The Efficacy of Shareholder Voting in Staggered and Non-Staggered Boards: The Case of Audit Committee Elections

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The Efficacy of Shareholder Voting in Staggered and Non-Staggered Boards: The Case of Audit Committee Elections

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SUMMARY: We examine whether shareholder votes can influence the audit committee and whether this influence is uniform across non-staggered and staggered boards. We find that through voting, shareholders can increase the efficacy of the audit committee, leading to improvements in audit committee structure, diligence, and financial reporting quality. These results hold only in firms with non-staggered boards, underscoring the need to separately examine staggered and non-staggered boards. Importantly, the non-responsiveness of staggered audit committees to shareholder disapproval presents an additional explanation for the weaker performance that is often documented for firms with staggered boards. Overall, our results support the movement to de-stagger boards.

Keywords: staggered boards; director elections; audit committee; proxy advisors.

INTRODUCTION

Accounting research provides evidence that certain characteristics of audit committees (ACs) are associated with improved effectiveness. This literature finds that features, such as size, independence, and member expertise, all contribute to the quality and effectiveness of the audit committee (DeZoort, Hermanson, Archambeault, and Reed 2002; Carcello and Neal 2003; Krishnan, Wen, and Zhao 2011). However, research on the influence of shareholders on AC effectiveness is sparse. We examine whether shareholders voting on AC members and the frequency of these elections (staggered versus non-staggered) can influence the effectiveness of the AC.

Voting in director elections and auditor ratifications is a primary way shareholders can voice their opinion (Krishnan and Ye 2005; Hermanson, Krishnan, and Ye 2009). Past research shows that shareholders cast votes against directors who perform poorly (Cai, Garner, and Walkling 2009; Ertimur, Ferri, and Maber 2012; Fischer, Gramlich, Miller, and White 2009), and these votes, in turn, are associated with board reactions (Cai et al. 2009; Fischer et al. 2009). Thus, shareholder votes in director elections provide an important mechanism to monitor and discipline directors. Yet past research has not focused on the election of AC members and on subsequent AC performance.

Although most directors stand for election every year, a significant number of firms have staggered boards (Cohen and Wang 2013), wherein only a fraction of members face election in a given year. Because of these different electoral regimes, the

efficacy of shareholder votes may not be uniform.[1] Under the staggered board regime, shareholders can typically voice their opinion on any given director only once every three years. It is therefore possible that directors on staggered boards who do not face election following poor performance will be insulated from the scrutiny of shareholders. In turn, this may influence their accountability, responsiveness, and the overall efficacy of shareholder votes. The expected diminished efficacy of delayed elections has also been researched in the realm of politics. For example, Barro (1973) finds that less frequent elections can decrease the accountability of public officials to their constituencies. However, research has not considered this issue in the context of shareholder voting and has not examined whether the effectiveness of shareholder votes is similar across staggered and non-staggered boards.

We seek to fill this void in the literature by examining the efficacy of AC members' elections in general and in staggered and non-staggered boards. We address this question using cross-sectional time-series data spanning the years 2004 to 2010. The data include the outcomes of shareholder votes. Our final sample includes over 18,296 director elections taking place in more than 6,786 firm-year observations. Our test variable captures the lowest decile of the difference between votes for AC members and votes for independent board members not serving on the AC.[2] We use several measures to test the reaction of ACs to low shareholder approval rates separately for non-staggered and staggered ACs. In choosing these measures, we concentrate on outcomes that encompass several important responsibilities of the AC, which include its proper staffing, diligence, oversight over auditor-provided non-audit services, and oversight over the financial reporting quality.

Our first set of measures relates to studies that find an association between low shareholder approval rate and a higher director and AC member turnover rate (Fischer et al. 2009; Kachelmeier, Rasmussen, and Schmidt 2016). We expand upon these studies, which focus on the overall turnover of directors or AC members, by examining the departure and subsequent appointment of qualified individuals who are classified as accounting financial experts (AFEs). We find that low shareholder votes are associated with a 5.2 percent increased likelihood that an AFE will leave the AC on a non-staggered board. Since AFE departures are relatively infrequent, occurring only in 12 percent of our sample observations, the increased departure likelihood is economically significant. In contrast, we find that low shareholder votes are not significantly associated with the departure of non-AFE AC members. We also find a 1.5 percent increase in the likelihood that non-staggered ACs that receive low votes will replace their AFE with another AFE. Since the unconditional likelihood of such replacement in our sample is only 3.6 percent, this is economically significant. Importantly, these results are insignificant among staggered ACs.

We next examine AC diligence, which we measure with AC meetings. Prior research suggests that meeting frequency could signal AC diligence (Beasley, Carcello, Hermanson, and Lapides 2000; Anderson, Mansi, and Reeb 2004). We find that, after receiving a low approval from shareholders, non-staggered ACs exhibit an average increase of 44.4 percentage points in the number of AC meetings. Since, on average, the AC meets 8.35 times a year, this translates to an increase of 3.7 meetings. Once again, these results are insignificant among staggered ACs.[3]

In the last set of tests, we examine two measures that reflect oversight of the auditor and the financial reporting quality. To capture oversight over the auditor, we concentrate on changes in tax fees because these fees represent the largest portion of non-audit fees. The literature provides evidence that investors are particularly concerned about tax, but not audit-related services as reflected in auditor ratification voting (Mishra et al. 2005).[4] To investigate AC oversight over the financial reporting quality, we use changes in the absolute value of discretionary accruals.[5] We find that the AC is more likely to reduce tax non-audit fees (discretionary accruals) following low shareholder approval rates only among non-staggered ACs. Thus, our results indicate

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[1] We refer to classified and staggered boards interchangeably throughout.

[2] As we describe later, we use the difference between AC and non-AC votes because this measure is more visible to company directors who are likely to benchmark themselves against their peers. This research design also helps alleviate endogeneity concerns. Furthermore, we note that the use of the lowest decile as our primary measure is not arbitrary. Figure 1 shows that differences between AC and non-AC independent directors are most pronounced in the lowest decile and are negligible in other deciles.

[3] We acknowledge that AC meetings could capture a low-cost signal of improvement in AC activity rather than an actual increase in diligence. Yet, if increased meetings are used as a low-cost signal, then staggered ACs should also adopt this low-cost approach. However, we do not observe a significant change in AC meetings among staggered boards. Further, Bédard and Gendron (2010) review the AC literature and find that in 30 percent (2 percent) of studies AC meetings are positively (negatively) associated with AC effectiveness. Therefore, we propose that the AC meetings results should be interpreted in conjunction with results of other AC performance metrics. Specifically, if meetings are simply a signal, then we should not expect to find improvements along other dimensions.

[4] Fees that fall into the "other" non-audit-service category are small on average. We do not examine audit fees in our main analysis because the expectations with respect to this variable are not clear. On the one hand, high audit fees may be appreciated by shareholders because they are associated with higher quality audits (Hribar, Kravet, and Wilson 2014; Liao and Radhakrishnan 2016). In contrast, shareholders who view the audit as a commodity may not support paying high audit fees. In the "Robustness Tests and Additional Analyses" section, we examine the influence of low shareholder votes on the change in audit fees and find that low votes are associated with a subsequent reduction in audit fees.

[5] We concentrate on accruals rather than on other measures of financial reporting quality, such as financial statement restatements, because our objective is to measure changes in financial reporting quality that cannot be measured with restatements. In the "Robustness Tests and Additional Analyses" section, we report results using internal control material weakness remediation likelihood and find results that are consistent with our predictions.

that non-staggered ACs appear to react to low shareholder votes, whereas staggered ACs do not. Throughout, our results remain generally consistent when we employ other measures of low AC votes.

Our study makes several contributions. First, we contribute to the shareholder voting literature that links board reaction to low shareholder votes (Cai et al. 2009; Del Guercio, Seery, and Woidtke 2008; Ertimur, Ferri, and Stubben 2010; Ertimur et al. 2012; Fischer et al. 2009) by showing an association between low AC approval rates and subsequent improvements along various dimensions of AC effectiveness. These results suggest that, through voting and differentiating between AC and non-AC directors, shareholders can influence the AC's oversight over financial reporting. These findings extend recent research that examines the efficacy of AC elections for non-staggered boards (Kachelmeier et al. 2016).

Second, we extend the literature that examines shareholder votes and oversight over financial reporting. Sainty, Taylor, and Williams (2002) provide evidence that shareholder dissatisfaction with the auditor results in subsequent auditor switches. We complement this study and show that dissatisfaction with AC members is also associated with subsequent turnover of accounting financial experts. In addition, Mishra, Raghunandan, and Rama (2005) find that shareholder disapproval of high tax non-audit fees is reflected in low auditor ratification votes. We expand on this study by showing that low auditor ratification *and* AC votes are both associated with a reduction in auditor-provided tax services.

Third, our results suggest that studies examining the efficacy of shareholder votes should separately consider staggered and non-staggered boards.[6] Otherwise, the different behavior of these two types of boards may obscure the underlying association. Our results also contribute to the extensive literature that links staggered boards to lower firm value (Bebchuk and Cohen 2005; Cohen and Wang 2013; Faleye 2007; Guo, Kruse, and Nohel 2008) by demonstrating that staggered ACs are less likely to respond to low shareholder approval rates and improve their performance. This lack of action significantly undermines the objectives of shareholder elections and may present another value-destroying channel of staggered boards. Thus, our results support the recent trend of board declassification.

The rest of the paper is organized as follows. The second section provides a brief overview of the shareholder rights literature and develops our hypotheses. The third section describes our sample and method. The fourth section presents the results of our analyses. The fifth section includes additional analyses and robustness tests. Finally, the sixth section concludes with a summary and implications of our findings.

LITERATURE REVIEW AND THEORETICAL DEVELOPMENT

Voting by shareholders is principally designed to influence corporate governance. Currently, shareholders vote on issues such as director elections, auditor ratification, and management say-on-pay proposals. In recent years, the call for greater shareholder rights has increased and recent regulation, such as the Dodd-Frank Act (U.S. House of Representatives 2010), concentrates on modifying and enhancing shareholder voting. In addition to these regulatory changes, proxy distribution and processing firms, such as Broadridge Financial Solutions, report a significant increase in the number of shares processed over the period 2009–2011 (Broadridge 2012), suggesting that shareholders are more engaged. Thus, overall there is increased interest in shareholder voting by regulators and greater participation by shareholders.

One important item in the proxy statement is the election of directors. Although nonbinding, annual elections allow shareholders to voice their opinion about the performance of corporate directors. This includes evaluation of their performance on the board and on subcommittees of the board, such as the audit committee (AC). One of the most important questions in the shareholder voting literature is whether nonbinding shareholder votes are effective.

The Efficacy of Shareholder Votes

Prior research provides evidence that lower shareholder approval rates are associated with board responsiveness. Several studies find that low shareholder approval rates are associated with changes to CEO compensation, CEO turnover, and turnover rates of board members (Cai et al. 2009; Fischer et al. 2009). Although past research concentrates on the efficacy of shareholder votes at the level of the board, some research has shown that shareholders can sophisticatedly differentiate between directors based on their assigned responsibilities. Ertimur et al. (2012) examine options backdating and find that shareholders withhold more votes from compensation committee members who were directly responsible for the structuring and oversight of these executive compensation contracts. Similarly, in the context of the AC, Kachelmeier et al. (2016) find that shareholders' votes can also influence AC turnover. Examining whether shareholders can influence the AC beyond overall member turnover is extremely important because the AC oversees the firm's financial reporting.[7] Therefore, our first objective is to focus on the

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[6] When staggered and non-staggered boards are jointly examined, our results are less consistent. We attribute this to differences in the efficacy of shareholder votes across staggered and non-staggered boards.

[7] Recent papers have shown that AC members, rather than board members who do not serve on the AC, drive the association with financial reporting quality (Krishnan et al. 2011; Cohen, Hoitash, Krishnamoorthy, and Wright 2014) and therefore support the need to evaluate the AC separately.

election of directors who serve on the AC and investigate whether they respond to low votes. In so doing, we select a broad and representative set of measures that encompass several key responsibilities of the AC.

Turnover of AC Members

Perhaps the most important factor that influences the effectiveness of the AC is its composition. Accordingly, the first measure of audit committee responsiveness to low shareholder votes that we focus on is the turnover of AC members. Kachelmeier et al. (2016) investigate non-staggered boards and find that a higher turnover of AC members is conditioned on negative recommendations from proxy advisors combined with lower shareholder votes. Rather than investigating the overall turnover of AC members, we examine whether the turnover is more prominent among AC members with specific qualifications, i.e., the accounting financial experts (AFEs). We do so because past research and regulation by the SEC (2003) recognize that accounting experts are important to the effectiveness of the AC (Dhaliwal, Naiker, and Navissi 2010; U. Hoitash, R. Hoitash, and Bedard 2009; Krishnan 2005). Additionally, research indicates that AFEs are more accountable and therefore more likely to lose their board positions following a restatement (Srinivasan 2005). Yet research does not link shareholder voting to the departure of an AFE and, more importantly, does not examine subsequent director replacements. Since the departure and appointment of AFEs can indicate an attempt by the AC to improve its structure, we expect that low shareholder votes will be associated with greater turnover and replacement of AFEs.[8]

AC Meeting Frequency

In addition to its structure, the audit committee can directly influence its level of activity. Prior research suggests that the number of meetings is a good measure of audit committee diligence and that increased meetings are often associated with improved performance (Anderson et al. 2004; Beasley et al. 2000; Farber 2005; McMullen and Raghunandan 1996). We therefore examine whether ACs respond to low shareholder approval rates by increasing their meeting frequency.

AC Oversight over Non-Audit Services and Financial Reporting Quality

In addition to a more direct impact on meetings and director turnover, prior research also finds that nonbinding shareholder votes can elicit board action on other dimensions such as CEO compensation, the removal of poison pills, and classified boards and subsequent CEO turnover acquisition returns (Cai et al. 2009; Fischer et al. 2009). Evidence on similar improvements in AC functioning is missing in the literature. One important AC responsibility is to approve all auditor-provided non-audit services and negotiate those fees with the auditor. Recent regulations require that ACs pre-approve the purchase of all non-audit services (SOX Section 201) and acknowledge that the purchases are compatible with the auditor remaining independent (SOX Section 303). Of the remaining SOX-approved non-audit services, ACs must separately disclose fees paid to the auditor for *tax, audit-related,* and *other* non-audit services (SOX Section 202). Tax and audit-related services are of particular interest because they represent the largest recurring category of non-audit fees paid to the auditor post-SOX.[9] Mishra et al. (2005) provide evidence that investors are particularly concerned about tax, but not audit-related services as reflected in auditor ratification voting. In addition, regulators and lawmakers continue to be particularly concerned about tax non-audit services (e.g., SEC 2006; McKenna 2013). Finally, proxy advisors recommend against auditor ratification and AC member support if recurring non-audit fees are excessive (Glass, Lewis & Co. 2013; Institutional Shareholder Services Inc. [ISS] 2013). We therefore concentrate on tax non-audit services and predict that, after a low shareholder approval, the AC will reduce excessive tax non-audit fees.

Prior research provides evidence that poor financial reporting quality, such as weak internal controls, restatements, and earnings management, comes at a significant cost to shareholders (e.g., Raghunandan and Rama 2006; U. Hoitash, R. Hoitash, and Bedard 2008; Hogan and Wilkins 2008). Research also finds that the AC can influence the quality of financial reports in terms of abnormal accruals (Dhaliwal et al. 2010; Bédard, Chtourou, and Courteau 2004), internal controls (Hoitash et al. 2009), and restatements (Cohen et al. 2014). Thus, given the cost to shareholders and a low shareholder approval rate, we predict that the AC will react to low votes by improving financial reporting quality. We summarize our predictions in the following hypothesis:

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[8] Examining whether the general board improves its director composition after a low shareholder approval rate is not trivial because it is unclear which director appointment represents a composition improvement. In the context of the AC, a composition improvement can be measured with greater accuracy.

[9] Although investors and regulators are concerned about the nebulous "other" non-audit service category, these fees are small on average and are rarely approved by ACs in consecutive years.

> **H1:** A lower shareholder approval rate of the audit committee will be positively associated with subsequent changes to audit committee structure, activity, and effectiveness.

Staggered versus Non-Staggered Boards

Our second objective is to examine whether the efficacy of shareholder votes is similar across staggered and non-staggered boards. Examining these differences matters because around 50 percent of public companies have staggered boards (Cohen and Wang 2013). Staggered boards are typically divided into three classes, wherein only one class of directors stands for reelection in any given year. In contrast, on non-staggered boards, all directors are elected annually. The staggered election structure makes it very difficult to gain control over the board of a company because rivals must win two consecutive elections. As a result, the staggered electoral system serves as a strong anti-takeover device. Accordingly, critics of staggered boards claim that this structure may prevent bidders from making offers that would otherwise benefit shareholders (Bates, Becher, and Lemmon 2008; Bebchuk, Coates, and Subramanian 2002).[10]

In addition to protection from takeover, research generally finds that the adoption of a staggered board classification is associated with negative market returns (Faleye 2007) and that firms with staggered boards are associated with lower firm value (Bates et al. 2008; Bebchuk and Cohen 2005; Cohen and Wang 2013; Faleye 2007; Guo et al. 2008).[11] The poor performance of staggered boards documented previously suggests that insulating incumbent directors from removal can enable staggered directors to deviate from the interests of shareholders (Bebchuk and Cohen 2005; Cohen and Wang 2013), remain passive (Bertrand and Mullainathan 2003; Zhao and Chen 2008), and be less likely to implement majority-approved shareholder proposals (Faleye 2007). As a result, the literature on shareholder elections finds that the shareholder approval rate of staggered board members is generally lower (Cai et al. 2009; Choi, Fisch, and Kahan 2010).[12]

Prior research did not extend these findings to investigate the relative efficacy of shareholder votes in staggered and non-staggered boards. A primary responsibility of corporate boards is to monitor management on behalf of shareholders. Shareholders can then voice their opinion in director elections to signal their satisfaction, or lack thereof, with the board. Past research has shown that, although directors are supposed to alleviate agency problems, directors themselves can engage in self-serving behavior (Bebchuk and Fried 2003). This behavior can manifest itself through the desire to retain their board position, enjoy their pecuniary and reputational benefits, and maintain their relationships with executives.

Prior research shows that shareholder votes are associated with director turnover (Fischer et al. 2009; Ertimur et al. 2012). But under the staggered board regime, director turnover is less likely. Because the personal risk to directors in non-staggered boards is higher and more immediate, non-staggered directors have greater incentives to respond to shareholders. Their greater responsiveness is analogous to that of public office officials who are more responsive to constituents when their terms are shorter (Barro 1973). As a result, relative to staggered boards, non-staggered directors have greater incentives to take costly actions to appease shareholders.

The AC actions that we examine in the first hypothesis can contribute to directors' personal cost. For example, an increase to the number of AC meetings will require greater time from directors. Since time is a scarce resource, an increase in this commitment is costly. Therefore, staggered directors that have lower incentive to appease shareholders will be less likely to increase meetings. Similarly, directors may be reluctant to change board composition, as they want to safeguard this lucrative position. Thus, we expect lower turnover likelihood for staggered directors. Finally, changes to tax fees and discretionary accruals require directors to confront managers, and once again inaction may be the least costly route for staggered directors. We therefore predict that staggered AC members may be less responsive to a low approval rate by shareholders. We summarize our predictions in the second hypothesis:

> **H2:** A lower shareholder approval rate of the audit committee will be positively associated with subsequent changes to audit committee structure, activity, and effectiveness in non-staggered boards, but not in staggered boards.

METHOD

Sample

We begin our sample selection with 85,177 director-firm-year observations between the years 2004–2010 obtained from the Glass Lewis (GL) Voting Analytics, ISS Voting Analytics, and BoardEx databases. The GL and ISS Voting databases

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[10] Major institutional investors such as CalPERS, Fidelity, and TIAA-CREF are opposed to staggered boards. The two leading proxy advisors, ISS and Glass Lewis (GL), also support proposals to repeal staggered boards and oppose proposals to stagger boards (ISS 2013; Glass, Lewis & Co. 2013).

[11] In contrast to studies that documented lower firm value of staggered boards, recent studies find that staggered boards are not necessarily associated with lower firm value and weaker performance (Ahn and Shrestha 2013; Cremers, Litov, and Sepe 2014; Ge, Tanlu, and Zhang 2014).

[12] Cai et al. (2009) include an indicator variable for boards that are either staggered or have a poison pill.

cover shareholder election results as well as GL and ISS voting recommendations for each director. BoardEx contains directors' characteristics, committee memberships, and other governance data. Because of our interest in AC elections, we eliminate 46,895 directors in years they do not serve on the AC.[13] Next, we eliminate 5,024 observations with missing GL, ISS, or BoardEx variables. We gather institutional ownership, auditor, and financial data from Thomson Financial, Audit Analytics, and Compustat databases, which results in the removal of 2,465 observations with missing data. Finally, due to differences in regulatory oversight, we exclude 7,174 director-firm-years belonging to the financial industry, yielding a sample of 23,619 director-firm-year observations serving on 9,204 firm-years between the years 2004–2010. Our sample includes 6,786 firm-year observations (18,296 director-firm-year observations)[14] in which at least one AC member and one independent non-AC member stood for election.[15]

Research Design

To test H1, we examine whether low AC votes are associated with changes in the composition and diligence of the AC, the relationship with the auditor, and financial reporting quality. To test H2, we investigate whether low votes influence AC composition, diligence, or activity differently for firms with staggered and non-staggered boards.[16]

Test Variables

To examine shareholder dissatisfaction with the AC, we follow the logic in Cai et al. (2009) and construct an adjusted measure of shareholder votes. Specifically, we subtract the average vote for independent board members not serving on the AC from the average AC vote (*DIFF_AC_VOTES*) and create an indicator variable equal to 1 if this difference is in the lowest decile, and 0 otherwise (*LOWDEC_AC_VOTES*).[17] We chose this cutoff because, as presented in Figure 1, the most significant observable negative difference between AC and non-AC votes is in the lowest decile, whereas differences in the following deciles are negligible.[18] This measure of shareholder dissatisfaction is particularly appealing since it controls for firm endogenous factors that may influence overall shareholder voting of AC and non-AC directors.[19] In addition, because voting outcomes for each firm are reported in the same 8-K form, it is likely that AC members will observe and react to the votes of the AC relative to other non-AC board members. Directors are less likely to be aware of the overall cross-sectional distribution of votes across the universe of public companies.

Dependent Variables

We measure *AC_VOTE_CONSEQUENCES* in Model 1 below, with four distinct measures that capture the responsiveness of the AC to director election outcomes. The first set of tests uses three variables to study the change in structure and composition of the AC. The first dependent variable (*LEAVE_NONAFE*) is equal to 1 if one or more non-accounting financial expert (AFE) left the AC in the year following the low vote, and 0 otherwise. The second dependent variable (*LEAVE_AFE*) is equal to 1 if any AC member classified as an accounting financial expert (AFE) left the AC in the year following the low vote, and 0 otherwise. We compare the results obtained in the *LEAVE_NONAFE* and *LEAVE_AFE* models to evaluate whether AFEs are held more accountable for low shareholder approval relative to other AC members. The third variable captures whether the AC replaces a departing AFE with a new AFE. We therefore construct an indicator variable (*REPLACE_AFE*) equal to 1 if the departing AFE is replaced with a new AFE within two years of the low approval period, and 0 otherwise.[20]

We next examine whether the diligence of the AC increases following low shareholder approval by looking at the change in the number of AC meetings in the year following the low vote (*CHG_ACMEETINGS*). We also consider whether low AC approval is

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[13] We later use 17,503 non-AC independent directors as a benchmark to construct the shareholder approval rate measure.

[14] This base sample is further reduced in each analysis based on data availability and lead/lag variable constructions.

[15] Because our main variable of interest captures the difference between average AC member votes and average independent non-AC member votes, we require a minimum of at least one AC member and one independent non-AC member up for election.

[16] Our analysis does not control for factors influencing the election structure choice, i.e., staggered or not. Rather, we examine the responsiveness of the AC, conditioned on that choice. We acknowledge the possibility that uncontrolled factors that influence this choice may also influence the responsiveness of the AC. Estimating our models separately within staggered and non-staggered firms alleviates, but does not fully eliminate, this concern.
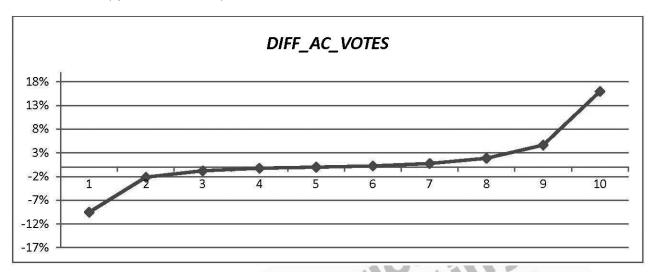
[17] We separately construct *LOWDEC_AC_VOTES* for each consequence analysis and within each staggered and non-staggered subsample. This assures an equal distribution of *LOWDEC_AC_VOTES* across our different tests.

[18] While we use the decile cutoff in our main analysis, we check the robustness of our results to alternative specifications of low votes in a subsequent section.
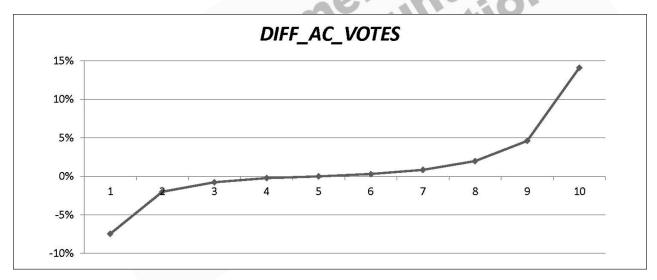
[19] Although our design controls for firm-specific endogenous characteristics, we acknowledge that a correlated omitted variable that differentially affects AC and non-AC votes may still exist.

[20] We use a two-year window in tests where improvements in the performance of the AC are assumed to span a longer window.

FIGURE 1
Distribution of Average *DIFF_AC_VOTES* by Decile

Panel A: All Firms (6,786 Observations)
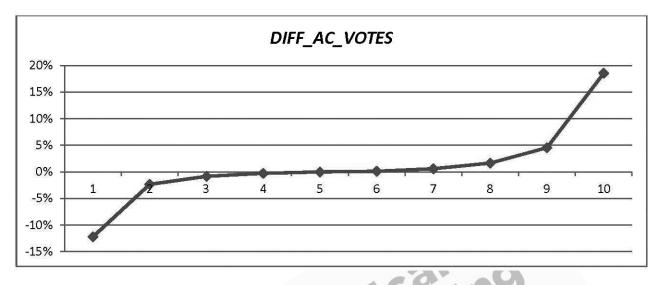

Panel B: Non-Staggered Firms (3,838 Observations)

FIGURE 1 (continued)

Panel C: Staggered Firms (2,948 Observations)

associated with changes in the relationship between the AC and the auditor. As such, we examine changes in the ACs willingness to purchase a high proportion of tax non-audit services. Because the PCAOB emphasizes the relative rather than nominal value of tax services provided by the auditor,[21] we capture changes in the ratio of auditor-provided tax fees as a proportion of total auditor fees (*CHG_TAX_FEE_RATIO*). Finally, our fourth test considers whether low AC approval rates are associated with subsequent improvements in financial reporting quality. Thus, we examine the two-year change in discretionary accruals estimated using a variant of the modified Jones model as introduced by Kothari, Leone, and Wasley (2005) (*CHG2_|DACC|*).

Control Variables

Because each consequence model uses a different set of control variables, we discuss the control variables in the "Results" section below. All models include year and industry fixed effects, and we correct for standard errors by clustering at the firm level. All variables are defined and described in Table 1.

The following model is used to test H1 for all firms in the sample. We also run the model separately for firms with non-staggered and staggered boards to test H2.

$$AC\_VOTE\_CONSEQUENCES = f\{LOWDEC\_AC\_VOTES, \text{Consequence-Specific Control Variables}, INDUSTRY, YEAR\}$$

$$(1)$$

RESULTS

Descriptive Statistics

Table 2, Panel A presents descriptive statistics for our broadest sample of 18,296 audit committee (AC) members and 17,503 independent directors not serving on the AC. We examine whether shareholder election results and other director characteristics differ between AC and independent non-AC members. We observe that the approval rates are fairly high: only 5.1 percent (5.9 percent) of votes are withheld by shareholders when electing AC (Non-AC) members. This figure is comparable to those of Cai et al. (2009) and Ertimur et al. (2010), who report, respectively, that 5.7 percent and 5.5 percent of voted shares are withheld from all directors. We observe that, on average, AC members receive significantly more support from

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[21] Sections 201 and 202 of SOX require that the audit committee pre-approve non-audit service relative to total fees.

TABLE 1

Variable Definitions

Variable Name	Variable Definition [Source]
Dependent Variables for H1	
LEAVE_AFE	= indicator variable equal to 1 if an AFE(s) left the AC in the year following an election period. An audit committee member is classified as an AFE if his/her biography indicates that this individual has at least one of the following qualifications: certified public accountant, chief financial officer, auditor, chief accounting officer, controller, treasurer, or vice president-finance. [BoardEx]
LEAVE_NONAFE	= indicator variable equal to 1 if an AC member not classified as an AFE(s) left the AC in the year following an election period. [BoardEx]
REPLACE_AFE	= indicator variable equal to 1 if a new AFE(s) replaced a departing AFE(s) within two years following the election period. [BoardEx]
CHG_ACMEETINGS	= change in the number of AC meetings. [Audit Analytics]
CHG_TAX_FEE_RATIO	= change in the ratio of tax fees divided by the total fees paid to the auditor. [Audit Analytics]
CHG2_|DACC|	= change in discretionary accruals over two years estimated using a variant of the modified Jones model (Dechow et al. 1995) as introduced by Kothari et al. (2005), which augments the modified Jones method by controlling for company performance with the lagged return on assets in the computation model. [Compustat]
Test Variable for H1	
DIFF_AC_VOTES	= the difference between average AC vote (*AVG_AC_VOTES*) and the average vote for independent board members not serving on the AC. [ISS Voting Analytics]
LOWDEC_AC_VOTES	= indicator variable equal to 1 if *DIFF_AC_VOTES* is in the lowest decile of the sample, 0 otherwise. [ISS Voting Analytics]
Firm-Level Control Variables	
MW	= a binary variable indicating whether the company has reported a material weakness in internal controls under Section 302 or 404. [Audit Analytics]
AUDITOR_CHG	= indicator variable equal to 1 if the firm switched auditors in the year of or the year following the election period. [Audit Analytics]
RESTATEMENT	= a binary variable indicating whether the company has restated its financial reports. [Audit Analytics]
LOG_AUDIT_FEES	= the natural log of audit fees. [Audit Analytics]
EXC_LOG_AUDIT_FEES	= the residual from a well-specified audit fee model.
LOG_NAF	= the natural log of non-audit fees. [Audit Analytics]
LITIGATION	= a binary variable indicating whether any litigation cases stemming from an accounting failure were brought up against a firm. Accounting failure is classified using the following Audit Analytics categories: (1) accounting and auditing enforcement, (2) accounting malpractice, or (3) financial reporting. [Audit Analytics]
RETURNS	= the annual stock returns less same-period returns on the CRSP value-weighted portfolio of NYSE/Amex/Nasdaq stocks. [CRSP]
ROA	= the ratio of net operating income before depreciation divided by total assets. [Compustat: OIBDP/AT]
INST_OWN	= the percentage of shares held by institutions. [Thomson Financials]
AVG_AGE	= indicator variable equal to 1 if the average age of the audit committee is greater than 65, 0 otherwise. [BoardEx]
AVG_DIR_TENURE	= average tenure of independent directors. [BoardEx]
CEO_CHANGE	= indicator variable equal to 1 if a CEO change occurred in the current year, 0 otherwise. [BoardEx]
AC_MEETINGS	= the number of AC meetings. [Audit Analytics]
SIZE	= the natural log of total assets. [Compustat data AT]
LEVERAGE	= ratio of total liabilities to total assets. [Compustat (data DLC + data DLTT)/data AT]
LOSS	= indicator variable equal to 1 if the firm made a loss in two consecutive years, 0 otherwise. [Compustat]
MTB	= market value of equity divided by book value of common equity. [Compustat CEQ divided by (CSHO ∗ PRCC_F)]
INSIDE_OWN	= the percentage of shares held by insiders. [Thomson Financials]
REGULATED	= indicator variable equal to 1 if the firm operates in a regulated industry, 0 otherwise. Regulated industries are those with four-digit SIC codes equal to 4810–4899 (communication), 4910–4924 and 4930–4939 (gas and electric), and 4940–4941 (water). Financial institutions are not classified as regulated because they are eliminated from the sample. [Compustat]

TABLE 1 (continued)

Variable Name		Variable Definition [Source]
HIGH_LITIGATION	=	indicator variable equal to 1 if the firm operates in a high-risk industry, 0 otherwise. High-risk industries are those with four-digit SIC codes equal to 2833–2836 and 8731–8734 (biotechnology), 3570–3577 and 7370–7374 (computers), 3600–3674 (electronics), and 5200–5961 (retail). [Compustat]
DUMMY_AFE	=	firm level—an indicator variable equal to 1 if the AC consists of at least one accounting expert, 0 otherwise. [BoardEx]
NO_AFE	=	the number of accounting experts on the AC. [BoardEx]
LOG_AC_SIZE	=	the natural log of the size of the audit committee. [BoardEx]
S&P1500	=	a binary variable indicating whether the company belongs to the S&P 1500 composite. [Compustat]
RESTRUCTURE	=	a binary variable indicating whether a firm was involved in a restructuring. [Compustat]
|DACC|	=	absolute value of discretionary accruals. Measured as a variant of the modified Jones model (Dechow et al. 1995) as introduced by Kothari et al. (2005).
NEW_FIN	=	an indicator variable equal to 1 if the client issues long-term equity greater than 5 percent of beginning total assets, and 0 otherwise. [Compustat data SSTK]
SALESGROWTH	=	a binary variable indicating whether the year-over-year industry-adjusted sales growth falls into the top quintile. [Compustat data SALE]
ALTMANZ	=	Z-Score is Altman's (1968) probability of bankruptcy measure. [Compustat]
ACQUIRE	=	merger and acquisition activity within a two-year period. [SDC]
LOW_AUDITOR_VOTES	=	indicator variable equal to 1 if the auditor ratification vote is in the lowest decile of the sample, 0 otherwise. [ISS Voting Analytics]
BIG4	=	a binary variable indicating whether the company is audited by a Big 4 auditor. [Audit Analytics]
AUDITOR_SPECIALIST	=	a binary variable indicating whether the auditor holds more than a 30 percent market share, based on audit fees, within two-digit SIC codes. [Audit Analytics]
SEGMENTS	=	the number of reported business and geographic segments. [Compustat Segment file]
LOG_BOARD_SIZE	=	the natural log of the size of the board of directors. [BoardEx]
INDEPENDENCE	=	the percentage of independent directors on the board. [BoardEx]
PLURAL	=	a binary variable equal to 1 for boards with plural voting rules. [ISS Voting Analytics]
SPECIAL_ITEM	=	a binary variable indicating whether the company reported positive or negative special items. [Compustat data item SPI]
FOREIGN	=	an indicator variable equal to 1 if the company has a nonzero foreign currency translation, 0 otherwise. [Compustat data item FCA]

shareholders than non-AC members ($p < 0.01$). Panel A also shows that AC members are significantly more likely than non-AC members to be accounting financial experts and busy directors.

Table 2, Panel B presents descriptive data for AC members separately for staggered or non-staggered boards. In our sample, 13,840 (4,456) AC members serve on non-staggered (staggered) boards.[22] Consistent with the prior literature (Choi et al. 2010), we observe that shareholder votes are higher in non-staggered boards than in staggered boards ($p < 0.01$). In addition, AC members on non-staggered boards are older.

Table 2, Panel C presents firm-level descriptive statistics as well as differences in the characteristics of staggered and non-staggered firms. First, we show that while the average AC votes (*AVG_AC_VOTES*) are higher in non-staggered firms ($p < 0.01$), the difference between average AC votes and non-AC votes (*DIFF_AC_VOTES*) is not statistically different in staggered and non-staggered firms. This is important because in the multivariate analysis, the main variable of interest, *LOWDEC_AC_VOTES,* is constructed based on the difference between AC and non-AC votes and the adjustment we make eliminates the inherent approval rate differences between staggered and non-staggered boards. This adjustment is a powerful way to control for endogeneity emanating from the voting differences due to the electoral structure. Panel C also shows that our proxies for AC changes and improvements are not significantly different between staggered and non-staggered boards.[23] Again, this

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[22] The number of non-staggered directors in our sample is approximately three times larger because only about one-third of staggered directors stand for election in any given year.

[23] Specifically, we do not observe differences between staggered and non-staggered boards for our dependent variables, i.e., *LEAVE_AFE, REPLACE_AFE, CHG_ACMEETINGS, CHG_TAX_FEE_RATIO,* and *CHG2_|DACC|* with one exception; *LEAVE_NONAFE* is marginally higher among staggered boards.

TABLE 2

Descriptive Statistics

Panel A: AC Members versus All Other Independent Directors

	AC Members			Non-AC Members			Test of Differences/ Proportions
	Mean	**Median**	**Std. Dev.**	**Mean**	**Median**	**Std. Dev.**	
FOR_VOTES	0.949	0.977	0.082	0.941	0.974	0.089	8.86***
AGE65	0.261	0.000	0.439	0.259	0.000	0.438	0.39
FEMALE	0.122	0.000	0.327	0.121	0.000	0.326	0.22
BUSY	0.284	0.000	0.451	0.244	0.000	0.430	8.49***
AFE	0.341	0.000	0.474	0.105	0.000	0.307	53.50***
AC_CHAIR	0.252	0.000	0.434	0.000	0.000	0.000	NA
Observations	18,296			17,503			

Panel B: AC Members—Non-staggered versus Staggered

	Non-Staggered AC Members			Staggered AC Members			Test of Differences/ Proportions
	Mean	**Median**	**Std. Dev.**	**Mean**	**Median**	**Std. Dev.**	
FOR_VOTES	0.952	0.978	0.079	0.942	0.974	0.089	6.62***
AGE65	0.266	0.000	0.442	0.243	0.000	0.429	3.03***
FEMALE	0.121	0.000	0.326	0.127	0.000	0.333	−1.11
BUSY	0.284	0.000	0.451	0.284	0.000	0.451	−0.06
AFE	0.343	0.000	0.475	0.338	0.000	0.473	0.61
AC_CHAIR	0.256	0.000	0.436	0.242	0.000	0.428	1.82*
Observations	13,840			4,456			

Panel C: Company Level—All, Non-Staggered versus Staggered

	All Firms			Non-Staggered Firms			Staggered Firms			Test of Differences/ Proportions
	Mean	**Median**	**Std. Dev.**	**Mean**	**Median**	**Std. Dev.**	**Mean**	**Median**	**Std. Dev.**	
AVG_AC_VOTES	0.947	0.973	0.076	0.951	0.974	0.067	0.941	0.972	0.086	5.53***
DIFF_AC_VOTES	0.011	0.000	0.072	0.011	0.001	0.061	0.010	0.000	0.084	1.00
LEAVE_NONAFE	0.275	0.000	0.447	0.266	0.000	0.442	0.287	0.000	0.452	−1.89*
LEAVE_AFE	0.088	0.000	0.284	0.089	0.000	0.285	0.088	0.000	0.283	0.24
REPLACE_AFE	0.021	0.000	0.144	0.023	0.000	0.149	0.019	0.000	0.137	0.97
AC_MEETINGS	8.162	8.000	3.395	8.164	8.000	3.494	8.160	8.000	3.265	0.05
CHG_ACMEETINGS	−0.215	0.000	2.923	−0.176	0.000	2.966	−0.264	0.000	2.867	1.13
TAX_FEE_RATIO	0.095	0.061	0.102	0.095	0.061	0.104	0.094	0.061	0.101	0.39
CHG_TAX_FEE_RATIO	−0.004	0.000	0.070	−0.004	0.000	0.070	−0.004	0.000	0.070	−0.02
|DACC|	0.053	0.035	0.069	0.053	0.036	0.068	0.052	0.034	0.070	0.79
CHG2_|DACC|	−0.001	0.001	0.087	−0.001	0.001	0.085	−0.000	0.001	0.089	−0.46
AC_SIZE	4.139	4.000	1.147	4.060	4.000	1.115	4.240	4.000	1.179	−6.42***
LOG_AC_SIZE	1.386	1.386	0.258	1.368	1.386	0.253	1.409	1.386	0.261	−6.64***
BOARD_SIZE	9.147	9.000	2.092	8.851	9.000	2.090	9.533	9.000	2.030	−13.48***
LOG_BOARD_SIZE	2.187	2.197	0.230	2.153	2.197	0.235	2.232	2.197	0.215	−14.21***
AVG_AGE	0.083	0.000	0.276	0.061	0.000	0.239	0.112	0.000	0.315	−7.54***
AVG_DIR_TENURE	7.504	6.950	3.758	7.452	6.850	3.863	7.572	7.054	3.617	−1.30
CEO_CHANGE	0.180	0.000	0.384	0.180	0.000	0.384	0.181	0.000	0.385	−0.06
PLURAL	0.891	1.000	0.311	0.877	1.000	0.328	0.910	1.000	0.287	−4.30***
INDEPENDENCE	0.793	0.818	0.133	0.783	0.800	0.151	0.806	0.833	0.104	−7.16***
INST_OWN	0.800	0.794	3.281	0.761	0.796	0.215	0.851	0.790	4.972	−1.12
LOW_AUDITOR_VOTES	0.986	0.992	0.025	0.986	0.992	0.026	0.985	0.991	0.024	1.30
BIG4	0.919	1.000	0.273	0.900	1.000	0.300	0.944	1.000	0.231	−6.53***
AUDITOR_SPECIALIST	0.302	0.000	0.459	0.296	0.000	0.456	0.310	0.000	0.462	−1.24

TABLE 2 (continued)

	All Firms			Non-Staggered Firms			Staggered Firms			Test of Differences/ Proportions
	Mean	Median	Std. Dev.	Mean	Median	Std. Dev.	Mean	Median	Std. Dev.	
SIZE	7.286	7.153	1.644	7.269	7.053	1.733	7.308	7.258	1.521	−0.98
ROA	0.025	0.047	0.155	0.028	0.049	0.161	0.020	0.046	0.148	2.18**
RESTATEMENT	0.094	0.000	0.292	0.096	0.000	0.294	0.092	0.000	0.289	0.52
MW	0.092	0.000	0.289	0.091	0.000	0.288	0.092	0.000	0.289	−0.15
AUDITOR_CHG	0.045	0.000	0.207	0.045	0.000	0.206	0.045	0.000	0.208	−0.18
LOG_AUDIT_FEES	14.363	14.275	0.999	14.358	14.265	1.045	14.369	14.297	0.937	−0.45
EXC_LOG_AUDIT_FEES	0.024	0.034	0.509	0.035	0.044	0.512	0.009	0.020	0.503	2.10**
LOG_NAF	11.573	12.319	3.430	11.516	12.285	3.534	11.646	12.363	3.288	−1.55
LITIGATION	0.017	0.000	0.129	0.018	0.000	0.132	0.016	0.000	0.125	0.56
RETURNS	0.139	0.136	0.488	0.139	0.135	0.493	0.140	0.137	0.482	−0.15
LEVERAGE	0.222	0.197	0.214	0.219	0.186	0.216	0.227	0.209	0.210	−1.58
LOSS	0.287	0.000	0.453	0.283	0.000	0.450	0.293	0.000	0.455	0.56
MTB	3.023	2.236	59.913	3.878	2.251	33.204	1.910	2.218	82.624	1.34
INSIDE_OWN	0.115	0.049	0.167	0.126	0.051	0.183	0.100	0.046	0.142	6.21***
REGULATED	0.093	0.000	0.290	0.086	0.000	0.280	0.102	0.000	0.303	−2.31**
HIGH_LITIGATION	0.322	0.000	0.467	0.361	0.000	0.480	0.272	0.000	0.445	7.74***
DUMMY_AFE	0.801	1.000	0.399	0.800	1.000	0.400	0.802	1.000	0.398	−0.28
NO_AFE	1.381	1.000	0.919	1.378	1.000	0.945	1.385	1.000	0.884	−0.32
S&P1500	0.608	1.000	0.488	0.581	1.000	0.493	0.644	1.000	0.479	−5.28***
RESTRUCTURE	0.368	0.000	0.482	0.359	0.000	0.480	0.379	0.000	0.485	−1.68*
NEW_FIN	0.106	0.000	0.308	0.105	0.000	0.307	0.108	0.000	0.310	−0.30
SALESGROWTH	0.190	0.081	2.526	0.185	0.079	1.929	0.196	0.083	3.137	−0.18
SEGMENTS	5.417	3.000	4.565	5.134	3.000	4.400	5.786	3.000	4.747	−5.85***
ALTMANZ	4.295	3.263	5.368	4.507	3.350	5.956	4.024	3.115	4.495	3.51***
ACQUIRE	0.492	0.000	0.500	0.488	0.000	0.500	0.496	0.000	0.500	−0.45
SPECIAL_ITEM	0.728	1.000	0.445	0.722	1.000	0.448	0.736	1.000	0.441	−1.21
FOREIGN	0.317	0.000	0.465	0.330	0.000	0.470	0.299	0.000	0.458	2.72***
Observations	6,786			3,838			2,948			

*, **, *** Indicate significant results at p < 0.10, p < 0.05, and p < 0.01, respectively.
Tests of differences (proportions) are between staggered and non-staggered boards and are reported for continuous (binary) variables. In Panel C, the numbers of observations for certain variables are less than 6,786 due to data availability.
All variables are defined in Table 1.

suggests that the AC's responsiveness to shareholder voting is likely the reason for our hypothesized outcomes, rather than fundamental differences between firms with staggered and non-staggered boards. Consistent with prior research, we also find that firms with non-staggered boards perform better (Bebchuk and Cohen 2005), as evidenced by a higher *ROA* (p < 0.05), and are more likely to have majority rather than plurality voting (p < 0.01). Other governance and financial variables can be viewed in Panel C.

AC Responsiveness to Low Shareholder Votes

AC Turnover and Composition Changes

In Table 3, we examine whether low approval rates are associated with changes in the composition of the AC.[24] The test variable, *LOWDEC_AC_VOTES,* measures the within-board shareholder dissatisfaction with the AC. While we expect this measure of dissatisfaction to be positively associated with the turnover of all AC members, prior literature suggests that AFEs experience higher levels of turnover (Srinivasan 2005). Thus, we separately examine the turnover of AFE and non-AFE AC members. In addition to the significant control variables used by Fischer et al. (2009) and Kachelmeier et al. (2016), we control for other factors that could influence turnover, composition changes, and low AC approval. These factors include revelations of

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[24] The sample in this analysis is significantly reduced because consecutive years are needed to calculate changes in AC composition.

TABLE 3
Changes in the Composition of the Audit Committee
Dependent Variables =

	Pred. Sign	LEAVE_NONAFE			LEAVE_AFE			REPLACE_AFE		
		All Firms (1)	Non-Staggered (2)	Staggered (3)	All Firms (4)	Non-Staggered (5)	Staggered (6)	All Firms (7)	Non-Staggered (8)	Staggered (9)
LOWDEC_AC_VOTES	+	0.017	0.128	−0.037	0.348**	0.611***	0.110	0.274	0.747**	−0.046
		(0.12)	(0.59)	(−0.18)	(1.94)	(2.38)	(0.42)	(0.83)	(1.94)	(−0.09)
MW	+	0.211	0.032	0.380*	0.034	−0.468	0.332	−0.207	−0.589	0.081
		(1.44)	(0.15)	(1.80)	(0.16)	(−1.28)	(1.16)	(−0.58)	(−1.13)	(0.14)
RESTATEMENT	+	−0.174	−0.275	−0.127	−0.030	−0.324	0.288	−0.488	−0.391	−0.571
		(−1.08)	(−1.22)	(−0.52)	(−0.15)	(−1.02)	(0.97)	(−1.12)	(−0.68)	(−0.73)
AUDITOR_CHG	+	−0.185	−0.328	−0.032	0.556**	0.373	0.733**	0.836**	0.320	1.083*
		(−0.87)	(−1.02)	(−0.11)	(2.29)	(0.91)	(2.26)	(2.10)	(0.46)	(1.82)
EXC_LOG_AUDIT_FEES	?	−0.036	−0.096	0.021	−0.027	−0.109	0.076	0.300	0.037	0.653*
		(−0.39)	(−0.72)	(0.15)	(−0.22)	(−0.65)	(0.41)	(1.47)	(0.14)	(1.86)
LOG_NAF	+	−0.008	−0.007	−0.011	−0.037**	−0.042*	−0.032	0.054	0.065	0.033
		(−0.63)	(−0.37)	(−0.57)	(−2.12)	(−1.69)	(−1.17)	(1.30)	(1.05)	(0.57)
LITIGATION	+	0.290	−0.271	1.011**	−0.794*	−0.887	−0.958	0.406	−0.546	1.677**
		(0.97)	(−0.64)	(2.19)	(−1.92)	(−1.30)	(−1.41)	(0.75)	(−0.62)	(2.48)
RETURNS	−	−0.133	−0.222	−0.011	0.118	0.218	−0.084	−0.835**	−0.909**	−0.783
		(−1.05)	(−1.26)	(−0.06)	(−0.72)	(−0.93)	(−0.33)	(−2.46)	(−2.27)	(−1.43)
LAG_RETURNS	−	−0.249*	−0.151	−0.370*	0.128	−0.100	0.251	0.030	−0.382	0.248
		(−1.80)	(−0.77)	(−1.82)	(0.78)	(−0.42)	(1.07)	(0.10)	(−0.90)	(0.55)
ROA	−	0.262	−0.172	0.759	0.004	0.862	−0.986	0.399	2.690	−2.997**
		(0.60)	(−0.34)	(0.97)	(0.01)	(1.28)	(−1.02)	(0.39)	(1.60)	(−2.09)
LAG_ROA	−	−0.948**	−1.086*	−0.875	−1.316**	−0.483	−2.144**	−1.396	−2.072*	−0.690
		(−2.06)	(−1.84)	(−1.13)	(−2.26)	(−0.59)	(−2.05)	(−1.53)	(−1.84)	(−0.38)
CHG_INST_OWN	+	0.666	1.104	0.045	−0.245	−0.797	0.648	0.308	−0.780	0.124
		(1.18)	(1.48)	(0.05)	(−0.31)	(−0.76)	(0.47)	(0.19)	(−0.34)	(0.05)
AVG_AGE	+	−0.373*	−0.573	−0.297	0.357*	0.908**	0.009	0.631*	0.458	0.619
		(−1.95)	(−1.62)	(−1.27)	(1.65)	(2.46)	(0.03)	(1.67)	(0.76)	(1.10)
AVG_DIR_TENURE	+	−0.040***	−0.035*	−0.049**	−0.064***	−0.085***	−0.043	−0.083**	−0.026	−0.162**
		(−2.80)	(−1.73)	(−2.25)	(−3.25)	(−3.15)	(−1.41)	(−2.14)	(−0.53)	(−2.26)
LOG_AC_SIZE	+	3.996***	4.275***	3.942***	3.830***	4.162***	3.721***	2.348***	3.102***	1.831***
		(19.38)	(14.27)	(12.81)	(15.24)	(11.72)	(9.43)	(5.93)	(5.13)	(3.21)
SALESGROWTH	−	0.235	0.168	0.310	−0.113	−0.181	0.044	−0.444	0.368	−1.725
		(1.29)	(0.62)	(1.19)	(−0.41)	(−0.43)	(0.12)	(−0.76)	(0.59)	(−1.43)
PLURAL	−	0.108	0.203	−0.049	−0.185	−0.268	−0.191	−0.405	0.044	−1.221**
		(0.67)	(0.92)	(−0.19)	(−0.94)	(−1.01)	(−0.61)	(−1.20)	(0.09)	(−2.35)

TABLE 3 (continued)

Dependent Variables =

	Pred. Sign	LEAVE_NONAFE			LEAVE_AFE			REPLACE_AFE		
		All Firms (1)	Non-Staggered (2)	Staggered (3)	All Firms (4)	Non-Staggered (5)	Staggered (6)	All Firms (7)	Non-Staggered (8)	Staggered (9)
CEO_CHANGE	+	−0.172	−0.113	−0.189	0.168	0.177	0.156	0.464*	0.521	0.497
		(−1.39)	(−0.64)	(−1.04)	(1.16)	(0.86)	(0.72)	(1.92)	(1.63)	(1.28)
Constant	?	−6.157***	−5.944***	−6.926***	−8.128***	−8.031***	−20.925***	−20.052***	−22.423***	−17.554***
		(−5.70)	(−3.15)	(−10.89)	(−8.55)	(−6.83)	(−17.15)	(−16.86)	(−12.63)	(−9.86)
Observations		3,453	1,830	1,621	3,470	1,840	1,630	3,063	1,766	1,297
Adjusted R^2		0.156	0.174	0.159	0.155	0.180	0.170	0.140	0.171	0.203
Area under ROC		0.7763	0.7955	0.7709	0.7778	0.7968	0.7854	0.7819	0.8087	0.8152

*, **, *** Indicate significant results at $p < 0.10$, $p < 0.05$, and $p < 0.01$, respectively.

The first three columns report coefficients (t-statistics) for logistic regression models that predict the likelihood of an AC member who is not classified as an AFE departing from the AC in the year following an annual meeting. Columns 4–6 report coefficients (t-statistics) for logistic regression models that predict the likelihood of an AFE departing from the AC in the year following an annual meeting. Columns 7–9 report coefficients (t-statistics) for logistic regression models that predict the likelihood that a new AFE will replace a departing AFE on the AC within two years following an annual meeting. We include industry and year fixed effects and cluster by firm in each regression. One-tailed tests are presented for hypothesized directional expectations. All other variables are defined in Table 1.

material weaknesses (*MW*) or restatements (*RESTATEMENT*), auditor switches (*AUDITOR_CHG*), unexpected audit fees (*EXC_LOG_AUDIT_FEES*), non-audit fees (*LOG_NAF*), and accounting related litigation (*LITIGATION*).[25]

In Columns 1–3 of Table 3, we examine the association between low votes and the subsequent turnover of non-AFEs in the first year following the election (*LEAVE_NONAFE*). Here and in subsequent analyses, Column 1 tests H1 among all firms, and Column 2 (3) tests H2 among non-staggered (staggered) ACs. We do not find support for the proposition that low votes are associated with subsequent turnover of AC members not classified as AFEs. In Columns 4–6, we examine whether AC members who are accounting financial experts are more likely to leave the AC following low shareholder support (*LEAVE_AFE*) in the first year following the election. In Column 4, our results show that *LOWDEC_AC_VOTES* is positive and significant ($p < 0.05$). This finding supports H1. In Columns 5 and 6, we observe that *LOWDEC_AC_VOTES* is positive and significant ($p < 0.01$) among non-staggered boards (Column 5), but not among staggered boards (Column 6). Overall these results support H2. The results in Column 5 are also economically significant, showing an increased likelihood of 5.2 percentage points that an accounting expert will leave the AC, when evaluating other variables at their sample mean. Since the unconditional likelihood that an AFE will leave the AC is 12 percent, this represents a nontrivial 43.2 percent increase. This provides evidence that following high shareholder disapproval, AFEs in non-staggered boards are more likely to leave the audit committee.

Similarly, in Columns 7–9, we examine whether the departure of an AFE is more likely to lead to an appointment of a different AFE within two years following low shareholder support (*REPLACE_AFE*). Our findings support H2, but not H1, because we find that *LOWDEC_AC_VOTES* is positive and significant ($p < 0.05$) in Column 8 only. The results are also economically significant, suggesting that low shareholder votes in firms with non-staggered boards are associated with an increased likelihood of 1.5 percentage points that a different AFE will replace the departing AFE. Since the unconditional likelihood of AFE replacement with a new AFE is 3.6 percent, this represents a nontrivial increase of 41.67 percent. Taken together, these results suggest that companies do not necessarily respond to low votes by indiscriminately replacing AC members. Rather, they remove and replace accounting financial experts on the AC when shareholders express dissatisfaction with the AC. However, AFE removal and replacement only occurs in non-staggered boards, whereas staggered boards do not react to low votes in this manner.

Changes in AC Meetings

In Table 4, we examine whether low shareholder approval will be associated with an improvement in AC diligence. We proxy for diligence with the change in the number of AC meetings following the election (*CHG_ACMEETINGS*). We expect the coefficient of *LOWDEC_AC_VOTES* to be positive and significant. In addition to the test variable, we control for the number of AC meetings in the year before the low approval election (*AC_MEETINGS*). We expect that if the number of meetings is high, then in the following year, the number of meetings will decrease and revert to the mean. We also control for other factors influencing the number of AC meetings, as identified by Raghunandan and Rama (2007) and Sharma, Naiker, and Lee (2009). Finally, we control for other events that are likely to influence shareholder approval and the number of AC meetings, such as auditor changes, material weaknesses, accounting-related litigation, and restatements.

In Column 1, we do not find support for H1 as *LOWDEC_AC_VOTES* is insignificant. However, when we separately examine this relationship in staggered and non-staggered boards, we find a statistically significant positive association only in non-staggered ACs (Column 2 $p < 0.05$), thus supporting H2. The Column 2 results are also economically significant, indicating that low AC support is associated with an increase of 44.4 percentage points in the number of AC meetings. Since on average the AC meets 8.35 times, this translates to an increase of 3.7 meetings. In conjunction with Table 3, these results reveal that low shareholder support is associated with an improvement in the composition and diligence of the AC. However, these associations are prominent only in non-staggered firms.

Nevertheless, we recognize that an increase in AC meetings may capture a relatively low-cost signal of AC improvement rather than an indication of actual improvement. Thus, these findings should be interpreted as an improvement in diligence only in conjunction with other results of substantive AC improvements.[26] Another concern is that some meetings happen before the votes are cast and tallied.[27] Therefore, to provide additional support for our findings, we examine whether low AC support is also associated with an increase in the meetings of the compensation committee or the board. If low shareholder votes increase

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[25] We obtain litigation data from the Audit Analytics database and identify all instances of litigation disclosed as of the year before the shareholder voting date listed in the following Audit Analytics categories: (1) accounting and auditing enforcement, (2) accounting malpractice, or (3) financial reporting. We limit our examination to these categories because they most likely capture litigation arising from lapses in financial reporting.

[26] We also note that if an increase in AC meetings is a low-cost signal, then staggered boards should also adopt it. Yet our results do not show any association between low votes and an increase in AC meetings for staggered boards.

[27] Since firms do not disclose the AC meetings dates, we cannot discern between meetings that happened before and after the shareholder meeting, and we acknowledge this is a limitation.

TABLE 4

Change in the Number of AC Meetings

	Pred. Sign	Dependent Variable = *CHG_ACMEETINGS*		
		All Firms (1)	Non-Staggered (2)	Staggered (3)
LOWDEC_AC_VOTES	+	0.184	0.444**	−0.155
		(1.21)	(1.98)	(−0.74)
AC_MEETINGS	−	−0.385***	−0.367***	−0.414***
		(−19.54)	(−13.71)	(−13.96)
CHG_SIZE	+	0.198	0.307	−0.055
		(0.84)	(0.96)	(−0.14)
CHG_LEVERAGE	?	−0.401	−0.515	−0.377
		(−0.63)	(−0.59)	(−0.40)
LOSS	+	−0.067	−0.152	−0.025
		(−0.64)	(−1.13)	(−0.15)
CHG_ROA	−	−1.432***	−1.528***	−1.277*
		(−3.22)	(−2.67)	(−1.77)
CHG_RETURNS	−	−0.077	−0.064	−0.113
		(−1.10)	(−0.66)	(−1.14)
CHG_MTB	−	0.006	0.002	0.015
		(0.79)	(0.21)	(1.44)
CHG_INSIDE_OWN	?	−0.103	−1.299	1.866
		(−0.12)	(−1.20)	(1.34)
CHG_INST_OWN	?	0.591	0.161	0.811
		(0.97)	(0.20)	(0.90)
REGULATED	?	0.096	0.212	−0.999***
		(0.20)	(0.42)	(−2.91)
HIGH_LITIGATION	?	0.163	0.105	0.162
		(0.95)	(0.46)	(0.60)
CHG_NO_AFE	+	−0.208**	−0.138	−0.250
		(−2.11)	(−1.06)	(−1.59)
CHG_AC_SIZE	?	0.021	−0.008	0.024
		(0.39)	(−0.10)	(0.30)
MW	+	0.308	0.553*	−0.114
		(1.43)	(1.88)	(−0.36)
RESTATEMENT	+	−0.652***	−0.947***	−0.242
		(−3.58)	(−3.70)	(−0.89)
AUDITOR_CHG	+	0.478	0.505	0.601
		(1.58)	(1.08)	(1.53)
CHG_LOG_NAF	+	−0.025	−0.028	−0.018
		(−1.56)	(−1.31)	(−0.69)
LITIGATION	+	0.007	−0.109	0.646
		(0.02)	(−0.26)	(1.28)
S&P1500	+	0.237**	0.253**	0.153
		(2.54)	(2.03)	(1.04)
RESTRUCTURE	+	0.289***	0.360***	0.166
		(3.10)	(2.77)	(1.22)
Constant		3.843***	3.611***	4.646***
		(7.80)	(6.37)	(11.89)
Observations		3,273	1,813	1,460
Adjusted R^2		0.212	0.209	0.219

*, **, *** Indicate significant results at $p < 0.10$, $p < 0.05$, and $p < 0.01$, respectively.

This table reports coefficients and, in parentheses, t-statistics for OLS regression models that explain the change in AC meetings over the fiscal year that follows the annual meeting. We include industry and year fixed effects and cluster by firm in each regression. Other than the event-specific and binary variables, the variables represent a one-year change (or percent change) of those defined in Table 1. One-tailed tests are presented for hypothesized directional expectations.

meetings across the board, then our findings may be invalidated. In contrast, if they only apply to AC meetings, then the results reported above are more likely attributable to the AC. Consistent with the latter, our findings suggest that *LOWDEC_AC_VOTES* is not associated with changes in the compensation committee or board meetings.[28]

Reduction in Tax Non-Audit Services

In response to low votes, the AC may change its relationship with external parties, such as the auditor. Thus, in Table 5, we examine whether low shareholder support is associated with changes in the ACs willingness to purchase large amounts of tax services from the auditor. Because proxy advisors base their recommendations on relative rather than the nominal amounts of NAS (non-audit services), we measure *CHG_TAX_FEE_RATIO* as the change in tax fees relative to total fees paid to the auditor in the year following the election.[29] We first limit the sample to firms purchasing tax NAS. These results are presented in Columns 1–3. Because shareholders are likely be more concerned about "excessive" tax NAS services, we also limit the sample to firms with a relatively high *TAX_FEE_RATIO* before the election (i.e., firms in the upper quintile) in Columns 4–6.[30]

We expect the coefficients on our main variable of interest, *LOWDEC_AC_VOTES*, to be negative and significant, reflecting a hypothesized reduction in the tax-fee ratio. We also include an indicator variable equal to 1 if the auditor ratification vote was in the bottom decile for the year (*LOW_AUDITOR_VOTES*), because NAS fee reductions may result from shareholders' dissatisfaction with the auditor (Raghunandan and Rama 2003). Finally, we control for other factors influencing the purchase of NAS identified by DeFond, Raghunandan, and Subramanyam (2002) and Whisenant, Sankaraguruswamy, and Raghunandan (2003).

In Table 5, Columns 1 and 4, the coefficients on *LOWDEC_AC_VOTES* and *LOW_AUDITOR_VOTES* are negative and significant. This suggests that dissatisfaction with the AC and the auditor expressed through low votes is associated with a decrease in the tax NAS ratio. These results support H1.

Consistent with our expectations in H2, Columns 2 and 3 (5 and 6) reveal that the negative coefficient on *LOWDEC_AC_VOTES* is only significant among non-staggered boards ($p < 0.10$ in the full sample, $p < 0.05$ in the high tax fees sample). Comparing the economic significance of *LOWDEC_AC_VOTES* in Column 5 (−0.029) and Column 2 (−0.008), we find that the reduction in tax fees is more prominent ($p = 0.06$) for firms purchasing high levels of tax services. Lower auditor approval is also influential in reducing tax NAS among non-staggered firms only. While the results are statistically significant, we acknowledge that their economic significance is small. Specifically, results in Column 5 suggest that low AC support is associated with a 2.9 percent decrease in *TAX_FEE_RATIO*. Since the average firm in the top quintile of *TAX_FEE_RATIO* spends \$759,131 in tax fees, this translates to a decrease of \$22,015.

Because our proxy for tax fee changes is based on a ratio of tax fees to total fees, a valid concern is that the decrease in tax-fee ratios is driven by an increase in the denominator, audit fees. To alleviate this concern, we examine the association between low AC votes and changes in the log of audit fees. In untabulated analysis, we find that audit fees decrease following low AC support. This finding biases against finding support for our hypothesis and lends more credence to the proposition that low shareholder votes are associated with a decrease in tax fees.

Decrease in Discretionary Accruals

We next examine the association between low AC votes and improvements in financial reporting quality. Specifically, we investigate whether ACs respond to low votes by working with management to increase the accuracy of the financial reports. We proxy for increased financial reporting quality using the two-year change[31] in the absolute value of discretionary accruals estimated based on the model proposed by Kothari et al. (2005).[32] Similar to the tax NAS analysis, in Table 6 we first analyze the results for all firms in Columns 1–3. We then limit the sample to firms with high levels of discretionary accruals before the election (i.e., firms in the upper quintile) in Columns 4–6, because low votes will be more likely to influence changes in financial reporting quality among firms that exhibited low quality before the election. We expect the coefficients on our test

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[28] We also tested whether *LOWDEC_AC_VOTES* is associated with two years of changes in AC meetings and do not find any support. This suggests that ACs increase their meetings in the year following the low shareholder votes and revert back to the mean in the following year.

[29] While Mishra et al. (2005) also construct tax fees as a ratio, they divide tax fees by audit fees rather than total fees. Our results do not change using this alternative scalar.

[30] Although the cutoff fluctuates each year, firm-year observations in the upper quintile have a *TAX_FEE_RATIO* of approximately 20 percent of total fees.

[31] In untabulated analyses, we find no evidence of a one-year change in the absolute value of discretionary accruals following low votes. Contrary to the other AC responses we investigate above, the AC may not be able to immediately influence the quality of the financial reports through improved monitoring.

[32] Results are robust to the original construction of the modified Jones model as estimated by Dechow, Sloan, and Sweeney (1995).

TABLE 5

Changes in Tax-Fee Ratio

Dependent Variable = *CHG_TAX_FEE_RATIO*

	Pred. Sign	Full Sample			Tax Fees at the Upper Quintile		
		All Firms (1)	Non-Staggered (2)	Staggered (3)	All Firms (4)	Non-Staggered (5)	Staggered (6)
LOWDEC_AC_VOTES	−	−0.006*	−0.008*	0.001	−0.018*	−0.029**	0.015
		(−1.48)	(−1.43)	(0.23)	(−1.52)	(−1.96)	(0.77)
LOW_AUDITOR_VOTES	−	−0.010**	−0.018***	−0.003	−0.015*	−0.024**	−0.004
		(−2.27)	(−3.02)	(−0.47)	(−1.78)	(−2.03)	(−0.26)
CHG_LOG_AUDIT_FEE	?	−0.075***	−0.069***	−0.083***	−0.114***	−0.108***	−0.124***
		(−11.08)	(−8.10)	(−7.24)	(−7.34)	(−4.34)	(−4.58)
CHG_SIZE	+	0.022***	0.030***	0.010	0.065***	0.069**	0.045
		(2.77)	(2.73)	(0.80)	(2.87)	(2.30)	(1.07)
AUDITOR_CHG	−	−0.025**	−0.039***	−0.003	−0.080***	−0.071**	−0.172***
		(−2.49)	(−3.24)	(−0.19)	(−2.81)	(−2.08)	(−4.28)
CHG_ROA	−	−0.014	−0.016	−0.011	−0.009	0.020	−0.016
		(−1.07)	(−0.89)	(−0.56)	(−0.23)	(0.33)	(−0.26)
CHG_RETURNS	−	−0.003	−0.002	−0.006	−0.005	−0.003	−0.012
		(−1.37)	(−0.51)	(−1.57)	(−0.82)	(−0.34)	(−0.91)
CHG_LEVERAGE	+	0.010	0.008	0.007	−0.009	−0.048	0.048
		(0.50)	(0.30)	(0.25)	(−0.18)	(−0.68)	(0.56)
CHG_SPECIAL_ITEM	+	0.000	−0.003	0.004	0.007	0.001	0.024*
		(0.13)	(−0.72)	(1.11)	(0.95)	(0.14)	(1.66)
CHG_MTB	+	0.000	0.000	0.000	−0.002	−0.001	−0.001
		(0.69)	(0.14)	(0.70)	(−1.03)	(−0.45)	(−0.53)
CHG_SALESGROWTH	+	−0.010**	−0.015**	−0.003	−0.024	−0.038**	0.013
		(−2.29)	(−2.28)	(−0.43)	(−1.63)	(−2.14)	(0.42)
CHG_FOREIGN	+	−0.000	−0.004	0.004	−0.025**	−0.034**	−0.003
		(−0.02)	(−0.54)	(0.39)	(−2.01)	(−2.20)	(−0.10)
NEW_FIN	+	0.000	−0.002	0.002	−0.006	0.001	−0.018
		(0.01)	(−0.53)	(0.36)	(−0.66)	(0.06)	(−1.14)
SEGMENTS	+	0.000	−0.000	0.001**	0.001	0.000	0.002
		(0.90)	(−0.63)	(2.23)	(0.99)	(0.18)	(1.30)
MW	+	0.007	0.007	0.007	−0.001	−0.003	0.004
		(1.62)	(1.16)	(1.21)	(−0.09)	(−0.16)	(0.11)
RESTATEMENT	+	−0.006	−0.003	−0.009	0.002	−0.001	0.004
		(−1.31)	(−0.55)	(−1.28)	(0.14)	(−0.06)	(0.14)
S&P1500	+	0.002	−0.000	0.002	0.009	0.007	0.011
		(0.63)	(−0.02)	(0.41)	(1.00)	(0.63)	(0.68)
RESTRUCTURE	+	−0.001	−0.001	−0.002	0.010	0.015	−0.001
		(−0.60)	(−0.36)	(−0.60)	(1.43)	(1.59)	(−0.10)
Constant		−0.009	−0.002	−0.012	−0.059***	−0.045	−0.060*
		(−0.87)	(−0.10)	(−1.52)	(−3.58)	(−1.52)	(−1.91)
Observations		3,219	1,771	1,448	665	393	272
Adjusted R^2		0.103	0.101	0.098	0.215	0.219	0.242

*, **, *** Indicate significant results at p < 0.10, p < 0.05, and p < 0.01, respectively.

This table reports coefficients and, in parentheses, t-statistics for OLS regression models that explain changes in the tax-fee ratio between the annual meeting (*t*) and the year following the annual meeting (*t*+1). The sample includes all firms (Columns 1–3) and firms with high (top quintile) tax-fee ratios (Columns 4–6). We include industry and year fixed effects and cluster by firm in each regression. Other than the event-specific and binary variables, all continuous variables are measured as a one-year change. One-tailed tests are presented for hypothesized directional expectations.

TABLE 6
Changes in the Absolute Value of Discretionary Accruals

		Dependent Variable =					
		$CHG2\_|DACC|$			$CHG2\_|DACC|$		
		Full Sample			Discretionary Accruals at the Upper Quintile		
	Pred. Sign	All Firms (1)	Non-Staggered (2)	Staggered (3)	All Firms (4)	Non-Staggered (5)	Staggered (6)
LOWDEC_AC_VOTES	−	−0.005	−0.009**	0.001	−0.007	−0.031***	0.021
		(−1.46)	(−1.94)	(0.13)	(−0.72)	(−2.51)	(1.44)
CHG2_SIZE	−	0.002	0.002	0.002	0.012*	0.020*	0.003
		(0.77)	(0.61)	(0.49)	(1.84)	(1.91)	(0.36)
CHG2_MTB	+	0.000	0.000	0.000	0.001**	0.001	0.001
		(1.15)	(1.33)	(0.25)	(1.99)	(0.95)	(1.45)
CHG2_ALTMANZ	−	0.000	0.000	0.001	−0.001	−0.000	−0.001
		(0.97)	(0.66)	(0.95)	(−1.04)	(−0.36)	(−1.31)
CHG2_SALESGROWTH	−	0.007*	0.011**	0.001	0.008	−0.004	0.025**
		(1.75)	(2.03)	(0.24)	(0.89)	(−0.23)	(2.25)
NEW_FIN	+	−0.010**	−0.007	−0.013*	−0.012	−0.006	−0.010
		(−2.13)	(−1.28)	(−1.78)	(−1.21)	(−0.42)	(−0.78)
ACQUIRE	+	−0.000	0.001	−0.001	−0.012**	−0.019**	−0.005
		(−0.06)	(0.26)	(−0.40)	(−2.13)	(−2.30)	(−0.50)
CHG2_ROA	+	−0.106***	−0.114***	−0.098***	−0.081***	−0.085***	−0.070*
		(−6.28)	(−5.26)	(−3.61)	(−3.52)	(−2.81)	(−1.72)
MW	−	0.004	0.000	0.009*	−0.001	−0.009	0.011
		(1.02)	(0.09)	(1.87)	(−0.07)	(−0.55)	(0.71)
RESTATEMENT	+	0.002	0.000	0.003	0.005	−0.001	0.007
		(0.62)	(0.08)	(0.66)	(0.52)	(−0.08)	(0.55)
CHG2_NAF	?	−0.000	−0.000	−0.000	0.001	−0.001	0.004
		(−0.88)	(−0.80)	(−0.58)	(0.49)	(−0.85)	(1.60)
TWOYR_AUDITOR_CHG	?	−0.001	−0.002	−0.001	−0.006	−0.015	0.019
		(−0.25)	(−0.36)	(−0.08)	(−0.45)	(−0.93)	(0.53)
LITIGATION	?	0.004	−0.001	0.013	0.004	−0.007	0.078
		(0.63)	(−0.06)	(1.23)	(0.20)	(−0.39)	(1.29)
S&P1500	?	−0.000	−0.001	−0.001	0.008	−0.001	0.022**
		(−0.08)	(−0.21)	(−0.26)	(1.27)	(−0.12)	(2.09)
RESTRUCTURE	?	−0.001	0.002	−0.005*	0.000	0.015	−0.015
		(−0.54)	(0.65)	(−1.66)	(0.04)	(1.39)	(−1.42)
Constant		−0.049	−0.085**	0.024***	−0.113***	−0.122***	−0.014
		(−1.51)	(−2.37)	(3.31)	(−3.27)	(−3.37)	(−0.34)
Observations		4,132	2,231	1,901	826	446	380
Adjusted R^2		0.046	0.053	0.028	0.049	0.055	0.084

*, **, *** Indicate significant results at p < 0.10, p < 0.05, and p < 0.01, respectively.
This table reports coefficients and, in parentheses, t-statistics for OLS regression models that explain the change in the absolute value of discretionary accruals between the annual meeting at time t and the two years following the annual meeting at time $t+2$. The sample includes all firms (Columns 1–3) and firms with high (top quintile) absolute value of discretionary accruals (Columns 4–6) at time t. We include industry and year fixed effects and cluster by firm in each regression. Other than the event-specific and binary variables, all continuous variables are measured as a two-year change. One-tailed tests are presented for hypothesized directional expectations.

variable to be negative and significant, reflecting a hypothesized reduction in discretionary accruals. In the OLS model, we control for other factors influencing the change in discretionary accruals as identified by Geiger and North (2006).

We do not find support for H1, as low AC votes do not influence the change in discretionary accruals when we jointly examine staggered and non-staggered boards (Columns 1 and 4). Yet low AC support is associated with a decrease in the two-

year change in discretionary accruals in non-staggered firms only in the full sample and in the high absolute value of the discretionary accrual sample (Column 2, $p < 0.05$; Column 5, $p < 0.01$). These findings support H2. Comparing the economic significance of *LOWDEC_AC_VOTES* in Column 5 (−0.031) and Column 2 (−0.009), we find that, in comparison to all firms in the sample, the decrease in discretionary accruals is more prominent ($p = 0.04$) for firms with high levels of discretionary accruals before the election.

As a whole, our findings suggest that low shareholder votes in firms with non-staggered boards are associated with changes to the composition and diligence of the AC, changes to the relationship with the auditor, and gradual changes to financial reporting quality. These associations are not evident in staggered firms. Importantly, these results explain the mixed support for H1 and suggest that staggered and non-staggered firms should be examined separately; otherwise, the underlying association may be masked.[33]

ROBUSTNESS TESTS AND ADDITIONAL ANALYSES

Alternate Constructions of Low AC Votes

As described earlier, the distribution of *DIFF_AC_VOTES* presented in Figure 1 supports the use of the lowest decile (*LOWDEC_AC_VOTES*) to capture low AC support. Nevertheless, we test the robustness of the results to alternate constructions of low AC votes. Specifically, instead of the lowest decile, we use the lowest quintile and a continuous variable. The results in Table 3 (AC composition changes) are robust to these alternative specifications of low AC votes. The results in Table 4 (changes in AC meetings) are not statistically significant when these alternative variables are applied. The Table 5 results (changes in tax fees) are only robust to the use of the lowest quintile as the proxy for low AC support. Finally, results in Table 6 (changes in the absolute value of discretionary accruals) are not robust to the alternative specifications. The inconsistent findings of the two alternative low-vote specifications, along with the distribution in Figure 1, highlight that to elicit AC action, shareholder votes must exhibit significant observable variation between AC and non-AC directors; otherwise, AC members will fail to view shareholder votes as a strong signal of dissatisfaction and will be less likely to react.

Alternate Staggered Firm Samples

In staggered elections, firm-year observations may end up in the bottom decile for reasons that do not necessarily reflect dissatisfaction with the overall AC, but dissatisfaction with an individual director who happens to serve on the AC. In other words, "person-specific" issues are more likely to influence the construction of *LOWDEC_AC_VOTES* in the staggered sample, because fewer directors are included in the calculation of average AC and non-AC votes.

To alleviate this concern in staggered boards, we first limit our sample to observations with at least two AC and two independent non-AC members facing election in a given year. However, we could not estimate the replacement of the AFE, change in tax fees, and change in accruals analysis because the samples under these specifications were too small. This is not surprising because the average number of independent directors in our sample is eight and only about one-third of independent directors stand for election in any given year. When the sample was large enough, repeating our analysis within the restricted sample for AC turnover, leave AFE, and change in AC meetings yields results that are similar to our main analysis. As an alternative to restricting the sample to at least two AC and two non-AC members, we restrict the sample to observations with at least two AC and one non-AC members. Under this construction, there were sufficient observations to estimate all models. Once again, results remain consistent with our main analysis. Nevertheless, we acknowledge that person-specific issues may still influence the staggered election results.

Consideration of Proxy Advisor Recommendation on AC Reactions

Following prior studies (e.g., Fischer et al. 2009), when examining the consequences of shareholders' votes at the firm level, we do not control for proxy advisor recommendations because of the high correlation between these recommendations and shareholder votes. Nevertheless, as an additional analysis, we added a variable that captures the recommendations of ISS and GL. We construct this variable in a similar fashion as our main test variable of interest (*LOWDEC_AC_VOTES*). First, we divide the number of positive AC (independent non-AC) member GL and ISS recommendations by the total number of AC (independent non-AC) member GL and ISS recommendations. This calculation yields the percentage of positive to total

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[33] We recognize that staggered ACs may respond to shareholder votes over a longer horizon, once shareholders are able to vote on more than one class of directors. The lack of response of staggered ACs that we document is therefore limited to a comparison of non-staggered boards and the election of one class of staggered directors. Future research may want to examine the association between shareholder votes over several consecutive years and the reaction of staggered ACs.

recommendations for AC members and non-AC members. We then subtract the non-AC-aggregate recommendation variable from the AC-aggregate recommendation variable to capture the difference in these recommendations. Finally, we create an indicator variable for the lowest decile of this difference. Untabulated results that include this variable are consistent with our main results.

Alternate Measure of Improvement in Financial Reporting Quality

As an alternative to discretionary accruals, we also examine whether firms that disclose internal control material weaknesses are more likely to remediate their weaknesses following low AC votes. Although the sample size in this analysis is relatively small, in untabulated analysis, we find that in non-staggered firms low AC votes are marginally associated with remediation within the subsequent two years ($p < 0.10$). We do not observe similar results in the full sample or the staggered firm sample.

CONCLUSION

We add to the literature on director elections by examining the efficacy of shareholder votes in staggered and non-staggered audit committee elections. We find that low shareholder approval rates in firms with non-staggered boards are associated with improvements to AC structure, activity, and financial reporting quality. Our results extend past research and show that, in addition to influencing the performance of corporate boards and the compensation committee, shareholders can also influence the performance of the audit committee and thus the quality of financial reporting. The differences in the efficacy of shareholder votes across staggered and non-staggered elections reveal that while non-staggered ACs respond to low shareholder votes, staggered ACs do not.

These results are important for two reasons. First, they suggest that future studies examining the efficacy of shareholder votes should consider separating staggered and non-staggered boards; otherwise, results may be masked by the election structure. Second, our results extend those of Cuñat, Gine, and Guadalupe (2012), who provide evidence that staggered boards are less likely to adopt shareholder resolutions, by showing that they are also less likely to react to low shareholder votes. This extension matters because the key difference between staggered and non-staggered boards is the ability of shareholders to promptly hold directors accountable through voting. Overall, our results support the recent trend to de-stagger corporate boards.

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