer, based on the ongoing discussion, this was not a rare occurrence. The recommendation might be triggered by the company, going from reviewed financial statements to audited financial statements, or it may be that the banker is concerned about the quality of the tax advice the customer is receiving or the quality of the financial statements themselves. Another banker said, 'At the end of the day, … [just like] you can outgrow your bank, you can outgrow your [certified public accountant] CPA'. The bankers will sometimes do this on a proactive basis and will sit down with the client and explain to them that if they continue to grow, they are probably going to have to change firms to obtain the level of service they are going to need to produce timely financial reports.

Two of the analysts worked for equity companies that do have the power to require/recommend specific auditors. When a client submits financial statements, the analyst will do some research on who the auditors are if they are not a Big 4 firm. If they are satisfied that the firm is adequate, then they will not recommend a change. On the other hand, they have made recommendations in the past. One analyst said that her company would recommend that the client use a 'reputable firm'. The other analyst said that her company would very likely recommend that the client employ one of the Big 4 firms, particularly for companies outside the United States.

CONCLUSIONS AND RECOMMENDATIONS FOR FUTURE RESEARCH

The research presented in this article contributes to the body of audit research literature in two ways. First, existing research *implicitly* derives stakeholders' perceptions regarding Big 4 accounting firms from archival studies. We used focus groups to *explicitly* identify stakeholders' perceptions regarding financial statement audits conducted by Big 4 accounting firms. Second, we included representatives from a wider range of stakeholders than any prior study. In many ways, our findings with these stakeholders paralleled the findings in literature, but our study brought out beliefs, opinions, issues, perceptions and concerns that have yet to be addressed in audit research literature.

Our findings included the following:

- Non-professional investors have no interest in who audited the financial statements. It could be argued that the investment club used in our study may not be representative of the larger population of investment clubs, but the investment club's exclusive reliance on secondary sources was in compliance with the guidelines of the NAIC. This leads us to believe that this lack of interest in who the auditor is applies to a larger number of non-professional investors.
- Stakeholders generally agree that for organizations that are some combination of large, complex and/or multinational, Big 4 audits will be superior because the Big 4 firms have the depth of resources needed to service these clients.
- Big 4 firm training seems to be a particularly strong contributor to that perceived superiority.
- For organizations that do not have the above characteristics, most of the stakeholders believed that second- and third-tier accounting firms will provide the same quality audit as the Big 4 firms – and may even provide a better audit because the client will receive more partner-level attention. However, there is a concern that the client could put undue pressure on the auditor because of the economic consequences of losing the audit client.

- One of contributing factors to why there were fewer differences between Big 4 and non-Big 4 firms was that a lot of the auditors at the non-Big 4 firms are alumni from the Big 4 firms.
- Some stakeholders expressed a concern that Big 4 quality has gone down primarily because of the rush to hire new staff because of increased work brought on by SOX.
- Regardless of whether a Big 4 audit is actually superior, the stakeholders (including even the non-professional investors) seem to all agree that the Big 4 audit has a cachet that has a monetary value in the financial marketplaces. It says something positive to the marketplace when an organization has a Big 4 auditor or moves to a Big 4 auditor and it definitely sends up a red flag when an organization changes from a Big 4 firm to a non-Big 4 firm.
- According to the auditors in our study, there is a lot of open communications between the Big 4 firms, and therefore those auditors believe that there is little difference between the firms in how they interpret GAAP or GAAS. On the other hand, the CFOs in particular have witnessed difference between the firms, particularly in GAAP interpretations. However, both the auditors and the CFOs generally agreed that the differences in interpretations become wider when Big 4 and non-Big 4 firms are compared.
- The stakeholders generally agree that there have been instances where bankers, underwriters, analysts and even other companies have required that an organization use a Big 4 firm for their audit. The motivation for imposing this requirement could be brand recognition, such as an IPO underwriter requiring a Big 4 audit, or because of the need for the industry specialty associated with a Big 4 firm.

Research limitations and suggested future research

Focus groups are a form of qualitative research. The purpose of focus groups is to identify beliefs, opinions, issues, perceptions and concerns related to some topic. The number of participants is too small to be a statistically valid sample, and the participants are volunteers, not a random sample; therefore, our findings outlined above must be viewed as preliminary and as a starting point for future research. Research could fall into two broad categories. First, would be quantitative research. For example, a provocative point brought up by a couple of stakeholders was that the quality of the Big 4 firms has decreased in recent years primarily because of rapid increase in hiring associated with the new demands of SOX. It would be very interesting to do some time-series analysis to test that hypothesis. In addition, a fact mentioned by several stakeholders was that the accounting firm has to be appropriate for the client. But, what is the optimal level of audit quality for a specific client? This is another interesting issue future research could examine. Second, would be behavioral research. The focus group participants seemed very open and honest in expressing their beliefs and opinions even when those comments could reflect negatively on themselves. However, it is one thing for people to express their beliefs and opinions as our focus group participants did, but another thing to see whether actions (behaviors) they take confirm or disconfirm those stated beliefs.

NOTES

1 Coincidently, this is also the relative ranking of the Big 4 firms in terms of their 2009 revenue.

2 This article expands on a part of a research study funded by the Auditing Standards Board (ASB) of the American Institute of Certified Public Accountants (AICPA) and the International Auditing and Assurance Standards Board (IAASB) operating under the auspices of the International Federation of Accountants (IFAC). Opinions expressed in this article are solely those of the authors and do not reflect the opinions of the

AICPA or IAASB. The unpublished report to the AICPA and IAASB for funded project is the Mock *et al* (2009) citation listed in the references.

3 The preparers were CFOs or equivalent and were volunteers from the Los Angeles and New York chapters of the Financial Executives International and the analysts were from the New York chapter of the CFA Institute. The auditors were managers and partners from two large, anonymous international accounting firms, with one focus group held in Los Angeles and one held in New York City. Bankers were from an anonymous international bank and the non-professional investors were members of a private investment club.

4 As a quick, unscientific test the terms 'auditor's report' and 'audit report' were used as search terms on the Motley Fool web site (www.fool.com). The search resulted in two hits – one from the year 2000 and one from year 2004. As such, it appears that the auditor's report does not play any role in their analysis of companies either.

5 NAIC is now more known as Better-Investing Community (www.betterinvesting.org).

6 'SAS 70 reports' is a common way for referring to reports produced in compliance with SAS No. 70, *Service Organizations*. When a client uses a service organization to process certain transactions, the client's auditor may ask the auditor of the service organization to provide a report on the adequacy of the controls at the service organization.

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