

Unintended Consequences of Accelerated Filings: Do Changes in Audit Delay Lead to Changes in Earnings Quality?

Tamara A. Lambert
Drexel University
LeBow College of Business
Department of Accounting
3141 Chestnut St
Philadelphia, PA 19104
610-751-8045
tal36@drexel.edu

Joseph F. Brazel
North Carolina State University
Department of Accounting
College of Management
Campus Box 8113
Nelson Hall
Raleigh, NC 27695
919-513-1772
Joe_brazel@ncsu.edu

Keith L. Jones
George Mason University
Department of Accounting
Enterprise Hall, MSN 5F4
Fairfax, VA 22030-4444
703-993-4819
kjones@gmu.edu

October 2007

We would like to thank Gary Peters, Randy Elder, Roger Meuwissen, Barbara Grein, Kevin Melendrez, and workshop participants at Drexel University, the 2007 International Symposium on Audit Research, and the 2007 AAA Annual Meeting for their helpful comments.

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ABSTRACT: SEC rule 33-8644 substantially reduces the 10-K filing period for large accelerated and accelerated filers from 90 to 60 and 75 days, respectively, for fiscal years ending on or after December 15, 2006. For many firms and their auditors, this rule has led to a reduction in audit delay, or the length of time from a company's fiscal year-end to the date of the auditor's report. We investigate the potential effects of this legislation by examining if (and how) changes in audit delay have been associated with changes in earnings quality. We find a significant, negative relationship between changes in audit delay and changes in discretionary accrual levels or that reductions (*increases*) in audit delay are associated with lower (*higher*) earnings quality. Similar results are found when we split our sample between current SEC mandated audit delay changes and voluntary changes in audit delay. Contrary to expectations, this relationship is not more acute for "busy season" audits. The negative relationship between changes in audit delay and changes in discretionary accruals also appears to be consistent across all three filer types: large accelerated, accelerated, and non-accelerated. These results are robust to using alternative measures of discretionary accruals, a levels (vs. changes) model, and conservatism as an alternative measure of financial reporting quality. Overall, our findings support claims by auditors and preparers that SEC rule 33-8644 has the capacity to reduce the quality of financial information supplied by large accelerated and accelerated filers, and that expansion of the legislation to non-accelerated filers may lead to deleterious effects.

Keywords: *audit delay; discretionary accruals; earnings quality; SEC filings*

Data availability: *The data used in this study are publicly available from the sources indicated in the text.*

I. INTRODUCTION

This paper examines the impact of changes in audit delay on earnings quality. The audit failures of the early 2000s led to the passage of the Sarbanes-Oxley Act of 2002 (SOX) which increases the amount of post-fiscal year-end audit procedures (e.g., PCAOB [2004]). Subsequent SEC legislation, which accelerated 10K filings for firms with greater than \$75 million in public equity float, reduces the length of time within which these procedures can take place (SEC [2002], [2004], [2005]). Therefore, post-SOX, auditors are required to perform more work in a shorter time period. Preparers and auditors, concerned with the impact that accelerated filings would have on financial reporting quality, reacted negatively to the controversial legislation.¹

The term audit delay is defined as the length of time from a company's fiscal year-end to the date of the auditor's report (Ashton, Willingham, and Elliot [1987]). In this paper, change in audit delay is defined as the current year's audit delay minus the previous year's audit delay. The objectives of this study are to determine if the proposed changes (i.e., truncation) to audit delay lead to reductions in earnings quality and to identify conditions under which this relationship may be more acute. We use changes in audit delay as our independent variable of interest, as opposed to changes in filing dates, because the date of the audit report often precedes the filing date. On the audit report date, all adjustments to the financial statements are complete and the financial statements in the 10K (the source of our dependent variable of interest) are finalized. Our results provide both descriptive and prescriptive evidence to illustrate the potential effects of this recent legislation on the quality of financial information supplied by large public companies, as well as the ramifications of expanding the legislation to smaller companies.

¹ <http://www.bloomberg.com/apps/news?pid=10000103&sid=atKZoxTtzuUY&refer=us;>
[http://www.sec.gov/rules/proposed/s70805/deloitte103105.pdf;](http://www.sec.gov/rules/proposed/s70805/deloitte103105.pdf)
<http://www.sec.gov/rules/proposed/s70802/bdoseidman1.htm>

Rule 33-8128, *Acceleration of Periodic Report Filing Dates and Disclosure Concerning Website Access to Reports* (SEC [2002]), rule 33-8507 *Temporary Postponement of the Final Phase-In Period for Acceleration of Periodic Filing Dates* (SEC [2004]), and rule 33-8644, *Revisions to Accelerated Deadlines for Filing Periodic Reports* (SEC [2005]), curtail the length of time within which the post-fiscal year-end audit takes place. The legislation initially reduced the 10-K filing period (i.e., the potential audit delay) for accelerated filers from 90 days to 75 days after December 15, 2003 (SEC [2002]).² In December of 2005, Rule 33-8864 (SEC [2005]) established a new category called a large accelerated filer. A large accelerated filer is an accelerated filer with a worldwide market value of outstanding voting and non-voting common equity by non-affiliates of \$700M or more. The deadline for large accelerated filers was further reduced to 60 days after December 15, 2006 (SEC [2005]). With respect to the sample used in this study, 64% of large accelerated filers had an audit delay of more than 60 days, and 26% of accelerated filers had audit delay of more than 75 days, in the year leading up to enactment of rule 33-8644 (SEC [2005]). It is also possible that similar legislation may be imposed on non-accelerated filers (SEC [2005]).

Previous research has found that a variety of client, engagement, and auditor related factors affect audit delay (Ashton, Willingham, and Elliot [1987], Ashton, Graul, and Newton [1989], Newton and Ashton [1989], Bamber, Bamber, and Schoderbek [1993], Kinney and McDaniel [1993], Knechel and Payne [2001], Ettredge, Li, and Sun [2006]). This research stream has yet to examine how changes in audit delay serves as an independent variable; affecting the quality of

² According to rule 33-8128 (SEC [2002]), an accelerated filer is one that meets the following conditions at the end of its fiscal year: 1) Its common equity public float was \$75M or more as of the last business day of its most recently completed second fiscal quarter; 2) The company has been subject to the reporting requirements of Section 13(a) or 15(d) of the Exchange Act for a period of at least 12 calendar months; 3) The company has previously filed at least one annual report pursuant to Section 13(a) or 15(d) of the Exchange Act; and the company is not eligible to use Forms 10-KSB and 10-QSB. A non-accelerated filer is one who does not meet the definition of an accelerated filer.

audited financial statements. Intuitively, there would seem to be two possible implications of reducing audit delay. On the one hand, as the SEC suggests the legislation is intended to accomplish, it should increase the relevance or timeliness of reported information (SEC [2002]). Conversely, as argued by most preparers and auditors, it may decrease the reliability of reported information because auditors have less time to perform a thorough audit of the financial statements. While audit delay has always been an important concern, the issue has become more prominent with the passage of legislation which reduces potential audit time. Whether changes in audit delay have an impact on earnings quality is an un-researched empirical question and the objective of this study is to investigate that question.³

To evaluate this issue, we examine the relationship between changes in audit delay and changes in discretionary accrual levels from the years preceding the SEC rule to the current period (2001-2007). In accordance with previous archival auditing studies, we use discretionary accruals to proxy for earnings quality (Myers, Myers, and Omer [2003], Larcker and Richardson [2004]). If changes in audit delay are historically and/or currently associated with changes in earnings quality, then it is likely that the SEC's truncation of fiscal year-end audit procedures may have implications for financial reporting quality. Thus, our study is the first to examine changes in audit delay as an independent variable affecting the quality of earnings and, in turn, we contribute empirical evidence to the debate over the potential effects of accelerated financial reporting.

Our results provide evidence that changes in audit delay are negatively associated with changes in the level of discretionary accruals. In other words, we find that reductions in audit delay are associated with increases in discretionary accruals levels or lower earnings quality (and vice

³ While this study does not empirically address whether the acceleration of filing deadlines has impacted the relevance of reported financial information, we provide evidence in Table 5 that the legislation resulted in 2,567 mandatory audit delay reductions from December 2003 thru May 2007. Therefore, it appears that the legislation did increase the timeliness or relevance of financial information for some filers.

versa for increases in audit delay). Similar results are found when we split our sample between SEC mandated audit delay changes and voluntary changes in audit delay. Contrary to expectations, we do not find this relationship to be stronger for companies that are audited during the audit firm's "busy season," or those with December and January fiscal year-ends. Lastly, we find the negative relationship to be consistent across all three types of filers: large accelerated, accelerated, and non-accelerated. These results are robust to using alternative measures of discretionary accruals, a levels (vs. changes) model, and conservatism as an alternative measure of financial reporting quality. This empirical evidence supports current claims by preparers and auditors that SEC rule 33-8644 (SEC [2005]) may impair the quality of audited earnings supplied to investors, and that this effect appears to be consistent across busy season audits, non-busy season audits, and filer type.

The remainder of the paper is organized as follows. Section II develops our hypotheses. Section III describes the sample selection and research method. Section IV displays the results. Section V provides a conclusion.

II. BACKGROUND AND HYPOTHESES DEVELOPMENT

SEC Legislation

Shortly after the passage of the Sarbanes-Oxley Act (SOX), the SEC passed rule 33-8128, *Acceleration of Periodic Report Filing Dates and Disclosure Concerning Website Access to Reports* (SEC [2002]). This rule was supposed to substantially shorten the Form 10-K filing deadline for accelerated filers from 90 days to 60 days. The reduction was stipulated to take place over a 2 year period. The deadline went from 90 days to 75 days on December 15, 2003 with a further reduction to 60 days scheduled for December 15, 2004 (which was later postponed). The objective of the deadline reduction was to provide investors with more timely, relevant

information, “While quarterly and annual reports at present generally reflect historical information, a lengthy delay before that information becomes available makes the information less valuable to investors” (SEC [2002]).

The acceleration of filings has been a controversial and heated topic of discussion. In a May of 2002 response to the SEC, BDO Seidman questioned the effects of accelerations on the reliability of financial reporting. BDO specifically cited the concurrent explosion of accounting pronouncements, increased globalization of clients, and the expanded audit standards related to fraud detection as impediments to simultaneously reducing audit delay and maintaining high quality reporting.⁴ Based on negative public reaction to the accelerated deadlines, and concerns expressed by filers and auditors over whether they would be able to file reports on a timely basis, the SEC adopted rule 33-8507 in November of 2004. This postponed the final phase-in date of the 60-day filing deadline to fiscal year-ends on or after December 15, 2005 (SEC [2004]). The one year delay of the final phase-in did little to quiet public dissatisfaction. As the end of 2005 drew near, accounting firms and issuers voiced their concerns regarding any additional reduction in filing deadlines. Large public companies attacked the acceleration of 10K filings with comments such as: “The concept that better and higher-quality financial filings will result from the compression of the time available to prepare them is illogical.”⁵ In an October 2005 response to the SEC, Deloitte & Touche pleaded with them to “permanently delay any further acceleration” as the “implementation of any additional acceleration of filing deadlines would diminish the quality of disclosures and result in increased and unnecessary costs, while not providing significant corresponding benefit to investors.”⁶

⁴ <http://www.sec.gov/rules/proposed/s70802/bdoseidman1.htm>

⁵ <http://www.bloomberg.com/apps/news?pid=10000103&sid=atKZoxTtzuUY&refer=us>

⁶ <http://www.sec.gov/rules/proposed/s70805/deloitte103105.pdf>

The SEC passed the most recent rule on the issue of accelerated filing deadlines, rule 33-8644, in December of 2005 (SEC [2005]). The new rule created a new category of accelerated filer – the large accelerated filer. A large accelerated filer (LAF) was defined as an accelerated filer (AF) with a worldwide market value of outstanding voting and non-voting common equity by non-affiliates of \$700M or more. LAFs became subject to the reduced 60-day deadline after December 15, 2006. AFs, firms with outstanding common equity by non-affiliates of between \$75M and \$700M, remained subject to a 75-day deadline. Non-accelerated filers (NAF), firms with outstanding common equity by non-affiliates of less than \$75M, continued to be subject to the original 90-day deadline. The SEC indicated in this most recent ruling that no further filing reductions are scheduled to occur at this time. However, public comments on the most recent filing were still mixed as to whether or not all companies should face the same deadline (SEC [2005]). Figure 1 illustrates the proposed changes to the 10-K filing deadline and the changes that were ultimately enacted.

[Insert Figure 1 about here]

Previous Literature

Little research to date has examined the SEC imposed shortened deadline. Bryant-Kutcher, Peng, and Zvinakis [2007] examine whether a sample of 82 timely filers in 2002 and 2003 (pre-SEC rule 33-8644) possess different characteristics than a sample of 103 late filers. Results show that late filers are more highly leveraged, less liquid, and less profitable than timely filers. In addition, they find that late filers have internal control system weaknesses and, as one would expect, longer audit delays.⁷ The primary difference between Bryant-Kutcher, Peng, and Zvinakis

⁷ Alford, Jones, and Zmijewski [1994] illustrated that late filers, prior to the acceleration of financial reporting, were very different than timely filers. They experience unfavorable economic events, are small, have negative accounting rates of return, negative earnings changes, low liquidity, and high financial leverage. In addition, they experience negative market-adjusted returns.

[2007] and this study is that they perform a descriptive comparison (excluding earnings/financial reporting quality) of timely filers to late filers, whereas we examine the potential effect of SEC rule 33-8644 on the quality of earnings across all forms of filers that are subject to the legislation (or may be subject in the future). In other words, Bryant-Kutcher, Peng, and Zvinakis [2007] attempt to investigate the effects of acceleration on the relevance/timeliness of financial information, while our objective is to describe the effects of acceleration on the reliability/quality of financial data. We study the relationship between current SEC mandated changes in audit delay and changes in earnings quality and examine the historical effects of voluntary changes in audit delay (i.e., pre-SEC rule 33-8644 and non-accelerated filers). In addition, we consider conditions (e.g., busy season, filer type) under which this relationship may be more acute. Such analyses allow us to make an important contribution to the debate over the acceleration of 10K filings.

Research related to determinants of audit delay report a variety of client, auditor, and financial factors that affect audit delay. Client size and concentration of ownership, the amount of work completed at interim, the percentage of manager and partner hours charged to an engagement, and the provision of non-audit services have all been found to have significant *negative* relationships with audit delay (Ashton, Willingham, and Elliot [1987], Ashton, Graul, and Newton [1989], Newton and Ashton [1989], Bamber, Bamber, and Schoderbek [1993], Knechel and Payne [2001]). Audit delay has been found to be *positively* related to a structured audit approach and incremental audit effort, a change in auditors, extraordinary items, net losses, December or January fiscal year-ends, financial vulnerability, client business complexity, issuance of modified audit opinions, correction of previously reported interim earnings, and identified material weaknesses in internal controls (Ashton, Graul, and Newton [1989], Newton and Ashton

[1989], Bamber, Bamber, and Schoderbek [1993], Kinney and McDaniel [1993], Schwartz and Soo [1996], Knechel and Payne [2001], Ettredge, Li, and Sun [2006]).

All of these factors that increase audit delay are observable by the auditor and would trigger greater audit scrutiny. Effectively, these findings are mechanical or consistent with the audit risk model (AICPA [2006a], AICPA [2006b]). For example, if the auditor knows he or she needs to perform more work due to an observed increase in an audit-related risk (e.g., a material weakness in internal control), then a longer audit delay, on average, is expected. We consider the *unobservable* audit characteristic of whether management intends to use its discretion with the reporting of accruals to manage earnings. Graham, Harvey, and Rajgopal [2006], in a survey of 401 senior financial executives and additional in-depth interviews, find that the presence of earnings management is pervasive and income *increasing* accruals are seen as a method of meeting earnings benchmarks. One CFO in the study stated, ““You have to start with the premise that every company manages earnings”” (Graham, Harvey, and Rajgopal [2006], 30). The authors report that several other interviewees provided similar comments.

If management intends to manage earnings, providing auditors with less time to perform an audit would allow a greater opportunity for management to do so. Whether the reduced audit delay is mandated by the SEC or simply requested by management, the effect would be the same (i.e., less time after year-end for the auditor to scrutinize year-end accruals). While previous research has identified important determinants of audit delay, it has not focused on the *consequences* of audit delay. We are not aware of any research that has considered the impact of audit delay on earnings quality.

Studies have argued that earnings quality, as proxied for by discretionary accruals, can be used to draw inferences about audit quality (Myers, Myers, and Omer [2003]). In the same vein as

Myers, Myers, and Omer [2003], this paper does not purport to speak directly to audit quality; however, it does make the argument that lower audit quality will be reflected in more extreme income increasing financial reporting choices by management (i.e., higher discretionary accrual levels). We do not use the absolute value of discretionary accruals, as is occasionally used in earnings management literature (e.g. Frankel, Johnson, and Nelson [2002]), because the focus of this paper is capturing the effect of changes in audit delay on audit/earnings quality. While earnings management could be income decreasing or income increasing, auditors face a much greater risk when the client manages income upward (i.e., higher discretionary accrual levels). For example, Kinney and Martin [1994] analyze nine data sets of audit-related adjustments from more than 1,500 audits and conclude that audit-related adjustments are income decreasing. Bonner, Palmrose, and Young [1998] and Palmrose and Scholz [2004] find a prevalence of non-GAAP income *increasing* activity leading to SEC Accounting and Auditing Enforcement Releases and restatement announcements, respectively. In addition, prior research indicates that client management prefer to record income increasing, over income decreasing, audit adjustments (Antle and Nalebuff [1991], Wang and Tuttle [2005], Sanchez, Agoglia, and Hatfield [2007]). Thus, as suggested by Myers, Myers, and Omer [2003], auditors are primarily concerned with clients over-reporting income (i.e., higher discretionary accrual levels). Reducing audit delay may impair their ability to address this concern and tests on signed accruals allow us to examine this possibility.⁸

Audit quality, as measured by auditor size, has been found to be associated with earnings management and the pricing of discretionary accruals (Becker et al. [1998], Krishnan [2003]). Positive relationships have been found between discretionary accrual levels and other audit-related variables such as auditor changes, the issuance of qualified audit opinions, eventual auditor

⁸ In addition to the argument contained herein for examining signed accruals to evaluate earnings quality, Hribar and Nichols [2007] find that using *unsigned* discretionary accrual models leads to an over-rejection of the null hypothesis of no earnings management and exposure to correlated omitted variables.

litigation, and audit failures (Becker et al. [1998], DeFond and Subramanyam [1998], Bartov, Gul, and Tsui [2000], Heninger [2001]). A higher level of auditor conservatism and audit tenure has been found to be negatively associated with discretionary accrual levels (Francis and Krishnan [1999], Myers, Myers, and Omer [2003]). We have no reason to believe that the accelerated deadline will directly impact these factors, only that the decreased deadline will result in changes (i.e., reductions) in audit delay. Whether changes in audit delay ultimately impact earnings quality, as reflected by changes in discretionary accruals, is a compelling question that has yet to be answered.

Hypotheses

The effect of changes in audit delay on earnings quality is expected to occur as a result of the aforementioned link between audit quality and earnings quality. As described below, changes in audit delay should impact audit quality. Comments expressed in response to SEC rule 33-8128 (SEC [2005]) did not question whether the reduced deadline would hinder the companies' closing processes, but rather they were concerned with the amount of time auditors and others would have to examine the financial statements. A common concern was that reduced deadlines/changes to audit delay would impair the ability of management, the audit committee, and external auditors to scrutinize 10K filings properly (SEC [2002]).

For example, with less time to audit the financial statements the auditor may be less able to fully evaluate the *qualitative* aspects of an accounting error that is quantitatively immaterial. Also, auditors obtain post-fiscal year-end evidence to evaluate year-end account balances and a reduction in audit delay may curb these practices. Hoffman and Zimbelman [2006] find that fraud experts propose extending post-fiscal year-end tests (e.g., examining subsequent cash receipts on year-end accounts receivable balances) substantially beyond the typical 45 day period to increase

the likelihood of detecting financial statement fraud. In addition, auditors often require considerable time after year-end (and substantial post-fiscal year-end evidence) to examine client estimations (e.g., the reserve for obsolete inventory).

A reduction in audit delay will decrease the amount of post-year-end time the auditor has at his or her discretion to audit the financial statements. The auditor simply has less time to do as much audit testing as he or she otherwise would have in the past, when 90 day filing deadlines were allowed for all public companies. This reduction in testing is especially problematic for auditors of firms that use discretion in the reporting of accruals to manage earnings. If management's intention to manage earnings is not observable by the auditor, then this increased risk would not automatically trigger an increased level of audit testing.

Auditors that are facing a short audit window at year-end will likely move the bulk of their testing to interim. However, audit standards explain that expanding interim testing may actually increase audit risk and exacerbate the problem auditors face with accelerated 10K filings. SAS 45 (AICPA [1983]) provides examples of when moving substantive testing may be especially challenging and discourages interim testing:

(1) The auditor should consider whether there are rapidly changing business conditions or circumstances that might predispose management to misstate financial statements in the remaining period. If such conditions or circumstances are present, the auditor might conclude that the substantive tests to cover the remaining period would not be effective in controlling the incremental audit risk associated with them. In those situations, the asset and liability accounts affected should ordinarily be examined as of the balance-sheet date.

(2) The auditor should consider whether the year-end balances of the particular asset or liability accounts that might be selected for interim examination are reasonably predictable with respect to amount, relative significance, and composition. He should also consider whether the entity's proposed procedures for analyzing and adjusting such accounts at interim dates and for establishing proper accounting cutoffs are appropriate. In addition, the auditor should consider whether the accounting system will provide information concerning the balances at the balance-sheet date and the transactions in the remaining period that is sufficient to permit investigation of (a) significant unusual transactions or entries (including those at or near year-end); (b) other causes of significant fluctuations, or

expected fluctuations that did not occur; and (c) changes in the composition of the account balances. If the auditor concludes that evidential matter related to the above would not be sufficient for purposes of controlling audit risk, the account should be examined as of the balance-sheet date.

Companies with the greatest opportunity to manage earnings (i.e., those in a rapidly changing business, using complex accounting, with unusually high fourth quarter profits or having any of the following concerns near year end: significant related party transactions, significant unusual transactions, or significant fluctuations in balance sheet accounts) would be companies that auditors would be reluctant to apply substantial testing of account balances at interim. Thus, shortening the time between year-end and the 10K filing deadline is particularly problematic for auditors of companies who pose the greatest risk to manage earnings. Indeed, Dell Inc. has recently disclosed that four years of financial results will be restated due to “improper adjustments to various reserve and accrued liability accounts on the balance sheet - usually at the close of the quarter to give the appearance that quarterly goals were met” (Lawton and Clark [2007]).

A decrease in the amount of time available to perform the year-end audit may also be accompanied by an increase in time pressure. Experimental research has shown that increasing time pressure decreases audit effectiveness and can result in behavior that reduces audit quality (e.g., accepting doubtful evidence, truncating sample selections) (McDaniel [1990], Coram, Ng, and Woodliff [2004]). As time pressure increases beyond moderate levels, research shows that auditors become overwhelmed and suffer anxiety which has a detrimental effect on performance (DeZoort and Lord [1997]). Therefore, if the SEC’s legislation has the effect of placing undue time constraints on audit engagements, this may lead to a reduction in audit quality and, in turn, a reduction in earnings quality.

By measuring the change in audit delay as current year audit delay minus prior year audit delay and calculating the change in discretionary accrual levels according to the model developed by Kothari, Leone, and Wasley [2005], we test the following hypothesis:

H1: Changes in audit delay are negatively associated with changes in discretionary accruals.

Hypothesis 1 does not differentiate between changes in audit delays that were mandated by SEC rules 33-8128 and 33-8644 (SEC [2002], SEC [2005]) and voluntary changes that are agreed upon by the auditor and management (e.g., pre-SEC rule changes, changes for non-accelerated filers). We perform our primary test of Hypothesis 1 on all (vs. mandated) changes in audit delay for our sample to allow us to examine the potential effects of expanding the legislation to NAFs and further reducing the filing deadline for AFs. Still, it is possible that agreed-upon changes in audit delay, if consistent with auditor risk assessments, may have less of a deleterious effect upon audit/earnings quality as those imposed by the SEC. We will therefore perform additional tests of Hypothesis 1 for both mandated and voluntary changes in audit delay. In both cases, however, we expect a negative relationship between changes in audit delay and changes in discretionary accrual levels. We do not expect the *reason* for the change in delay to be significant as the effect would be the same (i.e., less/more time for the auditor to test year-end balances).

The alternative to Hypothesis 1 is that no change in discretionary accruals is expected because auditors can simply assign a greater number of auditors to the engagement and perform the same amount of testing in a shorter window. We do not expect this alternative to neutralize the relationship posited in Hypothesis 1 for two reasons. First, audit firms generally cannot simply assign more staff to an audit because audit firms are currently being operated at or near 100 percent capacity (McGee [2005], Gullapalli [2005], Rose [2007]). Due to the requirements of SOX Section 404, auditors are simply working more hours, which increases time pressure and decreases

effectiveness as previously discussed. Also, if additional audit staff is available, their current lack of assignment to a concurrent audit engagement may suggest a possible lack of competence.⁹

Second, when increased risks require an expansion of audit testing, much of the additional work cannot be compressed into a short window. For example, consider a situation where an auditor notices a significant and unexpected *increase* in accounts receivable from interim testing to year-end and a significant and unexpected *decrease* in the allowance for bad debt. The effects taken together have a material impact on fourth quarter earnings (i.e. more revenue and less bad debt expense). If the auditor wanted to increase the number of confirmations of account receivable, a short audit window would make this very difficult because the response rate to the confirmations is determined primarily by the customers' ability and willingness to respond to auditor requests. Customers do not generally respond immediately to auditor requests and, when they do, it takes prodding by the auditor and diligence by the customers' accounts payable departments to search records to determine which invoices were outstanding at year-end. Discrepancies must then be followed up by the client and the auditor (Caster [1990]).¹⁰ Such factors delaying the audit are out of auditor's control and simply increasing the number of auditors assigned to the engagement will not speed the process. Much post-year-end audit work requires effort and time from the audit client as well as others (e.g., customers, creditors, attorneys) that the auditor cannot control. Thus, assigning more auditors cannot take the place of allowing more time for evidence accumulation, testing, research and correspondence between auditor, the client, and other third parties.

Workload Compression

⁹ Recent discussions with practitioners support the supposition that human resources are currently stressed at audit firms and that, when additional staff is obtained to meet reduced audit deadlines, the staff typically lack competence and/or required industry expertise.

¹⁰ For example, if a customer reports that an invoice was no longer due at year-end because the product was returned, then the audit client must research when the returned product was received, compare that date to the year-end date, and communicate that information and related evidence to the auditor.

Archival data on the amount of audit hours worked on an engagement, when fieldwork began, and other data related to the extent of time constraints auditors experienced on an engagement are not publicly available. However, one variable that is available and relates to the amount of time pressure the auditor feels is workload compression. Our second hypothesis examines whether the relationship between changes in audit delay and changes in earnings quality is more acute under higher levels of workload compression. Workload compression occurs during auditors' "busy season" and exists because most companies' fiscal year-ends coincide with the calendar year-end (Lopez-Acevedo [2007]).

The negative impact of workload compression has been shown across a variety of research methods. Lopez-Acevedo [2007] finds that workload compressed audits, defined as those with a December or January fiscal year-end date, display greater magnitudes of discretionary accruals. In an experimental setting, Agoglia et al. [2007] find that increased workload compression leads to managers and partners employing less effective audit techniques. A longitudinal study of auditors at staff through partner levels found that, by the end of busy season, these professionals experienced greater emotional exhaustion from their work and were more depersonalized in their approach to their job (Sweeney and Summers [2002]).

Workload compressed (i.e., busy season) engagements are therefore more likely to be served by overworked and exhausted audit teams who may employ less effective audit procedures in order to maintain audit efficiency. Also, during busy season, human resources at audit firms are often stretched to capacity and thus workload compressed audits will have a more difficult time obtaining additional, competent staff to assist in audits where audit delay is reduced. In short, the audit quality of work compressed audits should be more sensitive to changes in audit delay and

this heightened sensitivity may ultimately affect the quality of audited earnings. Therefore, our second hypothesis is:

H2: The negative association between changes in audit delay and changes in discretionary accruals is stronger for workload compressed audits than non-workload compressed audits.

Filer Type

The SEC's decision to have three distinct groups of filers (NAFs, AFs, and LAFs), and three separate reporting deadlines (90 days, 75 days, and 60 days respectively), was quite controversial. The SEC received 302 comments on the proposal to accelerate the deadlines, 20 supported the acceleration and 282 opposed it. The comments in support of the rule came from investors and financial analysts. Companies, business associations, accounting firms, and law firms overwhelmingly opposed the acceleration with the most common concern being that the acceleration would negatively affect the quality and accuracy of reports. Commentators also disagreed on the proposed definition of an accelerated filer. Some companies and associations (e.g., Comcast Corporation and Troutman Sanders LLP) expressed that all public companies should be required to adhere to the same deadline. The American Bar Association took issue with the assumption that larger companies are better equipped than other filers to meet the accelerated deadline, "large businesses tend to be more complex, often with international operations, multiple divisions and subsidiaries and investments from other entities from which they often must await reports."¹¹ Others, including the AFL-CIO and KPMG LLP, agreed with the notion of excluding smaller companies because they may not have the necessary resources or infrastructure to meet the accelerated deadline (SEC [2002]).

Although the SEC has indicated that no further filing reductions are scheduled to occur at this time, public comments on the most recent filing were still mixed as to whether or not all

¹¹ <http://www.sec.gov/rules/proposed/s70802/skeller1.htm>

companies should face the same deadline (SEC [2005]). We aim to shed light on whether the SEC's stratification of filers by size was warranted, and whether reduced deadlines should be imposed on smaller firms. Because we have no directional hypothesis for the impact of filer size on the association between changes in audit delay and changes in earnings quality, we propose the following research question:

RQ: Does the relationship between changes in audit delay and changes in discretionary accruals differ by filer size?

III. SAMPLE SELECTION AND RESEARCH METHOD

Sample

As shown in Table 1, our sample consists of all firms from Audit Analytics (our primary source for audit delay data) from January 2001 through May 2007 (latest available date for Compustat data). We obtained financial data on each firm from Compustat. We matched Compustat and Audit Analytics by Central Index Key (CIK code). We did not extend our sample to years prior to 2001 because Audit Analytics does not contain data for years prior to 2000 (i.e., the prior year audit delay is required to calculate change in audit delay). We excluded firms from our sample for one or more of the following reasons: firms that had a negative audit delay (i.e., observations where the report date was prior to the fiscal year-end date);¹² firms with missing prior year audit delay in Audit Analytics; firms with insufficient information on Compustat to calculate discretionary accruals; firms that were not available on both Compustat and Audit Analytics; financial institutions and other regulated industries¹³; firms with missing data on Compustat to calculate control variables; and firms with qualified audit opinions or missing audit opinions. Our

¹² We traced a sample of the firm years with negative audit delay to the report filed on edgar.gov. It appears that the negative audit delay is a result of a typo on the reports as they were originally filed, and therefore does not indicate a problem with the Audit Analytics database.

¹³ Financial and regulated industry firms are excluded because of their unique nature of calculating discretionary accruals (Frankel, Johnson, and Nelson [2002], Tucker and Zarowin [2006]).

final sample contains 28,243 firm-years. The observations from year to year range from a low of 131 in 2007 to a high of 5,251 in 2003.

[Insert Table 1 about here]

Hypotheses Testing

We first examine the relation between changes in audit delay and changes in earnings quality, as proxied for by discretionary accruals. Hypothesis 1 posits that changes in audit delay are negatively associated with changes in discretionary accruals. Specifically, we estimate the following regression:

$$\begin{aligned} \text{ChDAC}_t = & \beta_0 + \beta_1 \text{Chdelay}_t + \beta_2 \text{Seasn}_t + \beta_3 \text{CFO}_t + \beta_4 \text{AbsCFO}_t + \beta_5 \text{M/B}_t + \beta_6 \text{lgMVE}_t + \\ & \beta_7 \text{Big5}_t + \beta_8 \text{Loss}_t + \beta_9 \text{EXT}_t + \beta_{10} \text{PAR}_t + \beta_{11} \text{ChAud}_t + \beta_{12} \text{LEV}_t + \beta_{13-19} \text{Year} + \\ & \beta_{20-31} \text{Industry} + \varepsilon \end{aligned} \quad (1)$$

ChDAC refers to current year discretionary accruals less prior year discretionary accruals, measured using the modified-Jones model, and further modified to include ROA as described by Kothari, Leone, and Wasley [2005].¹⁴ Chdelay refers to our main variable of interest, change in audit delay. Consistent with Ashton, Willingham, and Elliot [1987], audit delay is defined as the audit report date less the fiscal year-end date. Chdelay is calculated as follows: current year audit delay minus prior year audit delay. For example, a negative chdelay indicates a decrease in audit delay from the previous year. Hypothesis 1 is supported if the coefficient for chdelay is negative and significant or if decreases (*increases*) in audit delay lead to increases (*decreases*) in discretionary accruals.

¹⁴ The specific model is $TA = \beta_0 + \beta_1(1/\text{Assets}_{it-1}) + \beta_2(\Delta\text{Sales}_{it} - \Delta\text{AR}_{it}) + \beta_3\text{PPE}_{it} + \beta_4\text{ROA}_{it} + \varepsilon_{it}$. Due to sample size restrictions, our measures of discretionary accruals are estimated from cross-sectional models. Further, Bartov, Gul, and Tsui [2000] find that the cross-sectional Jones model and the cross-sectional modified Jones model outperform their time-series counterparts in detecting earnings management. We estimate model coefficients from cross-sectional industry regressions by two-digit SIC codes. We require a minimum of 10 observations for each two-digit SIC code and year combination.

We control for workload compressed audits (Seasn) as they have been shown to display a higher magnitude of discretionary accruals (Lopez-Acevedo [2007]). We control for firm performance by including cash flows from operations (CFO), a commonly used control variable for models with levels of discretionary accruals as the dependent variable (Defond and Subramanyam [1998], Becker et al. [1998], Frankel, Johnson, and Nelson [2002], Myers, Myers, and Omer [2003], Choi, Kim, and Zang [2006]). Because the relation between cash flows and discretionary accruals is not linear, we also control for the absolute value of cash flows from operations (AbsCFO) (Defond and Subramanyam [1998], Frankel, Johnson, and Nelson [2002]). Following Frankel, Johnson, and Nelson [2002] and Choi, Kim, and Zang [2006], we control for firm growth by including the ratio of market to book value (M/B). We control for firm size using the log of the market value of equity (Frankel, Johnson, and Nelson [2002]). In accordance with previous research that examines discretionary accruals in an audit environment (Becker et al. [1998], Myers, Myers, and Omer [2003], Lopez-Acevedo [2007]), we include an indicator variable that specifies whether or not the firm was audited by a Big5 auditor (Big5). We include an indicator variable as to whether or not the firm reported a loss for the year (Loss), because firms are expected to manipulate accruals in a systematically different way during loss years (Frankel, Johnson, and Nelson [2002], Lopez-Acevedo [2007]). We also control for three variables that, intuitively, would be expected to increase audit delay: extraordinary items (EXT), an explanatory paragraph added to an unqualified opinion (PAR), and a change in auditors (ChAud). Because Becker et al. [1998] and Choi, Kim, and Zang [2006] find that leverage differences may cause firms to have different incentives to manage earnings (e.g., to meet debt covenants), we control for leverage (Lev), measured as the ratio of total liabilities to total assets (Frankel, Johnson, and Nelson [2002]). Finally, we include a dummy variable to control for year and, following

Ashbaugh, LaFond, and Mayhew [2003], we include 12 dummy variables to control for industry.¹⁵ In order to maintain parsimonious tables, the year and industry dummy variables are not tabulated.

Hypothesis 2 predicts that the negative relationship between changes in audit delay and changes in discretionary accruals is stronger for workload compressed audits. Workload compressed audits are those that take place during an audit firm's busy season, or audits of companies with fiscal year-endings during the months of December and January (Knechel and Payne [2001], Lopez-Acevedo [2007]). In order to test this expected relationship, we partition the sample between busy season audits and non-busy season audits.

Research Question

We consider whether filer size impacts the association between changes in audit delay and changes in discretionary accruals. As described in SEC rule 33-8644 (SEC [2005]), there are currently three groups of filers (i.e., LAF, AF, and NAF). The most prominent difference between these groups, and the most practical to examine from a data collection standpoint, is their public equity float. In order to determine whether the relationship between changes in audit delay and changes in discretionary accruals differs by filer type, we separate our sample into three groups based on their public equity float. We then estimate model 1 for each group and examine the effect of Chdelay in each of the three regressions. In accordance with SEC rule 33-8644 (SEC [2005]), we classify filers in the following way: as non-accelerated (NAF) if their MVE is less than \$75M; accelerated

¹⁵ Industries were divided into the following groups: SIC 0100-1499, SIC 1500-1999, SIC 2000-2199, SIC 2200-2399, SIC 2400-2799, SIC 2800-3299, SIC 3300-3499, SIC 3500-3999, SIC 4000-4899, SIC 5000-5299, SIC 5300-5999, SIC 7000-7999.

(AF) if their MVE is between \$75M and \$700M; and large accelerated (LAF) if their MVE is greater than \$700M.¹⁶

IV. RESULTS

Table 2 provides descriptive statistics for our variables of interest and control variables. The mean change in audit delay for the entire sample is 3.8 days (positive) with a standard deviation of 51.6. It is interesting to note that in the years preceding and immediately after SEC rule 33-8644 (SEC [2005]), audit delay, on average, appears to be increasing. When grouped into positive change in audit delay and negative change in audit delay, the means and standard deviations are 28.8 (47) and -24.1 (45.6), respectively. Thus, on average, both negative and positive changes in audit delay have been substantial (i.e., three to four weeks). Table 2 also illustrates that busy season audits do appear to be workload compressed. Indeed, for our sample, 72% of all audits were for fiscal years-ending in two months: December and January.

[Insert Table 2 about here]

Table 3 presents the results of estimating the model. The variable of interest for testing Hypothesis 1 and 2 is the Chdelay variable in model 1. When we include all firms in the sample, the coefficient on Chdelay is negative, as predicted, and significant ($p < .01$). Hypothesis 1 is therefore supported and we conclude that changes in audit delay are negatively associated with changes in discretionary accruals.¹⁷ When compared to the average discretionary accrual, a 7-day decrease (*increase*) in audit delay is associated with a 5 percent increase (*decrease*) in

¹⁶ The SEC classifies filers based on public equity float and other factors (see footnote 1). We classify each firms' filer status based on MVE because it is a measure that is publicly available and should be highly correlated with public equity float. The actual SEC classification scheme did not exist during most of our sample period.

¹⁷ Reported results control for the presence of the 6 dummy variables (seasn, big5, loss, ext, par, chaud) in the current year. We also performed the regressions controlling for whether the status of each dummy variable changed from year to year. In addition, we estimated model 1 with the continuous variables replaced by change variables. The p -value on the Chdelay variable reduced to 0.053 for this model.

discretionary accruals.¹⁸ As noted above and illustrated in Table 2, the average change in audit delay for the sample was between 3-4 weeks (i.e., 24 to 28 days). When we partition the sample into busy season firms and non-busy season audits, the coefficient on Chdelay is negative and significant ($p < .05$) for *both* busy season and non-busy season audits. Also, when we examine model 1 and include a term for the interaction between Chdelay and season, this term is not significant (not tabulated). The empirical evidence does not support Hypothesis 2. Workload compressed audits are not driving our Hypothesis 1 results and changes in audit delay, whether during busy season or not, appear to lead to changes in earnings quality.

[Insert Table 3 about here]

Table 4 presents results for our examination of model 1 by filer type (our research question). The coefficients on Chdelay for both NAFs, AFs and LAFs are negative and significant ($p < .10$, $p < .05$, and $p < .10$ respectively). In short, the relation between changes in audit delay and changes in discretionary accruals does not appear to differ substantially by filer size.¹⁹ These results are interesting in light of comments received on SEC rule 33-8644 (SEC [2005]). Commentators complained that large firms needed more time to compile information from their complex operations, and that the rule should not be extended to small firms because they lack the resources to comply with the reduced deadline. In fact, the quality of earnings for all three types of filers appears to be affected by changes in audit delay. Our results suggest that the current reduction of filing deadlines for LAFs and AFs, and any future reduction for NAFs, may negatively impact the earnings quality of these filers. Lastly, these results point to the potential

¹⁸ Amount computed as follows: Average change in discretionary accrual (-.0094) + [coefficient on Chdelay (-.00007) X 7 days] = -.00989 or a 5 percent decrease from -.0094.

¹⁹ In untabulated results, we ran multiple regressions with two of the three filer types as dummy variables and interacted the dummy variables with Chdelay and found that the coefficients on the interactions were not statistically significant (i.e., the coefficients on Chdelay for LAFs, AFs and NAFs in Table 4 are not significantly different from each other).

negative effects on the earnings quality of AFs if their deadline was reduced to the 60 days currently required of LAFs.

[Insert Table 4 about here]

As discussed in the development of Hypothesis 1, we do not expect the reason for the change in audit delay to affect our results. However, in Table 5 we partition our sample into two groups – mandated and voluntary. The first group (mandated) represents all firms that were forced into a reduction in audit delay due to the SEC mandate. The mandated sample contains LAFs and AFs with fiscal year-ends from December 2003 through November 2004 and audit delays greater than 75 days in the previous year and all LAFs with fiscal year-ends after December 2006 through May 2007 and audit delays greater than 60 days in the previous year. The filing deadline for LAFs and AFs changed from 90 to 75 days after December 15, 2003 and from 75 days to 60 days for LAFs after December 15, 2006 (SEC [2005]). As stated in the Method section, our sample period concludes in May of 2007 (last available date for Compustat data). The second group (voluntary) contains all other firms-years in our original sample.

Despite the fact that the legislation did not reach full impact until December 15, 2006 and therefore provides us with a substantially reduced sample (2,567 firms), the coefficient on *Chdelay* is negative and significant ($p < .05$) for the mandated sample. The coefficient on *Chdelay* on the voluntary sample continues to be negative and significant ($p < .05$). These results suggest that the reason for the change in audit delay (mandated vs. voluntary) does not affect the previous results, which find a negative relation between changes in audit delay and changes in discretionary accruals (e.g., reductions in audit delay are associated with increases in discretionary accruals).

[Insert Table 5 about here]

Sensitivity Analysis

Discretionary Accruals Models

The choice of discretionary accrual models has become increasingly controversial. Jones, Krishnan, and Melendrez [2007] empirically examine the ability of six discretionary accrual models, and three other types of models, to detect restated earnings due to earnings management and fraud. In accordance with their recommendation to consider using multiple models of discretionary accruals, we also tested our hypotheses and research question with discretionary accruals calculated using three additional models. The models were: the Jones model (Jones [1991]); the modified Jones model (Dechow, Sloan, and Sweeney [1995]); and the modified Jones model with book-to-market ratio and cash flows (Larcker and Richardson [2004]). For each of these three additional models, the significance and directional effects of our variables of interest are the same as those obtained from the Kothari, Leone, and Wasley [2005] model for which we report our results.

Levels vs. Changes Models

Throughout our testing, we have consistently used a “changes” model (i.e., we use change in audit delay as the independent variable and change in discretionary accruals as the dependent variable) to measure the immediate impact of decreasing audit delay from one year to the next. We also consider the general effect of having a shorter audit window, by estimating equation (1) using a levels model instead of a changes model. We used audit delays, as opposed to changes in audit delay, and discretionary accrual levels, as opposed to changes in discretionary accruals. We replicated Tables 3 and 4 using the following model:

$$DAC_t = \beta_0 + \beta_1 \text{Delay}_t + \beta_2 \text{Seasn}_t + \beta_3 \text{CFO}_t + \beta_4 \text{AbsCFO}_t + \beta_5 \text{M/B}_t + \beta_6 \text{lgMVE}_t \\ + \beta_7 \text{Big5}_t + \beta_8 \text{Loss}_t + \beta_9 \text{EXT}_t + \beta_{10} \text{PAR}_t + \beta_{11} \text{ChAud}_t + \beta_{12} \text{LEV}_t$$

$$+ \beta_{13-19} \text{Year} + \beta_{20-31} \text{Industry} + \varepsilon \quad (2)$$

where DAC refers to current year discretionary accruals measured using the modified-Jones model, and further modified to include ROA as described by Kothari, Leone, and Wasley [2005]. Consistent with Ashton, Willingham, and Elliot [1987], audit delay (Delay) is defined as the audit report date less the fiscal year-end date. The control variables are the same as those described in model 1. In non-tabulated results, we find similar, but not exact, replications as the changes model reported in Tables 3 and 4. Similar to the results in Table 3, there is a negative and significant ($p < .01$) coefficient on Delay when we perform the regression on all firms in the sample. When we split the sample into busy season and non busy season firms, the coefficient on delay is still negative and significant for both regressions ($p < .01$). Discretionary accrual levels appear to be greater when auditors have less time to perform audits, regardless of whether the audit is during busy season or not. Similar to Table 4, we find a negative and significant ($p < .01$) coefficient on Delay for LAFs and NAFs. However, we do not find a significant coefficient on Delay for AFs.

The changes model (model 1) attempts to simulate the short-term impact of recent SEC legislation reducing filing dates/audit delay, as well as the potential effects of any additional reductions for AFs and NAFs. The levels model (model 2) identifies the potential long-term effects of lower audit delays on earnings quality. Given the difference in time horizon associated with the models, some inconsistencies in the results are not surprising. However, it is important to note that in all cases of significant relationships, the observed relationship was *negative*. SEC accelerations of filing deadlines and truncations of audit delays, while intended to enhance the relevance of accounting information, may lead to short and long term reductions in the reliability of accounting information.

Conservatism as an Alternative Measure of Financial Reporting Quality

In addition to using discretionary accruals, we also examine a second measure of reporting quality. We consider the effect of audit delay on the level of conservatism (i.e., more timely loss recognition than gain recognition) in the audited financial statements. We suspect that auditors who must compress the timing of their audits are less likely to identify, and have their clients accrue for, unrealized losses such as asset impairments and contingent losses. Searching for unrecorded items or understatements is one of the more difficult audit procedures (e.g., testing the completeness and realizable value assertions). For example, while an auditor samples from the detail of the account balance population to perform tests of existence, the appropriate population for sample selection related to completeness tests is not always clear. Also, auditors must develop independent and precise estimates in order to effectively test the realizable value assertion via analytical procedures (e.g., an estimate of the allowance for doubtful accounts) Therefore, we would expect the audited financial statements of clients with shorter audit windows to be less conservative than audit clients with longer windows. We measure conservatism using the asymmetric operating accrual-cash flow test introduced by Ball and Shivakumar [2005].

Our findings are consistent with Hypothesis 1. In non-tabulated results, we find that audit delay is positively correlated with conservatism. On average, firms with shorter audit delays (i.e., audit delays less than 60 days) are less conservative than firms with audit delays greater than 60 days. In addition, we find consistent results when we partition the sample between mandated/voluntary changes in audit delay and between busy season audits/non-busy season audits. In all cases, shorter audit delays are associated with less conservatism.

V. CONCLUSION

SEC rule 33-8644 (SEC [2005]) substantially reduces the 10-K filing period for large accelerated and accelerated filers from 90 to 60 and 75 days, respectively, for fiscal years ending on or after December 15, 2006. It is also possible that similar legislation may be imposed on non-accelerated filers. For many firms and their auditors, this legislation will lead to a reduction in audit delay or the length of time from a company's fiscal year-end to the date of the auditor's report. Such a truncation of post-fiscal year-end audit procedures and inducement of time pressure may lead to lower audit quality and, in turn, lower earnings quality. In addition, the quality of audits performed during the "busy season," where time compression and workload are at their highest for auditors, may be most harmed by a reduction in audit delay.

We empirically assess the disputed effects of the rule by examining if (and how) changes in audit delay have been associated with changes in earnings quality from the years preceding the rule to the current post-rule period. Since the rule affects filer types differently, we also examine whether the relationship between changes in audit delay and changes in earnings quality is dependent on filer type. Consistent with hypotheses, we find a significant, negative relationship between changes in audit delay and changes in discretionary accrual levels (e.g., reductions in audit delay lead to increases in discretionary accruals/lower earnings quality). We find this effect to be consistent across SEC mandated and voluntary changes in audit delay. Contrary to our expectations, this relationship is not more acute for "busy-season" audits. With regard to filer type, results indicate the relationship is negative and significant for all three types of filers. These results are robust to using alternative measures of discretionary accruals, a levels (vs. changes) model, and conservatism as an alternative measure of financial reporting quality.

Overall, our findings support claims by auditors and preparers that SEC rule 33-8644 (SEC [2005]) has the capacity to reduce the quality of financial information supplied by large

accelerated and accelerated filers, and that expansion of the rule to non-accelerated filers may lead to deleterious effects. Given the substantial effect of this rule on the financial reporting and audit processes, and the current dearth of research investigating this topic, we believe the results of this study will spur future research related to the legislation's impact on preparers, auditors, investors, and the capital markets. For example, future studies could measure the increased relevance of accelerated filings and examine whether it possibly outweighs the reductions in information quality described herein. Researchers could investigate how investors perceive/balance the benefits of more timely financial information with the cost of potentially less reliable financial statements. Finally, a fruitful area of research might be to examine how auditors can cope with accelerated filings by making their audits more efficient, while not sacrificing their effectiveness.

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Figure 1
Proposed and Enacted Changes to the 10-K Filing Deadline for Accelerated Filers*

For Fiscal Year on or After	Proposed Deadline ¹	As Enacted
December 15, 2002	90 days	90 days
December 15, 2003	75 days	75 days
December 15, 2004	60 days	75 days ²
December 15, 2005	60 days	75 days
December 15, 2006	60 days	75 days – AFs ³ 60 days – LAFs ⁴

* According to rule 33-8128 (SEC 2002), an accelerated filer (AF) is one that meets the following conditions at the end of its fiscal year: 1) Its common equity public float was \$75M or more as of the last business day of its most recently completed second fiscal quarter; 2) The company has been subject to the reporting requirements of Section 13(a) or 15(d) of the Exchange Act for a period of at least 12 calendar months; 3) The company has previously filed at least one annual report pursuant to Section 13(a) or 15(d) of the Exchange Act; and the company is not eligible to use Forms 10-KSB and 10-QSB.

¹ Rule 33-8128, *Acceleration of Periodic Report Filing Dates and Disclosure Concerning Website Access to Reports* (SEC 2002)

² Rule 33-8507 *Temporary Postponement of the Final Phase-In Period for Acceleration of Periodic Filing Dates* (SEC 2004)

³ Rule 33-8644, *Revisions to Accelerated Deadlines for Filing Periodic Reports* (SEC 2005).

⁴ Rule 33-8644 created a new filer category called the Large Accelerated Filer (LAF), which is an accelerated filer with a worldwide market value of outstanding voting and non-voting common equity by non-affiliates of \$700M or more (SEC 2005).

TABLE 1
Sample Selection

	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>Total</u>
Initial Audit Analytics Sample	15,347	15,701	17,528	16,390	16,391	15,294	1,998	98,649
Negative Audit Delay	(89)	(98)	(65)	(62)	(47)	(95)	(10)	(466)
Missing PY Audit Delay	<u>(6950)</u>	<u>(3127)</u>	<u>(4238)</u>	<u>(1853)</u>	<u>(1807)</u>	<u>(1362)</u>	<u>(294)</u>	<u>(19631)</u>
Net Audit Analytics Sample	<u>8,308</u>	<u>12,476</u>	<u>13,225</u>	<u>14,475</u>	<u>14,537</u>	<u>13,837</u>	<u>1,694</u>	<u>78,552</u>
Initial Compustat Sample	9,821	9,382	9,060	8,733	8,225	6,831	317	52,369
Missing Information to Calculate DAC's	<u>(3,036)</u>	<u>(2,939)</u>	<u>(2,987)</u>	<u>(2,770)</u>	<u>(2,516)</u>	<u>(2,065)</u>	<u>(170)</u>	<u>(16,483)</u>
Net Compustat Sample	<u>6,785</u>	<u>6,443</u>	<u>6,073</u>	<u>5,963</u>	<u>5,709</u>	<u>4,846</u>	<u>147</u>	<u>35,886</u>
Net Observations after Combining Compustat & Audit Analytics	3,876	5,653	5,778	5,745	5,527	4,647	143	31,369
Financial Institutions (6000-6999) & Regulated Utilities (4900-4999)	(275)	(369)	(374)	(383)	(366)	(306)	0	(2073)
Missing Information to Calculate Control Variables	(95)	(141)	(149)	(224)	(198)	(208)	(12)	(1027)
Qualified Audit Opinion or No Audit Opinion	<u>(4)</u>	<u>(7)</u>	<u>(4)</u>	<u>(3)</u>	<u>(1)</u>	<u>(7)</u>	<u>0</u>	<u>(26)</u>
	<u>3,502</u>	<u>5,136</u>	<u>5,251</u>	<u>5,135</u>	<u>4,962</u>	<u>4,126</u>	<u>131</u>	<u>28,243</u>

TABLE 2
Descriptive Statistics

Variables	N	Mean	St. Dev.	Median	Upper Quartile	Lower Quartile
ChDAC	28243	-0.00940	0.49704	-0.00633	0.08121	-0.09930
Chdelay	28243	3.81330	51.62276	0.00000	14.00000	-7.00000
+ Chdelay	14111	28.77046	46.95020	14.00000	32.00000	5.00000
- Chdelay	12362	-24.12886	45.59086	-9.00000	-3.00000	-23.00000
Seasn	28243	0.71880	0.44959	1.00000	1.00000	0.00000
FilerAF	28243	0.31842	0.46587	0.00000	1.00000	0.00000
FilerLAF	28243	0.27458	0.44631	0.00000	1.00000	0.00000
CFO	28243	-0.09781	0.55698	0.05495	0.12589	-0.08148
AbsCFO	28243	0.45070	9.50336	0.11678	0.21104	0.06032
M/B	28243	0.60922	1.55765	0.47250	0.85549	0.21790
lgMVE	28243	4.89675	2.64993	4.98561	6.73000	3.05000
Big5	28243	0.68321	0.46523	1.00000	1.00000	0.00000
Loss	28243	0.47378	0.49932	0.00000	1.00000	0.00000
EXT	28243	0.02422	0.15373	0.00000	0.00000	0.00000
PAR	28243	0.46171	0.49854	0.00000	1.00000	0.00000
ChAud	28243	0.32982	0.47015	0.00000	1.00000	0.00000
LEV	28243	3.13641	76.95127	0.41225	0.62234	0.23962

ChDAC = CY discretionary accruals minus PY discretionary accruals
Chdelay = CY audit delay minus PY audit delay
Seasn = coded 1 if December or January FYE, 0 otherwise
FilerAF = coded 1 if \$75M < MVE < \$700M, 0 otherwise
FilerLAF = coded 1 if MVE > \$700M, 0 otherwise
CFO = cash from operations divided by average total assets
AbsCFO = the absolute value of CFO
M/B = market to book ratio
LgMVE = natural log of market value of equity
Big5 = coded 1 if auditor is Big 5, 0 otherwise
Loss = coded 1 if net loss reported, 0 otherwise
EXT = coded 1 if extraordinary item(s) reported, 0 otherwise
PAR = coded 1 if explanatory paragraph was added to audit opinion, 0 otherwise
ChAud = coded 1 if auditor change occurred during year, 0 otherwise
LEV = total liabilities divided by total assets

All variables are winsorized at the 1st and 99th percentiles.

TABLE 3

Multivariate Regressions to Test the Effect of Changes in Audit Delay on Changes in Discretionary Accruals

$$\text{ChDAC}_t = \beta_0 + \beta_1 \text{Chdelay}_t + \beta_2 \text{Seasn}_t + \beta_3 \text{CFO}_t + \beta_4 \text{AbsCFO}_t + \beta_5 \text{M/B}_t + \beta_6 \text{lgMVE}_t + \beta_7 \text{Big5}_t + \beta_8 \text{Loss}_t + \beta_9 \text{EXT}_t + \beta_{10} \text{PAR}_t + \beta_{11} \text{ChAud}_t + \beta_{12} \text{LEV}_t + \beta_{13-19} \text{Year} + \beta_{20-31} \text{Industry} + \varepsilon$$

Variables / Expected Sign	All Firms			Busy Season Firms			Non Busy Season Firms			
	Parameter Estimate	Standard Errors		Parameter Estimate	Standard Errors		Parameter Estimate	Standard Errors		
Intercept	?	0.02123	0.02041		0.01338	0.02537		0.04304	0.03470	
Chdelay	-	-0.00007	0.00003	***	-0.00007	0.00003	**	-0.00010	0.00005	**
Seasn	+	0.00250	0.00303							
CFO	-	-0.08409	0.00281	***	-0.09621	0.00344	***	-0.07456	0.00519	***
AbsCFO	-	-0.00056	0.00014	***	-0.00284	0.00036	***	0.00003	0.00016	
M/B	+	0.00661	0.00088	***	0.00625	0.00101	***	0.00669	0.00175	***
lgMVE	+	0.00091	0.00069	*	0.00104	0.00080	*	0.00116	0.00135	
Big5	-	0.01858	0.00363	***	0.02095	0.00427	***	0.01551	0.00691	**
Loss	-	-0.04224	0.00311	***	-0.04365	0.00363	***	-0.04270	0.00604	***
EXT	?	0.01976	0.00856	**	0.00998	0.00947		0.05785	0.01950	***
PAR	?	-0.01024	0.00280	***	-0.00762	0.00327	***	-0.01754	0.00548	***
ChAud	?	0.00056	0.00357		0.00522	0.00423		0.00162	0.00755	
LEV	-	-0.00009	0.00002	***	-0.00003	0.00002	**	-0.00061	0.00007	***
AdjustedR ²		0.0324			0.0386			0.0325		
N		28243			20301			7942		

Significance Levels: one-tailed, *** $p < .01$, ** $p < .05$, * $p < .10$

ChDAC = CY discretionary accruals minus PY discretionary accruals
Chdelay = CY audit delay minus PY audit delay
Seasn = coded 1 if firm has a December or January FYE
CFO = cash from operations divided by average total assets
AbsCFO = the absolute value of CFO
M/B = market to book ratio
lgMVE = natural log of market value of equity
Big5 = coded 1 if auditor is Big 5, 0 otherwise
Loss = coded 1 if net loss reported, 0 otherwise
EXT = coded 1 if extraordinary item(s) reported, 0 otherwise
PAR = coded 1 if explanatory paragraph was added to audit opinion, 0 otherwise
ChAud = coded 1 if auditor change occurred during year, 0 otherwise
LEV = total liabilities divided by total assets
All variables are winsorized at the 1st and 99th percentiles.

TABLE 4

Multivariate Regressions to Examine the Effect of Changes in Audit Delay on Changes in Discretionary Accruals by Filer Type

$$\text{ChDAC}_t = \beta_0 + \beta_1 \text{Chdelay}_t + \beta_2 \text{Seasn}_t + \beta_3 \text{CFO}_t + \beta_4 \text{AbsCFO}_t + \beta_5 \text{M/B}_t + \beta_6 \text{lgMVE}_t + \beta_7 \text{Big5}_t + \beta_8 \text{Loss}_t + \beta_9 \text{EXT}_t + \beta_{10} \text{PAR}_t + \beta_{11} \text{ChAud}_t + \beta_{12} \text{LEV}_t + \beta_{13-19} \text{Year} + \beta_{20-31} \text{Industry} + \varepsilon$$

Variables / Expected Sign	NAFs			AFs			LAFs			
	Parameter Estimate	Standard Errors		Parameter Estimate	Standard Errors		Parameter Estimate	Standard Errors		
Intercept	?	0.03498	0.21713	0.04582	0.03031	**	0.06943	0.01311	***	
Chdelay	-	-0.00009	0.00006	*	-0.00006	0.00003	**	-0.00002	0.00002	*
Seasn	+	0.00757	0.00635		-0.00277	0.00389		-0.00305	0.00233	*
CFO	-	-0.08490	0.00427	***	-0.16765	0.00775	***	-0.21990	0.01022	***
AbsCFO	-	-0.00052	0.00020	***	-0.04939	0.00437	***	-0.07683	0.00998	***
M/B	+	0.00617	0.00132	***	0.00440	0.00212	**	-0.00774	0.00218	***
lgMVE	+	-0.00059	0.00212		0.00035	0.00271		0.00172	0.00080	**
Big5	-	0.02694	0.00675	***	0.00704	0.00460	*	0.00448	0.00623	
Loss	-	-0.05635	0.00678	***	-0.05048	0.00383	***	-0.39800	0.00292	***
EXT	?	0.04387	0.01892	**	0.00142	0.01174		0.00360	0.00565	
PAR	?	-0.02296	0.00631	***	0.00148	0.00363		0.00070	0.00206	
ChAud	?	0.00657	0.00746		-0.00511	0.00442		-0.00459	0.00290	*
LEV	-	-0.00009	0.00002	***	-0.00587	0.00230	***	-0.01574	0.00492	***
AdjustedR ²		0.0357		0.0566			0.0805			
N		11495		8993			7755			

Significance Levels: one-tailed, *** $p < .01$, ** $p < .05$, * $p < .10$

ChDAC = CY discretionary accruals minus PY discretionary accruals
Chdelay = CY audit delay minus PY audit delay
CFO = cash from operations divided by average total assets
Seasn = coded 1 if firm has a December or January FYE
AbsCFO = the absolute value of CFO
M/B = market to book ratio
LgMVE = natural log of market value of equity
Big5 = coded 1 if auditor is Big 5, 0 otherwise
Loss = coded 1 if net loss reported, 0 otherwise
EXT = coded 1 if extraordinary item(s) reported, 0 otherwise
PAR = coded 1 if explanatory paragraph was added to audit opinion, 0 otherwise
ChAud = coded 1 if auditor change occurred during year, 0 otherwise
LEV = total liabilities divided by total assets
All variables are winsorized at the 1st and 99th percentiles.

TABLE 5

Multivariate Regressions to Examine the Effect of *Mandated* vs. *Voluntary* Changes in Audit Delay on Changes in Discretionary Accruals

$$\text{ChDAC}_t = \beta_0 + \beta_1 \text{Chdelay}_t + \beta_2 \text{Seasn}_t + \beta_3 \text{CFO}_t + \beta_4 \text{AbsCFO}_t + \beta_5 \text{M/B}_t + \beta_6 \text{lgMVE}_t + \beta_7 \text{Big5}_t + \beta_8 \text{Loss}_t + \beta_9 \text{EXT}_t + \beta_{10} \text{PAR}_t + \beta_{11} \text{ChAud}_t + \beta_{12} \text{LEV}_t + \beta_{13-19} \text{Year} + \beta_{20-31} \text{Industry} + \varepsilon$$

		Mandated			Voluntary		
Variables /	Expected Sign	Parameter Estimate	Standard Errors		Parameter Estimate	Standard Errors	
Intercept	?	0.02786	0.01742	*	-0.00218	0.00610	
Chdelay	-	-0.00011	0.00005	**	-0.00006	0.00003	**
Seasn	+	-0.02038	0.00711	***	0.00225	0.00318	
CFO	-	-0.25732	0.01814	***	-0.08345	0.00293	***
AbsCFO	-	-0.14571	0.01488	***	-0.00055	0.00014	***
M/B	+	-0.00090	0.00433		0.00663	0.00091	***
lgMVE	+	-0.00500	0.00204		0.00063	0.00072	
Big5	-	0.00337	0.00840		0.01871	0.00380	***
Loss	-	-0.06320	0.00755	***	-0.04339	0.00334	***
EXT	?	0.00351	0.01678		0.02082	0.00929	**
PAR	?	0.00677	0.00601		-0.01044	0.00297	***
ChAud	?	0.00103	0.00770		-0.00302	0.00309	
LEV	-	-0.00235	0.00333		-0.00009	0.00002	***
AdjustedR ²		0.0762			0.0320		
N		2,567			25,676		

Significance Levels: one-tailed, *** $p < .01$, ** $p < .05$, * $p < .10$

ChDAC = CY discretionary accruals minus PY discretionary accruals
 Chdelay = CY audit delay minus PY audit delay
 CFO = cash from operations divided by average total assets
 Seasn = coded 1 if firm has a December or January FYE
 AbsCFO = the absolute value of CFO
 M/B = market to book ratio
 lgMVE = natural log of market value of equity
 Big5 = coded 1 if auditor is Big 5, 0 otherwise
 Loss = coded 1 if net loss reported, 0 otherwise
 EXT = coded 1 if extraordinary item(s) reported, 0 otherwise
 PAR = coded 1 if explanatory paragraph was added to audit opinion, 0 otherwise
 ChAud = coded 1 if auditor change occurred during year, 0 otherwise
 LEV = total liabilities divided by total assets
 All variables are winsorized at the 1st and 99th percentiles.