

Abstract

Since the theoretical work of DeAngelo (1981), audit firm size has been widely used as a surrogate for audit quality in accounting and auditing literature as large audit firms with a greater number of clients have more to lose in case of audit failure. Other reasons including better training programs and the ability to recruit better quality graduates by large audit firms to support the use of audit firm size as a fundamental proxy of audit quality.

Nevertheless, we observe that large audit firms did not take good care of many of their clients, resulting in numerous audit failures and legal action over the years. In contrast, many small and medium audit firms are headed by prominent partners and have worked hard to provide the best service they can, especially for their important clients. This study investigates whether smaller audit firms provide better quality audits for their listed clients compared with Big 4 firms or Top 10 large firms for audit of clients of similar size and characteristics in China. We note that clients of similar sizes should normally be more important for a smaller audit firm than a large audit firm. We test whether the effect of the audit firm size may be offset by the effect of client importance.