

**A CASE STUDY ON THE FIRST PCAOB INSPECTION
REPORT ISSUED TO A BIG-4 FIRM THAT INCLUDED
PUBLIC DISCLOSURE OF THE FIRM'S QUALITY
CONTROL CRITICISMS—DELOITTE & TOUCHE LLP**

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Key Words: Section 104 of Sarbanes-Oxley Act, PCAOB Quality Control Criticisms, Deloitte & Touche LLP.

JEL Classification(s): M42, M48

Abstract

Section 104 of the Sarbanes-Oxley Act (2002) requires the PCAOB to conduct inspections and report on each registered accounting firm. Inspection reports may contain nonpublic content of potential defects in a firm's system of quality control. If any defect is not cured within 12 months, the portion of the report discussing the criticism is made publicly available. Until October 2011, such disclosures had only been made public about triennial firms. The purpose of this case study is to evaluate and assess the effects of the publication of the nonpublic portions of the first PCAOB inspection report issued to a Big-4 firm that included uncured quality control defects, thereby resulting in public disclosure—the 2007 inspection of Deloitte & Touche LLP.

INTRODUCTION

Section 104 of the Sarbanes-Oxley Act (USHR 2002) requires the Public Company Accounting Oversight Board (hereafter PCAOB or Board) to conduct inspections and report on each registered public accounting firm. Audit deficiencies that exceed certain thresholds are included in the public portion of the Board's inspection reports. The inspection reports may also contain nonpublic content which summarize potential defects in a firm's system of quality control. Such quality control criticisms remain nonpublic if the firm addresses them to the PCAOB's satisfaction within 12 months after the report date [Section 104(g)(2)]. Should a firm fail to satisfactorily address any of the quality control criticisms within 12 months, the portion of the report discussing the particular criticism(s) is made publicly available. In other words, Congress chose a legislative policy which favors correction of defects over the exposure of a firm's quality control deficiencies (PCAOB 2006).

Until October 2011, disclosure of quality control criticisms had only been made public about triennial firms.¹ The purpose of this case study is to evaluate the publication of the nonpublic portions of the first PCAOB inspection report issued to a Big-4 firm that included defects in the firm's quality controls systems which had not been addressed to the Board's satisfaction, thereby resulting in public disclosure—the 2007 inspection of Deloitte & Touche LLP (hereafter D&T or Deloitte), originally issued on May 19, 2008, with nonpublic portions of the inspection report published in mid-October 2011 (PCAOB 2008), to analyze whether such quality control defects weakens the firm as a member of the accounting profession, and to assess how quality control defects may affect the firm. To that end, the remainder of this paper is organized as follows: Section II presents a discussion

¹ The Sarbanes-Oxley Act (USHR 2002) requires the Board to conduct those inspections annually for firms that regularly provide audit reports for more than 100 issuers, and at least triennially for firms that regularly provide audit reports for 100 or fewer issuers.

about quality control; Section III provides a brief discussion about changes in the registrant's certifying accountant and Form 8-K; Section IV summarizes the nonpublic portions of D&T's 2007 inspection report. Four examples of U.S. Securities and Exchange Commission (hereafter SEC or Commission) or PCAOB actions taken against D&T are presented to illustrate concerns about the firm's auditing practices. Data and analyses related to auditor changes pre- and post the October 2011 public disclosure event and 2008 to 2011 are presented and analyzed. Supplemental analyses of fees earned by Deloitte and other firms from 2008 through 2011 are presented and analyzed; and Section V concludes with some final observations about this case study.

QUALITY CONTROL

A firm's system of quality control should provide reasonable assurance that its audit work will meet applicable professional standards and regulatory requirements. The Board's inspection process includes assessing the degree of compliance of the firm with applicable requirements related to selected audits. In addition, the inspection includes review of policies and procedures related to eight functional areas of the firm (PCAOB 2008, B1–B4):

- Review of partner evaluation, compensation, admission, assignment of responsibilities, and disciplinary actions.
- Review of independence policies.
- Review of client acceptance and retention policies.
- Review of practices for consultations.
- Review of internal inspection program.
- Review of policies and procedures for staffing audits.
- Review of policies related to foreign affiliates.
- Review of tone at the top.

An effective quality control system provides a firm's organizational underpinning for its audit work. While the Board's inspection process is intended to be a constructive engagement between the PCAOB and the firm, defects in a firm's quality control system may pose serious risks that can undermine the value of the independent audit and erode public confidence; hence, it is critical that a firm addresses its quality control criticisms. As defined in Section 104(g)(2), the term *criticism* refers to "criticisms of or potential defects in the quality control systems of the firm under inspection" (USHR 2002).

In addition to public disclosure of a firm's quality control criticisms, its failure to appropriately address such defects may lead to the Board's disciplinary action against the firm for failing to comply with PCAOB standards. When the Board's inspection team identifies issues related to a firm's quality control system, PCAOB inspectors address the matter with the firm, and the final inspection report includes a description of the problem. In short, every inspection report that includes a quality control criticism alerts the firm to the opportunity to prevent the criticism from becoming public.² To that end, a firm that wants to keep the criticism nonpublic may make a Rule 4009 submission concerning the ways in which the firm has addressed the criticism. When the PCAOB determines that a firm addressed a quality control criticism satisfactorily, the Board will notify the firm and provide a copy of that notice to the SEC and the appropriate state regulators. Such a favorable determination triggers the Section 104(g)(2) requirement that no portion of the inspection report describing the quality control criticism be made public (PCAOB 2006).

Should the PCAOB determine that a firm failed to address a criticism satisfactorily, the Board will notify the firm. A firm that wishes to contest such a determination has 30 days to seek review

² PART II of the report is nonpublic and redacted when an inspection report is initially released (PCAOB 2006).

by the SEC before the determination becomes final and is made public (PCAOB Rule 4009(d)(2)). If a firm fails to make a Rule 4009 submission, the portions of the inspection report describing the criticisms will be made public, without the Board providing any separate notice to the firm concerning the firm's failure to cure its defects (Rule 4009(d)).³ The PCAOB's unfavorable determination will be indicated on the "Inspection Reports" page of the Board's official web site with a notation next to the firm's name [shown as 'QC criticisms now public']. The publicly available portions of the original report will then include the relevant, previously nonpublic portions of the inspection report (PCAOB 2006).

CHANGES IN REGISTRANT'S CERTIFYING ACCOUNTANT

Another important issue that shareholders, investors, creditors, and regulators are interested in is when a public company changes its independent auditor. Such a change may be the result of a dismissal by the company or the resignation of the auditor. Either action is a *reportable event*⁴ separate from the engagement of a new independent accountant. The SEC requires every public company to file such a change on Form 8-K (Section 4, Item 4.01 *Matters Related to Accountants and Financial Statements*) [Item 304(a)(1) of Regulation S-K (17 CFR

³ If the firm does not seek SEC review of the Board's determination, or if the Commission reviews and upholds the Board's determination, that determination will be final for purposes of Section 104(g)(2). Note that a failure to make a timely Rule 4009 submission constitutes a failure to address the criticism and by operation of the PCAOB's rules, results in the Board making public the portions of the report describing the criticisms.

⁴ Other reportable events that must be filed on Form 8-K by registrants include ineffective internal controls, management cannot be relied upon, the financial statements cannot be relied upon, a scope limitation, the financial statements have been or will be restated, and an SEC investigation involving a registrant and/or its audit firm.

229.304(A)(1)] within four business days after occurrence of the event (USSEC 2012a). Specifically, if during the registrant's two most recent fiscal years, an independent accountant who was engaged as the principal accountant to audit the registrant's financial statements has resigned or was dismissed, Item 304(a)(1) of Regulation S-K [17 CFR 229.304(a)(1–3)] requires the registrant include the following disclosures using Form 8-K (USSEC 2012a):

- state whether the former accountant resigned, declined to stand for re-election or was dismissed and the date thereof [§ 229.304(a)(1)(i)];
- state whether the principal accountant's report on the financial statements for either of the past two years contained an adverse opinion or a disclaimer of opinion, or was qualified or modified as to uncertainty, audit scope, or accounting principles and describe the nature of each such adverse opinion, disclaimer of opinion, modification, or qualification [§ 229.304(a)(1)(ii)];
- state whether the decision to change accountants was recommended or approved by any audit or similar committee of the board of directors *or* the board of directors, if the issuer has no such committee [§ 229.304(a)(1)(iii)];
- state whether during the two most recent fiscal years there were any disagreements with the former accountant on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreements, if not resolved to the satisfaction of the former accountant, would have caused it to make reference to the subject matter of the disagreements in connection with its report [§ 229.304(a)(1)(iv)];
- state whether any reportable events occurred and the nature of the events (internal controls required to

develop reliable financial statements do not exist, management's representations cannot be relied upon, auditor's unwillingness to be associated with the financial statements prepared by management, audit scope needs to be expanded or other information has arisen that materially impacts previous audit reports or their underlying financial statements or subsequent financial statements) [§ 229.304(a)(1)(v)];

- state if a new independent accountant has been engaged as the principal accountant to audit the registrant's financial statements, and if so, disclose the name of the newly engaged auditors and the effective date of engagement [§ 229.304(a)(2)];
- state any consultation with the new auditor regarding accounting principles, potential opinions, or any matter that was subject to the disagreements or reportable events with the predecessor auditor, and if any of these have occurred, the nature of each issue should be event should be described [§ 229.304(a)(2)]; and
- the registrant shall provide the former accountant with a copy of the disclosures it is making in response to Item 304 that the former accountant shall receive no later than the day that the disclosures are filed with the Commission. The registrant shall request the former accountant to furnish the registrant with a letter addressed to the Commission stating whether it agrees with the statements made by the registrant in response to Item 304(a) and, if not, stating the respects in which it does not agree. The registrant shall file the former accountant's letters as an exhibit to the report on registration statement containing this disclosure. If the former accountant's letter is unavailable at the

time of filing such report or registration statement, then the registrant shall request the former accountant to provide the letter as promptly as possible so that the registrant can file the letter with the Commission within ten business days after the filing of the report or registration statement. Notwithstanding the ten business day period, the registrant shall file the letter by amendment within two business days of receipt [§ 229.304(a)(3)].

In addition to the above disclosures, the independent auditor is required to send a form letter directly to the Office of the Chief Accountant of the SEC within four business days, which is matched with the registrant's Form 8-K filing (Turner, Williams, and Weirich 2005).

DELOITTE & TOUCHE LLP AND OTHER ACCOUNTING FIRMS

By June 2011,⁵ the PCAOB had issued 96 inspection reports to triennial firms that included defects in the firms' quality control systems which had not been addressed to the Board's satisfaction, thereby resulting in public disclosure (Roybark 2012).⁶ In mid-October 2011, the PCAOB published its first inspection report to a Big-4 firm which included defects in the firm's quality control systems— nonpublic portions of the 2007 inspection of Deloitte & Touche LLP, originally issued on May 19,

⁵ As of May 20, 2012, the PCAOB has published disclosures of quality control defects to 118 firms that had failed to satisfactorily address the Board's quality control criticisms.

⁶ The quality control criticisms are based on observations made by the PCAOB inspection team during its inspection field work conducted from March 2007 through November 2007. "The inspection team performed field work at the Firm's National Office and at 18 of its approximately 74 U.S. practice offices" (PCAOB 2008, 2).

2008 (PCAOB 2008). On October 17, 2011, the PCAOB issued the following statement (PCAOB 2012a, 1):

The quality control remediation process is central to the Board's efforts to cause firms to improve the quality of their audits and thereby better protect investors. The Board therefore takes very seriously the importance of firms making sufficient progress on quality control issues identified in an inspection report in the 12 months following the report. Particularly with the largest firms, which are inspected annually, the Board devotes considerable time and resources to critically evaluating whether the firm did in fact make sufficient progress in that period. The Board can and does make the relevant criticisms public when a firm has failed to do so.

Based on its 2007 inspection, the following deficiencies about D&T's quality controls were made by the PCAOB (PCAOB 2008):

- *Audit performance*—management estimates and assumptions, audit evidence, audit documentation, income taxes, use of the work of specialists, and reliance on data, reports, and internal controls.
- *General observations concerning audit performance*—the firm's failure to obtain sufficient competent evidential matter, at the time it issued its audit report, to support its audit opinion [in nine (15 percent) of 61 engagements reviewed]. Criticisms relate to the firm's audit methodology and policies, the sufficiency of due care and professional skepticism when performing audits, supervision and review activities with due care, enforcement through monitoring and disciplinary activities for compliance with policies and procedures, and training programs for audit personnel;

- *Independence*—policies and procedures regarding independence with respect to foreign affiliated firms appear to be deficient.
- *Consultations*—quality controls may not result in appropriate and effective consultations when necessary. D&T is a member firm of Deloitte Touche Tohmatsu (DTT). D&T has no formal system in place to monitor the services its foreign affiliates actually perform.
- *Foreign affiliates*—specific results of the inspections of member firms or practice offices are not disseminated to the Firm's partners and global internal inspection program does not routinely provide a U.S. engagement partner with a basis for assessing a foreign office's qualifications and familiarity with U.S. GAAP, PCAOB standards, and SEC reporting requirements.

Note that the inspection process included both an assessment of the degree of compliance of the Firm's applicable requirements related to auditing issuers and a review of the eight functional areas (as outlined in Section II) to identify possible defects in the Firm's system of quality control (PCAOB 2008).

Deloitte & Touche LLP—Quality Controls

In 1984, the U.S. Supreme Court described the significance of the independent audit as a “public watchdog’ function” (818) in *United States v. Arthur Young & Company*, 465 U.S. 805 (USSC 1984). In short, an effective quality control system provides reasonable assurance that a firm's audit work performed will meet all applicable professional standards and regulatory requirements. Defects in a firm's quality control system may pose serious risks that can undermine the value of the independent audit and erode public confidence, so it is essential that a firm addresses its quality control defects. But what happens when the audit function does not

work correctly? And if not, has D&T satisfied its social responsibility as a public accounting firm? What other evidence may provide context for understanding D&T's quality control criticism identified by the PCAOB? Has the public disclosure of quality control defects affected Deloitte? To evaluate these questions, four independent examples which illustrate concerns about the firm's quality controls are presented next.

Example 1. This is a level three heading. You may not need to go to level three. It all depends on what you are writing about and the structure of your paper. On April 26, 2005, D&T agreed to a \$25 million civil penalty in settlement of *SEC v. Deloitte* (05 Civ. 4119, S.D.N.Y) in which D&T consented to the entry of a judgment related to the firm's failure to detect a massive fraud perpetrated by Adelphia Communications Corporation (hereafter Adelphia) and a number of its shareholders and members of the company's board of directors. The penalty was deposited into a fund to compensate victims of Adelphia's fraud. Specifically, the SEC asserted that Deloitte failed to act in accordance with GAAS and that Deloitte engaged in improper professional conduct in connection with the 2000 Adelphia audit by engaging in repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards. In a related administrative proceeding, the SEC censured D&T for improper professional conduct under Rule 102(e) of the Commission's Rules of Practice in which the firm agreed to pay an additional \$25 million into the fund, making a total of \$50 million which was paid to victims of Adelphia's fraud. In addition, D&T agreed to substantive undertakings designed to address its audit of high-risk clients in the future (USSEC 2005a, 2005b).

Deloitte served as Adelphia's independent auditor from at least 1998, the year when Adelphia's securities became publicly traded, until May 14, 2002, when Deloitte suspended its work on the audit for the year-ended December 31, 2001, citing, among other concerns, that Adelphia's books and records had been

falsified. Each year, D&T issued audit reports which contained unqualified opinions issued on Adelphia's annual financial statements filed with the SEC. However, the company's Form 10-K for 2000 contained significant material misstatements (USSEC 2005a, 2005b).

Example 2. On April 26, 2005, the SEC censured D&T and the firm agreed to pay remedial sanctions of \$375,000 in connection with the audit of Just for Feet, Inc. (hereafter JFF). The SEC charged Deloitte with improper professional conduct as the independent auditor of the company. The SEC asserted that D&T should have known that JFF's 1998 financial statements had not been prepared in accordance with GAAP, but issued an unqualified audit opinion and that the firm did not comply with GAAS in the conduct of the audit and engaged in improper professional conduct through repeated instances of unreasonable conduct (USSEC 2005c).

D&T served as JFF's independent auditor when the company went public in 1994 and audited the company's financial statements for the fiscal years 1995 to 1999. The company's 1998 financial statements were materially false and misleading, and in November 1999, the company filed for protection under Chapter 11 of the Bankruptcy Code, which was converted to a Chapter 7 liquidation proceeding in 2000. D&T resigned as JFF's auditor in December 1999 (USSEC 2005c).

Example 3. Deloitte was in the news again in 2011 and 2012. The SEC actions related to one of D&T's affiliates, Deloitte Touche Tohmatsu CPA Ltd. (hereafter DTT or D&T Shanghai) in Shanghai, China. DTT is a public accounting firm registered with the PCAOB since June 2, 2004 (PCAOB Registration No. 1113). On September 8, 2011, the SEC filed a subpoena enforcement action against DTT for its failure to produce documents related to the Commission's investigation into possible fraud by the public

accounting firm's client, Longtop Financial Technologies Limited⁷ (hereafter LFT or Longtop). Longtop is incorporated in the Cayman Islands with principal offices in Hong Kong and Xiamen, China. The company provides software, consulting, and support services for the financial services industry in the People's Republic of China. (USSEC 2011a, 2011b, 2011d, 2012b).

DTT issued an unqualified opinion on LFT's 2010 financial statements, but in May 2011, the firm stated that the prior audit reports on Longtop's financial statements contained in annual reports for 2008, 2009, and 2010 should no longer be relied upon. On May 22, 2011, DTT Shanghai resigned as LFT's auditor after discovering numerous irregularities during an audit for the year ended March 31, 2011 (USSEC 2011d, 2012b).

LFT is a foreign private issuer and is required to file annual reports with the SEC. On November 10, 2011, the SEC charged LFT with failing to file its annual report for the fiscal year that ended March 31, 2011. Note that LFT was the only registrant during the 13-month period with a *reportable event* of an SEC investigation disclosed on its Form 6-K (auditor changes for a *foreign issuer*). Form 6-K was filed with the SEC on May 23, 2011 and included the following disclosures: (1) reportable events; (2) scope limitations; (3) financial restatements; (4) audit opinion concerns; (5) management not reliable; (6) accounting issues; and (7) SEC investigation (USSEC 2011b, 2011d).

On May 9, 2012, the SEC announced an enforcement against DTT for its continued refusal to provide the Commission with its Longtop audit work papers. The SEC alleges that DTT willfully violated the Sarbanes-Oxley Act and the Securities Exchange Act of 1934 by failing to provide the SEC with the audit work papers. Counsel for D&T informed the SEC that the firm did not perform any audit work for the client and therefore did not

⁷ After an initial public offering in October 2007, LFT's shares were listed and traded on the New York Stock Exchange until August 29, 2011, when the NYSE delisted LFT after finding that the shares were no longer suitable for continued listing and trading (USEC 2011b, 2011d).

possess the documents related to the Commission's subpoena, but that its request for audit work papers had been communicated to DTT. D&T Shanghai would not produce the audit work papers because of its interpretation that it is prevented from doing so by Chinese law. According to the SEC, the Commission has also sought to obtain the audit work papers through international sharing mechanisms, but these efforts have been unsuccessful (USSEC 2011d, 2012b).

Example 4. New problems relating to BankGuam Holding Company (hereafter BGHC) may be on the horizon for D&T. On December 2, 2011, BGHC filed an amended Form 8-K wherein it asserted (USSEC 2011c, 2):

On November 14, 2011, BankGuam Holding Company (the "Company") and its wholly-owned subsidiary, the Bank of Guam (the "Bank"), terminated its engagement with Deloitte Guam, a member firm of Deloitte Touche Tohmatsu Limited (Deloitte Guam), as the independent auditor of the Company and the Bank. The Company's and the Bank's decision to dismiss Deloitte Guam is based on learning recently from Deloitte Guam that it is not registered with the Public Company Accounting Oversight Board (the "PCAOB"). Deloitte Guam had been the independent auditor of the Bank since the fiscal year ended December 31, 2003. The decision to dismiss Deloitte Guam was approved by the audit committees of the Company and the Bank.

Subsequently, Deloitte & Touche LLP (Guam) ("Applicant") filed a registration application with the PCAOB. On April 24, 2012, the PCAOB *disapproved* the firm's application for registration with the Board based on the following considerations (PCAOB 2012b, 2):

- Applicant is a public accounting firm located in Guam.
- Applicant issued audit reports with respect to the Bank of Guam for its fiscal years ended December 31, 2005 through December 31, 2010. Bank of Guam is an issuer as defined by the Sarbanes-Oxley Act of 2002 (the "Act") and the PCAOB Rules. On the dates Applicant issued the audit reports described above, Applicant was not registered with the Board. Accordingly, Applicant's issuance of the audit reports violated Section 102(a) of the Act and PCAOB Rule 2100, both of which require that, effective October 22, 2003, any person that issues an audit report with respect to an issuer must be registered with the Board.
- Applicant's violations described above resulted from Applicant's failure to exercise the degree of care that the Board would expect of a public accounting firm under the circumstances.

Analysis of Auditor Changes and Fees Earned

The data⁸ used in the following analyses were obtained from Audit Analytics™ of the Ives Group Inc., an independent research provider focused on the accounting, insurance, regulatory, legal, and investment communities. Audit Analytics™ provides data on over 20,000 public companies and more than 1,500 accounting firms (AA 2012a, 2012b).

⁸ The *auditor changes* data include all SEC registrants who have disclosed auditor changes in electronic filings (retrieved on May 10, 2012). The filings are principally from 8-K, 6-K, and N-SAR filings (AA 2012b). The *auditor fees* data contains all auditor fees data disclosed by SEC registrants in electronic filings (retrieved on May 12, 2012). The data are extracted primarily from the following form types: DEF 14A, DEF 14C, DEFM 14A, PRE 14A, 10-K, 10KSB, 20-F, 40-F and N-CSRs (AA 2012a).

Auditor Changes and Explanations of Changes. Auditor changes convey important information [Ettredge, Li, and Scholz (2007); Zhang, Zhou, and Zhou (2007); Stefaniak, Robertson, and Houston (2009)]. The distinction between a dismissal and a resignation is important and the SEC investigates such differences. According to Stefaniak et al. (2009), "an auditor change is one of the factors associated with whether a specific audit is selected for inspection" (47). Based on the six month period pre- and post the October 2011 quality control disclosure event, Big-4 auditor changes and whether the changes are based on dismissals or resignations from April 1, 2011 through April 30, 2012 are summarized in *Panel A of Table 1*.

During this 13-month period, 202 auditor changes were filed: 166 (82 percent) auditor changes were the result of client dismissals and 36 (18 percent) of the changes were resignations by the firms. D&T accounts for 76 (38 percent) of the 202 auditor changes. E&Y, KPMG, and PwC account for 36 (18 percent), 39 (19 percent), and 51 (25 percent) of the 202 auditor changes, respectively. Note that D&T accounts for 40 percent of the 166 auditor changes due to dismissals by the client and 28 percent of the 36 auditor changes due to resignations by the firm. In short, D&T accounts for more auditor changes and a higher percentage of changes due to dismissals than the other three audit firms.

Sixty-six (87 percent) of D&T's 76 auditor changes were dismissals by the client, while 10 (13 percent) of the changes were resignations by the firm. Twenty-seven (75 percent) of E&Y's 36 changes were dismissals by the audit client, while 9 (25 percent) of the changes were resignations by the firm. Thirty-four (87 percent) of KPMG's 39 changes were dismissals by the audit client, while 5 (13 percent) of the changes were resignations by the firm. Thirty-nine (76 percent) of PwC's 51 changes were dismissals by the audit client, while 12 (24 percent) of the changes were resignations by the firm. Note that some of these changes may be the result of Section 203 compliance (rotation of lead and concurring partners every five years). However, Alali and Romero (2012) studied

auditor tenure for 2000-2008 and found no indication that companies change audit firms instead of partners pre-or post implementation of Section 203.

Zhang et al. (2007) found that firms which change auditors are more likely to have internal control weaknesses. Resignations may signal reportable events such as ineffective internal controls, management cannot be relied upon, scope limitations, illegal acts by the client, and client-auditor disagreements. Ettredge et al. (2007) found that smaller clients who receive going concern opinions are most likely to dismiss auditors. While not presented in Table 1, 39 (19 percent) of the 202 auditor changes filed during the 13-month period included reportable events disclosures (D&T n = 13, E&Y n = 6, KPMG n = 7, and PwC = 13). Twenty-nine (14 percent) of the 202 auditor changes filed during the 13-month period included internal control disclosures (D&T n = 9, E&Y n = 5, KPMG n = 5, and PwC = 10). Fifteen (7 percent) of the 202 auditor changes filed during the 13-month period included going concern disclosures (D&T n = 2, E&Y n = 4, KPMG n = 5, and PwC = 4).

Given that 87 percent of D&T's 76 auditor changes were due to client dismissals, another point of interest relates to audit tenure represented by these auditor changes. While not shown in Table 1, many of Deloitte's 76 auditor changes (n = 66 dismissals, 87 percent) during the 13-month period had been long-standing D&T clients. For example, registrants that changed auditors during this period had been D&T clients from 1957 (n = 1, 1 percent) through 2011. Ten (13 percent) of the 76 registrants had been D&T clients from 1971 through 1998, 25 (33 percent) had been D&T clients since 2000, and 40 (53 percent) had been D&T clients from 2001 through 2011. Such auditor changes may signal a lack of client confidence due to D&T's quality control defects.

To determine if similar trends are present over a longer period of time, Big-4 auditor changes for 2008-2011 are summarized in **Panel B of Table 1** by year and whether the changes are the result of client dismissals or firm resignations.

During 2008, 283 auditor changes were filed: 257 (91 percent) changes were the result of dismissals and 26 (9 percent) of the changes were resignations. During 2009, 303 auditor changes were filed: 278 (92 percent) changes were the result of dismissals and 25 (8 percent) of the changes were resignations. During 2010, 286 auditor changes were filed: 163 (57 percent) changes were the result of dismissals and 123 (43 percent) of the changes were resignations. During 2011, 192 auditor changes were filed: 161 (84 percent) changes were the result of dismissals and 31 (16 percent) of the changes were resignations.

D&T had the highest number of auditor changes in each of the four years: 86 (30 percent) in 2008; 101 (33 percent) in 2009; 107 (37 percent) in 2010; and 74 (39 percent) in 2011. During 2008, the number of changes (percent) for E&Y, KPMG, and PwC was 72 (25 percent), 75 (27 percent), and 50 (18 percent), respectively. During 2009, the number of changes (percent) for E&Y, KPMG, and PwC was 82 (27 percent), 47 (16 percent), and 73 (24 percent), respectively. During 2010, the number of changes (percent) for E&Y, KPMG, and PwC was 90 (31 percent), 42 (15 percent), and 47 (17 percent), respectively. During 2011, the number of changes (percent) for E&Y, KPMG, and PwC was 43 (22 percent), 38 (20 percent), and 37 (19 percent), respectively. In summary, the same general trends observed during the 13-month period are present from 2008 to 2011.

Turner et al. (2005) reported 905 and 1,609 companies filed Form 8-K auditor changes in 2003 and 2004, respectively. In short, auditor changes have dropped significantly since 2004. One explanation for the increases in auditor changes may be the result of SEC registrants 'going dark' following the enactment of Sarbanes-Oxley – opting to deregister their stocks to privately-held status – possibility due to the high cost audits for public registrants. Nevertheless, dismissals may signal adverse information, as illustrated in BankGuam Holding Company (Example 4). Griffin and Lont (2010) report higher auditor resignations after 2002, but the researchers posit that these results are "presumably due to

SOX" (197). Such a conjecture seems reasonable, given the increased post-Sarbanes environment, litigation exposure, and Section 203 compliance. Furthermore, auditor resignations ranged from only 9 percent in 2008 to 43 percent in 2010 across the four-year period under review (2008-2011). Nonetheless, decisions to dismiss an auditor or resignation by the independent auditor can have significant consequences for both clients and auditors.

Auditor Changes and Firms Retained. Another issue that should be analyzed relates to the type of firms retained by the registrants represented by the auditor changes. To address this issue, the numbers of Big-4 auditor changes by firms retained from April 1, 2011 through April 30, 2012 are summarized in *Panel A of Table 2*. For this 13-month period, 68 percent (n = 137) of the 202 auditor changes were retained by other Big-4 firms, while 32 percent (n = 65) of the changes were retained by non Big-4 firms. D&T accounts for 42 percent (n = 58) of the 137 auditor changes were retained by other Big-4 firms, while 28 percent (n = 18) of the 65 changes were retained by non Big-4 firms. E&Y, KPMG, and PwC account for 18 percent (n = 25), 18 percent (n = 24), and 22 percent (n = 30) of the 137 auditor changes, respectively, while 17 percent (n = 11), 23 percent (n = 15), and 32 percent (n = 21) of the 65 auditor changes were retained by non Big-4 firms, respectively.

For the 13-month period, 58 (76 percent) of D&T's 76 auditor changes were retained by other Big-4 firms [40 retained E&Y, 9 retained KPMG, and 9 retained PwC], while 18 (24 percent) of D&T's changes were retained by non Big-4 firms. For E&Y, 25 (69 percent) of its 36 auditor changes were retained by other Big-4 firms, while 11 (31 percent) were retained by non Big-4 firms. For KPMG, 24 (62 percent) of its 39 auditor changes were retained by other Big-4 firms, while 15 (38 percent) were retained by non Big-4 firms. For PwC, 30 (59 percent) of its 51 auditor changes were retained other Big-4 firms, while 21 (41 percent) were retained by non Big-4 firms.

To determine if similar trends are present over a longer period of time, the numbers of auditor changes by firms retained from 2008 to 2011 are summarized in **Panel B of Table 2**. Like the 13-month period, D&T had the highest number (percent) of auditor changes in each of the four years, increasing from 30 percent (n = 86) of the 283 auditor changes in 2008 to 39 percent (n = 74) of the 192 auditor changes in 2011. In addition, D&T has the highest number (percent) of changes retained by other Big-4 firms, ranging from 53 (42 percent) in 2011 to 88 (39 percent) in 2010. For E&Y, the number of auditor changes (percent) retained by other Big-4 firms ranges from 30 (24 percent) in 2011 to 70 (31 percent) in 2010. For KPMG, the number of auditor changes (percent) retained by other Big-4 firms ranges from 17 (13 percent) in 2011 to 46 (27 percent) in 2008. For PwC, the number of auditor changes (percent) retained by another Big-4 firm ranges from 21 (17 percent) in 2008 to 50 (26 percent) in 2009.

Turner et al. (2005) reported that 564 (35 percent) of the 1,609 auditor changes in 2004 were retained by other Big-4 firms and noted that small audit firms were the primary beneficiaries of the auditor changes (58 percent). These results seem reasonable, given that this period followed the initial implementation of the Sarbanes-Oxley Act (USHR 2002). According to Rama and Read (2006), “Big 4 firms have become more aggressive in shedding relatively small, marginal SEC audit clients. The majority of these registrants have been absorbed by non-Big 4 audit firms, with local and regional audit firms gaining the most audit clients” (108). While total auditor changes and auditor changes retained by other Big-4 firms have dropped significantly since 2004, one concern about the current data relates to the auditor changes retained by non Big-4 firms. Smaller firms face an array of significant challenges such as staffing resources, industry-specific and technical expertise, and geographic limitations. These challenges may pose greater threats, given that smaller firms have assumed more risky audit engagements (Roybark 2008). Furthermore, these challenges are problematic and warrant concern, given that 34 percent of the

66 auditor changes filed in 2011 were retained by non Big-4 firms (and 32 percent of the 66 auditor changes filed by D&T registrants were retained by non Big-4 firms).

Big-4 Audits and Fees Earned: 2008–2011. To provide additional context for understanding auditor changes, fees earned by Big-4 firms for 2008-2011 and the changes between 2008 and 2011 are summarized in **Table 3**. While the number of audits conducted and fees earned by Big-4 firms are down significantly since 2008, no one can deny that the accounting profession is big business! The number of audits and fees earned are summarized in **Panel A of Table 3**. Total fees for Big-4 firms dropped from \$16.889 billion in 2008 to \$12.008 billion in 2011. Total audit fees dropped from \$13.448 billion in 2008 to \$9.547 billion in 2011, while the number of audits dropped from 7,069 in 2008 to 5,045 in 2011. Total nonaudit fees dropped from \$3.441 billion in 2008 to \$2.460 billion in 2011. Across this four-year period, D&T conducted an equal number of the total audits and earned an equal share of total fees, audit fees, and nonaudit fees, ranging from 23 percent to 25 percent.

The net changes in auditor changes and fees and the percent of changes from 2008 to 2011 are summarized in **Panel B of Table 3**. D&T had the largest decrease and percent of decrease in total fees (\$1.324 billion, 27 percent) and audit fees (\$1.045 billion, 27 percent), while KPMG had the largest decrease and percent of decrease for nonaudit fees (\$0.321 billion, 33 percent).

Big-4 Auditor Changes and Fees Earned: 2011. The number of audits and fees associated with the 2011 Big-4 auditor changes by firms retained are summarized in **Table 4**. Based on total fees associated with the 192 auditor changes filed in 2011, 86 percent of total fees associated with the 192 auditor changes were retained by other Big-4 firms, while 14 percent were retained by other non Big-4 firms. With the exception of PwC for nonaudit fees earned, the same trends as seen for total fees hold true for

audit fees and nonaudit fees. Seventy-six percent of D&T's total fees associated with its 74 auditor changes were retained by other Big-4 firms, while 24 percent were retained by other non Big-4 firms. Ninety-five percent of E&Y's total fees associated with its 43 auditor changes were retained by other Big-4 firms, while 5 percent were retained by non Big-4 firms. Seventy-five percent of KPMG total fees associated with its 38 auditor changes were retained by other Big-4 firms, while 25 percent were retained by non Big-4 firms. Eighty-nine percent of PwC's total fees associated with its 37 auditor changes were retained by other Big-4 firms, while 11 percent were retained by non Big-4 firms.

The 2011 statistics reveal that the lion's share of total fees, audit fees, and nonaudit fees earned by Big-4 firms associated with the 192 auditor changes were garnered by other Big-4 firms. One concern about these statistics relates to the recent economic crisis. As reported by CBS News (2010) and the National Bureau of Economic Research (2010), the period from December 2007 to June 2009 has been referred to as the "Great Recession" (CBS News 2010, 1). Regulators have voiced concern that the economic crisis and other factors might pressure auditors to significantly reduce their audit fees. The PCAOB (2010) asserts that (25-26):

Confronted with reduced revenues, some auditors might make inappropriate reductions in the extent of audit procedures in order to achieve cost savings, or firms might take certain cost cutting actions that could negatively affect a firm's investment in training, audit tools and methodology, or other aspects of its quality control systems. The Board's inspection staff continues to monitor whether audit quality and the firms' quality control systems have been compromised due to reduced revenues.

Based on the fees associated with the 192 auditor changes filed in 2011, D&T had the largest percentage of total fees, audit fees, and nonaudit fees retained by non Big-4 firms, while E&Y had the largest percentage of total fees, audit fees, and nonaudit

fees retained by other Big-4 firms. The D&T statistics may be problematic, given the post-Sarbanes environment, the significant reduction in fees earned by firms since 2008, and current economic conditions. Big-4 firms have reduced some of their business risk via client selection and retention (Roybark 2008). Many of the more risky and less profitable engagements have been assumed by smaller firms, which face an array of significant challenges [Rama and Read (2006); Roybark (2008)].

CONCLUSIONS

In 1984, the U.S. Supreme Court described the significance of the independent audit as a “‘public watchdog’ function” (818) in *United States v. Arthur Young & Company*, 465 U.S. 805 (USSC 1984). An effective quality control system provides a firm's organizational underpinning for its audit work. Until October 2011, disclosure of quality control issues had only been made public about triennial firms. The purpose of this case study was to evaluate the publication of the nonpublic portions of the first PCAOB inspection report issued to a Big-4 firm, to analyze whether such quality control defects weakened the firm as a member of the accounting profession, and to assess how quality control defects may have affected the firm.

Quality control was discussed. Section 104 of the Sarbanes-Oxley Act (USHR 2002) requires the PCAOB to conduct inspections and report on each registered public accounting firm. The inspection reports may also contain nonpublic content which summarize potential defects in a firm's system of quality control. Should a firm fail to satisfactorily address any of the quality control criticisms within 12 months, the portion of the report discussing the particular criticism is made publicly available (PCAOB 2006), as was the case with Deloitte's 2007 inspection report.

Auditor changes and Form 8-K reporting were discussed. Auditor changes convey important information to shareholders,

investors, creditors, and regulations. An auditor change, whether due to resignation or dismissal, is a reportable event. The SEC requires every public company to file such a change on Form 8-K within four business days after occurrence of the event (USSEC 2012a).

The nonpublic portions of D&T's 2007 inspection were presented (PCAOB 2008). Defects in a firm's quality control system may pose serious risks that can undermine the value of the independent audit and erode public confidence, so it is essential that a firm addresses its quality control criticisms. Based on the inspection team's evaluation of D&T's quality controls, the types of defects related to: (1) audit performance; (2) general observations concerning audit performance including the defects in the firm's methodology and policies, the sufficiency of due care and professional skepticism when performing audit, and enforcement issues; (3) independence; (4) consultations; and (5) foreign affiliates (PCAOB 2008). In short, these types of quality control defects cast doubt as to whether D&T has satisfied its social responsibility as a public accounting firm.

An effective quality control system provides reasonable assurance that a firm's audit work performed will meet all applicable professional standards and regulatory requirements. To provide additional evidence for evaluating D&T's quality control, four examples of SEC/PCAOB actions taken against D&T were presented to illustrate concerns about the firm. Excerpts from the four examples are provided below to illustrate some of the regulatory and professional violations cited in these examples:

Adelphia Communications Corporation— D&T failed to act in accordance with GAAS, engaged in improper professional conduct in connection with an audit, and engaged in repeated instances of unreasonable conduct;

Just for Feet, Inc.—D&T engaged in improper professional conduct as an independent auditor,

failed to comply with GAAS, and engaged in repeated instances of unreasonable conduct; *Longtop Financial Technologies Limited*—D&T failed to produce audit work papers and the firm willfully violated provisions of the Sarbanes-Oxley Act and the Securities Exchange Act of 1934; and *BankGuam Holding Company*—D&T violated Section 102(a) of the Sarbanes-Oxley Act and the PCAOB's Rule 2100 when one of its affiliates issued audit reports for 2005-2010 without being registered with the PCAOB and the firm failed to exercise the degree of care that is expected of a public accounting firm.

These illustrations cast doubt as to whether D&T has satisfied its social responsibility as a public accounting firm.

Data and analyses related to auditor changes and fees earned pre- and post the October 2011 public disclosure event and 2008 to 2011 were presented and analyzed. Auditor changes convey important information [Ettredge et al. (2007); Zhang et al. (2007); Stefaniak et al. (2009)]. During the 13-month period, 202 auditor changes were filed (Table 1-A). Of these, D&T accounted for more auditor changes than the other three firms (Table 1-A). In addition, D&T had the highest number and percentage of total auditor changes in each of the four years, ranging from 30 in 2008 to 39 percent in 2011 (Table 1-B). Furthermore, many of Deloitte's auditor changes had been long-standing D&T clients (1957-2011). Such auditor changes may signal a lack of client confidence due to D&T's quality control defects.

The distinction between a dismissal and a resignation is important. Dismissals may signal adverse information, as illustrated in *BankGuam Holding Company*. Resignations may signal reportable events such as ineffective internal controls, management cannot be relied upon, scope limitations, illegal acts by the client, and client-auditor disagreements. During the 13-month period, 82 percent of the total auditor changes were

dismissals, while 18 percent were resignations (Table 1-A). Again, D&T accounts for the largest number and percentage (n = 66, 40 percent) of auditor changes due to dismissals by registrants (Table 1-A). In short, decisions to dismiss an auditor or resignation by the auditor can have significant consequences for both clients and auditors.

For the 13-month period, 137 (68 percent) of the 202 auditor changes were retained by other Big-4 firms, while 65 (32 percent) of the total changes were retained by a non Big-4 firm (Table 2-A). For this period, D&T accounted for the highest number and percentage of total auditor changes retained by other Big-4 firms (Table 2-A).

Like the 13-month period, D&T has the highest number (percent) of auditor changes retained by other Big-4 firms during the four-year period, ranging from 53 (42 percent) in 2011 to 88 (39 percent) in 2010 (Table 2-B). While total auditor changes and auditor changes retained by other Big-4 firms have dropped significantly since 2004, one concern about the current data relates to the auditor changes retained by non Big-4 firms. Smaller firms face an array of significant challenges. Such challenges may pose greater threats, given that smaller firms have assumed more risky audit engagements (Roybark 2008). These challenges are problematic and warrant concern, given that 34 percent of the total auditor changes filed in 2011 were retained by non Big-4 firms [and 32 percent of the auditor changes filed by D&T registrants in 2011 were retained by non Big-4 firms] (Table 2-B).

All fees earned by Big-4 firms in 2011 are down significantly since 2008. Total audit fees dropped from \$13.448 billion in 2008 to \$9.547 billion in 2011 (Table 3-A). Across this four-year period, D&T conducted an equal number of the total audits and earned an equal share of audit fees, ranging from 23 percent to 25 percent (Table 3-A), but from 2008 to 2011, D&T had the largest decrease (percent) in audit fees [down by \$1.045 billion (down by 27 percent)] (Table 3-B).

Auditor changes and fees earned for 2011 were evaluated to further assess how D&T's quality control defects may have affected the firm. Based on the fees associated with the 192 auditor changes filed in 2011, D&T had the largest percentage of total fees, audit fees, and nonaudit fees retained by non Big-4 firms, while E&Y had the largest percentage of total fees, audit fees, and nonaudit fees retained by other Big-4 firms (Table 4). The D&T statistics may be problematic, given the post-Sarbanes environment, the significant reduction in fees earned by firms since 2008, and current economic conditions. Big-4 firms have reduced some of their business risk via client selection and retention (Roybark 2008). Many of the more risky and less profitable engagements have been assumed by smaller firms, which face an array of significant challenges [Rama and Read (2006); Roybark (2008)]. In short, the 2011 statistics reveal that the lion's share of total fees, audit fees, and nonaudit fees earned by Big-4 firms associated with the 192 auditor changes were garnered by other Big-4 firms (Table 4).

One assertion bears repeating—auditor changes convey important information. While the data reported have provided strong antidotal evidence that Deloitte's quality control deficiencies present serious concerns about the firm, one final observation is worth noting. While not included in the tables, consider the following statistics for the six-year period from 2002 through 2007:

PwC led the way with the highest number of total auditor changes in three of the six years (2003, 2005, and 2006), E&Y had the highest number of auditor changes in two of the six years (2002 and 2004), and KPMG had the highest number of auditor changes in one of the six years (2007);

PwC led the way with the highest number of auditor changes due to dismissals in five of the six years (2002-2006), while KPMG had the highest number

of auditor changes due to dismissals in one of the six years (2007); and

PwC had the highest number of auditor changes due to resignations in three of the six years (2003, 2005, and 2007) and E&Y had the highest number of auditor changes due to resignations in three of the six years (2002, 2004, and 2006).

During this six-year period, PwC lead the way with 67 percent (12 of 18) of the highest number of auditor changes (total auditor changes, auditor changes due to dismissals, and auditor changes due to resignations), E&Y accounted for 22 percent (4 of 18) of the highest number of auditor changes, and KPMG accounted for 11 percent of the highest number of auditor changes. Note that none of the statistics during this six-year period were attributable to Deloitte. In fact, D&T's percent of auditor changes during this period ranged from 16 percent to 24 percent in 15 of the 18 measures (with the remaining statistics as $n = 2$ at 25 percent and $n = 1$ at 29 percent). Now juxtapose these same statistics against the most recent four-year period as reported in the current study. From 2008 to 2011, D&T lead the way with 75 percent (9 of 12) of the highest number of auditor changes (total auditor changes, auditor changes due to dismissals, and auditor changes due to resignations), E&Y accounted for 17 percent (2 of 12) of the highest number of auditor changes, and PwC accounted for 8 percent (1 of 12) of the highest number of auditor changes. D&T accounted for 100 percent of the highest number of total auditor changes during the four-year period, 75 percent (2008, 2009, and 2011) of the highest number of total auditor changes due to dismissals, and 50 percent (2010 and 2011) of the auditor changes due to resignations. Given that auditor changes can serve as a proxy for lost engagements and revenues, these statistics reflect that Deloitte has lost significant standing over the past decade as one of the Big-4 accounting firms.

In summary, the public disclosures of D&T's quality control defects may cast doubt as to whether D&T has satisfied its social

responsibility as a public accounting firm. The four examples presented illustrate deficiencies that add further doubt about the firm's auditing practices. Auditor changes for the 13-month period may signal a lack of client confidence due to D&T's quality control defects. Across the four-year period, the amount and percentage of fees earned by D&T declined. The firm had the largest decrease in fees earned by Big-4 firms from 2008 to 2011. In short, these data provide strong anecdotal evidence that D&T's quality control defects have negatively affected Deloitte & Touche LLP.

This case study has contributed to the literature on quality control, disclosure of quality control criticisms by the PCAOB, and auditor changes. Learning from our mistakes is essential, both individually, and collectively as a profession. Understanding quality control criticisms can help accounting professionals when developing or refining strategies that will be used to develop, implement, and monitor appropriate policies and procedures related to the eight functional areas of quality control. Every accounting professional or public firm that receives quality control criticisms should evaluate their systems to find robust solutions which address the specific criticisms cited. Such improvements will help accounting professionals when conducting future engagements. In addition, educators need to understand such practice issues in order to better prepare accounting students for today's complex audit environment (Carmichael 2004). To that end, this case study has provided important insight into the issues of quality control, public disclosure of quality control criticisms, and auditor changes.

In conclusion, this case study has provided strong anecdotal evidence that D&T's quality control defects may have negatively affected Deloitte & Touche; however, the issues addressed in this study are multifaceted and too complex to provide empirical surety about how the public disclosure of Deloitte's quality control defects has directly affected the firm. Nevertheless, it is critical that a firm understand the consequences of quality control defects and the potential effects of public disclosure of those defects including

audit failures, the loss of professional reputations, the loss of current and future clients, increased risk and litigation exposure, and the erosion of public confidence in the audit function.

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Table 1												
Big-4 Auditor Changes and Explanation of Changes: April 1, 2011–April 30, 2012 and 2008–2011												
Auditor Changes—Year & Reason	D&T		E&Y		KPMG		PwC		Total Big-4 Firms			
	N ¹	(N ¹ /N ²)	N ¹	(N ¹ /N ²)	N ¹	(N ¹ /N ²)	N ¹	(N ¹ /N ²)	N ²	N ² %	N ²	N ² %
Panel A: Auditor Changes from April 1, 2011 through April 30, 2012												
Auditor Changes—04/01/11–04/30/12	<u>76</u>	<u>38%</u>	<u>36</u>	<u>18%</u>	<u>39</u>	<u>19%</u>	<u>51</u>	<u>25%</u>	<u>202</u>	<u>100%</u>	<u>202</u>	<u>100%</u>
Auditor Changes—Dismissed	66	87%	27	75%	16%	34	87%	20%	39	76%	166	82%
Auditor Changes—Resigned	10	13%	28%	9	25%	25%	5	13%	14%	12	24%	33%
Panel B: Auditor Changes from 2008 through 2011												
Auditor Changes—2008	<u>86</u>	<u>30%</u>	<u>72</u>	<u>25%</u>	<u>75</u>	<u>27%</u>	<u>50</u>	<u>18%</u>	<u>283</u>	<u>100%</u>	<u>283</u>	<u>100%</u>
Auditor Changes—Dismissed	79	92%	31%	64	89%	25%	70	93%	27%	44	88%	17%
Auditor Changes—Resigned	7	8%	27%	8	11%	31%	5	7%	19%	6	12%	23%
Panel C: Auditor Changes from 2009 through 2011												
Auditor Changes—2009	<u>101</u>	<u>33%</u>	<u>82</u>	<u>27%</u>	<u>47</u>	<u>16%</u>	<u>73</u>	<u>24%</u>	<u>303</u>	<u>100%</u>	<u>303</u>	<u>100%</u>
Auditor Changes—Dismissed	95	94%	34%	74	90%	26%	44	94%	16%	65	89%	24%
Auditor Changes—Resigned	6	6%	24%	8	10%	32%	3	6%	12%	8	11%	32%
Panel D: Auditor Changes from 2010 through 2011												
Auditor Changes—2010	<u>107</u>	<u>37%</u>	<u>90</u>	<u>31%</u>	<u>42</u>	<u>15%</u>	<u>47</u>	<u>17%</u>	<u>286</u>	<u>100%</u>	<u>286</u>	<u>100%</u>
Auditor Changes—Dismissed	38	36%	23%	45	50%	28%	37	88%	23%	43	91%	26%
Auditor Changes—Resigned	69	64%	56%	45	50%	37%	5	12%	4%	4	9%	3%
Panel E: Auditor Changes from 2011 through 2012												
Auditor Changes—2011	<u>74</u>	<u>39%</u>	<u>43</u>	<u>22%</u>	<u>38</u>	<u>20%</u>	<u>37</u>	<u>19%</u>	<u>192</u>	<u>100%</u>	<u>192</u>	<u>100%</u>
Auditor Changes—Dismissed	64	86%	40%	34	79%	21%	33	87%	20%	30	81%	19%
Auditor Changes—Resigned	10	14%	32%	9	21%	29%	5	13%	16%	7	19%	23%

Table 2 Big-4 Auditor Changes and Firms Retained: April 1, 2011–April 30, 2012 and 2008–2011														
Auditor Changes—Year & Reason	D&T			E&Y			KPMG			PwC			Total Big-4 Firms	
	N ¹	(N ¹ /N ²)	N ¹	(N ¹ /N ²)	N ¹	(N ¹ /N ²)	N ¹	(N ¹ /N ²)	N ¹	(N ¹ /N ²)	N ²	(N ¹ /N ²)	N ²	N ² %
Panel A: Big-4 Auditor Changes from April 1, 2011 through April 30, 2012														
Auditor Changes—04/01/11–04/30/12	76	38%	36	18%	39	19%	51	25%	202	100%			202	100%
Big-4 Firms to other Big-4 Firms	58	76%	42%	25	69%	18%	24	62%	18%	30	59%	22%	137	68%
Big-4 Firms to non Big-4 Firms	18	24%	28%	11	31%	17%	15	38%	23%	21	41%	32%	65	32%
Panel B: Big-4 Firm Auditor Changes from 2008 through 2011														
Auditor Changes—2008	86	30%	72	25%	75	27%	50	18%	283	100%			283	100%
Big-4 Firms to other Big-4 Firms	59	69%	35%	44	61%	26%	46	27%	27%	21	42%	17%	170	60%
Big-4 Firms to non Big-4 Firms	27	31%	24%	28	39%	25%	29	26%	19%	29	58%	23%	113	40%
Auditor Changes—2009	101	33%	82	27%	47	16%	73	24%	303	100%			303	100%
Big-4 Firms to other Big-4 Firms	73	72%	39%	41	50%	22%	25	53%	13%	50	68%	26%	189	62%
Big-4 Firms to non Big-4 Firms	28	28%	24%	41	50%	32%	22	47%	12%	23	32%	32%	114	38%
Auditor Changes—2010	107	37%	90	31%	42	15%	47	17%	286	100%			286	100%
Big-4 Firms to other Big-4 Firms	88	82%	39%	70	78%	31%	34	81%	15%	36	16%	15%	228	80%
Big-4 Firms to non Big-4 Firms	19	18%	33%	20	22%	34%	8	19%	14%	11	19%	19%	58	20%
Auditor Changes—2011	74	39%	43	22%	38	20%	37	19%	192	100%			192	100%
Big-4 Firms to other Big-4 Firms	53	72%	42%	30	70%	24%	17	45%	13%	26	70%	21%	126	66%
Big-4 Firms to non Big-4 Firms	21	28%	32%	13	30%	20%	21	55%	32%	11	30%	16%	66	34%

Table 3 Big-4 Audits and Fees Earned: 2008-2011															
# of Audits and Fees Earned [in Billions \$(B)]	D&T			E&Y			KPMG			PwC			Total Big-4 Firms		
	n	\$(B)	(n/\$(B))	n	\$(B)	(n/\$(B))	n	\$(B)	(n/\$(B))	n	\$(B)	(n/\$(B))	N	\$(B)	N %
	(\$'100M)	(\$'100M)	(\$'100M)	(\$'100M)	(\$'100M)	(\$'100M)	(\$'100M)	(\$'100M)	(\$'100M)	(\$'100M)	(\$'100M)	(\$'100M)	(\$'100M)	(\$'100M)	(\$'100M)
Panel A: Number of Big-4 Audits and Fees Earned from 2008 to 2011															
# of Audits—2008	98	2.7	25%	92	2.6	30%	93	2.6	19%	93	2.6	26%	307	2.6	100%
Total Fees—2008	\$4.208	\$4.208	25%	\$4.178	\$4.178	25%	\$3.445	\$3.445	20%	\$5.058	\$5.058	30%	\$16.889	\$16.889	100%
Audit Fees	\$3.334	\$3.334	79%	\$3.402	\$3.402	81%	\$2.743	\$2.743	80%	\$3.969	\$3.969	78%	\$13.448	\$13.448	80%
Nonaudit Fees	\$0.874	\$0.874	21%	\$0.776	\$0.776	19%	\$0.702	\$0.702	20%	\$1.089	\$1.089	22%	\$3.441	\$3.441	20%
# of Audits—2009	124	2.4	25%	124	2.4	30%	124	2.4	20%	124	2.4	25%	308	2.4	100%
Total Fees—2009	\$3.740	\$3.740	24%	\$3.926	\$3.926	25%	\$1.048	\$1.048	20%	\$4.829	\$4.829	31%	\$15.543	\$15.543	100%
Audit Fees	\$2.993	\$2.993	80%	\$3.204	\$3.204	82%	\$2.431	\$2.431	80%	\$3.795	\$3.795	79%	\$12.423	\$12.423	80%
Nonaudit Fees	\$0.746	\$0.746	20%	\$0.722	\$0.722	18%	\$0.617	\$0.617	20%	\$1.034	\$1.034	21%	\$3.120	\$3.120	20%
# of Audits—2010	163	3.3	25%	133	3.2	29%	133	3.2	19%	133	3.2	27%	331	3.2	100%
Total Fees—2010	\$3.607	\$3.607	24%	\$3.887	\$3.887	26%	\$2.985	\$2.985	20%	\$4.744	\$4.744	31%	\$15.224	\$15.224	100%
Audit Fees	\$2.810	\$2.810	78%	\$3.117	\$3.117	80%	\$2.374	\$2.374	80%	\$3.691	\$3.691	78%	\$11.992	\$11.992	79%
Nonaudit Fees	\$0.797	\$0.797	22%	\$0.771	\$0.771	20%	\$0.661	\$0.661	22%	\$1.053	\$1.053	22%	\$3.232	\$3.232	21%
# of Audits—2011	120	2.4	24%	120	2.4	30%	120	2.4	20%	120	2.4	26%	309	2.4	100%
Total Fees—2011	\$2.884	\$2.884	24%	\$3.005	\$3.005	25%	\$2.279	\$2.279	19%	\$3.840	\$3.840	32%	\$12.008	\$12.008	100%
Audit Fees	\$2.289	\$2.289	79%	\$2.369	\$2.369	79%	\$1.898	\$1.898	83%	\$2.992	\$2.992	78%	\$9.547	\$9.547	80%
Nonaudit Fees	\$0.595	\$0.595	21%	\$0.636	\$0.636	21%	\$0.381	\$0.381	17%	\$0.848	\$0.848	22%	\$2.460	\$2.460	20%
Panel B: Changes in Big-4 Audits and Fees Earned from 2008 to 2011 (\$B Δ from 2008 to 2011 = (2011-2008)/2008)															
# of Audits	26%	-33%	-29%	30%	-29%	-30%	25%	-17%	19%	-24%	-26%	-24%	29%	-29%	-100%
Total Fees	\$1.324	-31%	-27%	\$1.173	-28%	-24%	\$1.166	-34%	-24%	\$1.218	-24%	-25%	\$4.881	-29%	-100%
Audit Fees	\$1.045	-31%	-27%	\$1.033	-30%	-26%	\$0.845	-31%	-22%	\$0.977	-25%	-25%	\$3.901	-29%	-100%
Nonaudit Fees	\$0.279	-32%	-28%	\$0.140	-18%	-14%	\$0.321	-46%	-33%	\$0.241	-22%	-25%	\$0.981	-29%	-100%

Table 4

Big-4 Auditor Changes and Fees Earned by Firms Retained: 2011

# of Audits and Fees Earned [in Millions \$(M)]	D&T			E&Y			KPMG			PwC			Total Big-4 Firms		
	n	\$(M)	(n/N)	n	\$(M)	(n/N)	n	\$(M)	(n/N)	n	\$(M)	n	\$(M)	N	N %
	n %	\$(M)	(n/N)	n %	\$(M)	(n/N)	n %	\$(M)	(n/N)	n %	\$(M)	n %	\$(M)	N %	N %
	\$1	(\$1/\$1)	100%	\$1	(\$1/\$1)	100%	\$1	(\$1/\$1)	100%	\$1	(\$1/\$1)	\$1	(\$1/\$1)	\$1	100%
	\$11	(\$11/\$11)	100%	\$11	(\$11/\$11)	100%	\$11	(\$11/\$11)	100%	\$11	(\$11/\$11)	\$11	(\$11/\$11)	\$11	100%
	\$10	(\$10/\$10)	100%	\$10	(\$10/\$10)	100%	\$10	(\$10/\$10)	100%	\$10	(\$10/\$10)	\$10	(\$10/\$10)	\$10	100%

Big-4 Auditor Changes to other Big-4 Firms—Number of Auditor Changes and Fees Earned in 2011

Auditor Changes—2011	42%	24%	13%	21%	100%
Total Fees—2011	\$49,044	76%	\$21,172	95%	\$81,970
Audit Fees	\$40,471	75%	\$68,354	94%	\$190,169
Nonaudit Fees	\$8,573	16%	\$23,818	97%	\$54,548

Big-4 Auditor Changes to non Big-4 Firms—Number of Auditor Changes and Fees Earned in 2011

Auditor Changes—2011	32%	20%	32%	16%	100%
Total Fees—2011	\$15,785	24%	\$4,762	5%	\$10,471
Audit Fees	\$13,146	25%	\$4,025	6%	\$9,872
Nonaudit Fees	\$2,639	24%	\$0,737	3%	\$0,599

Total Big-4 Auditor Changes—Number of Auditor Changes and Fees Earned in 2011

Auditor Changes—2011	39%	22%	20%	19%	100%
Total Fees—2011	\$64,829	100%	\$96,934	100%	\$92,441
Audit Fees	\$53,617	100%	\$72,379	100%	\$72,231
Nonaudit Fees	\$11,212	100%	\$24,555	100%	\$20,210