Impact of Auditor and Audit Committee Report Changes on Audit Quality and Costs: Evidence from the United Kingdom*

Lauren C. Reid
University of Pittsburgh
[redacted]

Joseph V. Carcello
University of Tennessee
[redacted]

Chan Li
University of Pittsburgh
[redacted]

Terry L. Neal
University of Tennessee
[redacted]

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ABSTRACT: While substantial revisions to auditor and audit committee reporting are being discussed internationally, including in the United States, the impact of these reforms on audit quality is unknown. We exploit the United Kingdom's recent regulatory changes and find that the U.K.'s new reporting regime is associated with an improvement in audit quality as proxied by significant decreases in absolute abnormal accruals and the propensity to just meet or beat analyst forecasts. While we find that audit fees marginally increased after the reporting changes, the increase is not significantly different from the fee change documented in the prior year, suggesting a possible time trend of increasing fees unrelated to the new requirements. We also fail to document a significant change in audit delay. Taken together, this study finds that new auditor and audit committee reporting requirements are associated with a significant improvement in audit quality without detecting significant incremental costs.

Keywords: audit report changes; audit committee report changes; PCAOB; SEC; United Kingdom; audit quality; audit costs.

Data Availability: Data are available from public sources identified in the text.

I. INTRODUCTION

"Experiences from the countries with similar disclosure requirements are important in assessing possible consequences …" (PCAOB 2015a).

Recently, United States and international regulators have sought to improve transparency around the audit process by proposing significant changes to auditor and audit committee reporting. In the United States, for example, the Public Company Accounting Oversight Board (PCAOB) has proposed a new auditor reporting model that would require the auditor to discuss critical audit matters ("CAMs"), auditor tenure, and audit firm independence in the audit report (PCAOB 2013).[1] The U.S. Securities and Exchange Commission (SEC) issued a concept release in 2015 with the goal of improving the audit committee report and in turn, the work performed by audit committees (Heller 2014; SEC 2015; White 2014; Whitehouse 2014). The effects of these proposed reporting changes on audit quality and costs, however, are unknown.

Mirroring the PCAOB's call described in the opening quote, we examine the quality and cost effects of the recent reporting changes in the United Kingdom (U.K.). Proponents believe that reporting changes will improve audit quality by increasing the accountability of the auditor and the audit committee, which will lead to better performance (IOSCO 2009; Peecher et al. 2013). The disclosure of key financial reporting issues and risks of material misstatement could also increase the professional skepticism used by the audit committee and the auditor on the most significant areas in the financial reporting process, and in turn, lead to audit quality improvements (IAASB 2013b). Furthermore, supporters of enhanced audit committee and auditor disclosures contend that the ability of auditors and audit committees to include more detail in their reports will provide them with more leverage over management and allow them to push for more conservative adjustments, which will serve to decrease earnings management and

[1] The PCAOB plans to issue a revised proposal for this rule in the third quarter of 2015 (PCAOB 2015b).

therefore improve audit quality (PCAOB 2011). Opponents, however, argue that the reforms may decrease audit quality by focusing auditors and audit committees on reporting rather than their oversight duties (BDO 2013a). Those opposed to greater disclosures also fear that management may be less forthright in their discussions with audit committees and auditors to avoid either of these groups disclosing information in their reports that was previously confidential (BDO 2013b). Given these divergent opinions, whether audit quality is improved by additional auditor and audit committee disclosures is an empirical question. This study exploits the exogenous shock of the U.K.'s regulatory changes to examine how audit quality is impacted by significant revisions to auditor and audit committee reporting requirements.

Specifically, we examine the audit quality effects of the Financial Reporting Council's (FRC) changes to the U.K. Corporate Governance Code, its Guidance for Audit Committees, and the International Standards on Auditing (U.K. and Ireland), which became effective for financial years ending on or after September 30, 2013. These regulatory revisions require the audit committee report to include significant financial statement issues considered by the committee as well as a discussion of how these issues were addressed (FRC 2012b).[2] Furthermore, the FRC's revisions to the International Standard on Auditing 700 (U.K. and Ireland) require auditors to include a discussion of the following in their reports: (1) assessed risks of material misstatement, (2) the materiality threshold used in the engagement, and (3) the scope of the audit (FRC 2013b). We investigate the impact of these reporting reforms on audit quality using two common proxies: (1) absolute abnormal accruals and (2) the propensity to just meet or beat analyst forecasts. In addition, given the importance of assessing costs of regulatory revisions and particularly due to

[2] The report is also required to include a discussion of the evaluation of the external audit and information on how the external auditor is appointed or reappointed. Additionally, the audit committee report must disclose audit firm tenure and the timing of the most recent audit tendering. Also, the auditor is required to include in their report any information that the auditor does not find satisfactory in the audit committee's disclosure of issues communicated by the auditor to the audit committee (FRC 2012a).

the concern that costs will increase as a result of the new reporting requirements (Chalmers 2013; Overend 2013), we examine changes in audit fees and audit delay (i.e., the time between a company's fiscal year-end and the audit report date) surrounding the implementation of the new reports.

Using a balanced sample of companies required to comply with the regulatory changes, namely firms with a Premium listing of equity shares on the London Stock Exchange, we find evidence of improvements in audit quality. Specifically, both abnormal accruals and the propensity to just meet or beat analyst forecasts significantly decreased following the implementation of the additional auditor and audit committee disclosures. Economically, absolute abnormal accruals are 0.019 lower in the new reporting period compared to the pre-period, which is significant relative to the sample mean of 0.068. In addition, the meet or beat analysis reveals that firms are 7.4 percent less likely to just meet or beat analyst forecasts in the post-period compared to the pre-period, which represents a 24.2 percent decrease in the average likelihood of just meeting or beating analyst forecasts. These results suggest that the new reporting regime is associated with a decrease in opportunistic earnings management. As higher quality audits constrain earnings management, audit quality appears to have improved surrounding the introduction of the enhanced auditor and audit committee reporting requirements.

To minimize the threat of contemporaneous events that may confound the analysis, we re-perform the analysis using two control groups: (1) firms listed on the Alternative Investment Market (AIM) of the London Stock Exchange and (2) U.S. companies.[3] We find that U.K. Premium firms, relative to AIM firms as well as U.S. firms, experienced significantly greater improvements in audit quality from the year prior to the reporting changes to the first year of the

[3] AIM companies are not subject to the regulatory changes. See Section III for more information.

new reporting requirements. These tests assist in alleviating the concern that the results are driven by other U.K. specific or worldwide events. In additional analyses, we re-perform the tests using a strict change analysis to account for temporal changes within firms that are not associated with the new reporting regime. We find that audit quality increased more from year *t-1* (i.e., the year prior to the implementation of reporting requirements) to year *t* (i.e., the first year of reporting requirements) than from year *t-2* to *t-1*. Overall, these results continue to suggest that the new auditor and audit committee reporting requirements are associated with significant audit quality improvements.

To investigate the costs associated with the new reporting regime, we examine whether the additional auditor and audit committee disclosure requirements are associated with changes in audit fees and/or audit delay. In the main analysis, we find that audit fees marginallyincreased from the pre-period to the post-period. We also find that fees increased more for U.K. Premium firms relative to a control group of U.S. firms. However, we do not find that fees for U.K. Premium firms significantly increased when compared to a control group of AIM firms. Furthermore, when performing the change analysis, we fail to find evidence that the increase in audit fees from *t-1* to *t* is significantly greater than the increase from *t-2* to *t-1*. This lack of association in the change analysis suggests that while audit fees increased from *t-1* to *t*, this increase may not be attributed to the regulatory revisions, as the change in audit fees could be indicative of a trend of increasing fees over time. Regarding audit delay, we do not find significant changes in the reporting lag as a result of the new reporting requirements, suggesting that the time to generate auditor reports did not significantly change from the pre-period to the post-period. Taken together, it appears that audit costs did not significantly change in response to the enhanced auditor and audit committee reporting regime. However, since the “lack of

evidence of an association is not necessarily evidence of a lack of association", we cannot conclusively state that there are no significant audit costs associated with the new reporting requirements (DeFond 2010).

To further alleviate concerns of confounding events in our analysis, we examine whether other changes occurring during the same timeframe that only apply to U.K. Premium listed companies could impact the results of this study. The only such change that we are aware of is the requirement to replace the business review section of the annual report with a strategic report that discusses the company's business model, human rights, and gender diversity (Deloitte 2013). We randomly select 40 Premium firms and compare the company's strategic report to its prior year business review. Corroborating the widely held opinion that strategic reports did not substantially change management disclosures (Copnell 2013; Deloitte 2013), we find that each report contained the same primary disclosures. It is therefore unlikely that this regulatory change impacted our results.

Overall, this study reveals the benefits associated with the new auditor and audit committee reporting regime in the United Kingdom. Specifically, opportunistic earnings management decreased (as proxied by lower absolute abnormal accruals and a decline in the propensity to just meet or beat analyst estimates), which suggests that audit quality improved surrounding the implementation of the new U.K. reporting requirements. In our analysis of associated costs, we fail to find evidence that audit fees and audit delay significantly changed as a result of the enhanced reporting regime. While we cannot conclusively state that costs did not increase, it appears that the reporting requirements may offer audit quality benefits without generating significant costs. Moreover, the improvement in audit quality without a corresponding increase in audit costs is consistent with the argument that the increase in quality may be driven

by the reporting requirements providing auditors and audit committees with greater leverage over management and the ability to push for more conservative adjustments, rather than being due to the performance of additional audit procedures.

The findings of this study make several important contributions. First, the paper directly examines the effects of the auditor and audit committee reporting changes in the United Kingdom, which is an important market to examine.[4] Second, this study allows the examination of the effects of regulatory changes prior to the implementation of similar requirements in other countries. Specifically, since the United Kingdom and the United States share many regulatory and cultural commonalities, the analysis of the change in the U.K.'s reporting requirements creates a rare opportunity to examine the impact of potential standard changes in the United States. Third, this paper contributes to the audit quality literature by providing evidence that is consistent with enhanced auditor and audit committee disclosures increasing audit quality without a significant increase in audit costs.

The remainder of the paper is organized as follows. Section II provides background on auditor and audit committee reporting changes and develops hypotheses. Section III outlines the research method while Section IV describes the results. Section V describes additional analyses and the final section concludes.

II. BACKGROUND AND HYPOTHESES DEVELOPMENT

U.S. Discussion of Reporting Changes

Recently, regulators worldwide have formally discussed the implementation of significant reporting changes to improve the transparency of the audit report as well as the audit

[4] The United Kingdom ranked fourth in market capitalization of all countries with over $3 trillion in market capitalization in 2012 behind the United States, China, and Japan (WorldBank 2014).

committee report. In the United States, for instance, the PCAOB issued a proposed rule on August 13, 2013 to change the audit report with the goal of providing more entity- and engagement-specific information about the audit process (PCAOB 2013). The proposal would require the auditor to discuss critical audit matters ("CAMs"), which are defined as areas that the auditor found particularly challenging in the execution of the audit (PCAOB 2013). The PCAOB's model would also instruct auditors to disclose information regarding the auditor's tenure, independence, and responsibilities for fraud and financial statement notes (PCAOB 2013).[5] These proposed changes are in response to stakeholder dissatisfaction with the current auditor report (Turner et al. 2010; Blake et al. 2011; Carcello et al. 2011; CFA 2011; Gray et al. 2011).

Stakeholders have also voiced the need for additional and more valuable audit committee disclosures (CAQ 2013; CII 2013; EY 2013a, 2013b; NACD 2013; TapestryNetworks 2013). The Investor Advisory Group (IAG) of the PCAOB noted this call for more transparency from audit committees in the United States at a PCAOB board meeting on October 20, 2014 (IAG 2014). In response to these requests, the SEC issued a concept release in 2015 to investigate possible revisions to the audit committee report (SEC 2015). Potential changes to audit committee disclosures include the provision of information regarding (1) the committee's evaluation of the auditor, particularly the level of audit quality provided and the auditor's independence, (2) communications between the committee and the auditor, (3) the reappointment process, including whether or not the audit was put out for bid and (4) the qualifications of the auditor (SEC 2015).

[5] Changes to the audit report have either occurred or are being contemplated by standard setters from around the world. The IAASB recently adopted a new audit report that requires the disclosure of key audit matters, which are similar to the PCAOB's "CAMs" (IAASB 2015). The European Parliament has also proposed audit reporting changes, endorsing a draft agreement that would require auditors to provide detailed information on the audit process (Cohn 2014).

United Kingdom Reporting Regime Changes

The FRC made significant changes to the U.K. Corporate Governance Code, its Guidance for Audit Committees, and the International Standards on Auditing (U.K. and Ireland) in the fall of 2012. These regulatory revisions require audit committees and auditors to adopt new reporting models for fiscal years ending on or after September 30, 2013. More specifically, the FRC's modified governance policies instruct audit committees to discuss significant issues considered by the committee and how they addressed these issues, including (and focusing on) the issues communicated to the committee by the auditor (FRC 2012b).[6] The new reporting model also requires audit committees to disclose how they evaluated the external auditor as well as information regarding the auditor (re)appointment process (FRC 2012b). Furthermore, the audit committee report must disclose the tenure of the audit firm and information on when the audit contract was most recently tendered (FRC 2012b).[7]

The FRC's revisions to the International Standard on Auditing (U.K. and Ireland) 700 also take effect for fiscal years ending on or after September 30, 2013 and require auditors to expand their report to include a discussion of material misstatement risks, materiality, and the scope of the audit (FRC 2013b). Specifically, the auditor must disclose the risks that had the "greatest effect on the overall audit strategy, the allocation of resources in the audit, and directing the efforts of the engagement team" (FRC 2013b). Auditors should also explain how they determined and applied materiality during the audit in addition to disclosing the specific materiality threshold they employed in the planning and performance of the audit (FRC 2013b). Lastly, the auditor is instructed to describe how the scope of the audit sufficiently addressed the

[6] Additionally, the auditor is required to include information in the audit report information if they are not satisfied with the audit committee's disclosure of the issues communicated by the auditor to the audit committee (FRC 2012a).

[7] Additionally, FTSE 350 companies are required to put the audit out for bid at least every 10 years on a "comply or explain" basis.

material misstatement risks they identified (FRC 2013b).[8]

Consistent with the quote from the PCAOB that opened the paper, examining the effects of the United Kingdom's regulatory changes may provide useful feedback to other nations' standard setters. Moreover, PricewaterhouseCoopers has stated, "whilst the new reports may be a few years off for the rest of the world, what those reports will look like is becoming increasingly clear" (PwC 2013). By testing the new regime implemented in the United Kingdom, we are able to analyze the potential benefits and costs of these revised standards before comparable requirements are imposed in other regimes. "This sort of 'live' field-testing is really important at this point…[as]…standard setters need robust evidence of the practical implications of what they are proposing" (PwC 2013). Our "field-testing" of the United Kingdom is particularly relevant to the reporting proposals made in the United States given the similar levels of disclosure and securities regulation in these two countries as well as their comparable legal environments (Hail and Leuz 2006; La Porta et al. 1997). Additionally, as discussed above, the reporting regime changes being discussed in the United States are similar to the U.K.'s new standards.

Hypotheses Development

Proponents of reporting changes argue that audit quality will increase as a result of new auditor and audit committee disclosure requirements for three reasons. First, the enhanced transparency may increase the accountability of auditors and audit committee members to financial statement users (FRC 2013a; IAASB 2013a). Supporters believe that the short, boilerplate reports currently provided by auditors and audit committees do not provide users with insight into the critical roles that these groups play in the provision of reliable financial

[8] An example of the new audit committee and auditor reports can be found on pages 44 – 46 and 130 – 135, respectively, of the Rolls-Royce 2013 annual report (http://www.rolls-royce.com/Images/RR_Full%20_Annual%20Report__tcm92-55530.pdf). The 2012 audit committee and auditor reports for Rolls-Royce can be located on pages 47 – 48 and 129, respectively, of the 2012 annual report (http://www.rollsroyce.com/Images/rolls_royce_annual_report_2012_tcm92-44211.pdf).

statements to stakeholders. The limited communication between auditors, audit committees, and stakeholders prevents financial statement users from evaluating the work performed by the auditor as well as the audit committee. The enhanced disclosures by auditors and audit committees will increase the transparency of the work performed by them[9], which may in turn increase the accountability of these groups to stakeholders. Greater accountability has been shown, in a wide variety of settings, to lead to better performance. Carcello and Li (2013), for example, reveal that accountability in the form of audit partner signatures improves audit quality. Also, Asare et al. (2000) find, in an experimental setting, that accountability increases the breadth and nature of the work performed by auditors, which they link to better performance. In addition, Peecher et al. (2013) mention improved audit reports as a mechanism that could be used to enhance accountability, and in turn, audit quality. Overall, additional information provided in enhanced audit committee and auditor reports could allow investors to better assess the quality of the audit and governance practices, which may incentivize auditors and audit committees to perform their duties at a higher level (IOSCO 2009).

Second, the reporting changes may lead to an enhanced focus by audit committees and external auditors on the most significant areas in the financial reporting process. The disclosure of key financial reporting issues and critical audit matters by the audit committee and auditor, respectively, should impact the work performed by these groups. By focusing attention on key areas, audit committees and auditors are likely to increase their procedures around these issues as well as perform the procedures with a heightened "professional skepticism, among other contributors to audit quality" (IAASB 2013b).

[9] In fact, a recent working paper finds that the new U.K. auditor and audit committee reports are more useful to investors than the previous boilerplate disclosures (Reid et al. 2015).

Third, the ability of auditors and audit committees to include more detail in their reports may provide them with more leverage over management. This additional leverage would assist auditors and audit committees in constraining management behavior and promoting better financial reporting by pushing for more conservative adjustments. For instance, Ann Yerger, the former Executive Director of the Council of Institutional Investors (CII), stated at the PCAOB Roundtable held on September 15, 2011 that she believes enhanced auditor reporting would "give audit firms more leverage to effect change and enhance management disclosure in the financial statements" (PCAOB 2011). Similarly, the ability of the audit committee to report on financial statement risks, among other items, provides the committee with the opportunity to constrain management behavior and improve audit quality.

Opponents, however, claim that revising the audit committee and auditor reporting requirements will not impact audit quality and may even unintentionally decrease audit quality. Those opposed to the regulatory changes are concerned that auditors and audit committees will have to take time away from performing their normal duties in order to meet the new reporting requirements. Therefore, the effort to increase transparency for financial statement users may actually be at the expense of audit quality if sufficient time is not spent overseeing the external auditor (in the case of the audit committee) or performing audit procedures (in the case of the audit firm). For example, BDO commented that even with the "stringent quality control procedures and robust methodologies" in place at audit firms, the increased disclosures may be "an unwelcome pressure on audit quality" (BDO 2013a).

In conjunction, some fear that the enhanced disclosures will create tension between auditors, audit committee members, and management (BDO 2013b). Management, for example, may be less forthright in their discussions with the audit committee as well as the auditor to

avoid either of these groups disclosing information in their reports that was previously confidential. In the same vein, audit committees may withhold information from the external auditor if they believe that the auditor will be prone to report even arguably immaterial matters that were discussed. Without open communication between these groups, the auditor and the audit committee will not be able to properly perform their functions, which may serve to decrease audit quality.

Given the divergent opinions surrounding the effects of new audit committee and auditor reporting requirements on audit quality and the lack of empirical evidence in this area, we do not make a prediction on the impact of the implementation of the U.K.'s new reporting standards on audit quality. We therefore state the following hypothesis in null form:

H1: *Audit quality did not change in the United Kingdom after the new reporting regime became effective.*

As it is important for regulators to also assess the costs associated with new policies, we examine the potential costs that companies face in order to comply with the revised reporting requirements. While we are unable to quantify the costs directly related to the work performed by the audit committee, we are able to investigate if there was an associated increase in costs of the external audit by examining both audit fees and audit delay (i.e., the time between a company's fiscal year end and the audit report date). Audit fees as well as audit delay may increase in response to the new requirements for several reasons. First, as mentioned above, the inclusion of more detail about the audit process is likely to hold the auditors to a higher standard. It is possible that this higher standard could lead to additional review by senior members of the engagement team to ensure that expectations are met (Chalmers 2013; Overend 2013). The increased professional skepticism on key financial reporting areas could also require additional audit work. Second, some of the larger audit firms have noted that they expect to incur training

and implementation costs associated with setting up "additional quality control processes…around the new, more informative and tailored auditors' report" (Chalmers 2013). Third, the auditors will likely spend additional time discussing audit matters with management and the audit committee. Specifically, the revised regulations require that auditors report on issues that they do not believe were sufficiently discussed in the audit committee report. This "by exception" reporting could require extra collaboration between the auditors and the audit committee. Any additional time and effort expended by the auditors will likely trickle down to the company in the form of audit fees and/or delay in the issuance of the audit report.

It, however, is also possible that audit costs will not significantly increase as a result of the new requirements. For one, if the revised regulations do not substantially increase the amount of work performed by the auditors, we are unlikely to find that audit fees and audit delay significantly changed. While some stakeholders claim that the new reporting requirements will be associated with more audit procedures, greater need for high-level supervisor review, and/or substantially more work to prepare the report, others argue that the information that the auditors are providing in the reports is not new information. Most of the information contained in the report should be extracted from the summary memo the auditor already prepares for the audit committee. As PCAOB Board Member Steve Harris questioned, "since all that investors are asking for is what auditors already know, why can't this be done easily and cost effectively?" (PCAOB 2011). If this is the case, then audit costs are unlikely to significantly change.

Given that it is unknown *ex ante* whether auditor and audit committee reporting changes substantially change audit costs, we do not make a prediction of the impact of the revised reporting requirements on audit costs. We therefore state the following hypothesis in null form:

H2: *Audit costs did not change in the United Kingdom after the new reporting regime became effective.*

III. METHODOLOGY

Audit Quality

In order to capture audit quality, two proxies are employed: (1) absolute abnormal accruals (*ABS_ACC*) and (2) the propensity to just meet or beat analyst forecasts (*MEET*). These measures are designed to capture opportunistic earnings management, which increases as abnormal accruals and the propensity to just meet or beat analyst forecasts increase. Higher quality audits constrain earnings management. Therefore, improvements in audit quality would be evidenced by lower abnormal accruals and a lower propensity to just meet or beat analyst forecasts.[10]

We examine the relation between the new reporting regime and absolute abnormal accruals using the following model:

$$ABS\_ACC_t = \beta_0 + \beta_1 POST + \beta_2 SIZE_t + \beta_3 ROA_t + \beta_4 LOSS_t + \beta_5 MB_t + \beta_6 LEVERAGE_t + \beta_7 CFO_t + \beta_8 VOLATILITY_t + \beta_9 BIG4_t + \beta_{10} PRIOR\_ACC_t + IND\_FE + \varepsilon_{it} \quad (1)$$

The dependent variable in this regression is *ABS_ACC*, which is estimated using the modified Jones (1991) approach adjusted for firm performance as in prior literature (Carcello and Li 2013; Dechow et al. 1995; Kothari et al. 2005; Reichelt and Wang 2010). Our variable of interest, *POST*, equals one if the fiscal year is the first year of the new reporting regime and zero otherwise. As described above, we do not predict the sign of β_1 because the impact of the new reporting requirements on audit quality is unknown. In line with prior studies (Ashbaugh et al. 2003; Carcello and Li 2013), we control for various firm-level characteristics that have been shown to impact abnormal accruals. These control variables include firm size (*SIZE*),

[10] We do not examine the likelihood of misstatements because not enough time has passed since the implementation of the new reporting requirements for restatements to be reported. We do not examine the likelihood of auditors' qualified opinions either because there are only six qualified opinions issued by auditors for Premium listed companies in the pre-period and three in the post-period. Although there is a decrease in the issuance of qualified opinions from the pre to post periods, there are not enough observations to perform a valid statistical test.

profitability (*ROA* and *LOSS*), market-to-book ratio (*MB*), leverage (*LEVERAGE*), cash flow from operations (*CFO*), earnings volatility (*VOLATILITY*), the use of a Big 4 auditor (*BIG4*), and the prior year's accruals (*PRIOR_ACC*). Finally, we include industry fixed effects to account for differences in abnormal accruals across industries (*IND_FE*).

As an additional test of the association between audit quality and the new reporting regime, we use the propensity to just meet or beat analyst forecasts (*MEET*) as a proxy of quality and estimate the following logistic model:

$$MEET_t = \beta_0 + \beta_1 POST + \beta_2 LN\_MVE_t + \beta_3 ROA_t + \beta_4 LOSS_t + \beta_5 MB_t + \beta_6 LEVERAGE_t + \beta_7 CFO_t + \beta_8 VOLATILITY_t + \beta_9 BIG4_t + \beta_{10} NUM\_ANALYST + \beta_{11} DISP_t + \beta_{12} HORIZON_t + IND\_FE + \varepsilon_{it} \quad (2)$$

The dependent variable in this regression, *MEET*, equals one if the difference between the firm's annual earnings per share and the most recent analyst earnings forecast is greater than zero and less than or equal to one cent (Reichelt and Wang 2010). Once again, our variable of interest is *POST* and we do not make a prediction on the association between *POST* and *MEET*. Following prior literature (Davis et al. 2009; Prawitt et al. 2009; Reichelt and Wang 2010), we control for the market value of the firm (*LN_MVE*), profitability (*ROA* and *LOSS*), market-to-book ratio (*MB*), leverage (*LEVERAGE*), cash flow from operations (*CFO*), earnings volatility (*VOLATILITY*), the use of a Big 4 auditor (*BIG4*), analyst coverage (*NUM_ANALYST*), analyst forecast dispersion (*DISP*), and the lag between the firm's fiscal year-end and the earnings announcement date (*HORIZON*).[11] We also include industry fixed effects (*IND_FE*).

Audit Costs

To study the costs associated with the new auditor and audit committee reporting standards, we examine (1) audit fees and (2) audit delay. We first estimate the following audit

[11] Results remain quantitatively and qualitatively unchanged if *SIZE* is used in place of *LN_MVE*.

fee model:

$$LN\_FEE_t = \beta_0 + \beta_1 POST + \beta_2 SIZE_t + \beta_3 ROA_t + \beta_4 LOSS_t + \beta_5 MB_t + \beta_6 LEVERAGE_t + \beta_7 CFO_t + \beta_8 VOLATILITY_t + \beta_9 BIG4_t + \beta_{10} INV_t + \beta_{11} REC_t + \beta_{12} FOREIGN_t + \beta_{13} BUSY_t + IND\_FE + \varepsilon_{it} \quad (3)$$

The dependent variable, *LN_FEE*, represents the natural logarithm of audit fees. As described earlier, we do not predict the sign of β_1 as the impact of the revised requirements on audit fees is unknown. Following prior literature (Simunic 1980; Carcello and Li 2013), we control for firm size (*SIZE*), profitability (*ROA* and *LOSS*), market-to-book ratio (*MB*), leverage (*LEVERAGE*), cash flow from operations (*CFO*), earnings volatility (*VOLATILITY*), the use of a Big 4 auditor (*BIG4*), inventory and receivables intensity (*INV* and *REC*), foreign operations (*FOREIGN*), and auditor busy season (*BUSY*). As in models (1) and (2), we also include industry fixed effects to capture differences in audit fees across industries (*IND_FE*).

Costs of the new regulatory regime may also come in the form of a longer delay between a firm's fiscal year end and the issuance of the audit report. Therefore, as an additional test of H2, we estimate the following audit delay model:

$$DELAY_t = \beta_0 + \beta_1 POST + \beta_2 SIZE_t + \beta_3 ROA_t + \beta_4 LOSS_t + \beta_5 MB_t + \beta_6 LEVERAGE_t + \beta_7 CFO_t + \beta_8 VOLATILITY_t + \beta_9 BIG4_t + \beta_{10} INV_t + \beta_{11} REC_t + \beta_{12} BUSY_t + \beta_{13} FOREIGN_t + \beta_{14} LN\_FEE_t + IND\_FE + \varepsilon_{it} \quad (4)$$

DELAY equals the number of calendar days between the fiscal year end of a firm and the date of the audit report (Ashton et al. 1987; Ettredge et al. 2006; Abbott et al. 2012). In addition to the control variables used in model (3), we control for audit fees (*LN_FEE*) as in Ettredge et al. (2006). A complete list of variable definitions for all the models is provided in Appendix 1.

Sample

Only entities with a Premium listing of equity shares on the London Stock Exchange are required to comply with the auditor and audit committee reporting changes in the United Kingdom (FRC 2012b, 2013b). We obtain data related to the first year of implementation (*t*) as well as the prior period (*t-1*) for each firm.[12] Based on the London Stock Exchange's record of listings, there are 1,436 firm-years associated with a Premium listing. Of these, however, 497 firm-year observations are associated with investment funds. Due to the unique nature of investments funds, we exclude these listings and only test commercial equity firm-year observations (N=939).

Panels A and B of Table 1 provide detail regarding the sample construction for the abnormal accrual and meet or beat analyses, respectively. Datastream is used to collect the financial information for the Premium commercial equity firms including analyst forecast data, which is available from I/B/E/S on Datastream. The samples in panels A and B are generated using the following process: (1) exclude firm-years missing data necessary to compute the dependent variable in the analysis, (2) delete firm-year observations without the data required to calculate control variables, and (3) exclude observations missing complete data for both the pre and post periods. This final data requirement allows the comparison of firms in the pre-period to the same firms in the post-period. The use of this balanced panel design reduces the threat of firm-level correlated omitted variables (Doyle and Magilke 2013). The final sample used in the abnormal accrual analysis is comprised of 454 firm-year observations while the sample examined in the meet or beat analysis is comprised of 688 firm-year observations.

<Insert Table 1 Here>

[12] We are aware of only three companies that voluntarily adopted these requirements in year *t-1*: Vodafone Group, British Sky Broadcasting Group PLC, and Ashmore Group PLC. In untabulated tests, we exclude these firms from the analysis and the results remain unchanged.

Panel C presents the sample selection procedure for the audit fee and delay analyses. Reliable audit fee data for U.K. companies is unavailable electronically. We therefore hand collect this information directly from the annual reports of the sample firms. To minimize the hand collection effort, we identified observations with the data necessary to compute control variables. This process resulted in the exclusion of 306 observations. There were only two observations for which we were unable to collect audit fee data. After deleting observations that lack complete data in both the pre and post periods, the final audit fee sample is comprised of 574 firm-year observations. To generate the audit delay sample, an additional 66 observations without audit report date data to compute *DELAY* in both periods are excluded.[13] The final audit delay sample is comprised of 508 firm-year observations.

Control Groups

Even though a balanced panel accounts for time-invariant firm-specific characteristics that may confound the analysis, it is possible that other events occurring around the same time as the new reporting standards could impact the results. We therefore use two control groups: firms listed on the Alternative Investment Market (AIM) and U.S. companies.

AIM Control Group

In order to alleviate concerns that the results may be driven by a correlated omitted variable related to U.K.-specific or global events outside of the reporting revisions, we use a control group comprised of companies listed on a sub-market of the London Stock Exchange – the Alternative Investment Market (AIM). These firms are not required to comply with the U.K. Corporate Governance Code and are therefore not subject to the regulatory changes. They are, however, listed on the same exchange as our sample of firms and are likely impacted by similar

[13] Given the inclusion of audit fees as a control variable in the audit delay model, we use the audit fee sample as the starting point for the creation of the audit delay sample.

external factors that may also affect the dependent and test variables.

We hand collect audit fee data from the annual reports of AIM firms and gather the remainder of the necessary data for this control group from Datastream. In models (1) - (4), we add an indicator variable for the U.K. Premium companies that are required to adopt the audit committee and auditor report changes (*PREMIUM*) as well as the interaction of *POST* and *PREMIUM*.

U.S. Control Group

We also use a control group of U.S. firms for two reasons. First, while AIM firms are listed on the London Stock Exchange, the AIM market is designed for smaller, growing companies, which creates significant differences between the AIM firms and the more established Premium equity companies. Companies listed on U.S. stock exchanges are more similar to our sample firms and therefore represent a good alternative control group. Second, U.S. firms are impacted by global events that likely also affect U.K. companies, but they are not subject to the new U.K. reporting regime. The use of the U.S. control group therefore assists in mitigating the concern that global changes might be correlated omitted variables.

To perform this analysis, we gather U.S. data from Compustat, Audit Analytics, and I/B/E/S. We then re-perform the main tests including an indicator for U.K. firms (*UK*) and interacting *UK* with *POST*.

IV. RESULTS

Univariate Statistics

Table 2 compares the means of the variables used in each audit quality and audit cost analysis for the pre-period (*POST*=0) and the post-period (*POST*=1). Panel A reports that the

absolute value of mean abnormal accruals is significantly lower in the post-period at 0.059 compared to the pre-period at 0.078 ($p<0.05$). This univariate result provides preliminary evidence that abnormal accruals decreased upon the implementation of additional reporting requirements for auditors and audit committees. Panel A also reveals that the only statistical change in the sample firms from the pre-period to the post-period for the control variables is a greater use of Big 4 auditors in the post-period ($p<0.10$). Panel B reports that the firm's propensity to just meet or beat analyst forecasts significantly decreased from 0.340 to 0.259 from the pre-period to the post-period ($p<0.05$), providing initial evidence of a lower propensity to just meet or beat analyst forecasts surrounding the introduction of enhanced auditor and audit committee reporting requirements. Furthermore, there are no statistical differences in the means of the control variables from the pre-period to the post-period, suggesting that the sample firms did not materially change during this timeframe. Taken together, Panels A and B provide initial evidence that audit quality increased (as proxied by lower abnormal accruals and a decrease in the propensity to just meet or beat analyst forecasts) from the year prior to the new reporting requirements to the first year of implementation.

Panels C and D present the univariate results for the audit fee and audit delay analyses, respectively. Panel C reports that there is not a significant change in audit fees from the pre-period to the post-period. Similarly, Panel D reveals that the number of days between the fiscal year-end and the audit report date did not significantly change from the pre-period to the post-period. Panels C and D also show that there are no significant differences between the control variables in the pre-period and the post-period in either sample. Thus, at the univariate level, we fail to find any significant change in audit cost (as proxied by audit fees and audit delay) from the year before the new reporting requirements to the first year of implementation.

<Insert Table 2 Here>

Regression Results

Tables 3 and 4 present the regression results for the audit quality and audit cost analyses, respectively. The primary model for each analysis is provided in column 1 of each table. For both sets of analyses, we present the results using the AIM control group and the U.S. control group in columns 2 and 3, respectively.

Abnormal Accrual Analysis

Panel A of Table 3 reports the results of model (1). Column 1 shows that the coefficient on *POST* is negative and highly significant at the $p<0.01$ level. This result provides evidence that abnormal accruals significantly decreased in the post-period compared to the pre-period for the U.K. companies required to provide the new disclosures. Thus, it appears that audit quality improved under the new reporting regime. Furthermore, this result is economically significant as absolute abnormal accruals are 0.019 lower on average, which is significant relative to the sample mean of 0.068. With regard to the control variables, large firms and firms with higher prior-year current accruals are associated with lower abnormal accruals.

Column 2 (column 3) reports that the coefficient on the interaction of *POST* and *PREMIUM* (*UK*) is significantly negative ($p<0.05$). This result suggests that the relation between the new reporting requirements and improved audit quality is stronger for Premium (UK) companies compared to AIM (US) companies. In fact, there is no evidence that such a relation between the new reporting requirements and improvements in audit quality even exists for AIM (US) companies given the insignificant (positive) coefficient on *POST*. Furthermore, while the lack of significance on the *PREMIUM* (*UK*) base variable indicates there was not a difference in the level of absolute accruals between Premium (UK) and AIM (US) companies in the pre-

period, the joint test of *PREMIUM + POST x PREMIUM* (*UK + POST x UK*) is negative and significant, indicating that there is a difference in the post-period, consistent with the new reporting requirements resulting in an improvement in audit quality.

<Insert Table 3>

Meet or Beat Analysis

Panel B of Table 3 provides the results of the estimation of model (2). Column 1 reports that the coefficient on *POST* is significantly negative at the $p<0.05$ level, suggesting that the propensity for Premium firms to just meet or beat analyst forecasts is lower in the post-period compared to the pre-period. This finding suggests that audit quality improved under the enhanced auditor and audit committee reporting requirements. This result is also economically significant as firms are 7.4 percent less likely to just meet or beat analyst forecasts in the post-period compared to the pre-period, which represents a 24.2 percent decrease in the average likelihood of just meeting or beating analyst forecasts.[14] Results for control variables suggest that firms with larger market values and higher market-to-book ratios have a lower propensity to just meet or beat analyst forecasts.

Column 2 (column 3) reports the results using the AIM (US) control group and shows a negative and significant coefficient on *POST* x *PREMIUM* (*POST x UK*), which suggests that, consistent with the accrual analysis in Panel A, the relation between the new reporting requirements and improved audit quality is stronger for Premium (UK) companies compared to AIM (US) companies. Also consistent with the accrual analysis in Panel A, the insignificant coefficient on *POST* indicates that no such relation even exists between the new reporting requirements and improvements in audit quality for AIM (US) companies. Furthermore, while

[14] Economic significance is computed as follows: *POST* coefficient * mean *MEET* * (1 – mean *MEET*). As the mean of *MEET* for the overall sample period is 0.306, the economic significance is (-0.347) * (0.306) * (1 – 0.306), or 0.074.

the significantly positive coefficient on the *PREMIUM* (*UK*) base variable indicates that Premium (UK) companies were more likely to just meet or beat analyst forecasts in the pre-period, the insignificance for the joint test of *PREMIUM + POST x PREMIUM* suggests that this was no longer the case in the post-period, consistent with the new reporting requirements improving audit quality for Premium companies. Although the joint test of *UK + POST x UK* is significant indicating that UK companies continue to be more likely to just meet or beat analyst forecasts in the post-period compared to US companies, the coefficient for the joint test is smaller resulting from the negative and significant coefficient on the *POST x UK* interaction term, which suggests that this difference has been diminished by the new reporting requirements.

In sum, the results from analyses of both abnormal accruals and the likelihood of just meeting or beating analyst forecasts suggest that audit quality improved after the implementation of the new auditor and audit committee reports for those companies subject to the new disclosure requirements. Next, we discuss the results of the audit cost analyses.

Audit Fee Analysis

Panel A of Table 4 provides the results for the audit fee analysis. Column 1 reports that *POST* is positive at the $p<0.10$ level, after controlling for client and auditor characteristics that likely impact fees. This result suggests that audit fees marginally increased after the implementation of the new reporting requirements. Regarding economic significance, audit fees are 3.4 percent higher in the post-period.[15] Consistent with prior literature, audit fees are higher for larger firms, firms audited by a Big 4 auditor, firms with more receivables, and firms with foreign operations. Column 2 (column 3) provides the results of equation (3) using a control group of AIM (US) firms. The lack of significance on the *POST* variable indicates there was not a significant change in audit fees for AIM (US) companies after the implementation of the new

[15] Economic significance is computed as follows: $e^z - 1$ where z equals the coefficient on the variable of interest.

reporting requirements for UK premium companies. In addition, joint test results indicate that Premium (UK) companies had significantly higher (lower) audit fees compared to AIM (US) companies in both the pre- and post-periods. The lack of significance on our variable of interest, *POST x PREMIUM*, suggests that the difference between audit fees for Premium and AIM companies did not change following the new requirements, while the positive and significant coefficient on the *POST x UK* interaction suggests that the difference between UK and US audit fees diminished somewhat following the new requirements. These results provide weak evidence that Premium companies' audit fees increased surrounding the implementation of the additional auditor and audit committee disclosures.

<Insert Table 4>

Audit Delay Analysis

Panel B of Table 4 presents the results of the estimation of equation (4). Column 1 shows, in line with the univariate tests, that audit delay did not significantly change from the pre-period to the post-period. Consistent with prior literature, larger firms experienced shorter audit reporting delays while more volatile companies and firms with busy season fiscal year-ends experienced longer reporting delays. Column 2 reports the audit delay results using the AIM control group. We find an insignificant coefficient on *POST*, which suggests that AIM companies did not experience a significant change in audit delay following the new reporting regime. Furthermore, the negative and significant coefficients for *PREMIUM* and the joint test of *PREMIUM + POST x PREMIUM* indicate that Premium companies have shorter audit delays in both the pre- and post-periods, which, along with the insignificant coefficient on the *POST x PREMIUM* interaction variable, is consistent with our finding that the new reporting requirements did not result in a significant change in audit delay for Premium companies.

Column 3 reports the audit delay results using the U.S. control group. The negative and significant coefficient on *POST* indicates that audit delay decreased for U.S. companies, while the positive and significant coefficient on the *POST x UK* interaction term indicates that the UK companies did not experience a similar decrease in audit delay. Finally, neither the base variable *UK* nor the joint test of *UK + POST x UK* is significant, which indicates that audit delay was not different for U.K. versus U.S. companies in either the pre- or post-period. Thus, it appears that the reporting lag of U.K. Premium companies was not significantly impacted by the new reporting requirements.

V. ADDITIONAL ANALYSES

Strict Change Analysis

To consider temporal changes within firms unrelated to the new U.K. reporting regime, we re-run equations (1) – (4) using a strict change analysis. More specifically, we compare changes in the dependent variables from *t-2* to *t-1* with changes in these variables from *t-1* to *t*. We replace *POST* with *CHG_POST*, which equals one for observations associated with changes from year *t-1* to year *t*, and zero for observations associated with changes from year *t-2* to year *t-1*. All other variables in the models, including the respective dependent variables, are also transformed to change variables.

Given that we found evidence of a significant increase in audit quality in the main analyses, we expect the coefficient on *CHG_POST* to be negative and significant in the abnormal accrual and meet or beat change analyses. Panel A of Table 5 presents the results of these analyses. Column 1 shows that the coefficient on *CHG_POST* is negative and significant ($p<0.05$ one-tailed), suggesting that discretionary accruals decreased more from year *t-1* to year *t*, than

from year *t-2* to year *t-1*. *CHG_POST* is also negative and marginally significant in the meet or beat analysis presented in column 2 ($p<0.10$ one-tailed), which provides further evidence that the propensity to just meet or beat analyst forecasts decreased more surrounding the implementation of the new reporting regime, compared to the changes in the two years before the implementation. Overall, the results of these change analyses provide additional evidence that audit quality improved after the implementation of the new auditor and audit committee report requirements for U.K. Premium firms, in support of the main findings.

<Insert Table 5>

Panel B of Table 5 presents the analysis of changes in audit fees and audit delay. If the marginal increase in audit fees documented in Table 4 is a result of the regulatory changes, the coefficient on *CHG_POST* should be positive and statistically significant. If, however, the fee increase is a product of a time trend, the change from *t-1* to *t* would be insignificantly different from the change from *t-2* to *t-1* and the coefficient on *CHG_POST* would be insignificant. Column 1 of Panel B reports an insignificant coefficient on *CHG_POST*, which suggests that the increase in fees surrounding the new reporting requirements is not significantly greater than the increase in fees from *t-2* to *t-1*. Thus, even though we find some evidence suggesting an increase in audit fees in the levels analysis, we cannot attribute the audit fee increase to the additional disclosure requirements. Column 2 of Panel B also reports an insignificant coefficient on *CHG_POST*, indicating that the change in audit delay around the new reports is not different from the change in the prior period. This lack of result suggests that audit delay did not significantly change surrounding the implementation of the revised reporting requirements. Taken together, the change analyses fail to document significant costs attributable to the auditor and audit committee reporting changes. However, since the "lack of evidence of an association is

not necessarily evidence of a lack of association", we cannot conclusively state that there are no significant audit costs associated with the new reporting requirements (DeFond 2010).[16]

Strategic Reports Review

While we address the concern of confounding events using a balanced panel design, control groups, and a strict change analysis, it could still be possible that other changes, only applicable to U.K. Premium listed companies, occurred during the same timeframe as the new reporting regime. To our knowledge, the only such change is the replacement of the business review section of the annual report with a strategic report that discusses the company's strategy, business model, human rights, and gender diversity (Deloitte 2013). The requirement took effect for fiscal years ending on or after September 30, 2013, but a strategic report has been recommended by the U.K. Corporate Governance Code on a 'comply or explain' basis since 2010 (Deloitte 2013). Additionally, audit partners, such as KPMG partner Tim Copnell, have questioned the reporting change given that the strategic report requirement does not appear to be significantly different than the business review it replaces (Copnell 2013). For a random sample of 40 Premium firms, we compared the company's new strategic report to its business review in the prior year's annual report and found that each report disclosed the same primary information. Our review therefore supports the sentiment that the strategic reports did not substantially change management behavior and therefore this additional regulation is unlikely to influence our results.

VI. CONCLUSION

Regulators internationally, including in the U.S., are considering dramatic reforms to audit committee and auditor reporting. The impact of these revisions on audit quality and audit

[16] The analyses, however, do not appear to suffer from low statistical power, particularly given the statistically significant increase in audit fees documented in Panel A of Table 4.

costs, however, is unknown. We exploit the recent reporting changes in the United Kingdom to gain insight into the effects of new auditor and audit committee disclosures on the level of audit quality provided and audit costs incurred. Using a balanced sample of firms, we find that the U.K.'s new reporting regime is associated with an improvement in audit quality. Specifically, we document significant decreases in abnormal accruals and the propensity to just meet or beat analyst forecasts surrounding the implementation of the new auditor and audit committee reports. Furthermore, while we find some limited evidence that audit fees increased after the reporting changes, the increase in fees is not significantly different from the audit fee change documented in the prior year. This suggests that there is a time trend of increasing fees that is likely unrelated to the new reporting requirements. We also fail to document a significant change in the amount of time between a firm's fiscal year-end and the issuance of the audit report. Taken together, this study documents that the new auditor and audit committee reporting requirements are associated with a significant improvement in audit quality without detecting a significant incremental cost. Moreover, the improvement in audit quality without a corresponding increase in audit costs suggests that the increase in quality may be driven by the reporting requirements' provision of greater leverage over management to the auditor and audit committee rather than the generation of additional audit work.

By investigating the effect of the new reporting regime on audit quality, audit fees, and audit delay, this study is of interest to auditors, audit committee members, public companies, regulators, and financial statement users. Our results indicate that enhanced audit committee and auditor reporting requirements benefit financial statement users by increasing underlying audit quality, and thus, the quality of the financial reports issued by the company. In addition to revealing the impact of these reporting changes in the United Kingdom, our analyses provide

important information that should be considered in the evaluation of standards proposed by other regulators worldwide, particularly those in the United States.

In conclusion, we briefly describe the limitations of the study as well as opportunities for future research. First, the lack of results related to audit costs cannot be interpreted as conclusive evidence that additional costs are not generated by the new reporting requirements. Future research should examine possible other costs, such as subsequent auditor and/or audit committee turnover. Second, our study examines the first year of implementation of the United Kingdom's new reporting regime and is thus able to contribute timely and relevant information to the auditing profession, governance bodies, regulators, and investors. However, it is unknown whether our results persist in future years and future research could examine this research question. Third, while there are many similarities between the United Kingdom and the United States, there are differences in these countries that should be considered, including the litigation environment and the division of responsibilities among the regulatory bodies in each country. The results of this paper should be interpreted in light of these differences. Future research could examine the potential effect these differences have on audit committee and audit report reforms. Nevertheless, this study provides timely and relevant evidence on the costs and benefits of new auditor and audit committee reporting requirements, which will inform the ongoing, worldwide debate.

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Table 1: Sample Construction

Panels A, B, and C of Table 1 present the sample selection process for the abnormal accrual, meet or beat, and audit cost analyses, respectively.

Panel A: Abnormal Accrual Analysis Sample	**Firm-Year Observations**
Premium Equity Listing Firm-Years	1,436
Less: Investment Fund Firm-Years	(497)
Premium Equity Commercial Firm-Years	939
Less: Missing necessary data to calculate *ABS_ACC*	(349)
Less: Missing data necessary to compute control variables	(16)
Less: Missing complete data for both periods	(120)
Final Sample for Abnormal Accrual Analysis	**454**

Panel B: Meet or Beat Analysis Sample	**Firm-Year Observations**
Premium Equity Listing Firm-Years	1,436
Less: Investment Fund Firm-Years	(497)
Premium Equity Commercial Firm-Years	939
Less: Missing necessary data to calculate *MEET*	(189)
Less: Missing data necessary to compute control variables	(22)
Less: Missing complete data for both periods	(40)
Final Sample for Meet or Beat Analysis	**688**

Panel C: Audit Fee & Delay Samples	**Firm-Year Observations**
Premium Equity Listing Firm-Years	1,436
Less: Investment Fund Firm-Years	(497)
Premium Equity Commercial Firm-Years	939
Less: Missing data necessary to compute control variables	(306)
Less: Missing audit fee data	(2)
Less: Missing complete data for both periods	(57)
Final Sample for Audit Fee Analysis	**574**
Less: Missing data necessary to calculate *DELAY*	(66)
Final Sample for Audit Delay Analysis	**508**

Table 2: Univariate Statistics

Panels A, B, C, and D of Table 2 present the differences in means between the pre-period and post-period for variables used in the abnormal accrual, meet or beat, audit fee, and audit delay analyses, respectively. All variables are defined in Appendix 1. * and ** indicate significance at the 0.10 and 0.05 levels, respectively (based on two-tailed tests).

Panel A: Abnormal Accrual Analysis

	***POST*=0 (N=227)**	***POST*=1 (N=227)**	**Difference**	**t-stat**	
ABS_ACC	0.078	0.059	-0.019	-2.26	**
SIZE	14.095	14.113	0.018	0.11	
ROA	0.045	0.043	-0.002	-0.10	
LOSS	0.167	0.181	0.013	0.37	
MB	3.302	4.200	0.898	0.56	
LEVERAGE	0.187	0.189	0.002	0.12	
CFO	0.100	0.100	0.000	-0.02	
VOLATILITY	0.247	0.220	-0.027	-1.22	
BIG4	0.872	0.921	0.048	1.70	*
PRIOR_ACC	0.002	-0.010	-0.011	-1.02	

Panel B: Meet or Beat Analysis

	***POST*=0 (N=344)**	***POST*=1 (N=344)**	**Difference**	**t-stat**	
MEET	0.340	0.259	-0.081	-2.34	**
LN_MVE	14.083	14.272	0.188	1.35	
ROA	0.040	0.047	0.007	0.53	
LOSS	0.166	0.148	-0.017	-0.63	
MB	2.810	3.406	0.596	0.57	
LEVERAGE	0.174	0.171	-0.003	-0.22	
CFO	0.087	0.083	-0.003	-0.29	
VOLATILITY	0.274	0.248	-0.026	-1.32	
BIG4	0.895	0.919	0.023	1.05	
NUM_ANALYST	11.247	10.948	-0.299	-0.50	
DISP	0.010	0.010	-0.001	-0.27	
HORIZON	11.980	12.555	0.576	0.48	

Table 2 (continued): Univariate Statistics

Panel C: Audit Fee Analysis

	***POST*=0**	***POST*=1**		
	(N=287)	**(N=287)**	**Difference**	**t-stat**
LN_FEE	13.626	13.692	0.065	0.46
SIZE	14.146	14.188	0.043	0.24
ROA	0.045	0.049	0.004	0.26
LOSS	0.157	0.146	-0.010	-0.35
MB	2.883	3.535	0.652	0.52
LEVERAGE	0.165	0.158	-0.007	-0.46
CFO	0.082	0.079	-0.003	-0.19
VOLATILITY	0.238	0.214	-0.023	-1.29
BIG4	0.878	0.902	0.024	0.93
INV	0.084	0.080	-0.005	-0.41
REC	0.157	0.158	0.001	0.05
FOREIGN	0.338	0.286	-0.052	-1.35
BUSY	0.861	0.861	0.000	0.00

Panel D: Audit Delay Analysis

	***POST*=0**	***POST*=1**		
	(N=254)	**(N=254)**	**Difference**	**t-stat**
DELAY	61.177	60.736	-0.441	-0.34
SIZE	14.375	14.418	0.044	0.25
ROA	0.054	0.047	-0.007	-0.44
LOSS	0.138	0.142	0.004	0.13
MB	3.012	3.616	0.604	0.43
LEVERAGE	0.170	0.166	-0.004	-0.26
CFO	0.089	0.086	-0.003	-0.21
VOLATILITY	0.241	0.219	-0.022	-1.14
BIG4	0.909	0.933	0.024	0.99
INV	0.081	0.077	-0.004	-0.36
REC	0.157	0.157	0.000	0.02
FOREIGN	0.350	0.299	-0.051	-1.23
BUSY	0.866	0.866	0.000	0.00
LN_FEE	13.811	13.875	0.064	0.44

Table 3: Audit Quality Analyses

Panels A and B of Table 3 present the results of the abnormal accrual and meet or beat analyses, respectively. Column 1 of each panel reports the results using the sample of U.K. Premium firms required to comply with the new reporting requirements. Columns 2 and 3 present the results using the AIM control group and the U.S. control group, respectively. Robust t-statistics for the abnormal accrual analysis (z-statistics for the meet or beat analysis) adjusted for firm clustering effects are presented in parentheses below the coefficients. All variables are defined in Appendix 1. *, **, and *** indicate significance at the 0.10, 0.05, and 0.01 levels, respectively (based on two-tailed tests).

Panel A: Abnormal Accrual Analysis

	(1)	(2)	(3)
VARIABLES	ABS_ACC	ABS_ACC	ABS_ACC
POST	-0.019***	0.010	0.226***
	(-2.72)	(0.78)	(5.53)
PREMIUM		0.008	
		(0.66)	
POST x PREMIUM		-0.029**	
		(-2.03)	
UK			-0.137
			(-1.38)
POST x UK			-0.248**
			(-2.54)
SIZE	-0.005*	-0.007***	0.027
	(-1.93)	(-4.12)	(0.68)
ROA	-0.041	0.059***	-6.936
	(-1.31)	(4.11)	(-1.60)
LOSS	0.002	0.036***	-0.936
	(0.13)	(2.61)	(-1.60)
MB	0.000	-0.000	0.001
	(0.82)	(-1.31)	(0.90)
LEVERAGE	-0.005	0.019	-0.371
	(-0.20)	(1.42)	(-1.38)
CFO	-0.015	-0.083***	4.931
	(-0.23)	(-2.69)	(1.56)
VOLATILITY	0.016	0.021	-0.316
	(0.69)	(0.93)	(-0.64)
BIG4	-0.014	0.006	-0.148
	(-0.93)	(0.54)	(-1.15)
PRIOR_ACC	-0.050**	-0.045**	-0.220
	(-2.20)	(-1.98)	(-0.70)
Industry Fixed Effects Included	Yes	Yes	Yes
Constant Included	Yes	Yes	Yes
Observations	454	1,024	3,900
UK Premium Observations	454	454	454
AIM Observations		570	
US Observations			3,446
R-squared	0.220	0.215	0.332
JOINT TESTS:			
PREMIUM + POST x PREMIUM		-0.022**	
		(-2.05)	
UK + POST x UK			-0.385***
			(-3.81)

Table 3 (continued): Audit Quality Analyses

Panel B: Meet or Beat Analysis

VARIABLES	(1) MEET	(2) MEET	(3) MEET
POST	-0.347**	0.028	0.022
	(-1.98)	(0.19)	(0.25)
PREMIUM		0.443**	
		(2.23)	
POST x PREMIUM		-0.392*	
		(-1.73)	
UK			1.229***
			(7.78)
POST x UK			-0.432**
			(-2.29)
LN_MVE	-0.243***	-0.304***	-0.155***
	(-2.67)	(-4.49)	(-3.13)
ROA	-0.603	0.175	-0.724*
	(-0.70)	(0.34)	(-1.72)
LOSS	-0.002	-0.118	-0.243*
	(-0.01)	(-0.61)	(-1.70)
MB	-0.052**	0.001	-0.001
	(-2.14)	(0.25)	(-1.18)
LEVERAGE	0.305	-0.005	0.185
	(0.58)	(-0.02)	(0.77)
CFO	-0.428	-0.013	0.616
	(-0.32)	(-0.02)	(1.30)
VOLATILITY	0.089	-0.072	-0.076
	(0.19)	(-0.31)	(-0.36)
BIG4	0.529	0.062	0.091
	(1.60)	(0.35)	(0.65)
NUM_ANALYST	0.026	0.034**	0.031***
	(1.22)	(2.13)	(3.27)
DISP	-13.268	-12.337**	-35.068*
	(-1.55)	(-2.32)	(-1.93)
HORIZON	-0.005	0.000	-0.003
	(-0.77)	(0.14)	(-0.85)
Industry Fixed Effects Included	Yes	Yes	Yes
Constant Included	Yes	Yes	Yes
Observations	688	1,344	4,094
UK Premium Observations	688	688	688
AIM Observations		656	
US Observations			3,406
Pseudo R-squared	0.081	0.067	0.053
JOINT TESTS:			
PREMIUM + POST x PREMIUM		0.051	
		(0.25)	
UK + POST x UK			0.797***
			(4.80)

Table 4: Audit Cost Analyses

Panels A and B of Table 4 present the results of the audit fee and audit delay analyses, respectively. Column 1 of each panel reports the results using the sample of U.K. Premium firms required to comply with the new reporting requirements. Columns 2 and 3 present the results using the AIM and U.S. control groups, respectively. Robust t-statistics adjusted for firm clustering effects are presented in parentheses below the coefficients. All variables are defined in Appendix 1. *, **, and *** indicate significance at the 0.10, 0.05, and 0.01 levels, respectively (based on two-tailed tests).

Panel A: Audit Fee Analysis

VARIABLES	(1) LN_FEE	(2) LN_FEE	(3) LN_FEE
POST	0.033*	0.012	0.004
	(1.69)	(0.54)	(0.81)
PREMIUM		0.639***	
		(5.29)	
POST x PREMIUM		0.031	
		(1.24)	
UK			-0.414***
			(-5.31)
POST x UK			0.039**
			(2.48)
SIZE	0.613***	0.495***	0.514***
	(19.50)	(17.93)	(60.67)
ROA	0.256	0.012	-0.209***
	(1.15)	(0.40)	(-3.01)
LOSS	-0.043	-0.021	0.153***
	(-0.26)	(-0.23)	(5.94)
LEVERAGE	-0.213	0.030	-0.293***
	(-0.70)	(1.01)	(-5.28)
MB	-0.001	0.000	0.000***
	(-0.30)	(0.39)	(2.61)
CFO	0.226	-0.146**	-0.035
	(0.47)	(-2.57)	(-0.49)
VOLATILITY	-0.536**	-0.055	-0.022**
	(-2.03)	(-0.75)	(-2.15)
BIG4	0.385***	0.268***	0.509***
	(2.65)	(2.78)	(17.85)
INV	-0.979**	-0.351	0.346***
	(-2.50)	(-1.30)	(2.87)
REC	0.837**	0.635***	0.598***
	(2.17)	(3.40)	(5.25)
FOREIGN	0.423***	0.174*	0.217***
	(2.86)	(1.67)	(7.54)
BUSY	0.047	-0.004	-0.034
	(0.18)	(-0.03)	(-0.59)
Constant Included	Yes	Yes	Yes
Industry Fixed Effects Included	Yes	Yes	Yes
Observations	574	1,508	5,448
UK Premium Observations	574	574	574
AIM Observations		934	
US Observations			4,874
R-squared	0.618	0.688	0.776
JOINT TESTS:			
PREMIUM + POST x PREMIUM		0.670***	
		(5.62)	
UK + POST x UK			-0.375***
			(-4.79)

Table 4 (continued): Audit Cost Analyses

Panel B: Audit Delay Analysis

VARIABLES	(1) DELAY	(2) DELAY	(3) DELAY
POST	-0.129	-1.397	-1.459***
	(-0.25)	(-1.14)	(-5.06)
PREMIUM		-14.456***	
		(-5.81)	
POST x PREMIUM		1.226	
		(0.94)	
UK			-1.637
			(-1.51)
POST x UK			1.473**
			(2.54)
SIZE	-4.301***	-4.033***	-3.005***
	(-6.94)	(-5.32)	(-10.28)
ROA	-6.196	6.671	-2.225*
	(-0.39)	(0.82)	(-1.85)
LOSS	3.921	4.545*	3.062***
	(1.51)	(1.94)	(5.00)
LEVERAGE	7.207	3.760	4.838***
	(1.56)	(0.98)	(3.68)
MB	0.004	-0.030	-0.010*
	(0.06)	(-1.59)	(-1.76)
CFO	-3.699	-12.385	0.934
	(-0.35)	(-1.41)	(0.54)
VOLATILITY	14.244**	9.812***	0.194
	(2.15)	(2.61)	(0.73)
BIG4	2.043	1.789	-4.402***
	(0.90)	(0.74)	(-5.87)
INV	-5.719	-14.855**	0.413
	(-0.98)	(-2.11)	(0.16)
REC	0.035	-6.459	2.960
	(0.01)	(-1.01)	(1.23)
FOREIGN	-0.373	-0.315	3.356***
	(-0.18)	(-0.15)	(5.05)
BUSY	6.040**	5.248**	3.842***
	(2.50)	(2.25)	(4.80)
LN_FEE	0.979	0.410	-0.610
	(1.41)	(0.56)	(-1.15)
Constant Included	Yes	Yes	Yes
Industry Fixed Effects Included	Yes	Yes	Yes
Observations	508	1,004	5,382
UK Premium Observations	508	508	508
AIM Observations		496	
US Observations			4,874
R-squared	0.326	0.431	0.267
JOINT TEST:			
PREMIUM + POST x PREMIUM		-13.230***	
		(-5.36)	
UK + POST x UK			-0.164
			(-0.16)

Table 5: Change Analysis

Panels A and B of Table 5 present the results of a strict change analysis for the audit quality tests and audit costs tests, respectively. Columns 1 and 2 of Panel A report the results for the abnormal accrual and meet or beat analyses, respectively. Columns 1 and 2 of Panel B report the results for the audit fees and audit delay analyses, respectively. *CHG_POST* equals one if the year is from *t-1* to *t* and zero if the year is from *t-2* to *t-1*. All other variables are also transformed to change variables. *, **, and *** indicate significance at the 0.10, 0.05, and 0.01 levels, respectively (based on one-tailed tests when a direction is predicted, two-tailed otherwise).

Panel A: Audit Quality Analyses

	(1)	(2)
VARIABLES	CHG_ABS_ACC	CHG_MEET
CHG_POST	-0.026**	-0.078*
	(-1.83)	(-1.40)
CHG_SIZE	0.002	
	(0.05)	
CHG_LN_MVE		-0.062
		(-0.94)
CHG_ROA	-0.058*	-0.100
	(-1.69)	(-0.67)
CHG_LOSS	-0.004	-0.006
	(-0.20)	(-0.10)
CHG_MB	0.001	-0.002
	(1.17)	(-0.68)
CHG_LEVERAGE	-0.127*	0.168
	(-1.90)	(0.58)
CHG_CFO	-0.152	0.146
	(-1.23)	(0.39)
CHG_VOLATILITY	-0.069**	0.228
	(-2.20)	(1.34)
CHG_BIG4	-0.008	0.030
	(-0.43)	(0.45)
CHG_PRIOR_ACC	-0.042	
	(-0.76)	
CHG_NUM_ANALYST		0.014
		(1.35)
CHG_DISP		-1.157
		(-1.36)
CHG_HORIZON		-0.000
		(-0.39)
Constant Included	Yes	Yes
Industry Fixed Effects Included	Yes	Yes
Observations	428	670
R-squared	0.063	0.042

Table 5 (continued): Change Analysis

Panel B: Audit Cost Analyses

VARIABLES	(1) CHG_LN_FEE	(2) CHG_DELAY
CHG_POST	-0.013	0.562
	(-0.64)	(-0.85)
CHG_SIZE	0.266***	-2.795
	(-5.03)	(-1.39)
CHG_ROA	0.146***	-7.824
	(-5.01)	(-1.23)
CHG_LOSS	0.028	0.784
	(-1.43)	(-0.70)
CHG_LEVERAGE	0.031	0.716
	(-0.61)	(-0.19)
CHG_MB	-0.000	0.077
	(-0.44)	(-1.53)
CHG_CFO	-0.145	-7.567
	(-1.50)	(-1.01)
CHG_VOLATILITY	-0.086	3.809
	(-1.13)	(-1.02)
CHG_BIG4	0.014	0.543
	(-0.67)	(-0.59)
CHG_INV	-0.357	-8.523
	(-1.48)	(-0.75)
CHG_REC	0.054	1.606
	(-0.39)	(-0.37)
CHG_FOREIGN	-0.018	-0.862
	(-0.79)	(-0.70)
BUSY	0.005	1.479**
	(-0.39)	(-2.22)
CHG_LN_FEE		0.637
		(-0.55)
Constant Included	Yes	Yes
Industry Fixed Effects Included	Yes	Yes
Observations	506	460
R-squared	0.155	0.108

Appendix 1: Variable Descriptions

Main analysis dependent and test variables

ABS_ACC	The absolute value of abnormal accruals using the modified Jones (1991) approach and including the firm performance adjustment suggested by Kothari et al. (2005).
DELAY	The number of calendar days between the fiscal year-end and the audit report date.
LN_FEE	The natural logarithm of total audit fees for year *t*.
MEET	Indicator variable equal to one if the difference between the firm's annual earnings per share and the most recent analyst earnings forecast is greater than zero and less than or equal to one cent.
POST	Indicator variable equal to 1 if the fiscal year is the first year of the new reporting regime, 0 otherwise.

Main analysis control variables

BIG4	Indicator variable equal to 1 if the company is audited by a Big 4 firm, 0 otherwise.
BUSY	Indicator variable equal to 1 if the company's fiscal year end is between December and March in year *t*.
CFO	Cash flow from operations divided by total assets at end of year *t*.
DISP	The standard deviation of analysts' earnings forecasts scaled by the stock price at the end of the fiscal year.
FOREIGN	Indicator variable equal to 1 if the company has foreign transactions in year *t*, 0 otherwise.
HORIZON	The number of calendar days between the firm's fiscal year end and the earnings announcement date.
IND_FE	Industry fixed effects based on two-digit industry codes defined by the Industry Classification Benchmark (ICB) system.
INV	Total inventory divided by total assets at the end of year *t*.
LEVERAGE	Total debt divided by total assets at the end of year *t*.
LN_FEE	The natural logarithm of total audit fees for year *t*.
LN_MVE	The natural logarithm of the market value of equity measured at end of year *t*.
LOSS	Indicator variable equal to 1 if the company's net income is less than 0, 0 otherwise.
MB	Market value divided by book value at the end of year *t*.
NUM_ANALYST	The number of analysts that follow a firm during the year of the earnings announcement.
PRIOR_ACC	Total current accruals for year *t-1* (measured as net income before extraordinary items plus depreciation and amortization less operating cash flows) scaled by total assets at end of year *t-1*.
REC	Total accounts receivables divided by total assets at end of year *t*.
ROA	Earnings before extraordinary items in year *t* divided by total assets at end of year *t*.
SIZE	The natural logarithm of total assets at end of year *t*.
VOLATILITY	Standard deviation of annual sales measured over the prior seven years.