

Market-Based Incentives for Optimal Audit Quality*

Andrew Acito Amir Amel-Zadeh James Anderson William Anderson

Daniel Aobdia Thomas Bourveau Francois Brochet Huaizhi Chen

Jonathan Fluharty-Jaidee Martin Schmalz[†] Manyun Tang

Scott J. Wang Joshua T. White William Zame

This version: December 2024

Abstract

We examine how equity markets respond to the public release of audit-firm inspection reports by the U.S. regulator. Investors react differently based on the identifiability of the public issuers whose audits are covered in the inspection report. Auditors with identifiable issuer clients show positive abnormal returns for non-deficient reports and negative reactions for deficient ones. In contrast, issuers less easily linked to specific auditor inspections experience muted responses. More timely publication of inspection reports intensifies market reactions, while delays reduce their informativeness. The findings highlight how regulatory transparency can enable investors to better incorporate audit quality information into equity prices. We discuss implications for market-based incentives for issuers and auditors.

Keywords: Audit Quality, Audit Regulation, Event Study, Abnormal Returns, Inspection Report
JEL Classification: M41, M42, M48, G18, G14

*Acito is with Virginia Tech; Amel-Zadeh is with University of Oxford; J. Anderson is with Saginaw Valley State University; W. Anderson is with the Public Company Accounting Oversight Board (PCAOB); Aobdia is with Penn State University; Bourveau is with Columbia University and the PCAOB; Brochet is with Boston University; Chen is with University of Notre Dame and the PCAOB; Fluharty-Jaidee is with the PCAOB; Schmalz is with University of Oxford and the PCAOB; Tang is with University of Oxford; Wang is with Penn State University and the PCAOB; White is with Vanderbilt University and the PCAOB; Zame is with UCLA. We thank Peter Easton, Joseph Gerakos, Colleen Honigsberg, Andrew Indieke, Christian Leuz, Maureen McNichols, Elizabeth Pollman and Chad Syverson along with seminar participants at the University of Notre Dame and PCAOB for helpful feedback and suggestions. The views expressed herein are the authors' own and do not necessarily reflect the views of the Board, individual Board members, or PCAOB staff. Any errors and omissions are those of the authors alone.

[†]Corresponding author: University of Oxford (Saïd School of Business) and Public Company Accounting Oversight Board - martin.schmalz@sbs.ox.ac.uk

1 Introduction

The market for public-company audits in the U.S. was historically self-regulated and relied on private mechanisms to ensure audit quality. However, the corporate governance and auditing failures revealed by the collapse of Enron highlighted two critical frictions: (i) investors cannot easily observe audit quality, and (ii) dispersed investors lack sufficient incentives to collect and act upon information regarding audit quality.¹ These challenges spurred congressional action aimed at restoring trust in capital markets (Hail et al., 2018). While one approach could have been to fully centralize the audit market under public agents—similar to the Internal Revenue Service’s role in tax audits (DeBacker et al., 2018)—Congress instead implemented a hybrid model combining public oversight with private market mechanisms. This paper seeks to inform the ongoing policy debate over the optimal design of audit regulation by examining whether equity markets respond to the public release of audit-firm level inspection reports issued by the primary U.S. audit regulator.

In theory, an audit regulator could directly address these frictions by designing a market-based approach that efficiently integrates inspection results into investors’ decision-making processes. Specifically, the regulator would (i) inspect financial statement audits for quality, and (ii) make the information gathered from such inspections available to investors in a standardized and transparent way at the *issuer* level. Such a regulatory response would enable investors to incorporate audit quality into equity prices, thereby allowing the market—rather than the regulator—to determine the optimal allocation of resources across various audit dimensions.² This market-based approach represents an efficient, transparent, and free-market alternative to addressing a regulator’s policy-induced inefficiencies.

¹We define audit quality following DeFond and Zhang (2014), assuming that audit quality is higher when there is “greater assurance that the financial statements faithfully reflect the firm’s underlying economics, conditioned on its financial reporting system and innate characteristics.”

²In many jurisdictions, including the U.S., legal limitations restrict the regulator’s ability to freely disclose information from inspections. This paper does not address the legal question of whether inspection reports could be released at the level of individual audits or broader political economy implications of such a decision. Instead, we contribute to the policy debate by providing the first empirical analysis of how financial markets respond to audit inspection information.

The current U.S. regulatory approach differs by granting anonymity to issuers whose audits are inspected. While public inspection reports detail deficiencies—such as failures to detect accounting errors—at the audit-firm level, they do not identify *which* issuers’ audits were inspected or found to be deficient. This lack of issuer-specific transparency may restrict capital markets from fully assessing and pricing audit quality, leaving investors with incomplete information about the reliability of financial statement disclosures.

Revealing issuer-specific audit inspection results could improve market efficiency by reducing information asymmetry and investor uncertainty. Enhanced transparency could allow investors to better assess the quality of financial reporting, enabling more accurate security pricing. Economic theory suggests this would lead to higher average stock prices for public issuers (Leland and Pyle, 1977; Verrecchia, 2001; Lambert et al., 2007). Greater transparency in audit inspections could also incentivize issuers and auditors to prioritize audit quality. Knowing that inspection outcomes will be public, issuers might pressure auditors to deliver an appropriate level of assurance in the areas of financial reporting that matter most to their investors. This dynamic could create a market-driven mechanism where auditors aim to provide a level of quality that is optimal based on investor preferences, reducing reliance on prescriptive regulatory interventions aimed at discouraging poor audit quality. Such a shift could make audit oversight more efficient, as the market itself would reward high-quality audits and penalize those with a level of deficiencies that do not match investor preferences.

By contrast, theory posits that if equity prices do not fully reflect audit quality, then (i) incentives to provide high-quality audits are reduced, and (ii) issuers may prioritize lower-cost audits. In turn, this may lead audit firms to compete on cost rather than quality. This situation would necessitate a higher level of prescriptive regulation to protect investors, which may come with unintended consequences that are costly to auditors, issuers, and ultimately investors. Hence, whether equity prices are able to reflect audit quality at the issuer level is critical to the design of regulatory policy in the market for assurance services.

The question of whether the U.S. audit regulator should disclose issuer-specific inspection

results is central to an ongoing policy debate (Levitt, 2020). Proponents, including investor groups, have long advocated for issuer-level disclosures, citing transparency and investor welfare benefits (Investor Advisory Group, 2020; Fung and Weil, 2007).³ Opponents, including business groups such as the U.S. Chamber of Commerce, argue that such disclosures could unfairly reduce stock prices (Maurer, 2024).⁴ They contend that deficiencies may result from inspector judgment and regulatory disagreements rather than meaningful concerns related to the issuer or auditor.⁵ Critics also note that U.S. inspection reports are narrow in scope and often delayed, potentially limiting their relevance to investors (e.g., Maksymov and Westermann, 2024). This ongoing debate highlights the need for empirical analysis to determine how equity markets respond to issuer-specific information regarding audit quality.

To address this question, we examine whether equity markets react to the publication of U.S. regulatory audit inspection reports between 2006 and 2022 and identify the conditions under which these reactions occur. We focus on triennially inspected firms, which are smaller audit firms that audit 100 or fewer public issuers annually and are inspected at least once every three years. Using public data sources, we collect the exact timing of report dissemination to investors for 3,500 inspection results by the U.S. audit regulator. After constructing our sample, we retain 731 inspection events for 3,148 issuer events. Of these, 2,154 issuers (68.4 percent) are associated with deficient inspection reports, while 994 issuers (31.6 percent) are not. The resultant data panel represents the most comprehensive academic event-study resource linking audit quality reports to investor reactions in the capital market.

Ex ante, several reasons exist as to why equity markets might not measurably respond to inspection reports. First, investors may not perceive audit quality as a critical determinant of issuer value. Second, the absence of issuer-specific information in firm-level reports may

³For example, the U.S. audit regulator’s investor advisory group notes that withholding the names of issuers whose audits were inspected deny investors information about which audits met compliance and professional standards (Levitt, 2020).

⁴This view contrasts with economic theory discussed above, which suggests that reducing information asymmetry and increasing investor confidence would likely lead to *higher* stock price.

⁵In efficient markets, investors would adjust their response for the perceived quality of audit inspections.

limit investors' ability to identify affected issuers. Third, if inspection reports are perceived as low quality or heavily influenced by inspector discretion, investors may question whether reported deficiencies are material to their investment decision. Fourth, if equity markets are strong-form efficient, inspection report information may already be reflected in stock prices before their public release. Based on these factors, any observed market reaction to the release of these reports would represent a lower-bound estimate of the importance investors place on audit quality information contained in inspection reports.

Our research design leverages heterogeneity in the degree to which inspection results can be attributed to particular issuers. In the U.S., a small number of larger audit firms audit many public issuers (Francis et al., 2013), making it generally difficult to attribute deficiencies in audit firm-level inspection reports to a particular issuer. By contrast, many smaller audit firms audit a small number of public issuers, enabling investors to more easily link deficiencies in inspection reports to specific issuers. This creates two dimensions of heterogeneity in our analysis: whether audits were found deficient and whether issuers are more easily identifiable from the inspection reports.

We find that equity market reactions depend on whether investors can identify the inspected issuers. For issuers audited by firms with four or more clients, where individual audits are less identifiable, we observe no measurable difference in the market responses to reports of deficient versus non-deficient audits. This lack of differentiation suggests that when issuer-specific information cannot be directly tied to a given issuers, investors treat all audits (within the report) as a pooled average, limiting their ability to price audit quality into equity valuations. These results highlight a fundamental limitation in the current regulatory regime, where the anonymity of issuers constrains the market's ability to incorporate audit quality information effectively.

Conversely, for issuers audited by firms with three or fewer clients, where deficiencies can be more easily attributed to specific issuers, the market reacts strongly and immediately to audit inspection outcomes. Non-deficient audits are associated with positive abnormal

returns on average, while deficient audits experience negative returns. The difference in returns between these two groups ranges from 1.9 to 2.6 percent, depending on the asset-pricing model used, and is generally statistically significant at conventional levels. These findings demonstrate that when investors can identify inspected issuers, they incorporate audit quality into equity prices, effectively using inspection results as a signal of financial reporting credibility. Notably, we find no evidence that identifiable issuers, as a group, experience negative abnormal returns to the release of audit inspection information. This suggests that transparency regarding audit outcomes does not broadly penalize issuers.

Additionally, we examine whether greater identifiability of issuers is associated with the market's sensitivity to audit quality. For issuers with auditors who engage four to six clients, the market reactions to deficiencies are more muted but still directionally consistent with those of fully identifiable issuers. Beyond this, issuers audited by firms with seven or more clients exhibit negligible differences in returns between deficient and non-deficient inspections. These findings highlight the importance of transparency in audit inspections: greater identifiability enhances investors' ability to differentiate between higher- and lower-quality audits, creating stronger incentives for issuers to demand quality audits and for auditors to deliver them. Together, our results provide evidence that linking audit quality information to specific issuers can be an efficient way to impound audit quality into stock prices and potentially align audit incentives with investor interests.

We further investigate and find that the timeliness of inspection report releases influences investors' reaction to audit quality signals. Reports released with shorter delays elicit stronger and more differentiated market responses. For low-delay reports, non-deficient inspections are associated with a positive response, while deficient inspections generate significant negative reactions, with an economically meaningful difference in returns between the two groups.

By contrast, high-delay reports fail to produce significant market reactions, with both non-deficient and deficient inspections eliciting muted returns. These results highlight the

importance of timely information for investor decision-making, as shorter delays likely enhance the perceived relevance and credibility of inspection findings, while longer delays may reduce the perceived relevance and informativeness of the reports. One possibility for the muted response to delayed information is that investors believe that the deficiencies have already been addressed or are no longer material.

In our final test, we examine whether investor responses to inspection reports for identifiable issuers have evolved over time. Such changes could reflect differences in regulatory practices, market conditions, or investor awareness of audit inspection reports. For these tests, we partition our sample around the midpoint of 2014 and find a slightly widening gap between non-deficient and deficient issuers in the second half of the sample. Although these differences are not statistically significant, the trend indicates that investors may have become more attuned to audit quality signals from inspection reports, potentially due to heightened attention to regulatory findings or shifts in the perceived informativeness of the reports.⁶

We caution the reader that the results may have limited external validity, as only a small fraction (about six percent) of triennially inspected audits are presently identifiable. That said, the findings are directionally consistent with the arguments based on economic theory laid out above and establish that investors price information about audit quality when it is available. With this caveat in mind, our paper contributes to the rich academic literature on audit regulation (DeFond and Zhang, 2014) while bearing some policy implications.

From an academic standpoint, several papers document the benefits of a public inspection regime by providing evidence on product-market benefits of inspected audit firms over non-inspected ones (e.g., Aobdia and Shroff, 2017) and the capital-market benefits of inspected (foreign) issuers over non-inspected ones (e.g., Shroff, 2020). Closer to our study, Gipper et al. (2020) find evidence that a shift from industry self-regulation to agency oversight

⁶Inspection reports have grown in the degree of disclosure over time, with more recent reports including more granular detailing of information, such as industry of the issuer, tabulations of outcomes, and historical comparisons. Most recent reports additionally include a section disclosing independence violations.

increases the credibility of financial reporting. Our approach allows us to more directly assess the potential benefits of a public inspection regime by documenting that the equity prices are further sensitive to information pertaining to the inspection results of audit firms.

Amidst the evolving regulatory landscape ([United States Supreme Court, 2024](#); [Iacone, 2024](#)) and a heightened focus on incentivization through enforcement ([CPA Practice Advisor, 2024](#)), understanding the market implications of greater transparency is increasingly timely. With U.S. equity capital just under \$60 trillion ([Securities Industry and Financial Markets Association \(SIFMA\), 2024](#)), even modest market responses to issuer-specific disclosures could generate significant benefits for investors. The potential incentives are orders of magnitude greater than statutory enforcement penalties in the U.S. under Section 105(c)(4)(D) of the Sarbanes-Oxley Act of 2002 (SOX). Thus, this issue holds relevance not only for policymakers debating audit reform ([House of Representatives, 2021](#); [Senate 865, 2023](#)), but also for international regulators, financial economists, and accounting scholars.

The rest of the paper is organized as follows. Section 2 discusses the institutional details of the U.S. audit regulatory regime and the literature related to and observations of audit quality in financial markets. Section 3 discusses the empirical design and summary statistics. Section 4 presents empirical results. In Section 5, we conclude by discussing the empirical limitations, economic considerations, and possible variations of the policy choices.

2 Institutional Background and Literature

2.1 The Statutory Origins of Audit Regulation

The U.S. Securities and Exchange Commission (SEC) has required issuers with publicly listed securities to file audited financial statements since 1934 for those listed on a major exchange (e.g., [Stigler, 1964](#); [Benston, 1973](#)) and since 1964 for public issuers registered with the SEC and quoted on the over-the-counter (OTC) markets (e.g., [Greenstone et al., 2006](#)). While managers are responsible for producing these financial reports for investors, they have

pecuniary and reputational incentives to conceal unfavorable outcomes and overstate positive results ([Jensen and Meckling, 1976](#)). As issuers became larger and more complex—and thereby exacerbating agency conflicts—investors began demanding that issuers obtain voluntary audits of financial statements ([Watts and Zimmerman, 1983](#)). This demand eventually led to audits being mandated under the Securities Exchange Act of 1934 ([Bourveau et al., 2024](#)).

Audits are intended to enhance the credibility of financial statements by providing reasonable assurance that financial statements are free from material misstatements. Initially, the U.S. audit profession was self-regulated, with audit quality assessed through a peer review program governed by the American Institute of Certified Public Accountants (AICPA) ([Hilary and Lennox, 2005](#); [DeFond, 2010](#); [Anantharaman, 2012](#)). However, auditors sometimes failed to exert adequate effort, lacked the technical expertise to sufficiently address risks of misstatement, or succumbed to client pressures despite the disciplining effect of concerns about their reputation ([DeAngelo, 1981](#); [Antle, 1984](#); [Ronen, 2010](#); [Causholli and Knechel, 2012](#)). In response to these failings and the high-profile corporate scandals, such as the collapse of Enron, Congress established a U.S. audit regulator under SOX to strengthen oversight in public-issuer audits through regular, independent inspections of auditor engagements and public reporting of inspection outcomes.

2.2 The Regulatory Audit Inspection Process and Reports

The U.S. regulator’s audit inspection reports consist of two main components: (i) Part I findings, which detail deficiencies in issuer audits at the audit-firm level and are always made public, and (ii) Part II findings, which address auditors’ firm-wide quality control issues. Part II findings are drafted concurrently with Part I but are only publicly disclosed if the audit firm fails to remediate the identified criticisms after 12 months.⁷

Draft inspection reports are initially shared with the audit firm, allowing the firm to

⁷For further details on the U.S. audit regulator’s inspection process, see, for example, [DeFond and Lennox \(2017\)](#), [Aobdia \(2018\)](#), and [Gipper et al. \(2020\)](#).

review and respond before the regulator formally approves a final version for public release. Once finalized, the reports are published online and distributed via email to registered subscribers. These reports summarize all deficient inspected audit engagements during the inspection cycle. However, the identities of the inspected issuers are kept anonymous due to legal requirements under Section 105(c)(4)(D) of SOX.

The frequency of inspections depends on the size of the audit firm and its public issuer audit portfolio. Audit firms performing more than 100 public issuer audits annually, such as the Big Four accounting firms, are inspected every year. Firms auditing 100 or fewer public issuers annually are inspected at least once every three years. As noted above, our focus is on these firms, which are sometimes refer to as “triennial inspected firms.”

For smaller audit firms with limited client portfolios, the regulator often inspects all—or nearly all (approximately seventy percent, on average)—issuer engagements, effectively enabling investors to infer the identities of inspected issuers through publicly available information. Even without explicit disclosure, details within the inspection reports, such as noted deficiencies, particular industries, or the occurrence of financial restatements, can help investors deduce the specific issuers involved (Swanquist, 2014). Moreover, this identifiability is likely more prevalent among smaller audit firms and their corresponding issuer clients, where a high proportion of the audit portfolio is inspected.

2.3 Related Work on Investors’ Response to Inspections

Economic theory indicates that reducing information asymmetry and investor uncertainty should improve market efficiency and translate into higher average stock prices for public issuers (Leland and Pyle, 1977; Verrecchia, 2001; Lambert et al., 2007). Indeed, revealing issuer-specific audit inspection results could allow investors to better assess the quality of financial reporting, enabling more accurate security pricing. There is limited direct insights about the release of inspection level data about issuer-level audit topic from the theoretical literature in accounting and auditing. One notable exception is the study

by [Attar-Niggemann et al. \(2024\)](#). Their theoretical work highlights the benefits of publicly disclosing issuer-level audit deficiencies. The authors argue that traceable deficiencies could amplify legal and reputational pressures on auditors, enhancing audit quality. Yet, their model does not address whether equity markets incorporate this information into stock prices or whether issuers have incentives to demand higher-quality audits in response.

On the empirical side, existing evidence also offers limited insight into how equity markets respond to audit-firm inspection reports by the U.S. regulator, especially in terms of directly observable stock price reactions. Despite the theoretical importance of these disclosures, only a handful of studies examine whether this information shapes investor perceptions of audit quality and, in turn, affects equity valuations. Two relevant studies provide evidence that public audit oversight can influence market perceptions of financial reporting credibility. For example, [Gipper et al. \(2020\)](#) document changes in earnings response coefficients after the transition from auditor self-regulation to public oversight, suggesting that more credible financial reporting environments under regulatory inspections enhance earnings informativeness. Another paper by [Erinc and Zach \(2024\)](#) shows that investors discount earnings surprises when those earnings are more likely influenced by audit deficiencies highlighted in inspection reports, suggesting that inspection information shapes perceptions of financial reporting quality. However, these studies focus is on how inspection-related signals affect the interpretation of subsequent earnings news, rather than directly examining market reactions to the publication of inspection reports themselves.

A single unpublished working paper by [Offermanns and Peeks \(2011\)](#) attempt to directly address this question. Using the “stamp” dates from Audit Analytics as proxies for actual release dates, it posits that inspection reports may influence market volatility. However, this approach rests on approximated timing and broad event windows, since the reported stamp dates frequently diverge from the actual public release dates of inspection reports. Although [Offermanns and Peeks \(2011\)](#) observe heightened return volatility following the reports, they do not identify a clear directional price response. Moreover, the focus on early inspection

periods and the need to rely on less precise timing data constrains their study’s ability to isolate the direct price effects of inspection disclosures on individual issuers.

In sum, while existing research recognizes that the regulatory audit oversight can shape investor perceptions and market outcomes, direct evidence on the price effects of publicly released inspection reports remains limited. Our study addresses this gap by providing a direct analysis of how equity markets react to the public release of audit inspection reports and the conditions that drive meaningful price updates. By identifying release dates, accounting for issuer identifiability, and exploring the role of inspection timeliness, we offer new evidence on how regulatory transparency and audit quality information flow into capital markets, thereby informing policy debates over the design and disclosure of inspection regimes.

3 Empirical Design

3.1 Event Study

Our primary tests estimate the stock market reactions to the release of regulatory audit inspection reports, following standard event-study methodologies (Fama et al., 1969; Kothari and Warner, 2007). We compute abnormal returns using two approaches: (i) market-adjusted returns and (ii) the Fama-French 3-Factor model (*FF-3*), employing standard estimation parameters over a 180-day period preceding the event window. Abnormal returns are then summed over the two-day $[0,1]$ and three-day $[0,2]$ event window around the release to generate cumulative abnormal returns (*CAR*). We then average these values across relevant subsamples, and label this the Cumulative Averaged Abnormal Returns (*CAAR*).

3.2 Data Sources and Sample Period

We utilize publicly available data from multiple sources to conduct our analysis. Information on the release of inspection reports is obtained from the audit regulator in the U.S.—the Public Company Accounting Oversight Board (PCAOB)—through email announcements

and the PCAOB’s inspection release website. Equity return data are collected from the Center for Research in Security Prices (CRSP), while issuer financial information is sourced from Compustat. Additionally, auditor and client information is obtained from Audit Analytics. These data sources collectively provide a comprehensive and publicly replicable dataset, ensuring that our analysis reflects the information environment available to investors.

Our sample period is designed to ensure consistency and comparability across time. Although the PCAOB began inspecting audit firms in June 2003 and released its first reports in 2004, these early inspections were limited in scope and conducted prior to the PCAOB’s formal registration process (Gipper et al., 2020).

To address these limitations, we focus on inspection releases beginning in inspection year 2006, for which we have reliable data. An “inspection year” denotes the year of the inspection program as reported on the PCAOB’s website. We note that report details do not specifically align with the issuers’ fiscal years or the calendar year when the reports are released. Thus, our sample focuses on inspection releases from inspection years 2006 to 2022. The inspection reports during this period typically contain the identity of the auditor, the total number of issuers audited, the number of issuers inspected, the audit deficiencies identified, and detailed descriptions of these deficiencies. This focus ensures reliability and comparability of the data used in our analysis.

3.3 Inspection Report Release Date

Table 1 reports summary statistics on the timing of inspection report releases and the discrepancies between the Audit Analytics-provided dates and the actual release dates. Of the 3,503 inspection reports, only 1,533 (approximately 44 percent) have release dates that align within one day of the Audit Analytics-reported issue date. Notably, over 40 percent of the Audit Analytics dates differ from the actual release dates we collected by more than ten days.

[Insert Table 1 here]

3.4 Data Sample of the Inspection Reports

To accurately measure the market impact of the inspection reports, each report is matched with the issuers audited by the inspected firm using Audit Analytics’ record of audit opinions. Replicating the information set available to investors, we match an issuer to the inspected audit firm whether or not the issuer was actually inspected. We identify these issuers using a one-year lookback (based on the signature date of the opinion) from the inspection publication date. Starting with 3,503 inspection reports, we lose three reports due to missing information, and following the merge with Audit Analytics, CRSP, Compustat, and common share-type restrictions on issuer securities, we retain a final sample of 1,535 inspection reports.

We further restrict our sample to triennially inspected firms for better comparability between identifiable and non-identifiable issuers. As noted above, triennially inspected auditors are those that issue 100 or fewer audit opinions each year. In the post-estimation sample, this includes 731 triennial inspection reports, covering 260 unique audit firms, 1,479 unique issuers, and 151 distinct inspection report publication dates.

3.5 Audit Firm, Market, and Issuer Characteristics

Table 2 reports sample statistics collected under the inspection report release-date lookback for triennially inspected U.S. audit firms. The table includes counts of issuer-events (i.e., issuers tied to an inspection report release), issuer-events with and without deficiencies, and identifiable issuers.

An issuer-event is classified as *Non-Deficient* if the inspection report does not identify any Part I.A deficiencies for the auditor. Issuer-events are classified as *Identifiable* if the auditor disclosed in the inspection report has three or fewer public issuer audit clients, while those with four or more clients are classified as *Non-Identifiable*. Alternative thresholds for identifiability, such as two or fewer clients, were tested, and the results remain consistent both qualitatively and quantitatively. Issuer-events are included in the sample only if complete

data are available for all days within the estimation window used in the market models.

[Insert Table 2 here]

Panel A of Table 2 details the final sample of issuer-events. Over the 17 years covered in the sample, there are an average of 43 triennial audit firm inspections and approximately 186 issuers inspected per year. The dataset includes 731 inspection events, corresponding to 3,148 issuer-events. Of these, 2,154 (68 percent) have at least one deficiency noted, while 994 issuers (32 percent) have no deficiencies noted in the inspection report. Out of the 3,148 issuer events, 182, or about 5.8 percent, meet the identifiability criteria.

Panel B presents descriptive statistics for key issuer characteristics, including market capitalization, leverage, return-on-assets, issuer age, and book-to-market ratios for identifiable and non-identifiable issuers. We formally tests for differences in these characteristics between identifiable and non-identifiable issuers in Panel C.

We define *market capitalization* as the total market value of the issuer’s outstanding common stock as of the prior fiscal year end in millions of U.S. dollars, from CRSP. *Leverage* is the long-term debt plus long-term debt in current liabilities divided by total assets, from Compustat. *Return-on-assets* is the income before extraordinary items divided by total assets, from Compustat. *Issuer age* is the number of years since the issuer’s initial public offering date (until report publication), using data from CRSP. *Book-to-market* is the book-to-market ratio with book equity as the book value of stockholders’ equity with balance sheet deferred taxes and investment tax credit. If available, we adjust the value of preferred stock using redemptions, liquidations, or the par value (e.g., Daniel and Titman, 2006).

These panels show that identifiable issuers are significantly smaller, with a mean market capitalization of \$117 million compared to \$215 million for non-identifiable issuers, and the difference of $-\$98$ million is statistically significant ($t = 5.56$). Leverage is also slightly lower for identifiable issuers, with a mean of 11 percent versus 13 percent for non-identifiable issuers, where the difference of -2.0 percent is statistically significant ($t = 2.39$). Return-on-assets is higher for identifiable issuers, averaging 1.0 percent compared to -9.0 percent

for non-identifiable issuers, with the difference of 11 percent being statistically significant ($t = 6.42$).

By contrast, issuer age and book-to-market ratios are similar across the two groups, with no statistically significant differences ($t = 1.18$ for issuer age and $t = 1.13$ for book-to-market). Taken together, the results in Panels B and C suggest that while identifiable issuers tend to be smaller and more profitable, they are broadly comparable to non-identifiable issuers in terms of age and book-to-market valuation ratios.

In untabulated analysis, we focus on audit firms rather than issuers and examine whether there are differences in the incidence of deficiencies between audit firms with identifiable and non-identifiable client bases. Using inspection reports, we calculate the average number of unique audit deficiencies per inspected engagement.⁸ Specifically, we identify references to Auditing Standards (AS) and Interim Standards (AU) in the reports, counting only unique standards mentioned and excluding repeated sub-paragraphs.

The results reveal slight differences across the two groups. The median number of referenced standards per deficient inspected audits of triennial firms is four for identifiable issuers and two for non-identifiable issuers. The mean, however, is slightly higher for identifiable issuers, averaging around 4.8 compared to 2.9, and the difference is statistically significant at the 1% level. While significant, the findings suggest that the incidence of audit deficiencies, as measured by referenced standards, is broadly comparable across firms with identifiable and non-identifiable client bases with identifiable clients having a couple more referenced violations on average. A plausible explanation is that resource constraints decrease in audit firm size, and such economies can lead to comparatively weaker internal controls and a marginally greater likelihood of multiple violations of auditing standards. Differences in the particular nature of these deficiencies likely reflect the size of the firm and the size and complexity of its audit clientele.

⁸Some reports were not extractable (around one percent) and are excluded. To improve the reliability of the analysis we focus on the post-2013 period where violations are readily referenced by their standard code.

4 Results

4.1 Univariate Market Reactions to Inspection Report Releases

Table 3 reports the CAARs and respective t -statistics across different event windows and risk-adjusted models for issuers related to audit inspection report releases. In the sample of non-identifiable issuers, Panel A shows insignificant market reactions to inspection reports with non-deficient outcomes. Specifically, using the market-adjusted model, non-deficient issuers underperform their deficient counterparts by approximately -0.02 percent in the $[0,2]$ window, which is not statistically different from zero ($t = 0.06$). The results are similar using different return windows and the FF-3 model. These muted responses suggest that investors of non-identifiable issuers do not significantly differentiate based on the inspection outcomes, and audit quality signals have limited impact on equity prices for this group. Excluding earnings announcements and restatements near the inspection release does not materially alter these results.

[Insert Table 3 here]

By contrast, when the issuers are identifiable, as shown in Panel B, a clear distinction emerges between market reactions to deficient and non-deficient audits. While individual reactions for non-deficient and deficient issuers are not always significantly different from zero, the difference between the two groups is both economically and statistically significant. Using the market-adjusted model, the difference in returns ranges from 1.9 to 2.6 percent across event windows, which are statistically different from zero at the five percent level or better in most specifications. This economically meaningful gap illustrates the potential of market-based mechanisms to incentivize audit quality, often exceeding the financial penalties imposed by regulators.⁹

⁹Even for relatively small issuers, this change in market value can far exceed typical regulatory fines. For example, applying the 1.9 to 2.6 percentage point difference in market value to the average sample market capitalization of \$117 million results in a change of \$2.2 to \$3.0 million. This amount is 17 to 24 times larger than the average enforcement penalty of \$126,470 imposed on triennially inspected firms from 2005 to 2017 (Hollingsworth and Irving, 2021).

Panel C examines issuers that are marginally observable, meaning their auditors have slightly more clients than those of the identifiable group (four to six clients), making it only partially possible to link audit deficiencies to specific issuers. The results show a muted investor reaction compared to the fully identifiable group. Specifically, non-deficient issuers in this category exhibit higher returns than deficient issuers, with a difference of approximately 0.88 percent in the $[0,2]$ event window using the market-adjusted model, though this difference is not statistically significant ($t = 0.92$). These findings suggest that marginal observability leads to a weaker, yet directionally consistent, market response to audit inspection outcomes.

In untabulated results, we assess the overall market reaction to inspection reports for *all* identifiable issuers, encompassing both deficient and non-deficient audits. The analysis reveals no significant market response around inspection report releases. For example, identifiable issuers exhibit a CAAR of an insignificantly positive 0.49 percent ($t = 0.88$) in the $[0,2]$ event window. These findings challenge the claim that naming issuers in inspection reports would broadly depress their stock prices. Instead, the overall evidence from Table 3 suggests that identifiability enhances the market’s ability to discern audit quality effectively.

We extend our analysis by examining a wider event window and plotting the CAARs for both identifiable and non-identifiable issuers. Figure 1 displays CAARs over the $[-10,10]$ trading day window, based on market-adjusted returns. The findings support the conclusion that identifiability does not adversely affect the average stock performance of public issuer clients of triennially inspected audit firms. In fact, the results indicate that for identifiable issuers, CAARs tend to be more positive around the publication of inspection reports compared to non-identifiable issuers.

[Insert Figure 1 here]

Focusing on the subsample of deficient and non-deficient issuers across both identifiable and non-identifiable categories, Panel B reveals that the CAARs for issuers audited by non-deficient auditors are, on average, lower than those for issuers audited by deficient auditors.

This indicates that the market has difficulty distinguishing between issuers with deficient and non-deficient reports when issuer identifiability is limited.

Finally, Figure 2 illustrates the differences in abnormal returns for non-deficient versus deficient inspection reports based on issuer identifiability over the [-10,10] trading day window. Panel A uses market-adjusted returns, while Panel B employs the FF-3 model. The results align with earlier findings, showing significantly higher abnormal returns for non-deficient issuers compared to deficient ones in the identifiable group, whereas the distinction is largely absent for non-identifiable issuers.

[Insert Figure 2 here]

Overall, the evidence suggests that investors incorporate audit quality into equity prices when issuers are identifiable. However, investors pool issuers with and without deficiencies when identifiability is challenging.

4.2 Inspection Metrics by Identifiability

Understanding the relation between issuer identifiability and market reactions to audit inspection reports is crucial for assessing how transparency influences investor decision-making and audit quality incentives. Our definition of identifiable and non-identifiable issuers is determined by the number of issuers for the auditor. We classify issuers as identifiable or non-identifiable based on the number of clients audited by their auditor. Table 4 categorizes issuers according to this identifiability metric, which reflects the total number of clients engaged by the auditor as disclosed in the inspection reports.

[Insert Table 4 here]

Panel A shows that, for auditors with one to three clients in our sample, inspection reports typically cover 69 to 100 percent of the auditor’s portfolio, effectively including the majority of an auditor’s clients. However, as the auditor’s client base expands to five or more, only a minority of the client portfolio (less than 33 percent) gets inspected. As the number of clients for an auditor increases, the likelihood that any particular individual client

gets inspected becomes much smaller. For example, triennially inspected auditors with seven or more (up to 99 by definition) clients in our sample have only about a 14 percent chance that the audit of any individual client issuer will be included in a given inspection. Thus, as the client base grows, the ability of investors to associate audit inspection deficiencies to any particular issuer becomes more challenging.

The other characteristics of these public issuers, such as market capitalization and probability of deficiency, differ but remain broadly comparable between the identifiable and non-identifiable samples. For example, the average market capitalization is \$144 million for issuers audited by firms with three public clients, \$143 million for firms with five public clients, and \$215 million for firms with seven to 99 public clients. Similarly, the average deficiency rates in inspections show a slight variation: firms with three clients have an average deficiency rate of 27 percent, compared to 34 percent for firms with seven or more clients.

Panels B and C of Table 4 provide further evidence that issuer identifiability influences the market’s reaction to audit inspection results. These panels break down the CAAR gap, based on market-adjusted and Fama-French adjusted models, between non-deficient and deficient inspection reports across auditor-client size groups. The equity market reacts most strongly to the inspection reports of issuers audited by firms with one to three clients (i.e., those designated as *Identifiable*). For these issuers, the CAAR gap between non-deficient and deficient inspection reports ranges from 1.36 to 3.00 percent during the public release windows of [0,2] using the market-adjusted model (and 0.40 to 2.96 percent using the FF-3 model), although the *t*-statistics indicate the estimates are not significant at the 10 percent level or lower.

For issuers audited by firms with four to six clients, the market reactions are mostly similar and often muted, with lower CAAR gaps for most client counts. However, for issuers audited by firms with seven or more clients, where identifiability is minimal, the market reactions become negligible, with a CAAR gap of -0.10 to -0.21 percent depending on the model employed. These findings again highlight the importance of issuer identifiability

in enhancing the informativeness of audit inspection reports and their ability to influence equity prices.

4.3 Inspection Reporting Delays

The market response to inspection reports might differ based on the delay in releasing information. Longer delays could reduce the timeliness and perceived relevance of the information contained in the report. Investors may discount the significance of findings in highly delayed reports if they believe the deficiencies identified have already been addressed or are no longer material. Conversely, shorter delays may enhance the perceived credibility and usefulness of the report, as the information is more likely to reflect the current state of the audited financial statements.

To assess whether the market response varies with the timing of inspection report releases, we define *Report Delay* as the number of days elapsed from the initiation of the inspection to the report’s publication date.¹⁰ We then partition the sample based on the median delay of 670 days across all reports. Reports with delays longer than the median are categorized as *High Delay*, while those with delays at or below the median are classified as *Low Delay*. We then re-estimate the market response for identifiable and non-identifiable issuers by comparing the effects of deficient and non-deficient reports. The results of this analysis are presented in Table 5.

[Insert Table 5 here]

For *Low Delay* reports, the market reacts positively to non-deficient inspections, with CAARs of 1.50 percent ($t = 2.09$) in the $[0,2]$ window using the market-adjusted model, which is significantly different from zero at the five percent level. The return is an insignificant 0.88 percent ($t = 1.24$) using the FF-3 model.

Conversely, deficient inspections elicit significant negative market reactions in low-delay settings, with CAARs of -1.27 percent ($t = 1.29$) and -1.61 percent ($t = 1.66$) for the

¹⁰The start date is used to estimate delay, as the end date is not consistently reported by Audit Analytics.

market-adjusted and FF-3 models, respectively. Importantly, the difference in returns between non-deficient and deficient inspections for *Low Delay* reports is both statistically and economically significant: 2.77 percent ($t = 2.27$) in the market-adjusted model and 2.49 percent ($t = 2.07$) in the FF-3 model.

In contrast, when the delay is high (i.e., *High Delay*), market responses are somewhat muted. Non-deficient inspections yield CAARs of -1.31 percent ($t = 0.68$) and -2.86 percent ($t = 1.54$) for the market-adjusted and FF-3 models, respectively. Deficient inspections produce similarly weak reactions, with CAARs of -0.67 percent ($t = 0.26$) and -0.18 percent ($t = 0.07$), yielding insignificant differences in market reactions between deficient and non-deficient reports. These results indicate that the timeliness of inspection report releases impacts the informativeness of audit quality signals to the market.

4.4 Time Trends

Understanding how reactions to inspection reports evolve over time can provide valuable insights into the influence of changes in regulatory practices, market dynamics, or investor awareness of inspections. Shifts in sensitivity to identifiable issuers could signal broader trends, such as heightened attention to audit quality or adjustments in how inspection findings are reported and perceived. This subsection analyzes whether market reactions to inspection reports for identifiable issuers have changed over time.

For this analysis, we partition the sample period of 2006 to 2022 into two equal parts: *pre-2014*, which includes the years 2006 to 2013, and *post-2014*, covering the years 2014 to 2022. We then compare investor reactions to inspection reports across these two time periods to evaluate whether the observed patterns in market responses differ over time for identifiable issuers. The results are presented in Table 6.

[Insert Table 6 here]

We do not observe significant changes in market reactions to inspection reports between the two periods. Using the market-adjusted model, non-deficient inspection reports elicit a

positive but insignificant market reaction in both time periods. For the *pre-2014* period, the CAAR for non-deficient issuers is 1.69 percent ($t = 1.48$), while the *post-2014* period shows a slightly smaller, but still positive, reaction of 0.81 percent ($t = 1.32$). Deficient inspection reports, in contrast, generated mixed reactions, but are also insignificant. In the *pre-2014* period, deficient reports resulted in a CAAR of -0.44 percent ($t = 0.54$), while the *post-2014* period shows a larger negative reaction of -1.63 percent ($t = 1.06$). The difference between non-deficient and deficient issuers widen in the *post-2014* period, increasing from 2.13 percent ($t = 1.51$) in the earlier period to 2.44 percent ($t = 1.47$) in the later period, but none of the differences achieve statistical significance at the ten percent level or lower.

Similarly, for the FF-3 model, non-deficient reports generate positive returns in both periods, though smaller in magnitude compared to the market-adjusted model and still statistically insignificant. The *pre-2014* period shows a CAAR of 0.88 percent ($t = 0.79$) for non-deficient issuers, while the *post-2014* period shows a CAAR of 0.27 percent ($t = 0.41$). For deficient reports, the market reaction becomes more negative over time, with CAARs of -0.60 percent ($t = 0.73$) in the earlier period and -1.76 percent ($t = 1.20$) in the later period, neither of which are significantly different from zero. The difference in returns between non-deficient and deficient issuers increases slightly over time, from 1.48 percent ($t = 1.06$) in the *pre-2014* period to 2.03 percent ($t = 1.26$) in the *post-2014* period, but these differences are not significant at the ten percent level or lower.

The greater differentiation emerging in the post-2014 period between non-deficient and deficient issuers may indicate heightened investor awareness of audit inspection findings or changes in the perceived relevance of these reports. Non-deficient issuers consistently show positive abnormal returns across both periods, while the market reaction to deficient issuers has become more negative in the later period. This trend implies no significant decline in and perhaps increasing investor sensitivity to audit quality signals in recent years.

5 Conclusion and Discussion

This study highlights the significant role that issuer identifiability plays in shaping equity market reactions to audit inspection reports. In sum, we find that (i) equity markets do not significantly react to the release of inspection reports that cannot be easily linked to specific issuers; conversely, and that (ii) when issuers are identifiable, equity markets exhibit strong and economically significant responses to inspection outcomes.

These findings are consistent with the prediction from economic theory that removing asymmetric information improves market efficiency. The results are also consistent with the theoretical prediction that increasing investors' ability to assess individual audits' quality enables the reflection of audit quality in issuers' stock prices, thus improving the efficiency of capital markets and providing incentives for issuers to demand optimal levels of audit quality. By contrast, issuers whose audits are not identifiable do not benefit from obtaining a non-deficient audit. Hence, their incentives to demand a quality audit are muted. As a result, when issuers are not identifiably linked to audit inspections reports, demanding low-cost audits becomes relatively more attractive than demanding quality audits.

Our study is not without limitations. First, the small sample size and the characteristics of the sample limit the generalizability of our findings. The identifiable issuers in our study tend to be smaller companies audited by smaller triennially inspected firms, which may not fully represent the market dynamics for larger, annually inspected firms. Theoretical arguments suggest that similar reactions might occur for larger issuers, but future research should explore how factors like analyst coverage and lower variance in audit quality among large issuers might influence these outcomes. Additionally, the greater uncertainty surrounding smaller issuers might amplify market reactions when new information becomes available.

Importantly, our findings do not support concerns raised by issuer advocacy groups that naming issuers in inspection reports would lead to broad declines in stock prices. Instead, our results suggest that providing audit-quality information at the engagement level, rather than the firm level, could enable more market-based enforcement of auditing standards. This shift

could increase the reputational stakes for audit firms, encouraging them to deliver higher-quality audits. However, we emphasize that the arguments and limited findings presented in this paper do not imply that any one particular regulator can or should “name issuers” in inspections reports. This determination includes legal and political-economy considerations, the evaluation of which falls outside the scope of this paper.

Future research could, however, explore alternative mechanisms for releasing granular information on audit deficiencies. Options could include disclosing only positive audit outcomes, naming partners rather than firms, or creating opt-in transparency regimes for audit firms. These approaches could be tailored to balance stakeholder interests, such as investors’ demand for actionable audit information versus audit firms’ concerns over reputational risks. Additionally, the potential for spillover effects—such as increased demand for quality audits across the market—should be evaluated (e.g., [Johnson, 2020](#)).

Finally, regulatory and legal barriers may limit the feasibility of some of these options. In such cases, private-sector initiatives, such as efforts by proxy advisers or institutional investors to promote audit transparency as part of corporate governance practices, could serve as a complementary solution. Alternatively, legislative action to remove statutory obstacles might be an option to fully realize the benefits of market-based audit regulation. Ultimately, shifting from competition on cost to competition on quality could strengthen audit markets, enhance investor confidence, and improve overall financial reporting quality.

References

- Anantharaman, D., 2012, Comparing self-regulation and statutory regulation: Evidence from the accounting profession, *Accounting, Organizations and Society* 37, 55–77.
- Antle, R., 1984, Auditor independence, *Journal of Accounting Research* 22, 1–20.
- Aobdia, D., 2018, The impact of the PCAOB individual engagement inspection process—Preliminary evidence, *The Accounting Review* 93, 53–80.
- Aobdia, D., and N. Shroff, 2017, Regulatory oversight and auditor market share, *Journal of Accounting and Economics* 63, 262–287.
- Attar-Niggemann, N., V. Laux, and F. Niggemann, 2024, Revealing client names in inspection reports: Effects of PCAOB transparency on audit quality and private litigation, Working paper (Available at: [SSRN link](#)).
- Benston, G., 1973, Required disclosure and the stock market: An evaluation of the Securities Exchange Act of 1934, *American Economic Review* 63, 132–155.
- Bourveau, T., M. Breuer, J. Koenraadt, and R. Stoumbos, 2024, Public company auditing around the Securities Exchange Act, Working paper (Available at: [SSRN link](#)).
- Causholli, M., and R. Knechel, 2012, An examination of the credence attributes of an audit, *Accounting Horizons* 26, 631–656.
- CPA Practice Advisor, 2024, Heightened PCAOB and SEC enforcement against auditors continues in H1 2024, according to report. Published August 19th (Available at: [link](#)).
- Daniel, K., and S. Titman, 2006, Market reactions to tangible and intangible information, *Journal of Finance* 61, 1605–1643.
- DeAngelo, L., 1981, Auditor size and audit quality, *Journal of Accounting and Economics* 3, 183–199.
- DeBacker, J., B. Heim, A. Tran, and A. Yuskavage, 2018, Once bitten, twice shy? The lasting impact of enforcement on tax compliance, *Journal of Law and Economics* 61, 1–35.
- DeFond, M., 2010, How should the auditors be audited? comparing the PCAOB inspections with the AICPA peer reviews, *Journal of Accounting and Economics* 49, 104–108.
- DeFond, M., and J. Zhang, 2014, A review of archival auditing research, *Journal of Accounting and Economics* 58, 275–326.

- DeFond, Mark L, and Clive S Lennox, 2017, Do pcaob inspections improve the quality of internal control audits?, *Journal of Accounting Research* 55, 591–627.
- Erinc, M., and T. Zach, 2024, Auditor-client compatibility and audit quality, Working paper (Available at: [SSRN link](#)).
- Fama, E., L. Fisher, M. Jensen, and R. Roll, 1969, The adjustment of stock prices to new information, *International Economic Review* 10, 1–21.
- Francis, J., P. Michas, and S. Seavey, 2013, Does audit market concentration harm the quality of audited earnings? evidence from audit markets in 42 countries, *Contemporary Accounting Research* 30, 325–355.
- Fung, M. Graham, A., and D. Weil, 2007, *Full Disclosure: The Perils and Promise of Transparency* (Cambridge University Press).
- Gipper, B., C. Leuz, and M. Maffett, 2020, Public oversight and reporting credibility: Evidence from the PCAOB audit inspection regime, *Review of Financial Studies* 33, 4532–4579.
- Greenstone, M., P. Oyer, and A. Vissing-Jorgensen, 2006, Mandated disclosure, stock returns, and the 1964 Securities Acts amendments, *Quarterly Journal of Economics* 121, 399–460.
- Hail, L., A. Tahoun, and C. Wang, 2018, Corporate scandals and regulation, *Journal of Accounting Research* 56, 617–671.
- Hilary, G., and C. Lennox, 2005, The credibility of self-regulation: Evidence from the accounting profession’s peer review program, *Journal of Accounting and Economics* 40, 211–229.
- Hollingsworth, Carl W, and James H Irving, 2021, A review of the PCAOB’s enforcement program: 2005–2017, *Current Issues in Auditing* 15, A1–A18.
- House of Representatives, 2021, Streamlining public company accounting oversight act, 117th Congress.
- Iacone, A., 2024, SEC drops auditor misconduct cases after in-house judges ruling, *Bloomberg Law* Published September 24th.
- Investor Advisory Group, 2020, Briefing to the PCAOB - recommendations Working paper (Available at: [link](#)).

- Jensen, M., and W. Meckling, 1976, Theory of the firm: Managerial behavior, agency costs and ownership structure, *Journal of Financial Economics* 3, 305–360.
- Johnson, Matthew S., 2020, Regulation by shaming: Deterrence effects of publicizing violations of workplace safety and health laws, *American Economic Review* 110, 1866–1904.
- Kothari, S.P., and J. Warner, 2007, Chapter 1 - Econometrics of Event Studies, in B. Espen Eckbo, ed., *Handbook of Empirical Corporate Finance*, Handbooks in Finance, 3–36 (Elsevier, San Diego).
- Lambert, R., C. Leuz, and R. Verrecchia, 2007, Accounting information, disclosure, and the cost of capital, *Journal of Accounting Research* 45, 385–420.
- Leland, H., and D. Pyle, 1977, Informational asymmetries, financial structure, and financial intermediation, *Journal of Finance* 32, 371–387.
- Levitt, A., 2020, Without an independent watchdog, who will audit the auditors?, *Wall Street Journal* ([link](#)) Published February 19th.
- Maksymov, Eldar, and Kim Westermann, 2024, Providing transparency over the PCAOB inspection process: The perspective of former inspectors Working paper (Available at: Available at [SSRN link](#)).
- Maurer, Mark, 2024, Regulator explores naming companies tied to auditing deficiencies amid investor pushback, *Wall Street Journal* ([link](#)) Published May 6th.
- Offermanns, M., and E. Peeks, 2011, Investor reactions to PCAOB inspection reports, Working paper (Available at: [SSRN link](#)).
- Ronen, J., 2010, Corporate audits and how to fix them, *Journal of Economic Perspectives* 24, 189–210.
- Securities Industry and Financial Markets Association (SIFMA), 2024, Quarterly report: US equity & related, 3Q24 ([link](#)).
- Senate 865, 2023, PCAOB Enforcement Transparency Act of 2023, 118th Congress.
- Shroff, N., 2020, Real effects of PCAOB international inspections, *The Accounting Review* 95, 399–433.
- Stigler, G., 1964, Public regulation of the securities markets, *The Journal of Business* 37, 117–142.

- Swanquist, Q., 2014, Client responses to non-compliant audits: An analysis of clients targeted by PCAOB inspection, Working paper (Available at: [TRACE link](#)).
- United States Supreme Court, 2024, Securities and Exchange Commission v. Jarkesy et al., No. 22-859.
- Verrecchia, R., 2001, Essays on disclosure, *Journal of Accounting and Economics* 32, 97–180.
- Watts, R., and J. Zimmerman, 1983, Agency problems, auditing, and the theory of the firm: Some evidence, *Journal of Law and Economics* 26, 613–633.

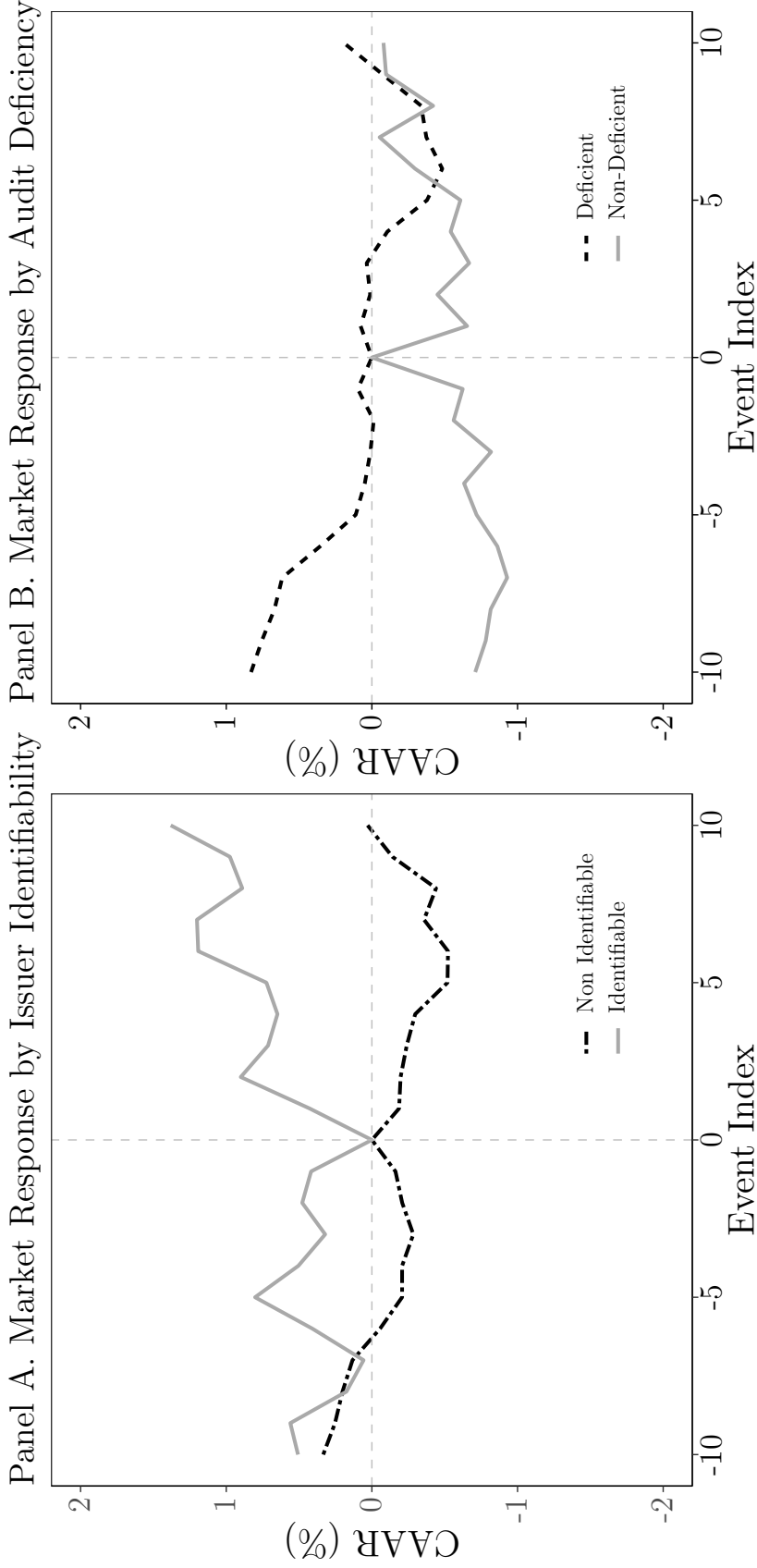


Figure 1: Cumulative Average Abnormal Returns (CAAR) for Issuer Identifiability and Audit Deficiency
Panel A presents illustrates CAARs for issuers categorized as *Identifiable* and *Non-Identifiable*, based on market-adjusted excess returns over a $[-10, 10]$ trading day event window. *Panel B* presents CAARs over the same window for issuers linked to audits categorized as *Deficient* or *Non-Deficient*. The market adjustment reflects individual equity returns minus the market return. The dashed vertical line marks the event date, with CAARs normalized such that $t = 0$ is set to zero.

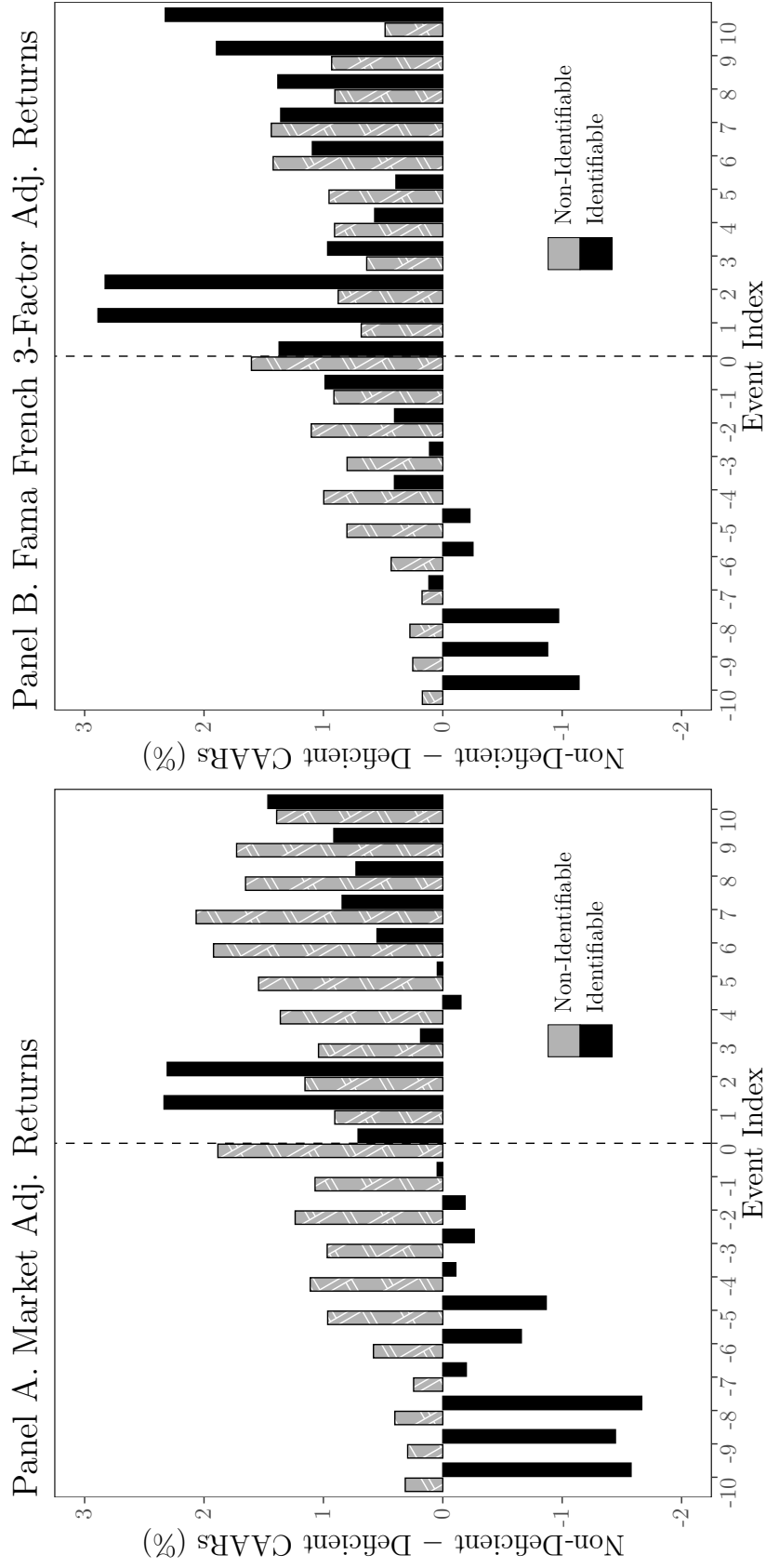


Figure 2: Differences in Market Reaction to Deficient and Non-Deficient Reports by Issuer Identifiability

This figure presents cumulative abnormal returns (CAARs) for non-deficient and deficient inspection reports, segmented by issuer identifiability (*Identifiable* versus *Non-Identifiable*), over a [10,10] trading day event window. Panel A presents the CAARs based on market-adjusted excess returns, while Panel B uses the Fama-French 3-factor model for risk adjustment.

Table 1: Date Differentials between Actual Inspection Report Releases and Audit Analytics Data

This table summarizes the inspection date discrepancy between the actual regulatory audit inspection release dates minus the dates recorded in Audit Analytics. The columns represent bins of differences – from -1,000 or less to over 1,000 or more – in the number of day difference in the two data items. The gray highlights the number of observations where the two dates approximately agree. The final rows report the number of inspections released by year and their proportion.

Insp. Year	>-1,000 days	-1,000 to -100 days	-100 to -10 days	-10 to -1 days	-1 to 1 days	1 to 10 days	10 to 100 days	100 to 1,000 days	Null or Unde- fined	Insp. Re- ports
2022							142	6	4	152
2021							135		6	141
2020							102	49	1	152
2019							173		3	176
2018							124	39	5	168
2017			1		1	2	157	33	1	195
2016					17		101	77	3	198
2015					111		67	29	8	215
2014				1	207		6	2	3	219
2013			1		198		29			228
2012		2	1		217		22		3	253
2011	1				126	16	60	1	1	212
2010			9		153	20	64		5	252
2009		1	42		212	5	24	1	2	287
2008			95		130	17	5	2	3	252
2007			117	1	76	33	3		2	232
2006			68	1	85	14	1		2	171
Total	1	3	18	335	1,533	107	1,215	239	52	3,503
%	0.03	0.09	0.51	9.56	43.76	3.05	34.68	6.82	1.48	

Table 2: Summary Statistics

This table details the sample of the triennial audit inspection reports. *Inspection Year* is the year of the inspection report. *Inspection Events* is the number of inspections associated with the inspection year. *Issuer Event* is the number of issuer clients associated with the auditors inspected. *Deficient Issuer Events* is the number of issuers for reports discovered to have a deficiency by the inspections within our d sample. *Non-Deficient Issuer Events* is the number of issuer events coded as non-deficient, i.e., having zero identified deficiencies in the inspection report. *Identifiable Issuers* signifies the number of inspection events on auditors that have three or fewer public issuer clients. *Non-Identifiable Issuers* have four or more public issuer clients. In Panel B, we present the mean, median, and standard deviation (SD) for characteristics of identifiable and non-identifiable issuers. *Market capitalization* is the total market value of the issuer's outstanding common stock as of the prior fiscal year end in millions of U.S. dollars. *Leverage* is the long-term debt plus long-term debt in current liabilities divided by total assets. *Return-on-assets* is the operating income before depreciation divided by total assets. *Issuer age* is the number of years since the issuer's initial public offering date (until report publication). *Book-to-market* is the book-to-market ratio with book equity as the book value of stockholders' equity adjusted with balance sheet deferred taxes and investment tax credit. Panel C tests for differences in the mean value of these characteristics. We report *t*-statistics for a univariate two-tailed tests. *, **, *** indicate significance at the 90%, 95%, and 99% confidence levels, respectively.

Panel A: Number of Observations by Year

Inspection Year	Inspection Events	Issuer Events	Deficient Issuer Events	Non- Deficient Issuer Events	Identifiable Issuers
2022	32	102	67	35	9
2021	45	317	281	36	10
2020	23	109	92	17	5
2019	40	202	177	25	9
2018	35	211	181	30	7
2017	51	135	103	32	16
2016	39	209	166	43	5
2015	47	195	105	90	19
2014	47	139	69	70	11
2013	48	183	144	39	12
2012	61	208	119	89	16
2011	39	133	76	57	12
2010	44	151	86	65	10
2009	69	341	211	130	18
2008	57	209	103	106	18
2007	29	132	43	89	5
2006	25	172	131	41	0
Total	731	3,148	2,154	994	182

Table 2 (Continued)

Panel B: Descriptive Statistics for Identifiable and Non-Identifiable Issuers

	Identifiable Issuers				Non-Identifiable Issuers			
	Mean	Median	SD	N	Mean	Median	SD	N
Market Capitalization (\$ millions)	117.05	47.70	206.54	182	214.95	68.29	473.36	2,966
Leverage	0.11	0.06	0.13	182	0.13	0.08	0.16	2,962
Return-on-Assets	0.01	0.02	0.20	182	-0.09	0.02	0.40	2,956
Issuer Age (years)	14.40	13.80	9.37	76	13.10	12.80	8.65	1,367
Book-to-Market	1.05	0.85	0.84	182	0.98	0.71	1.38	2,962

Panel C: Difference in Means between Identifiable and Non-Identifiable Issuers

	Difference in	
	Means	t-stat
Market Capitalization (\$ millions)	-97.90***	5.56
Leverage	-0.02**	2.39
Return-on-Assets	0.11***	6.42
Issuer Age (years)	1.30	1.18
Book-to-Market	0.08	1.13

Table 3: Cumulative Returns Around Inspection Releases

This table reports the Cumulative Averaged Abnormal Returns (CAAR) (%) of clients of U.S. triennially inspected auditors around an inspection report event. *Non-Deficient* indicates the reporting of zero audit deficiency in the inspection report, whereas *Deficient* indicates all other inspection events. The index column displays the event-time horizons of the measurement period of the returns. For instance, [0,1] is for the event starts at the first trading date coinciding with the time of the inspection release and ends at the next trading day. Market-Adjusted CAAR uses simple market-adjusted returns (daily abnormal return is stock return minus market returns), whereas FF-3 CAAR uses the returns adjusted using the Fama French 3-factors model. Panel A presents the results for *Non-Identifiable* issuers, which are inspection reports for an auditor with four or more public issuer clients. Panel B reports tests for *Identifiable* issuers, which are inspection reports for an auditor with three or fewer public issuer clients. Panel C presents results for auditors with four to six public issuer clients. *, **, *** indicate significance at the 90%, 95%, and 99% confidence levels, respectively.

Panel A: Non-Identifiable Issuers								
Model Index	Non-Deficient			Deficient			Difference	
	CAAR	t-stat	N	CAAR	t-stat	N	CAAR	t-stat
<i>Market-Adjusted</i>								
[0, 1]	-0.03	0.15	873	0.04	0.23	2,076	-0.07	0.27
[0, 2]	-0.04	0.17	872	-0.02	0.09	2,094	-0.02	0.06
<i>FF-3 Factor</i>								
[0, 1]	0.08	0.40	873	0.18	1.02	2,076	-0.10	0.40
[0, 2]	0.06	0.25	872	0.12	0.56	2,094	-0.06	0.19

Panel B: Identifiable Issuers								
Model Index	Non-Deficient			Deficient			Difference	
	CAAR	t-stat	N	CAAR	t-stat	N	CAAR	t-stat
<i>Market-Adjusted</i>								
[0, 1]	0.95	1.47	122	-1.65**	2.16	60	2.60**	2.60
[0, 2]	1.29*	1.90	122	-1.13	1.18	60	2.42**	2.06
<i>FF-3 Factor</i>								
[0, 1]	0.44	0.69	122	-1.66**	2.27	60	2.10**	2.17
[0, 2]	0.60	0.89	122	-1.28	1.39	60	1.88	1.64

Table 3 (Continued)

Panel C: Four-to-Six Issuer Audit Clients									
Model Index	Non-Deficient			Deficient			Difference		
	CAAR	<i>t</i> -stat	N	CAAR	<i>t</i> -stat	N	CAAR	<i>t</i> -stat	
<i>Market-Adjusted</i>									
[0, 1]	1.19*	1.77	61	-0.04	0.08	88	1.23	1.49	
[0, 2]	1.09	1.38	61	0.21	0.38	88	0.88	0.92	
<i>FF-3 Factor</i>									
[0, 1]	1.58**	2.30	61	0.14	0.31	88	1.44*	1.77	
[0, 2]	2.00**	2.32	61	0.04	0.08	88	1.96*	1.96	

Table 4: Inspection Coverage and Market Reactions by Auditor Client-Base Size

This table reports the characteristics of U.S. issuers and auditors using triennially inspected auditors around an inspection report event categorized by the size of their auditors' client bases, as well as the market reactions to inspection reports. Each column is the number of clients that the auditor has at the time of the inspection report. Panel A presents characteristics. *Issuer Inspected (%)* is the average percent of the clients inspected in a report. *Average Rate of Inspection Deficiencies (%)* is the percent of deficiency reported in the regulatory inspection. *Inspections with Any Deficiencies (%)* is the percent of inspection reports with at least a single Part I.A deficiency. *Number of Inspections in Sample* is the number of inspection reports within the sample for each column. Average market capitalization is based on the issuer's equity market and is reported in millions of U.S. dollars. Panel B presents the market response to inspection reports based on market-adjusted return CAAR (calculated as the daily abnormal return by subtracting market returns from the stock return). Panel C presents the market response using the Fama-French 3-factor model, which adjusts returns by accounting for market, size, and value risk factors to provide a more comprehensive measure of abnormal performance. Both panels use a window of [0,2] beginning on the inspection release date. *, **, *** indicate significance at the 90%, 95%, and 99% confidence levels, respectively.

Panel A: Characteristics

Metrics	Identifiable			Non-Identifiable			
	1	2	3	4	5	6	7+
Issuers Inspected (%)	100.00	68.75	69.12	59.26	29.17	32.62	14.02
Average Rate of Inspection Deficiencies (%)	34.00	24.22	26.99	42.11	50.00	42.19	34.21
Inspections with Any Deficiencies (%)	34.00	28.13	36.76	62.96	58.33	55.32	71.21
Number of Inspections in Sample	48	56	53	36	30	30	478
Number of Issuer Events in Sample	50	64	68	54	48	47	2,817
Average Market Capitalization (\$ millions)	94.11	105.96	144.34	343.02	142.87	167.56	214.51

Table 4 (Continued)

Panel B: Market Reactions (Market-Adjusted) by Auditor Client-Base

Metrics	Identifiable			Non-Identifiable			
	1	2	3	4	5	6	7+
All Issuers	-0.73	0.68	1.19	1.20	1.82	-1.43	-0.06
Non-Deficient	0.29	1.59	1.69	2.24	3.36	-2.08	-0.13
Deficient	-2.71	-1.63	0.33	0.59	0.72	-0.90	-0.03
Difference	3.00	3.22	1.36	1.65	2.64	-1.18	-0.10
<i>t</i> -statistic	1.33	1.44	0.78	1.25	1.25	0.95	0.31

Panel C: Market Reactions (FF-3 Factor) by Auditor Client-Base

Metrics	Identifiable			Non-Identifiable			
	1	2	3	4	5	6	7+
All Issuers	-0.73	0.15	0.35	1.08	2.30	-0.91	0.06
Non-Deficient	0.21	0.98	0.50	1.73	4.83	-0.43	-0.09
Deficient	-2.57	-1.98	0.10	0.70	0.50	-1.31	0.12
Difference	2.78	2.96	0.40	1.03	4.33*	0.88	-0.21
<i>t</i> -statistic	1.30	1.36	0.22	0.82	1.85	0.71	0.65

Table 5: Reactions for Identifiable Issuers Based on Report Delay

This table reports the cumulative risk-adjusted returns (CAAR) (%) of clients of U.S. triennially inspected auditors, with a report classified as identifiable, around an inspection report event based on the reporting delay. We define *Report Delay* as the number of days elapsed between the start of the inspection process and the publication date of the report. Reports with delays exceeding the median are classified as *High Delay*, while those with delays at or below the median are categorized as *Low Delay*. *Identifiable Issuers* indicates that the inspection report occurred on an auditor with three or fewer public issuer clients. *Non-Deficient* indicates the reporting of zero audit deficiencies in the inspection report, whereas *Deficient* indicates all other inspection events. *Market-Adjusted* is the excess return for a given equity based on a market-adjusted model. *FF-3 Factor* adjusts returns using the Fama French 3-factor model. *, **, *** indicate significance at the 90%, 95%, and 99% confidence levels, respectively.

Model Index	Non-Deficient			Deficient			Difference	
	CAAR	t-stat	N	CAAR	t-stat	N	CAAR	t-stat
<i>Market-Adjusted</i> [0, 2]								
Low Delay	1.50**	2.09	113	-1.27	1.29	46	2.77**	2.27
High Delay	-1.31	0.68	9	-0.67	0.26	14	-0.64	-0.20
Difference	2.81	1.37		-0.60	0.22			
<i>FF-3 Factor</i> [0, 2]								
Low Delay	0.88	1.24	113	-1.61	1.66	46	2.49**	2.07
High Delay	-2.86	1.54	9	-0.18	0.07	14	-2.69	-0.89
Difference	3.74*	1.88		-1.44	0.56			

Table 6: Reactions for Identifiable Issuers Across Time

This table reports the cumulative risk-adjusted returns (CAAR) (%) of clients of U.S. triennially inspected auditors, with a report classified as identifiable, around an inspection report event across time. We partition the sample into two periods: *pre-2014*, encompassing the years 2006 to 2013, and *post-2014*, covering the years 2014 to 2022. We then evaluate whether investor responses to inspection reports differ across these two time periods. *Identifiable Issuers* indicates that the inspection report occurred on an auditor with three or fewer public issuer clients. *Non-Deficient* indicates the reporting of zero audit deficiency in the inspection report, whereas *Deficient* indicates all other inspection events. *Market-Adjusted* is the excess return for a given equity based on a market-adjusted model. *FF-3 Factor* adjusts returns using the Fama French 3-factor model. *, **, *** indicate significance at the 90%, 95%, and 99% confidence levels, respectively.

Model Index	Non-Deficient			Deficient			Difference	
	CAAR	<i>t</i> -stat	N	CAAR	<i>t</i> -stat	N	CAAR	<i>t</i> -stat
<i>Market-Adjusted</i> [0,2]								
Pre-2014	1.69	1.48	66	-0.44	0.54	25	2.13	1.51
Post-2014	0.81	1.32	56	-1.63	1.06	35	2.44	1.47
Difference	0.88	0.68		1.19	0.68			
<i>FF-3 Factor</i> [0,2]								
Pre-2014	0.88	0.79	66	-0.60	0.73	25	1.48	1.06
Post-2014	0.27	0.41	56	-1.76	1.20	35	2.03	1.26
Difference	0.61	0.47		1.16	0.69			