

## **A Re-Examination of Pre-SAS No. 59 Auditor Classification Accuracy: Implications for Future Research**

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Previous research has found auditors' ability to accurately predict imminent client insolvency to be very low (in most cases, less than 50%). Two methodological issues, however, affect not only the measurement of auditor classification accuracy, but also comparisons between the pre- and post-SAS No. 59 periods: 1) the definition of going-concern disclosure, and 2) the measurement of the report horizon (the delay between the audit report date and the bankruptcy filing date). In this research note, we re-examine auditor classification accuracy in the pre-SAS No. 59 period, and illustrate how event definition and horizon measurement may affect the conclusions reached. Our results indicate that, depending on the definition and event horizon used, auditors may have been more accurate in predicting imminent client bankruptcy than previous studies have indicated. More importantly, we document the existence of an intraperiod increase in auditor classification accuracy, a finding that has direct consequences for pre- and post-SAS No. 59 comparison studies.

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### **INTRODUCTION**

The going concern disclosure determination is one of the most difficult and complex decisions faced by the auditing profession (Chow, McNamee, and Plumlee 1987).<sup>1</sup> For example, Altman and McGough (1974) found that, of a sample of 34 corporate bankruptcies, auditors issued qualified or disclaimer opinions for less than half of the distressed clients. This result was later supported in studies by Deakin (1977), Menon and Schwartz (1987), Hopwood et al. (1989), and McKeown et al. (1991), each of which found auditor classification accuracy (auditors' ability to predict imminent client insolvency) to be less than 50%. (See Table 1 for a description of the studies' reported accuracies.) In response to this documented lack of success in predicting imminent client insolvency and the consequent high costs associated with litigation, the Auditing Standards Board of the American Institute of

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<sup>1</sup> Such a disclosure is considered when there are concerns as to the continued existence of the audited client.