In the wake of the disclosure of the Bernard Madoff fraud, attention has been drawn to the use of a solo auditor by Bernard L. Madoff Investment Securities LLC. Some claim that the use of a solo auditor was a red flag, or a symptom of fraud, that was ignored by investors, regulators, feeder fund operators, and auditors of the feeder funds. This motivates empirical research to determine whether evidence suggests that solo auditors are lower quality auditors than other auditors, and thus really a red flag.

Using an audit failure auditor litigation outcome metric, based on 396 observed auditor outcomes in financial reporting litigation commenced from 1996 through 2008, this paper focuses on the analysis of the relative auditor quality of solo auditors. Because one may argue that the relevant auditing services market for this analysis should include 1) all auditors other than the Big 4, 2) all auditors other than the Big 4 or Medium 2, or 3) just the Very Small (2 to 9 accountants) CPA firms and the solo auditors, the investigation uses three different models and samples. Similar results are obtained regardless which approach is used. The findings suggest that solo auditors are lower quality auditors, and further suggest that the use of a solo auditor is a red flag.

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