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Real Effects of PCAOB International Inspections

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ABSTRACT

This paper examines the effect of the Public Company Accounting Oversight Board (PCAOB) international inspection program on companies' financing and investing decisions. Estimates from difference-in-differences regressions suggest that companies respond to their auditor receiving a 'deficiency-free' inspection report by issuing additional external capital amounting to 1.4% of assets and increasing investment by 0.5% of assets. These effects are larger for (i) financially constrained companies and (ii) companies located in countries where there is no audit regulator or the audit regulator does not conduct inspections. Further, the effect on financing decisions is stronger in countries with (i) low corruption, (ii) strong rule of law, and (iii) high regulatory quality. Descriptive evidence suggests that inspections increase the use of financial covenants in debt contracts, which is likely one of the mechanisms through which inspections generate real effects. This paper documents the value of PCAOB inspections in mitigating financing frictions for non-U.S. companies.

Keywords: investment, real effects, financing constraints, auditing, financial reporting, regulation

JEL Classifications: D8, D25, G15, G31, G38, M4, M41, M42

Data Availability: Data are available from the public sources cited in the text

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I. INTRODUCTION

The introduction of the Public Company Accounting Oversight Board (PCAOB) to oversee the work of public company auditors represents one of the most fundamental shifts in audit regulation in the U.S. Several studies examine the consequences of PCAOB oversight on auditor behavior and audit quality, focusing on the effect of its inspection program because it serves as the PCAOB's primary oversight tool. Prior studies generally find that PCAOB inspections improve audit quality in the U.S. (e.g., Gramling et al. 2011; DeFond and Lennox 2017; Aobdia 2018; Gipper et al. 2019), even though the audit profession is critical of the inspection program (Johnson et al. 2019; Westermann et al. 2019). Since the PCAOB inspects the work of non-U.S. auditors that participate in the audits of companies registered with the Securities and Exchange Commission (SEC), prior studies test and find that the benefits of PCAOB inspections with respect to audit quality improvements extend to the clients of non-U.S. auditors (e.g., Lamoreaux 2016; Fung et al. 2017; Krishnan et al. 2017).¹ However, there is little evidence on whether audit quality improvements associated with PCAOB inspections translate into lower financing frictions for the companies whose financial statements are being audited.

In this paper, I examine whether PCAOB inspections of non-U.S. auditors help reduce external financing frictions for non-U.S. clients of these auditors. In theory, PCAOB inspections can reduce financing frictions for clients of inspected auditors for two reasons. First, prior research finds that higher audit quality is associated with a lower cost of capital and greater access to capital (e.g., Blackwell et al. 1998; Mansi et al. 2004; Pittman and Fortin 2004; and Minnis 2011). To the extent that PCAOB inspections improve audit quality, they could lower the cost of capital, thereby allowing companies to raise more capital and increase investment. Second, the information

¹ Following the naming convention of the PCAOB, I refer to firms performing audits as “auditors” or “audit firms” and those receiving audits as “companies” or “issuers” throughout the paper.

disclosed in PCAOB inspection reports could provide investors additional information about auditor quality which is difficult for investors to assess (Doty 2012, 2014; PCAOB 2015). PCAOB inspection reports contain information about auditors' firm-wide quality control deficiencies as well as deficiencies at the audit engagement-level, which can help investors differentiate between auditors supplying high and low quality audits (e.g., Nagy 2014; Aobdia and Shroff 2017). To the extent the information in PCAOB inspection reports reduces information asymmetry between managers and investors, inspections can lower adverse selection and monitoring costs, thus reducing financing frictions (Jensen and Meckling 1976; Myers and Majluf 1984).

To test the effect of PCAOB international inspections on companies' corporate finance decisions, I construct a sample of *non-U.S.* companies that are audited by PCAOB-inspected auditors but are not directly subject to any SEC or PCAOB regulation (e.g., my sample *excludes* U.S. cross-listed companies).² Focusing exclusively on non-U.S. companies that are not directly affected by U.S. securities regulation helps mitigate the concern that the effects of PCAOB inspections are confounded by the effects of the other provisions of SOX or other concurrent regulatory changes in the U.S. In addition, restricting the sample to the set of companies that have all chosen to be audited by a PCAOB-inspected auditor mitigates the concern that auditor selection bias affects my inferences. Finally, I include country \times industry \times year fixed effects in my regressions and thereby, identify the effect of PCAOB inspections on company behavior using only the variation in auditor inspection timing within each country. Since all non-U.S. auditors, except the Canadian Big-4, have thus far been subject to only triennial inspections, such a design is feasible in the international setting.³ This fixed effect structure controls for time-invariant

² The Sarbanes-Oxley Act of 2002 (SOX) requires the PCAOB to inspect the auditing procedures of not only U.S. auditors but also non-U.S. auditors that participate in the audit of SEC registrants.

³ Auditors that issue an audit report for more than 100 SEC registered companies are subject to annual inspections; the rest are inspected at least triennially (see section 2 for more detail).

country- and industry-characteristics as well as time-varying factors such as GDP growth, IFRS adoption, enforcement changes, etc. that affect companies' financing and investing decisions. All regressions also include company-fixed effects to mitigate concerns that time-invariant company characteristics affect my inferences. As such, my difference-in-differences design benchmarks changes in the financing and investing behavior of companies whose auditors are inspected by the PCAOB in the current period to changes in the financing and investing behavior of companies in the *same country-industry and year* whose auditors (i) have already been inspected at an earlier period and (ii) will be subsequently inspected in the future.

Using data from 35 countries over the period 2002 to 2014, I test whether companies change their financing and investing decisions following the (i) completion of their auditor's inspection fieldwork and (ii) public disclosure of their auditor's inspection report. I find that companies audited by PCAOB-inspected auditors raise significantly more external capital and increase investment following the disclosure of their auditor's PCAOB inspection report, provided the inspection report does not contain any criticisms related to the manner in which the auditor performs audit engagements (i.e., Part I Findings). On average, clients of auditors that receive a "clean" inspection report raise additional external capital equal to 1.4% of assets and increase investment by 0.5% of assets. By contrast, companies whose auditors receive at least one engagement-level deficiency in their inspection reports do not significantly change their capital raising or investment behavior. The coefficient estimates suggest that companies' respond to a clean PCAOB inspection report by issuing 11.9% additional external capital and increasing investment by 8.8%.

Next, I examine whether financially constrained companies are more responsive to the PCAOB inspections of their auditor than financially unconstrained companies. By definition,

financially constrained companies have binding capital constraints that restrict their investment decisions. If PCAOB inspections reduce financing frictions for the clients of inspected auditors, financially constrained companies are predicted to raise more external capital and increase investment by a larger magnitude than unconstrained companies. This is exactly what I find. Specifically, financially constrained companies respond to their auditor receiving a clean inspection report by issuing additional external capital equal to 3.2% of assets, while unconstrained companies respond by issuing additional external capital equal to 1.5% of assets. Similarly, financially constrained (unconstrained) companies increase capital expenditure by 1.3% (0.4%) of assets if their auditor receives a clean inspection report. These results suggest that PCAOB inspections mitigate the agency problems in external financing arrangements and relax financing constraints, which lead to increases in corporate investment.

I also examine whether the presence of a local audit regulator and cross-sectional variation in its characteristics affect the value of PCAOB inspections. I find that companies whose auditors receive clean PCAOB inspections reports raise additional capital and increase investment regardless of whether there is a local regulator but the economic magnitude of these effects is smaller in countries where the local audit regulator is similar to the PCAOB. Relatedly, I examine whether the effect of PCAOB inspections on company behavior is affected by cross-country differences in institutions. I find that the effect of PCAOB inspections on capital issuances are concentrated in countries with low corruption, strong rule of law and high regulatory quality. These results suggest that PCAOB inspections are more valuable in countries with strong institutions because the local institutional environment complements PCAOB inspections. However, there is no significant difference in relation between PCAOB inspections and investment for companies located in countries with a strong versus weak institutional environment. Finally, I examine

whether PCAOB inspections are associated with greater use of accounting numbers in debt contracts. I find that clients of auditors that receive a clean inspection report obtain debt contracts with more accounting-based covenants and longer loan maturities, suggesting a substitution between a non-accounting monitoring mechanism (i.e., shorter loan maturity) and an accounting-based monitoring mechanism (i.e., financial covenants).

This paper contributes to the growing literature examining the consequences of PCAOB inspections. Prior studies find that PCAOB inspections are associated with audit quality improvements for U.S. companies (Gramling et al. 2011; Gipper et al. 2017; DeFond and Lennox 2017; Aobdia 2018) and non-U.S. companies cross-listed in the U.S. (Lamoreaux 2016; Krishnan et al. 2017). Additionally, Fung et al. (2017) and Aobdia and Shroff (2017) find that PCAOB international inspections have spillover effects on non-U.S. companies, *not* cross-listed in the U.S., if they are audited by non-U.S. PCAOB-inspected auditors. This paper extends the literature by (i) documenting real effects of PCAOB international inspections on corporate finance decisions of non-U.S. companies and (ii) providing evidence of cross-country variation in the effect of PCAOB inspections due to differences in local audit regulator and institutional characteristics. Further, this paper shows that the benefits of PCAOB inspections occur following the disclosure of inspection reports, suggesting that such disclosures are essential to derive economic benefits from inspections. This evidence complements that in Aobdia and Shroff (2017) and is potentially useful from a policy perspective because many non-U.S. regulators do not publicly disclose inspection reports (at the auditor-level), perhaps limiting the economic benefits of their inspection programs.

This paper is also related to the literature on the real effects of accounting (see Leuz and Wysocki (2016) and Roychowdhury et al. (2019) for reviews). Prior studies such as Hope and Thomas (2008), McNichols and Stubben (2008), Biddle et al. (2009), and Balakrishnan et al.

(2014, 2016) provide evidence that financial reporting quality helps alleviate financing frictions, which then leads to more efficient investment. Other studies examine the effect of accounting rules, managers' information sets, and financial reporting incentives on corporate investment behavior (e.g., Graham et al. 2011; Bae et al. 2017; Shroff 2017). This paper contributes to the literature by examining the real effects of auditor inspections, which hitherto has not been examined. This paper is also related to a study by Kausar et al. (2016), which finds that in a setting where audits are not mandatory, a company's choice to purchase an audit is incrementally informative to the information conveyed by audited financial statements; thus, observing the "audit choice" alleviates financing frictions and facilitates investment. The evidence in Kausar et al. (2016) highlights a cost of audit regulation, which forces all companies to obtain audits. By contrast, this paper highlights a benefit of audit regulation, which subjects auditors to inspections.

II. INSTITUTIONAL SETTING AND HYPOTHESES

PCAOB's international inspection program

The PCAOB was established in 2002 via Section 101 of the Sarbanes-Oxley Act (SOX). Section 104 of SOX requires the PCAOB to inspect the auditing procedures of all auditors that substantially participate in auditing the financial statement of SEC registered companies, including the non-U.S. auditors of companies cross-listed on a U.S. stock exchange. Auditors that issue audit reports for more than 100 SEC registered companies are subject to annual inspections; the rest are subject to (at least) triennial inspections. Inspections are typically performed at the offices of auditors and last for two weeks on average (for non-U.S. auditors). PCAOB inspections involve two parts: (i) an in-depth analysis of select audit engagements of SEC registrants performed by an auditor and, (ii) an examination of the auditor's firm-level quality control systems.

In the first part of the inspection, the PCAOB inspectors select a subsample of audit engagements (of SEC registered clients) for inspection based on a risk-weighted system. For each audit selected, the inspection team meets with the audit engagement team and examines the audit work papers. The purpose of examining the audit work papers is to “identify and address weaknesses and deficiencies related to how a firm conducts audits” (PCAOB Annual Report 2012). The second part of the inspection concerns the auditor’s firm-level quality control system, which focuses on issues such as the audit firm’s approach to evaluate partners, compensation criteria, management structure, culture, etc. (see PCAOB Annual Report 2012 for details about the inspection process; also see Lamoreaux 2016, Aobdia and Shroff 2017, Krishnan et al. 2017).

Upon completion of each inspection, the PCAOB prepares a written report on the inspection and makes portions it publicly available, subject to statutory restrictions on disclosure. The public portion of the inspection reports describes audit deficiencies found within the sample of audit engagements examined by PCAOB inspectors (known as Part I Findings). These deficiencies typically concern instances where the auditor failed to gather sufficient audit evidence to support an audit opinion (PCAOB Release No. 2012-003). However, the report does not divulge names of clients whose audit engagements were inspected by the PCAOB.

The PCAOB is restricted from disclosing quality control deficiencies of the inspected audit firm (known as Part II Findings). However, if the audit firm fails to satisfactorily address the PCAOB’s concerns within one year of the issuance of the inspection report, the Part II Findings can be publicly disclosed (SOX Section 104). That said, the initial inspection report allows readers to infer whether the auditor received a quality control deficiency, without providing information about the nature of the deficiency. Specifically, in cases where an auditor receives a quality control criticism by the PCAOB, the inspection report includes the text “PART II AND III OF THIS

REPORT ARE NONPUBLIC AND ARE OMMITTED FROM THIS PUBLIC DOCUMENT.”

In cases where an auditor does not receive a quality control deficiency, the inspection report typically includes the text “The inspection team did not identify anything that it considered to be a quality control defect that warrants discussion in a Board inspection report.”⁴

Hypothesis Development

Theory suggests a financial statement audit reduces external financing frictions, such as adverse selection and moral hazard between managers and capital providers, which enables companies to raise capital from investors (Jensen and Meckling 1976; Watts and Zimmerman 1983). Specifically, auditors provide independent verification of manager prepared financial statements, which contributes to the quality and reliability of financial statements. Increases in financial statement quality and reliability reduces information asymmetry between managers and investors and facilitates contracting, which leads to a lower cost of capital and greater access to external capital (e.g., Myers and Majluf 1984; Easley and O’Hara 2004; Lambert et al. 2007). Consistent with theory, prior research finds that an audit lowers the cost of debt and equity capital (see e.g., Blackwell et al. 1998, Mansi et al. 2004, Chang et al. 2009, and Minnis 2011, among others). For example, Willenborg (1999) and Weber and Willenborg (2003) find that higher quality auditors are associated with lower IPO underpricing while Mansi et al. (2004) and Pittman and Fortin (2004) find that the cost of debt is lower for companies audited by higher quality auditors. Teoh and Wong (1993) find that the earnings response coefficient is higher for companies audited by higher quality auditors, suggesting that equity investors are more reliant on the financial

⁴ I confirmed such an interpretation of the inspection report via email correspondence with a PCAOB inspector. From speaking with a PCAOB inspector, I also learned that auditors that receive a Part I Finding almost always receive a (non-public) Part II Finding as well.

statements of companies audited by high quality auditors. Similarly, Minnis (2011) finds that audits increase lenders' reliance on financial statements for pricing decisions.⁵

I hypothesize that PCAOB inspections increase a company's access to external capital and decrease its cost of capital for two reasons. First, by increasing audit quality, PCAOB inspections can lower a company's cost of capital and increase its access to capital. Prior studies find that PCAOB international inspections are associated with improvements in the audit quality supplied by non-U.S. auditors. For example, Lamoreaux (2016) finds that the threat of a PCAOB inspection leads to audit quality improvements for non-U.S. companies cross-listed in the U.S. Krishnan et al. (2017) find that PCAOB international inspections improve audit quality for non-U.S. companies cross-listed in the U.S. Specifically, Krishnan et al. (2017) document a decrease in abnormal accruals and an increase in value relevance of accounting numbers following PCAOB inspections. Finally, Fung et al. (2017) document that PCAOB inspections of non-U.S. auditors lead to audit quality improvements for these auditors' non-U.S. clients (that are *not* SEC registrants). To the extent PCAOB inspections improve audit quality, I predict that clients of PCAOB-inspected auditors will have greater access to external capital following inspections.

Second, I argue that PCAOB inspection reports reveal additional information about auditor quality, allowing investors to differentiate between high- and low-quality auditors, thus reducing information asymmetry. Since much of the audit process is unobservable, it is hard for investors to know the audit quality supplied by a company's auditor (Doty 2012; PCAOB 2015).⁶ PCAOB inspection reports provide investors information about deficiencies relating to individual audit

⁵ See DeFond and Zhang (2014), Donovan et al. (2014), and Minnis and Shroff (2017) for reviews of the literature.

⁶ For example, the 2008 Final Report of the Advisory Committee on the Auditing Profession to the U.S. Department of the Treasury discusses that "Currently, there is minimal publicly available information regarding indicators of audit quality at individual accounting firms. Consequently, it is difficult to determine whether audit committees...have the tools that are useful in assessing audit quality that would contribute to making the initial auditor selection and subsequent auditor retention evaluation processes more informed and meaningful."

engagements as well as deficiencies relating to quality control systems at the firm-level. Prior research finds evidence consistent with investors using the information disclosed in PCAOB inspection reports to infer auditor quality. For example, Christensen et al. (2016) survey investors and find that they use information in auditors' PCAOB inspection reports to infer overall audit firm quality. Aobdia and Shroff (2017) find that PCAOB-inspected non-U.S. auditors gain market share if their inspection report reveals that they had no engagement-level deficiencies. As such, the PCAOB inspection report can help reduce information asymmetry between investors and managers of companies audited by a PCAOB-inspected auditor.

The manner in which capital providers respond to PCAOB inspection reports is ex ante unclear. On the one hand, if a PCAOB inspection report reveals that an auditor is low-quality and has deficiencies in the manner in which it conducts audits, then investors might respond by raising the cost of capital for, and/or rationing capital from, the clients of such an auditor. By contrast, if inspection reports reveal that an auditor is high-quality, then investors are likely to respond by lowering the cost of capital and/or increasing access to external capital for the clients of such an auditor. On the other hand, it is plausible that regardless of the content of the PCAOB inspection report, the provision of an inspection report by the PCAOB lowers information asymmetry. Reductions in information asymmetry will, all else equal, result in greater access to external capital for companies audited by a PCAOB-inspected auditor. This discussion leads to my first hypothesis.

H_{1a}: Non-U.S. companies audited by a PCAOB-inspected auditor raise additional external capital following their auditor's PCAOB inspection.

H_{1b}: Clients of PCAOB-inspected auditors that receive deficiency-free inspection reports raise more external capital than the clients of PCAOB-inspected auditors that have at least one deficiency in their inspection reports.

In the neo-classical investment model, investment opportunities are the only determinant of investment, and the availability of financing has no effect on investment (e.g., Hayashi 1982).

However, several prior studies, dating back to Fazzari et al. (1988), provide evidence that information asymmetry generates financing frictions, which affects companies' investment decisions (see Hubbard 1998 and Stein 2003 for reviews of the literature). Specifically, information asymmetry between managers and investors creates a difference in the cost of internally available funds and external capital, which can result in a company turning down a positive NPV project if the company lacks the internal funds to invest (e.g., Jensen and Meckling 1976; Myers and Majluf 1984). Consistent with theory, prior studies show that factors that decrease information asymmetry (e.g., disclosure, banking relationships, credit ratings, etc.) lead to increases in investment (see Roychowdhury et al. 2019 for a review). Along the same lines, if PCAOB inspections relax financing frictions and increase companies' access to external capital, I predict that PCAOB inspections would lead to an increase in investment.

However, it is ex ante unclear whether companies would respond to their auditor receiving a PCAOB inspection by increasing investment. First, it is plausible that the PCAOB inspection report reveals that a company's auditor is low-quality, which could result in a decrease in the company's access to capital and its ability to invest. Second, prior research suggests that a reduction in information asymmetry could lead to a reduction in precautionary savings and hedging needs, which results in companies reducing their cash holdings rather than increasing investment (e.g., Acharya et al. 2007, Bolton et al. 2013). This discussion leads to my next hypothesis.

H_{2a}: Non-U.S. companies audited by a PCAOB-inspected auditor increase investment following their auditor's PCAOB inspection.

H_{2b}: Clients of PCAOB-inspected auditors that receive deficiency-free inspection reports increase investment by a larger magnitude than the clients of PCAOB-inspected auditors that have at least one deficiency in their inspection reports.

III. DATA AND SAMPLE

I obtain the complete list of non-U.S. auditors inspected by the PCAOB and the date when the inspection reports are made public from the PCAOB website as of November 10, 2014. I then

hand collect data on the inspection end date from the individual inspection reports downloaded from the PCAOB website. My analyses are conducted on non-U.S. companies operating in countries with at least one PCAOB inspected auditor. I obtain the financial statement information of non-U.S. companies from the Compustat Global Vantage database and hand collect the auditor identities from the S&P Capital IQ database for all company-year observations in the intersection of Compustat Global and Capital IQ.⁷ Although Compustat Global has a variable identifying the auditor for its sample company-years, I hand collect auditor data from Capital IQ for three reasons: (i) over 60% of the observations in Compustat Global have auditors classified in the generic category “Other;” (ii) the vast majority of observations with identified auditors are those a big-four auditor; (iii) the auditor variable in Compustat Global is often incorrect. As a final step, I manually clean the auditor identities for the observations in my sample as the auditor names are not uniformly coded in the Capital IQ database.⁸

My sample period begins in 2002 (following the creation of the PCAOB) and ends in 2014 (the most recent year on Compustat Global at the time I began collecting auditor identities). I require company-years to be in the intersection of the Compustat Global and Capital IQ databases and have non-missing values for total assets, capital expenditure, Tobin’s Q, and cash flow. These restrictions yield an initial sample of 158,763 company-year observations. I exclude companies cross-listed on a U.S. exchange as they are subject to the other provisions of SOX, and the timing of PCAOB inspection effects are likely to be different for these companies, leaving me with 146,340 observations. Dropping companies without a PCAOB inspected auditor results in a

⁷ I use the Global Vantage database (rather than Datastream) in part because the primary source of auditor data is Capital IQ, and Datastream does not share a reliable company identifier with Capital IQ. GVKEY serves as a common company identifier for observation in Global Vantage and Capital IQ.

⁸ For example, the auditor field in the Capital IQ database can refer to PwC as “Pricewaterhouse Coopers,” “Pricewaterhousecoopers,” “Pricewater House,” or “PwC.”

sample of 86,077 observations. I also drop 1,205 observations with annually inspected auditors since the treatment effect for such companies are not staggered. I drop observations in which companies have multiple auditors and in which companies change their auditor during my sample period. I drop companies with auditor changes because Aobdia and Shroff (2017) find that PCAOB inspected auditors gain market share from those not inspected by the PCAOB. Thus, companies that switch auditors during my sample period could induce a selection bias in my results. My final sample comprises of 52,329 company-year observations and 6,924 unique companies from 35 countries that allow the PCAOB to inspect their domestic auditors (see Table 1).

IV. Research Design and Descriptive Statistics

Research Design

I estimate the following difference-in-differences regressions to test my predictions:

$$y_{i,t} = \beta_1 INSPECTION_{i,t} + \beta_2 REPORT_{i,t} + \alpha_i + \alpha_t \times \alpha_{ind} \times \alpha_c + \mathbf{r}'\mathbf{X} + \varepsilon_{i,t} \quad (1)$$

$$y_{i,t} = \beta_1 INSPECTION_{i,t} + \beta_2 INSPECTION \times Deficiency_{i,t} + \beta_3 REPORT_{i,t} + \beta_4 REPORT \times Deficiency_{i,t} + \alpha_i + \alpha_t \times \alpha_{ind} \times \alpha_c + \mathbf{r}'\mathbf{X} + \varepsilon_{i,t} \quad (2)$$

where i , t , ind , and c indexes companies, years, industries, and countries, respectively; $y_{i,t}$ is a proxy for the amount of external capital raised or investment expenditures. I proxy for the amount of external capital raised using the sum of debt and equity issuances ($DEBT\ ISSUANCE + EQUITY\ ISSUANCE$), where $DEBT\ ISSUANCE$ is the net amount of long-term debt issued in a year (Compustat data item $dltis$ minus dlr) or the change in total debt if $dltis$ and dlr are missing. $EQUITY\ ISSUANCE$ is the sum of the proceeds raised from the sale of common and preferred stock (Compustat data item $sstk$). In cases where $sstk$ is missing, I assume equity issuances are zero. However, I include an indicator variable that equals one for such cases to control for any systematic effects of treating missing equity issuances as a zero issuance.⁹ I scale the amount of

⁹ My inferences are robust to dropping observations with missing equity issuance data (untabulated).

capital raised by lag total assets. I proxy for investment using capital expenditure scaled by lag total assets (*CAPEX*). α_i , α_t , α_{ind} , and α_c are company, year, industry (2-digit SIC), and country indicators. X is a vector of controls, following prior research (e.g., Kaplan and Zingales 1997; Hadlock and Pierce 2010; Badertscher et al. 2013).

In the international inspection setting, the time elapsed between the completion of an auditor's inspection fieldwork and the disclosure of its inspection report is 569 days on average (Table 3). Given the significant lag between the inspection end date and report disclosure date, I estimate separate treatment effects for these two events as it is *ex ante* unclear when companies would change their corporate finance decisions in response to PCAOB inspections. Specifically, I include indicator variables to capture the fiscal years that *begin* following the (i) completion of the inspection fieldwork (*INSPECTION*) and (ii) public disclosure of the inspection report (*REPORT*). *INSPECTION* is an indicator variable that equals one for the fiscal years beginning after the completion of a company's auditor's PCAOB inspection fieldwork and ending before the disclosure of the inspection report. Thus, this variable captures changes in a company's financing and investing behavior in the period *in between* the completion of its auditor's inspection fieldwork and the public disclosure its auditor's inspection report. *REPORT* is an indicator variable that equals one for the fiscal years *after* the disclosure of a company's auditor's inspection report.¹⁰ On the one hand, it is plausible that auditors respond to the feedback received during the inspection fieldwork and supply higher audit quality to their clients immediately after the completion of the

¹⁰ By including a separate variable, *INSPECTION*, to capture the period in between the inspection fieldwork end date and disclosure of the inspection report, I can test when companies begin to respond to PCAOB inspections and mitigate concerns about potential biases in the estimated treatment effect. Specifically, if companies respond to PCAOB inspections as soon as the inspection fieldwork is complete, then coding the 'treatment' period as beginning after the disclosure of the inspection report would downward bias any treatment effect. Alternatively, if companies respond to PCAOB inspections only after the disclosure of the inspection report, then coding the 'treatment' period as beginning when the inspection fieldwork is complete would again downward bias any treatment effect. In untabulated analyses, I verify that my inferences are robust to excluding the variable *INSPECTION* from the regressions.

inspection fieldwork. To the extent, such audit quality improvements occur, and are observed by capital providers, it is plausible that companies respond to the audit quality improvements by raising more capital and increasing investment after their auditor's PCAOB inspection fieldwork is complete. On the other hand, it is plausible that investors supply additional capital to companies only following the disclosure of the company's auditor's PCAOB inspection reports because audit quality improvements (if any) are hard to observe and/or the content of the inspection report helps investors identify high versus low quality auditors.

Note that the variable *REPORT* equals one for all fiscal years following a company's auditor's first inspection even though some auditors are inspected as many as three times during my sample period. In other words, the regression specification in equation 1 does not capture any differential treatment effect that results from an auditor's first versus subsequent inspection. Nevertheless, equation 2 conditions the treatment effect of PCAOB inspection based on the content of each report (as discussed below). Since the content of an auditor's inspection report changes from one inspection to another, my research design incorporates the information in each of the inspection reports disclosed during my sample period.

Much of my analyses utilize content from auditors' inspection reports, which enter my regressions as interaction terms (see equation 2). Specifically, *Deficiency* in equation 2 represents one of following two variables: *PART I FINDING* is an indicator variable that equals one for inspection reports with at least one engagement-level deficiency. *NP PART II FINDING* is an indicator variable that equals one for inspection reports with a non-public quality control deficiency. I classify inspection reports as having a quality control deficiency if it includes the text "PART II AND III OF THIS REPORT ARE NONPUBLIC AND ARE OMMITTED FROM THIS PUBLIC DOCUMENT."

A few important features of my research design are as follows. First, my regressions include company-fixed effects and country-industry-year fixed effects, and is estimated on a sample of companies whose auditors are *all* inspected by the PCAOB (on a triennial basis). As a result, my main regressions estimate the effect of PCAOB inspections on corporate decisions using within-country and within-industry variation in the timing of PCAOB inspections. Specifically, my research design benchmarks the change in external financing/investment of a company whose auditor is inspected at the beginning of the current fiscal year to the change in the external financing/investment of another company in the same country-industry during the same period but whose auditor is (i) yet to be inspected by the PCAOB or (ii) was inspected at an earlier date. Thus, my regressions identify the effect of PCAOB inspections on corporate decisions entirely from the staggering of PCAOB inspections (see Figure 1 for a diagrammatic illustration of my design). Given that my regressions are identified from the staggering of auditor inspections within each country, it is important to ensure there is a sufficient amount of such variation to facilitate identification from a broad sample. Table 2, Panel C shows the extent of staggering in PCAOB inspection disclosures in each country.

Second, my analyses focus on PCAOB's international inspection program, which provides some important research design advantages compared to the U.S. inspection setting. Specifically, the international inspection setting has significantly more variation in the timing of auditor inspections than the U.S. setting, which is the central source of identification. In the U.S., variation in inspection timing is restricted to the small auditors that have 100 or fewer public clients, which audit fewer than 10% of U.S. publicly traded companies. By contrast, aside from the Canadian Big-4, all non-U.S. auditors have been subject to triennial inspections (during my sample period). Thus, the degree of staggering in "treatment" in the U.S. is much more limited than that

internationally, making the latter setting relatively more powerful. Importantly, since the clients of the triennially inspected U.S. auditors are also small (i.e., small companies endogenously match to small auditors), the other provisions of SOX also apply to these companies at later dates, which could confound the effect of PCAOB inspections in the U.S. For example, “Smaller Reporting Companies” and “Non-Accelerated Filers” had different effective dates for some of the SOX provisions and were exempt from some provision. Such differences make isolating the effect of PCAOB inspections in a U.S. setting vulnerable to endogeneity problems. Further, these endogeneity issues are exacerbated when examining variables such as external financing and investment because they are “slow moving” compared to market-based variables.¹¹

The identifying assumption essential to the interpretation of my difference-in-differences coefficient is that the treated and control company-year observations would have had parallel trends in external financing and investment had it not been for the PCAOB inspections. The fixed effects structure and control variable set help mitigate concerns about violation of the parallel-trends assumption. Further, I empirically test and find no evidence of a differential pre-treatment trend in the corporate finance policies of treatment and control observations (see Section 5).

Descriptive Statistics

Table 2 presents the distribution of company-year observations in my sample, the number of PCAOB inspections, and the number of inspection reports with deficiencies by country (Panel A) and year (Panel B). Panel A shows that Japan, Taiwan, and the U.K. make up a large fraction of the total number of observations. Although Canada has the largest numbers of auditor

¹¹ Note that I restrict my sample to companies audited by PCAOB-inspected auditors to mitigate the concern that companies audited by a PCAOB-inspected auditor have systematically different corporate policies than companies audited by non-PCAOB inspected auditors. I also restrict my sample to companies that do not change auditors during my sample period (2002 to 2014) to reduce concerns that auditor selection during my sample period affects my inferences. Nevertheless, it is important to note that each company serves as its own control in my difference-in-differences design, thereby differencing any time-invariant selection bias related to a company’s auditor choice.

inspections in my sample, Canadian companies make up less than 1% of the sample. This is because Canadian companies are often cross-listed on a U.S. stock exchange. Panel A also reveals that the number of PCAOB inspections in my sample exceed the number of PCAOB inspection reports, which occurs because some of the inspection reports are disclosed in 2014 towards the end of my sample period. Finally, Panel A shows that the number of inspection reports with a Part I Finding (related to engagement-level deficiencies) far exceed the number of inspection reports with a publicly disclosed Part II Finding (related to auditor-level quality control criticisms). However, the number of reports with a non-public Part II Finding is generally greater than or equal to the number of reports with a Part I Finding. These patterns suggest that the vast majority of auditors take steps to address PCAOB's concerns related to the auditor's quality control systems.

Table 2, Panel B shows that the number of observations in my sample by year. PCAOB inspections begin in 2005 and significantly vary through the years in my sample. The first PCAOB inspection report is disclosed in 2006 (for the set of auditors included in my sample) and there is reasonable variation in the number of reports disclosed each year. Since my identification comes from variation in the timing of auditor inspections *within each country*, I also tabulate the distribution of the number of unique auditors that receive their first PCAOB inspection report by each country-year (see Table 2, Panel C). Each of 146 initial inspection reports in Panel C serves as a unique treatment source for different companies in my sample.

Table 3 presents the descriptive statistics for the variables used in my analyses. The average company spends 4.9% of its assets on investment and raises external capital amounting to 2.6% of assets in a year. The average net debt (equity) issuance is 0.7% (1.9%) of assets. The table also shows that the median (75th percentile) company-year has zero debt (equity) issuances, indicating that capital issuances are infrequent events. Upon further exploration, I find that 42.1% (22.1%)

of the company-year observations in my sample have a positive debt (equity) issuance, implying that companies raise additional debt (equity) once every 2.4 (4.5) years, on average. Since capital issuances involve non-trivial transaction costs (e.g., underwriting fee, legal fee, etc.) it is not surprising that they are infrequent events; yet they are economically important.

Table 3 reports PCAOB inspection characteristics at the inspection-report and company-year levels. At the report-level, the table shows that 55.4% of the inspection reports have at least one engagement-level deficiency (*PART I FINDING* equal to one) and 68.5% of the inspection reports have a non-public quality control deficiency (*NP PART II FINDING* equal to one). However, only 2.5% of inspections result in a public quality control deficiency. Table 3 also shows that the average company's auditor is inspected two times by the PCAOB during my sample period. The majority of sample is audited by a big-four network auditor, which is partly because the big-four affiliates have the largest aggregate market share of publicly traded companies across the world and because they are more likely to have SEC registered companies as clients.

V. RESULTS

Do PCAOB International Inspections Affect External Financing Decisions?

I begin my analyses by examining whether companies audited by a PCAOB-inspected auditor raise additional external capital following their auditor's PCAOB inspection and whether the content of the inspection report affects such behavior. Table 4 presents the results. Column 1 in Table 4, Panel A presents the results from a regression without conditioning on the content of the inspection report and shows that the coefficient for *INSPECTION* is insignificant (coef.=0.001; t-stat.=0.51) but the coefficient for *REPORT* is significant at the 10% level (coef.=0.007; t-stat.=1.86). The coefficient estimate for *REPORT* suggests that companies raise additional external capital equal to 0.7% of assets, which is 5.9% of the standard deviation in external financing. This

result provides initial evidence that companies audited by PCAOB-inspected auditors raise additional external capital following the disclosure that their auditor is inspected by the PCAOB.

Column 2 presents the results from a regression that includes two additional covariates, $INSPECTION \times PART\ I\ FINDINGS$ and $REPORT \times PART\ I\ FINDINGS$, that capture the incremental effect of having an engagement-level deficiency in an auditor's inspection report.¹² I find that the coefficients for $INSPECTION$ and $INSPECTION \times PART\ I\ FINDINGS$ are statistically insignificant. However, the coefficient for $REPORT$ is positive and significant (coef.=0.014; t-stat.=3.25) while the coefficient for $REPORT \times PART\ I\ FINDINGS$ is negative and significant (coef.=-0.011; t-stat.=-2.57). These coefficients suggest that companies audited by PCAOB-inspected auditors respond to their auditor's inspection report by raising significantly more external capital when the report reveals that the auditor did not receive any engagement deficiency. An F-test for the significance of the sum of the coefficients indicates that the increase in external financing in response to a PCAOB inspection report is insignificant when the company's auditor's inspection report reveals that the PCAOB found one or more deficiencies in the manner in which the auditor performed an audit. These results are related to the evidence in Christensen et al. (2016) who survey 102 investors and find that "...investors overwhelmingly associate fewer PCAOB [engagement-level] deficiencies with higher overall audit firm quality." (p.1651) That is, if investors perceive engagement deficiency as evidence of poor auditor quality, then it follows that investors are less likely to supply additional capital to clients of such auditors, as I find.

Column 3 repeats the above analyses using *non-public* quality control criticisms as a proxy for inspection report deficiencies. Similar to the evidence in column 2, I find that the coefficients for $INSPECTION$ and $INSPECTION \times NP\ PART\ II\ FINDINGS$ are insignificant, the coefficient for $REPORT$ is positive and significant (coef.=0.012; t-stat.=2.59), and the coefficient for

¹² The main effect of $PART\ I\ FINDINGS$ is not included in the regressions because it is perfectly collinear with the interaction terms (since only company-years with PCAOB inspections can have a Part I Finding).

REPORT \times *NP PART II FINDINGS* is negative and significant (coef.= -0.008; t-stat.= -1.81). However, in column 4, when I jointly examine the effect of both Part I Findings and non-public Part II Findings, I find that the effect of Part I Findings subsumes that for non-Public Part II Findings.¹³ Since initial inspection reports do not disclose the nature of quality control criticisms and require investors to infer whether the auditor even received a quality control criticism based on cross-sectional variation in the text of the report, it is plausible that investors do not place much emphasis on *non-public* Part II Findings because the information is not salient to them. The coefficient estimate for *REPORT* in columns 2 and 4 imply that companies issue additional capital equal to 1.4% of assets if their auditor does not have any engagement deficiency in its inspection report. This economic magnitude equals 11.9% of the standard deviation of capital issuances.

To mitigate endogeneity concerns and examine whether there is any observable violation of the parallel-trends assumption, I investigate the pre-treatment trend in external capital issuances. If my results are picking up a company-specific trend related to changing economic conditions, then such economic changes are likely to affect capital issuances even before the PCAOB inspection report is disclosed. However, if companies systematically change their financing behavior only after their auditor's inspection report is disclosed, which is staggered in time and varies in its content, then it is unlikely that a correlated omitted variable can explain the results.

Table 4, Panel B presents the results from repeating the analyses in columns 1 and 2 of Table 4, Panel A after replacing *REPORT* with nine indicator variables: *REPORT* [-4], *REPORT* [-3], *REPORT* [-2], *REPORT* [-1], *REPORT* [0], *REPORT* [1], *REPORT* [2], *REPORT* [3] and *REPORT* [4+]. Each of these are event-time indicators that equal one for the individual years in the nine-year period around the disclosure of a company's auditor's PCAOB inspection report. For

¹³ Conversations with a PCAOB inspector revealed that a Part I Finding automatically leads to a non-public Part II Finding (i.e., auditors that receive a Part I Finding will also receive a non-public Part II Finding). Consistent with the inspector's assertion, I find that all 153 reports in my sample that have a Part I Finding also have a non-public Part II Finding. At an informal level, the inspector suggested that Part I Findings tend to have more bite than a Part II Finding.

example, the variable *REPORT [-4]* equals one for a company four years prior to the date its auditor's PCAOB inspection report is publicly disclosed. Similarly, *REPORT [3]* equals one for a company three years after the date its auditor's PCAOB inspection report is made public. *REPORT [4+]* equals one for a company for the fourth and later years after the date its auditor's PCAOB inspection report is made public.

Table 4, Panel B shows that eight of the nine indicator variables are insignificant when I do not condition on the content of inspection reports (column 1). However, once I include interaction terms that capture the content of the inspection reports (*PART I FINDINGS*), I find that all five post-treatment indicator variables become significant. Specifically, the coefficients for *REPORT [0]*, *REPORT [1]*, *REPORT [2]*, *REPORT [3]* and *REPORT [4+]* are all positive and significant at the 5% two-tailed level or better. Further, the coefficients for the interaction of these post-treatment indicator variables and *PART I FINDINGS* are negative and significant at the 10% two-tailed level in five cases.¹⁴ Importantly, none of the pre-treatment indicator variables are significant, which provides comfort regarding the validity of the parallel-trends assumption. Figure 2 presents a graphical representation of the coefficients for the nine indicator variables and their 90% confidence intervals. Panel A (B) in the figure corresponds to the regression results in the first (second) column in the table. Panel B shows a sharp jump in the coefficient estimates for the indicator variables capturing the post-treatment periods, suggesting that companies raise additional capital *only after* the disclosure of their auditor's inspection report, provided the report is 'clean.'

Do PCAOB International Inspections Affect Corporate Investment Decisions?

Next, I examine whether PCAOB inspections affect the investment decisions of companies audited by PCAOB-inspected auditors. Table 5 presents the results. Column 1 in Table 5, Panel A shows that the coefficient for *INSPECTION* is insignificant but the coefficient for *REPORT* is

¹⁴ I focus on Part I Findings rather than non-public Part II Findings (or variation in the severity of Part I Findings) because the analysis in Panel A suggests that the effect of Part I Findings subsumes that of non-public Part II Findings.

marginally significant (coef.=0.002; t-stat.=1.70). The coefficient estimate for *REPORT* suggests that, on average, companies increase investment by 0.2% of assets in response to the disclosure of their auditor's PCAOB inspection report, which equals 3.5% of the standard deviation of capital expenditures. This result provides initial evidence that companies audited by PCAOB-inspected auditors increase investment following the disclosure that their auditor is inspected by the PCAOB.

Column 2 in the table presents the results from a regression that conditions on whether the inspection report contains an engagement-level deficiency. The table shows that the coefficients for *INSPECTION* and *INSPECTION* \times *PART I FINDINGS* are insignificant, consistent with the evidence in Table 4. Also consistent with Table 4, the coefficient *REPORT* is positive and significant (coef.=0.005; t-stat.=3.44) and the coefficient for *REPORT* \times *PART I FINDINGS* is negative and significant (coef.=-0.005; t-stat.=-3.04). These coefficients suggest that companies audited by PCAOB-inspected auditors increase investment by a much larger magnitude if their auditor's inspection report does not have any engagement-level deficiencies. By contrast, companies audited by PCAOB-inspected auditors that receive an engagement-level deficiency do not increase investment (per the F-test). The coefficient estimate for *REPORT* (in column 2) suggests that companies increase investment by 0.5% of assets or 8.8% of the standard deviation of capital expenditures if their auditor receives a clean PCAOB inspection report.

Column 3 repeats the above analyses using non-public quality control criticisms as a proxy for inspection report deficiencies. The results parallel that in Table 4 when external financing is the dependent variable. Specifically, when I jointly examine the effect of both Part I Findings and non-public Part II Findings (in column 4), I find that the coefficient for *REPORT* \times *PART I FINDINGS* is negative and significant but the coefficient for *REPORT* \times *NP PART II FINDINGS* is insignificant. These results suggest that investors pay greater attention to Part I Findings relative

to non-public Part II Findings in PCAOB-inspection reports. Overall, the evidence in Table 5, Panel A suggests that PCAOB inspections increase in the reliability of companies' audited financial statements, which increase companies' access to external capital (Table 4) and lead to subsequent increases in investment (Table 5).

Table 5, Panel B presents the dynamic analyses when *CAPEX* is the dependent variable. Column 1 presents the regression results without conditioning on the content of inspection reports. The table shows that the coefficient estimates for the pre-treatment indicator variables (*REPORT [-4]*, *REPORT [-3]*, *REPORT [-2]* and *REPORT [-1]*) range between -0.001 and 0.000 and none of them are statistically different than zero. By contrast, the coefficient estimates for the post-treatment periods (*REPORT [0]*, *REPORT [1]*, *REPORT [2]*, *REPORT [3]* and *REPORT [4+]*) are larger in magnitude and significant in three of the five cases. Column 2 in the table presents the results from a regression that includes interaction terms between the nine indicator variables and *PART I FINDINGS*. The table shows that none of the pre-treatment indicator variables or its interaction with *PART I FINDINGS* is statistically significant. However, the four of the five post-treatment indicator variables (*REPORT [1]*, *REPORT [2]*, *REPORT [3]* and *REPORT [4+]*) are positive and significant and four of the five interaction terms with *PART I FINDINGS* are negative and significant. Figure 3 plots the coefficients for the nine indicator variables and their 90% confidence intervals. Panel A (B) in the figure corresponds to the regressions results in the first (second) column in the table. The figures and tables show that there is no evidence of a pre-treatment effect of PCAOB inspections on companies' capital expenditures, providing comfort regarding the validity of the parallel-trends assumption. Further, the coefficient estimates are close to zero in the pre-treatment period and gradually increase in the post-treatment periods beginning one after the disclosure of the PCAOB inspection report.

Cross-Sectional Analyses: The Role of Financing Constraints

To further substantiate my inference that PCAOB inspections ease financing frictions, I examine whether (ex ante) financially constrained companies respond to PCAOB inspections by raising more capital and increasing investment by a larger magnitude than financially unconstrained companies. Companies that face *binding* financing constraints are more likely to raise additional capital and/or increase investment when such constraints are relaxed. Thus, to the extent PCAOB inspections ease financing constraints, I predict that the effects documented in the previous tables would be larger in magnitude for financially constrained companies.

To test this prediction, I partition my sample into two groups based on a proxy for financing constraints and estimate separate regressions on the sample of financially constrained and unconstrained companies. I proxy for financing constraints using a modified version of the Size-Age index (Hadlock and Pierce 2010) that is adapted for an international setting. Specifically, the Hadlock and Pierce (2010) financing constraints index (HP index) is calibrated for the sample of U.S. companies on Compustat and thus their index coefficients, as estimated in their paper, are not suitable for non-U.S. companies. Thus, I rely on the intuition underlying the HP index – i.e., financing constraints is a function of size and age, and partition my sample into constrained and unconstrained companies based on these variables. I classify companies as financially constrained if they are below median in age *and* below median in size, within each country-year group.^{15,16}

¹⁵ I verify that my inferences are robust to using other iterations of the HP index, including using their index as reported in their paper, and another proxy for financing constraints based on the non-payment of dividends (untabulated).

¹⁶ Farre-Mensa and Ljungqvist (2016) provide evidence that existing proxies for financing constraints are not successful at partitioning companies into constrained and unconstrained groups. While I employ multiple measure of financing constraints, I acknowledge that all currently available proxies (especially in a non-U.S. setting) are subject to significant limitations. Further, I note that all my proxies for financing constraints partition companies based on “sticky” characteristics such as size, age, dividend payment status, etc. Thus, financially constrained companies could be systematically different than financially unconstrained companies. However, I note that my research design compares the investing/financing behavior of the same company before and after treatment (i.e., a PCAOB inspection of its auditor) and benchmarks this change to that for other companies, whose auditors receive a PCAOB inspection in some other period. Thus, the difference in company-type between financially constrained and unconstrained

Table 6, Panel A (B) presents the results when the dependent variable is *EXTERNAL FINANCING (CAPEX)*. Consistent with my prediction, columns 1 and 2 in Panel A show that the coefficient for *REPORT* is significantly larger for the sample of financially constrained companies relative to that for unconstrained companies (p-value of difference is 0.10). Columns 3 and 4 repeat the above analyses but condition the effect of PCAOB inspections on external financing on whether the auditor receives a Part I Finding. Similar to the results in columns 1 and 2, the table shows that the coefficient for *REPORT* is significantly larger for financial constrained companies relative to unconstrained companies (p-value of difference is 0.08). These coefficients suggest that financially constrained companies raise more capital than financially unconstrained companies in response to their auditor's PCAOB inspection report.

Table 6, Panel B presents the results when *CAPEX* is the dependent variable. Columns 1 and 2 in Panel A show that the coefficient for *REPORT* is positive and significant for the sample of financially constrained but not for the sample of unconstrained companies. However, the coefficient estimate for *REPORT* is not significantly different for financially constrained companies (p-value of difference is 0.12). Columns 3 and 4 condition the analyses on whether the auditor receives a Part I Finding. The table shows that the coefficient for *REPORT* is significantly larger for financial constrained companies relative to unconstrained companies (p-value of difference = 0.04) once I condition on the content of the inspection report. These coefficients suggest that financially constrained companies increase investment by a larger magnitude than financially unconstrained companies in response to their auditor's PCAOB inspection report when the inspection report does not contain a Part I Finding. Overall, the results in Table 6 support my

companies is likely to be canceled out in the measurement of the treatment effect. As such, differences in company-type should have a minimal effect on my inferences given the research design.

hypothesis that PCAOB inspections relax financing constraints for the clients of inspected auditors.

Cross-Sectional Analyses: The Role of the Local Audit Regulator

Following the creation of the PCAOB, several countries followed suit and have instituted regulators to inspect the work of auditors.¹⁷ While the scope and powers of audit regulators differ across countries, the primary purpose of creating an audit regulator in other countries is largely the same as that in the U.S. Thus, it is plausible that the characteristics of the local audit regulator (e.g., whether a regulator conducts inspections, discloses the results of inspections, etc.) affect the value of PCAOB inspections across countries. As discussed in Aobdia and Shroff (2017), on the one hand, local regulators could share information and expertise with PCAOB inspectors in a manner that enhances the effectiveness of PCAOB inspections. For example, in some countries, the PCAOB coordinates with the local regulator to conduct inspections, and in some other countries, auditor inspections are jointly conducted with local regulators. It is plausible that such coordination enhances the value of PCAOB oversight. On the other hand, it is also plausible that local regulatory oversight substitutes for PCAOB inspections, and diminishes its value.

I obtain data on the auditor inspection programs in non-U.S. countries from Aobdia and Shroff (2017) and examine whether the real effects of PCAOB international inspections vary with (i) the presence of a local audit regulator, (ii) whether the regulator is a member of IFIAR, (iii) the existence of a local auditor inspection program, and (iv) whether auditor inspection reports are publicly disclosed.¹⁸ I partition my sample into two groups based on the local regulator

¹⁷ The inclusion of Country \times Industry \times Year fixed effects controls for the introduction of local audit regulators in my main tests.

¹⁸ I find that 69% of the countries in my sample have a local regulator that oversees auditors, most of whom are IFIAR members and have instituted an auditor inspection program (per IFIAR's guidelines; untabulated). However, aside from the Netherlands, Norway and the U.K., none of the local regulators disclose inspection reports at the *individual-auditor* level. Further, inspection report disclosures in the U.K. are restricted to those of the largest auditors.

characteristics and estimate separate regressions for each sample. I find that regardless of local regulator characteristic examined, companies respond to the disclosure that their auditor was inspected by PCAOB by raising additional capital and increasing investment but only if the auditor receives a clean inspection report (untabulated for brevity). However, I also find that companies' response to their auditor's PCAOB inspection report is smaller in magnitude when (i) there is a local audit regulator, (ii) the local audit regulator is an IFIAR member, and (iii) the local regulator conducts inspections. These results suggest that local audit regulators partially substitute for PCAOB inspections.

Cross-Sectional Analyses: The Role of Local Institutional Characteristics

Next, I examine whether the value of PCAOB international inspections varies as a function of the institutional characteristics of the country in which the company resides. Several prior studies find that external financing patterns and financial reporting properties are related to legal and institutional differences across countries (see La Porta et al. (2013) for a review). Broadly speaking, prior research finds that in countries with strong legal systems, in which property and investor rights are protected, companies are more likely to rely on external finance to fund their investment because these institutions reduce agency costs associated with external financing. While prior evidence finds that the demand for high quality audits does indeed depend on a country's institutional characteristics, such as strength of law enforcement, regulatory quality, societal trust and civic cooperation, etc. (see e.g., Choi et al. 2008, 2009; Francis and Wang 2008; Knechel et al. 2019), it is unclear whether PCAOB inspections substitute for or complement the institutional environment in a country.

On the one hand, auditor inspections could be more valuable for companies operating in countries with strong institutions because external financing arrangements are more likely to be

governed by formal contracts rather than informal agreements. By increasing the reliability of financial statements, PCAOB inspections could increase the contracting value of financial statements, thus complementing the local institutions in the country. By contrast, in countries with weak law enforcement and investor protection, companies are more likely to rely on informal financing arrangements (e.g., Beck et al. 2008) that are less reliant on financial statements. If so, any changes in financial statement reliability or quality that occur due to PCAOB-inspections are likely to be less relevant and valuable in countries with weak institutions.

On the other hand, it is plausible that PCAOB inspections serve as a substitute for the quality of a country's local institutions. Absent regulation, there are two forces that create incentives for auditors to supply high-quality audits: reputation and litigation risk. Accounting frauds/restatements damage an auditor's reputation and increase its legal fees, which incentivizes auditors to supply higher quality audits ex ante and reduce the risk of audit failures (Shu 2000; Venkataraman et al. 2008; Weber et al. 2008; Skinner and Srinivasan 2012). However, the effectiveness of this incentive mechanisms depends on the extent to which audit failures are detected when they occur and prior research finds that the probability of detecting audit failures is lower in countries with weaker institutions (e.g., Srinivasan et al. 2015). If PCAOB inspections facilitate the detection of audit failures in countries with weak institutions, it could serve as a substitute for the weak regulatory and legal institutions of a country.

I examine whether the real effects of PCAOB international inspections vary with (i) the degree of corruption, (ii) legal rights and enforcement, (iii) overall regulatory quality, and (iv) capital market development (the ratio of private credit to GDP). Specifically, I partition my sample into two groups based on median values of the proxies each year, and estimate separate regressions for each partition of the sample. Table 7, Panel A shows that the coefficient *REPORT* is

significantly larger in the sub-sample of country-years with low corruption, strong rule of law, and high regulatory quality. Table 7, Panel B shows that the coefficient for *REPORT* is not significantly different in any of the sample partitions. Collectively, these results suggest that companies respond to the disclosure that their auditor received a clean PCAOB inspection report by raising additional capital in countries with strong institutions but not in countries with weak institutions. However, the investment responses to receiving a clean PCAOB inspection report are not statistically different for companies in countries with weak vs. strong institutions.

Additional Analyses

PCAOB inspections and debt contract characteristics

Prior research finds that one of the primary purposes of financial accounting is to facilitate debt contracting (Watts and Zimmerman 1986; Holthausen and Watts 2001). Further, several studies find that lenders explicitly rely on financial statement numbers in setting debt covenants (see Armstrong et al. 2010 for a review). I hypothesize that one of the mechanisms through which PCAOB inspections reduce financing frictions is by increasing the contracting value of financial statements. If PCAOB inspections increase the reliability of financial statement as perceived by lenders, then lenders are likely to increase their reliance on financial statements for contracting (e.g., Minnis 2011; Baylis et al. 2017). To conduct this analysis, I obtain contract-level data from the DealScan database and match DealScan identifiers (ISIN or Ticker) with that in my primary dataset. For each debt issuance, I require non-missing information on issue date, loan amount, yield spread, covenants, and maturity. Following Ball et al. (2015), I exclude debt issuances with no covenants recorded on DealScan because missing covenant data represent a failure to collect

such information by DealScan rather than the absence any covenant in the loan agreement. My final sample is comprised of 401 debt issuances for the period 2002 to 2014.¹⁹

I examine whether PCAOB inspections are associated with the following three contract terms: (i) yield spreads, (ii) maturity, and (iii) the number of financial covenants. I estimate regressions of each of the above contract terms on *INSPECTION*, *REPORT*, and interactions between these variables and *PART I FINDINGS*. While I continue to include country \times industry \times year fixed effects, I do not include company-fixed effects because there are too few companies that have multiple debt issuances in my sample. Finally, my regressions control for several company- and contract-level variables following prior research. Table 8 presents the results.

Column 1 shows that when the dependent variable is *YIELD SPREAD*, the coefficients for *INSPECTION*, *REPORT* and *INSPECTION* \times *PART I FINDINGS* is insignificant. However, the coefficient for *REPORT* \times *PART I FINDINGS* is positive and significant, which suggests that companies audited by a PCAOB-inspected auditor that receive a Part I Finding in its inspection report observe an increase yield spreads relative to companies audited by PCAOB-inspected auditors that receive clean inspection reports. An F-test for the significance of the sum of the coefficients for *REPORT* and *REPORT* \times *PART I FINDINGS* is insignificant (p-value=0.19), suggesting that the relation between PCAOB inspections and yield spreads is mixed.

Column 2 shows that when the dependent variable is *MATURITY*, the coefficient for *REPORT* is positive and significant, while the coefficient for *REPORT* \times *PART I FINDINGS* is insignificant. These coefficients suggest that companies audited by a PCAOB-inspected auditor raise debt with longer maturities if the auditor receives a clean inspection report. Prior research argues that shorter maturities force managers to refinance more frequently, and thus shorter

¹⁹ As Ball et al. (2015) report, only 10% of the international debt issuances have at least one reported covenant. Thus, requiring covenant data significantly reduces my sample size.

maturities help lenders better monitor borrowers (Rajan and Winton 1995; Demirgüç-Kunt and Maksimovic 1999). For loans with longer maturity, financial covenants represent the primary mechanism through which lenders are able to intervene over the life of the loan, making it more important that lenders have faith in borrowers' audited financial statements. The results in column 2 suggest that PCAOB auditor inspections help clients of inspected auditors with clean inspection reports obtain longer maturity loans.

Column 3 shows that when the dependent variable is *NO. FINANCIAL COVENANTS*, the coefficient for *REPORT* is positive and significant and the coefficient for *REPORT* \times *PART I FINDINGS* is negative and significant. These coefficients imply that lenders include more accounting covenants when they contract with companies audited by a PCAOB-inspected auditor, provided the auditor receives a clean inspection report. These results complement that in column 2 and they jointly suggest that PCAOB inspections are followed by a substitution of accounting-based monitoring tools (financial covenants) in place of non-accounting-based monitoring tools (short loan maturities). As such, my inference from the regressions in columns 2 and 3 is that lenders are more willing to trust financial statements as a monitoring tool when a company's financial statements are audited by a PCAOB-inspected auditor with a clean inspection report.²⁰

Effect of PCAOB inspection access

Lamoreaux (2016) argues that the threat of a PCAOB inspection provides auditors incentives to improve audit quality ex ante because such inspection are similar to a pre-commitment to disclose audit work papers at the discretion of the regulator. Consistent with his

²⁰ However, I caveat that my analyses are based on a small sample of debt contracts available for non-U.S. companies and thus the documented results might be idiosyncratic to my sample. Importantly, as discussed in Armstrong et al. (2010), debt contracts are as a package of *several simultaneously chosen* contract terms, which makes it difficult to pin down the effect of any one financial reporting attribute, such as PCAOB auditor inspections, on individually examined contract terms or overall debt contracting efficiency.

prediction, Lamoreaux (2016) finds that once a country allows the PCAOB access to inspect the local auditors of SEC registrants, these auditors supply higher quality audits for local companies cross-listed in the U.S. Following Lamoreaux (2016), I examine whether the threat of a PCAOB inspection leads the non-U.S. clients of auditors subject to PCAOB inspections to raise more capital and increase investment.²¹

I find no evidence that PCAOB inspection access affects the financing or investing decisions of non-U.S. companies (untabulated).²² These results are consistent with that in prior tables: changes in companies' financing and investing decisions occur *after* the disclosure of PCAOB inspection reports (and not at the time of, or before, inspections). However, my results should not be viewed as contradicting that in Lamoreaux (2016) because he examines non-U.S. companies *cross-listed in the U.S., whose audit engagements inspected by the PCAOB*, while I examine the effect of PCAOB inspections on the behavior of non-U.S. companies that are not cross-listed in the U.S.

Untabulated robustness tests

I conduct a number of untabulated robustness tests. First, I re-examine my main results using a matched sample design. Specifically, the sample of non-U.S. companies that are audited by PCAOB-inspected auditors but are not directly subject to any SEC/PCAOB regulation (as constructed for my main analyses) serve as the treatment group. I then construct a sample of matched control companies that are observably similar to the treatment companies in terms of the determinants of investment and financing but are not affected by PCAOB inspections because their

²¹ I thank Phil Lamoreaux for sharing his data on when the PCAOB had access to inspect the auditors in each country.

²² Testing the effect of PCAOB inspection access on corporate investment/financing decisions requires me to relax the fixed effects structure employed in the analyses presented thus far. Specifically, since all companies in a country are simultaneously affected by PCAOB inspection access, I cannot include country \times industry \times year (or country \times year) fixed effects. Rather, I use the fixed effects structure in Lamoreaux (2016) in this analysis.

auditor does not participate in the audit of any SEC registrant. I find that my main inferences are largely unchanged using the matched sample design.²³ Second, I test and find that my inferences are unchanged when my sample excludes the four countries (Japan, UK, Taiwan and Australia) that dominate the sample, regardless of whether these countries are dropped one at a time and all at once. Third, I examine whether the effect of PCAOB inspections on financing/investment decisions varies based on the length of the delay between the inspection and report dates. It is plausible that long delays in the disclosure of the inspection report make the information in these reports stale. However, I find that there is no significant difference in the effect of PCAOB inspections on financing and investment for reports that are disclosed sooner vs. later.

Fourth, I examine whether my main results differ based on when the PCAOB began their inspection in a country. I partition the sample into two groups based on the median year in which the PCAOB began conducting inspections in each country. I find that there is no significant difference in the effect of PCAOB inspections on financing and investment based on when the PCAOB begins inspections in a country. Finally, I examine whether imbalance in the pre- and post-treatment periods affect my inferences. I re-do my main tests using a balanced panel, beginning up-to four years before the inspection date and ending up-to four years after the disclosure of the inspection report. I find that my main inferences are unchanged.

VI. CONCLUSION

In this paper, I examine the real effects of the PCAOB international inspection program on the corporate financing and investing decisions of non-U.S. companies. Even though non-U.S. companies are not subject to U.S. securities regulation, their auditor can be subject to PCAOB

²³ The benefit of my primary research design relative to the matched sample design is that all companies in the sample have auditors inspected by the PCAOB. By contrast, the matched sample design compares companies with PCAOB-inspected auditors to those without a PCAOB inspected auditor, which introduces concerns about selection bias.

inspections if the auditor has even one client that is an SEC registrant. As a result, the PCAOB international inspection program subjects non-U.S. auditors to PCAOB inspections, which could have consequences for the non-U.S. clients of these auditors. Specifically, I hypothesize that PCAOB international inspections relax financing frictions for the non-U.S. clients of non-U.S. auditors inspected by the PCAOB. My hypothesis is predicated on the idea that PCAOB international inspections (i) help improve audit quality and (ii) provide additional information about auditors' engagement practices and policies, which reduce information asymmetry between managers and capital providers.

My results based on a generalized difference-in-differences design show that companies audited by a PCAOB-inspected auditor raise significantly more external capital and increase capital expenditure following their auditor's PCAOB inspection, if the auditor receives a clean inspection report from the PCAOB. The economic magnitude of the change in external financing and investment in response to receiving a clean PCAOB inspection report is greater for (i) financially constrained companies, (ii) companies operating in countries where there isn't a local audit regulator or a local auditor inspection program, and (iii) companies operating in countries with strong legal protection, high regulatory quality and low corruption. Finally, I find descriptive evidence suggesting that PCAOB-inspections are associated with greater use of accounting covenants in debt contracts, which I interpret as PCAOB inspections improving debt contracting efficiency. Overall, my evidence suggests that PCAOB international inspections reduce external financing frictions for the non-U.S. clients of inspected auditors.

The evidence in this paper is important because it highlights the role of PCAOB inspections in the capital allocation process. Prior studies examine the effect the PCAOB has on the audit market and on audit outcomes. This is the first study to examine the real effects of PCAOB

inspections. Further, by examining the effect of the international inspection program, this paper provides insights into how the value of PCAOB inspections vary with cross-country differences in auditor regulation and institutional arrangements.

Before concluding, I highlight that my inferences are based on a sample of non-U.S. companies that operate in countries with different regulatory and institutional environments than that in the U.S. Thus the results of this paper might not generalize to U.S. companies. In addition, my study does not speak to *net* benefits of auditor inspections because I do not examine the costs of such inspections on auditors and their clients.

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Appendix A Variable Definitions

This table provides a detailed description of the procedure used to compute each variable used in my analyses. My data are obtained either through Audit Analytics, Compustat Global, Capital IQ, or the PCAOB website. All continuous variables are winsorized at 1% and 99% of the distribution and all dollar amounts are in millions. The variables are listed in alphabetical order.

Variable	Definition
<i>ASSET TANGIBILITY</i>	The ratio of total tangible assets measured as net property, plant and equipment (data PPENT) scaled by total assets (data AT) as of the fiscal year preceding the dependent variable measurement date.
<i>BIG4</i>	An indicator that equals one for companies audited by one of the big-four affiliated auditors. The big-four auditors include Deloitte, E&Y, KPMG, and PwC.
<i>CAPEX</i>	Capital expenditure (data CAPX) scaled by lag total assets (data AT).
<i>CASH</i>	Total cash and cash equivalent balance (data CHE) scaled by lag total assets (data AT) as of the fiscal year preceding the dependent variable measurement date.
<i>CFO</i>	Operating cash flows (data OANCF) scaled by lag total assets (data AT) as of the fiscal year preceding (concurrent to) the dependent variable measurement date in the external financing (investment) regression.
<i>DAYS BTW INSPECTION & REPORT</i>	The number of days since the completion of an auditor's PCAOB inspection fieldwork and the public disclosure of its inspection report.
<i>DEBT ISSUANCE</i>	Net debt issuance (data DLTIS minus DLTR) scaled by lag total assets (data AT). When DLTIS and DLTR are missing, this variable equals the change in total debt for the company (change in data DLTT plus change in data DLC) scaled by lag total assets.
<i>DIVIDEND INDICATOR</i>	An indicator that equals one for company-years with positive dividend payments (data DVC > 0). This variable is measured as of the fiscal year preceding the dependent variable measurement date.
<i>EQUITY ISSUANCE</i>	Equity issuance (data SSTK) scaled by lag total assets (data AT). This variable is set to zero if the variable SSTK is missing in Compustat.
<i>EXTERNAL FINANCING</i>	The sum of <i>DEBT ISSUANCE</i> and <i>EQUITY ISSUANCE</i> as defined above.
<i>INSPECTION</i>	An indicator variable that equals one for the fiscal years beginning after (or in the same month as) the completion of the auditor's PCAOB inspection fieldwork and ending before (or in the same month as) the public disclosure of the inspection report.
<i>LEVERAGE</i>	The ratio of the sum of short- and long-term debt (data DLC plus data DLTT) to total assets (data AT) as of the fiscal year preceding the dependent variable measurement date.
<i>LN(MVE)</i>	The natural log of a company's market value of equity (data PRCC_F \times CSHO) as of the fiscal year preceding the dependent variable measurement date for Canadian companies. Compustat Global does not include price and share price data in their main dataset. These data for non-Canadian companies are obtained from the Compustat Global Securities Daily file.
<i>MISSING DUMMY</i>	An indicator variable that equals one for company-years in which the variable <i>EQUITY ISSUANCE</i> is set equal to zero because the Compustat data item SSTK is missing.
<i>NO. OF INSPECTION</i>	The total number of times an auditor is inspected by the PCAOB during my sample period.

<i>NP PART II FINDINGS</i>	An indicator variable that equals one for companies whose auditors receive a Part II Finding (i.e., a quality control deficiency) during the inspection fieldwork but the content and nature of the deficiency is omitted from the PCAOB inspection report. Inspection reports that include the text “PART II AND III OF THIS REPORT ARE NONPUBLIC AND ARE OMITTED FROM THIS PUBLIC DOCUMENT” are classified as having a nonpublic Part II Finding. For auditors with more than one publicly disclosed inspection report, this variable is based on whether the most recent inspection report, following the company’s fiscal year end date, has a nonpublic Part II Finding.
<i>PART I FINDINGS</i>	An indicator that equals one for companies whose auditors receive a Part I Finding in the PCAOB inspection report. For auditors with more than one publicly disclosed inspection report, this variable is based on whether the most recent inspection report, following the company’s fiscal year end date, has a Part I Finding.
<i>PUBLIC PART II FINDINGS</i>	An indicator variable that equals one for auditor inspection reports that <i>later receive</i> a public Part II Finding. Note that this variable is defined only at the inspection report level (and not company-year level).
<i>ROA</i>	Return on assets is measured as income before extraordinary items (data IB) divided by lag total assets (data AT) as of the fiscal year preceding the dependent variable measurement date.
<i>REPORT</i>	An indicator variable that equals one for the fiscal years beginning after (or in the same month as) the public disclosure of the company’s auditor’s initial PCAOB inspection report.
<i>REPORT[-4]</i>	An event time indicator that equals one for the fiscal year of a company four years prior to its auditor’s initial PCAOB inspection report disclosure date.
<i>REPORT[-3]</i>	An event time indicator that equals one for the fiscal year of a company three years prior to its auditor’s initial PCAOB inspection report disclosure date.
<i>REPORT[-2]</i>	An event time indicator that equals one for the fiscal year of a company two years prior to its auditor’s initial PCAOB inspection report disclosure date.
<i>REPORT[-1]</i>	An event time indicator that equals one for the fiscal year of a company immediately preceding its auditor’s initial PCAOB inspection report disclosure date.
<i>REPORT[0]</i>	An event time indicator that equals one for the fiscal year in which a company’s auditor’s initial PCAOB inspection report is publicly disclosed.
<i>REPORT[1]</i>	An event time indicator that equals one for the fiscal year of a company immediately following its auditor’s initial PCAOB inspection report disclosure date.
<i>REPORT[2]</i>	An event time indicator that equals one for the fiscal year of a company two years after its auditor’s initial PCAOB inspection report disclosure date.
<i>REPORT[3]</i>	An event time indicator that equals one for the fiscal year of a company three years after its auditor’s initial PCAOB inspection report disclosure date.
<i>REPORT[4+]</i>	An event time indicator that equals one for the fiscal years of a company four or more years after its auditor’s PCAOB initial inspection report disclosure date.
<i>SALES GROWTH</i>	Percentage change in sales (data SALE) as of the fiscal year preceding the dependent variable measurement date.
<i>TOBIN’S Q</i>	Market value of equity (data PRCC_F \times CSHO) plus the book value of short- and long-term debt (data DLC + DLTT) scaled by total assets (data AT) measured at the fiscal year preceding the dependent variable measurement date.

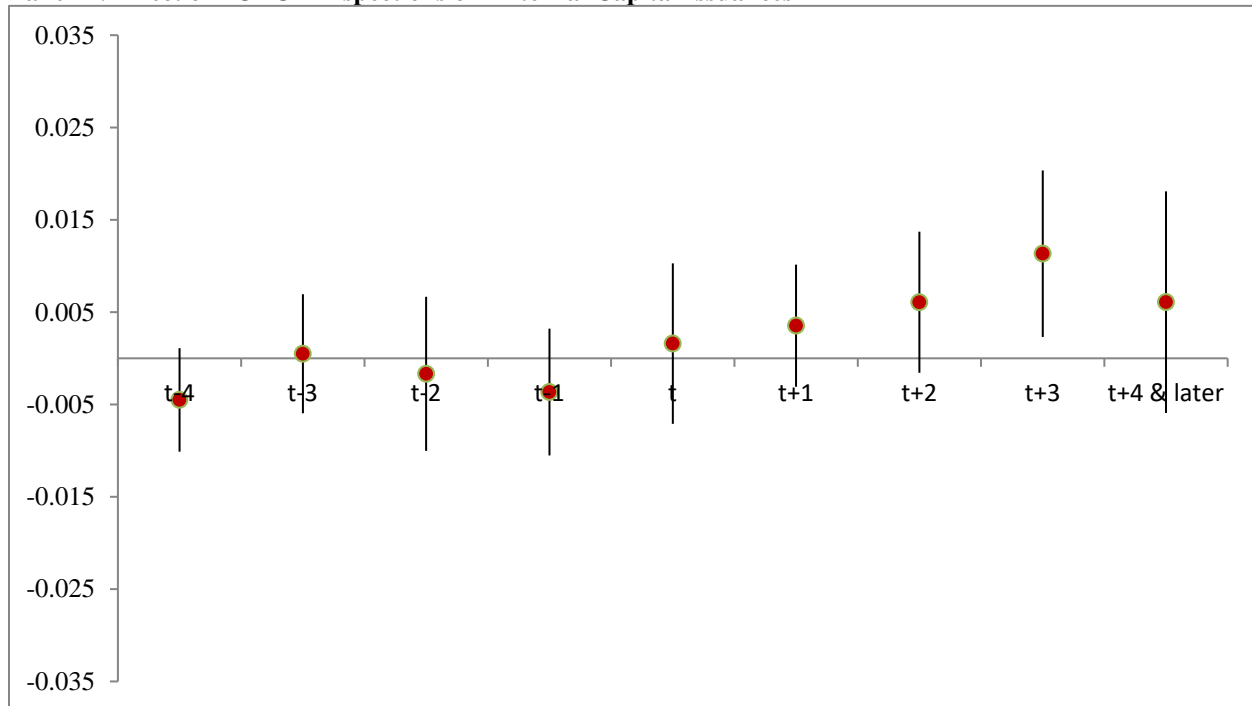
FIGURE 1
Diagrammatic Representation of the Research Design

Country	Auditor	Insp. dates	Rep. dates	Clients	Fis. Month	Variable	F05	F06	F07	F08	F09	F10	F11	F12	F13	F14	F15
India	S.R. Batliboi & Co	10/7/2011	2/2/2012	Exide Industries	31-Mar	INSPECTION	0	0	0	0	0	0	0	0	0	0	0
						REPORT	0	0	0	0	0	0	0	0	1	1	1
				Oudh Sugar Mills	30-Jun	INSPECTION	0	0	0	0	0	0	0	0	0	0	0
						REPORT	0	0	0	0	0	0	0	0	1	1	1
				Bata India	31-Dec	INSPECTION	0	0	0	0	0	0	0	0	0	0	0
						REPORT	0	0	0	0	0	0	0	0	1	1	1
	Deloitte Haskins & Sells	2/29/2008 11/22/2010 3/8/2013	4/29/2011 10/27/2011 10/24/2013	Mahindra & Mahindra	31-Mar	INSPECTION	0	0	0	0	1	1	1	0	0	0	0
						REPORT	0	0	0	0	0	0	0	1	1	1	1
				Automotive Axles	30-Sep	INSPECTION	0	0	0	0	1	1	0	0	0	0	0
						REPORT	0	0	0	0	0	0	0	1	1	1	1
				KSB Pumps	31-Dec	INSPECTION	0	0	0	0	1	1	0	0	0	0	0
						REPORT	0	0	0	0	0	0	0	1	1	1	1
	T.R. Chadha & Co.	9/13/2013	3/25/2014	Narmada Gelatines	31-Mar	INSPECTION	0	0	0	0	0	0	0	0	0	0	0
						REPORT	0	0	0	0	0	0	0	0	0	0	1
United Kingdom	BDO	12/16/2005 11/2/2012	12/20/2006 12/19/2013	Blacks Leisure	28-Feb	INSPECTION	0	0	0	0	0	0	0	0	0	0	0
						REPORT	0	0	0	1	1	1	1	1	1	1	1
				Prezzo	31-Dec	INSPECTION	0	1	0	0	0	0	0	0	1	0	0
						REPORT	0	0	1	1	1	1	1	1	1	1	1
	Grant Thornton	7/17/2008 6/29/2012	4/29/2011 7/1/2013	Caffyns	31-Mar	INSPECTION	0	0	0	0	0	1	1	0	0	0	0
						REPORT	0	0	0	0	0	0	0	1	1	1	1
				ADVFN	30-Jun	INSPECTION	0	0	0	0	1	1	0	0	1	0	0
						REPORT	0	0	0	0	0	0	0	1	1	1	1
				Nichols	31-Dec	INSPECTION	0	0	0	0	1	1	0	0	0	0	0
						REPORT	0	0	0	0	0	0	0	1	1	1	1
	PWC	2/29/2008 8/19/2011	9/30/2008 10/1/2013	Harvey Nash Group	31-Jan	INSPECTION	0	0	0	0	0	0	0	0	1	0	0
						REPORT	0	0	0	0	0	1	1	1	1	1	1
				Sportech	31-Dec	INSPECTION	0	0	0	0	0	0	0	1	0	0	0
						REPORT	0	0	0	0	1	1	1	1	1	1	1

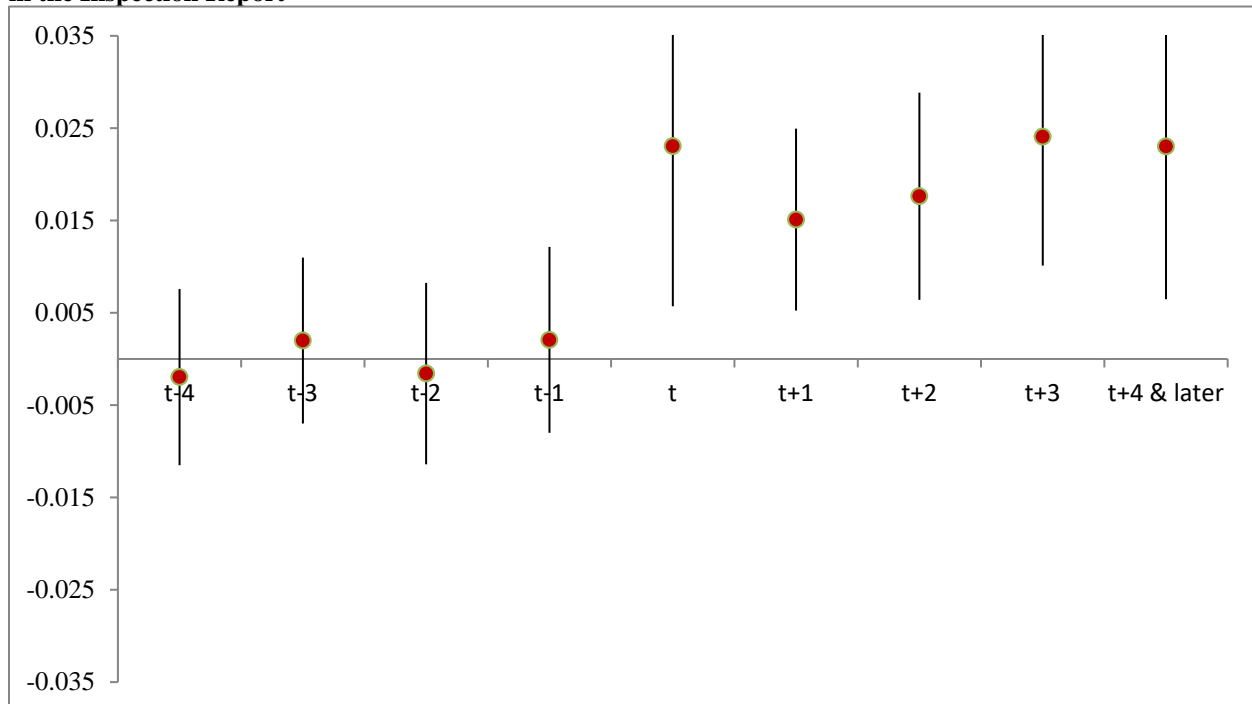
Notes: This figure presents an example of my difference-in-differences design where the non-U.S. clients of non-U.S. auditors are affected by PCAOB inspections at different points in time. The inspection/report dates are staggered in time, which is the primary source of variation for my identification. The figure also shows that my design exploits variation in the fiscal year ends of companies with the same auditor. Overall, the figure shows that my design compares the change in the behavior of companies located in the same country in the same period but whose auditors undergo PCAOB inspections at different points in time. In the figure above, **Insp. dates** refers to the date the PCAOB inspection fieldwork ended, **Rep. dates** refers to the date when an auditor's PCAOB inspection reports are made available to the public via the PCAOB website, **Clients** refer to the clients of the auditor in the second column, **Fis. Month** refers to the fiscal month end of a company, and **F05** to **F15** refer to the fiscal years ending from 2005 to 2015.

FIGURE 2
Effect of PCAOB Auditor Inspections on External Capital Issuances by Companies

Panel A: Effect of PCAOB Inspections on External Capital Issuances



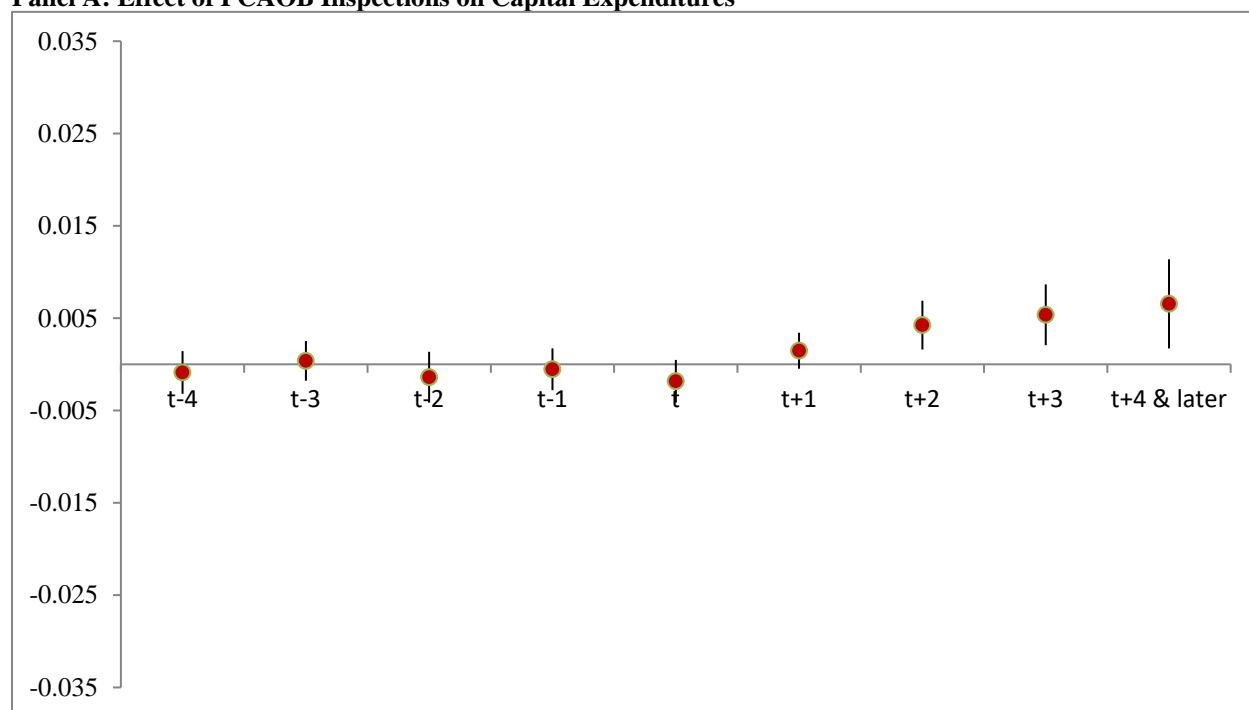
Panel B: Effect of PCAOB Inspections on External Capital Issuances Conditional on having Zero Deficiencies in the Inspection Report



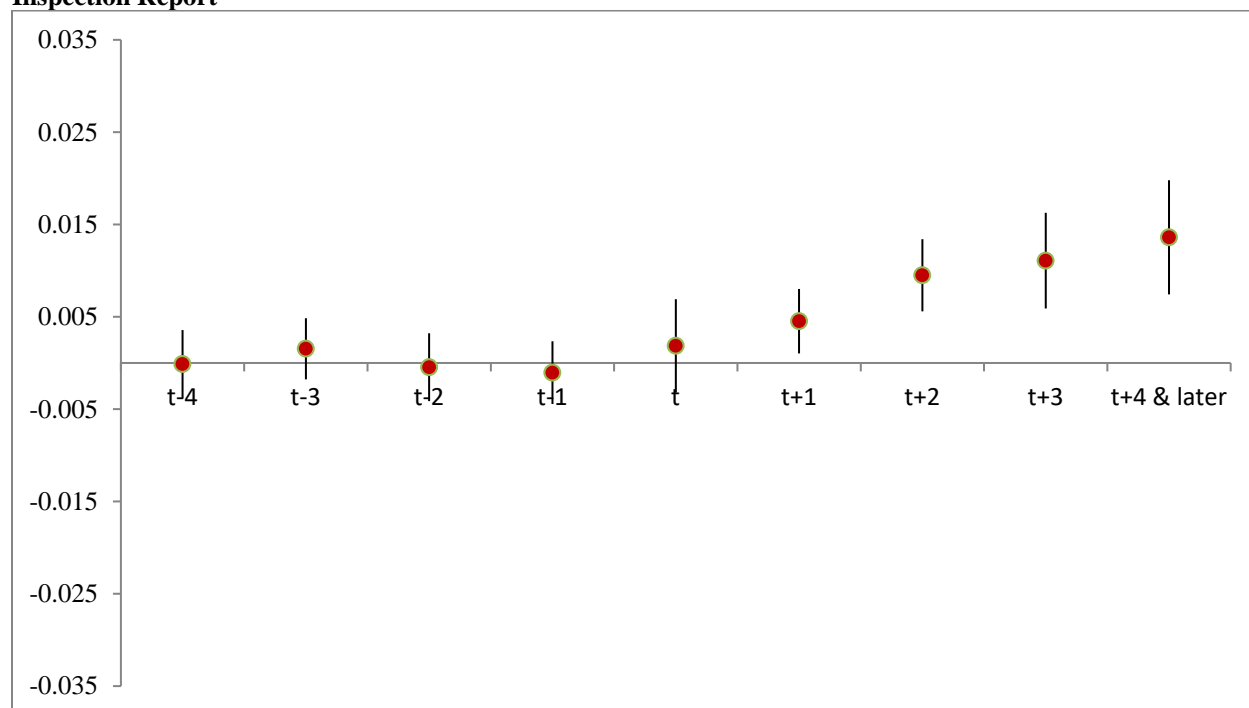
Notes: In the figure above, the x-axis represents time relative a company's auditor's PCAOB report date and the y-axis represents the amount of external capital (debt plus equity) issued scaled by assets. The figure plots the two-tailed 90% confidence interval around each point estimate of the relation between PCAOB inspections and external financing. Panel A presents the average effect for all company-years and Panel B presents the average effect conditional on the auditor receiving a clean PCAOB inspection report (i.e., one without a Part I Finding).

FIGURE 3
Effect of PCAOB Auditor Inspections on Capital Expenditures by Companies

Panel A: Effect of PCAOB Inspections on Capital Expenditures



Panel B: Effect of PCAOB Inspections on Capital Expenditures Conditional on having Zero Deficiencies in the Inspection Report



Notes: In the figure above, the x-axis represents time relative a company's auditor's PCAOB report date and the y-axis represents the capital expenditures scaled by assets. The figure plots the two-tailed 90% confidence interval around each point estimate of the relation between PCAOB inspections and capital expenditures. Panel A presents the average effect for all company-years and Panel B presents the average effect conditional on the auditor receiving a clean PCAOB inspection report (i.e., one without a Part I Finding).

TABLE 1
Sample Selection

No.	Sample Selection (2002 - 2014)	Number of Observations
(1)	Company-year observations in the intersection of Capital IQ & Compustat Global with fiscal years ending after 2002 and non-missing data on key variables	158,763
(2)	Company-year observations excluding SEC registered companies	146,340
(3)	Company-year observations with a PCAOB inspected auditor	86,077
(4)	Company-year observations with triennially inspected auditors (i.e., companies not audited by one of the Canadian big-four)	84,872
(5)	Company-year observations without multiple auditors and without auditor changes in the sample period	52,755
(6)	Company-year observations in non-financial industries	52,329
Final sample of company-years available for analyses		52,329

TABLE 2
Sample Distribution by Country and Year

Panel A: Sample Distribution by Country

Country	No. of Observations	No. of Inspections	No. of Reports	No. Reports with Engagement Deficiencies	No. of Reports with Non- Public QC Criticisms	No. of Reports with Public QC Criticisms
Argentina	232	11	11	4	6	0
Australia	3,894	21	21	11	15	1
Bermuda	34	6	6	3	4	0
Brazil	52	12	12	8	10	0
Canada	328	28	27	18	20	1
Cayman Islands	11	4	4	1	1	0
Chile	317	9	9	6	7	0
Colombia	29	4	4	2	3	0
Germany	1,386	4	4	4	4	0
Greece	55	2	2	0	1	0
Hong Kong	30	2	2	2	2	0
India	1,566	16	15	8	10	0
Indonesia	482	5	5	2	3	0
Ireland	221	2	2	0	1	0
Israel	921	23	23	17	19	0
Japan	17,994	15	14	12	12	1
Malaysia	988	4	4	1	3	1
Mexico	442	18	17	14	14	2
Netherlands	680	4	4	3	4	0
New Zealand	462	4	4	1	1	0
Norway	857	5	5	4	5	0
Papua New Guinea	7	2	2	1	1	0
Peru	108	4	3	0	1	0
Philippines	777	7	7	3	5	0
Russia	311	8	8	5	5	0
Singapore	2,168	7	7	0	2	0
South Africa	1,314	13	13	3	6	0
South Korea	1,346	9	9	4	4	1
Spain	185	1	1	1	1	0
Switzerland	642	2	2	2	2	0
Taiwan	8,447	10	10	3	4	0
Thailand	161	2	2	0	0	0
Turkey	13	1	1	1	1	0
United Arab Emirates	37	2	2	0	1	0
United Kingdom	5,832	15	14	9	11	0
Total	52,329	282	276	153	189	7

TABLE 2 (continued)

Panel B: Sample Distribution by Year

Year	No. of Observations	No. of Inspections	No. of Reports	No. Reports with Engagement Deficiencies	No. of Reports with Non- Public QC Criticisms	No. of Reports with Public QC Criticisms
2002	2,917	0	0	0	0	0
2003	3,139	0	0	0	0	0
2004	3,587	0	0	0	0	0
2005	3,741	4	0	0	0	0
2006	3,880	11	1	0	0	0
2007	4,087	27	3	2	2	0
2008	4,118	37	17	4	4	0
2009	4,162	50	6	4	6	1
2010	4,291	36	31	26	27	3
2011	4,421	26	92	37	53	3
2012	4,530	57	37	16	21	0
2013	4,697	30	48	35	41	0
2014	4,759	4	41	29	35	0
Total	52,329	282	276	153	189	7

TABLE 2 (continued)

Panel C: Distribution of the Number of Auditors Receiving their First Inspection Report by Country-Year pair

Country \ Year	2006	2007	2008	2009	2010	2011	2012	2013	2014
Argentina	0	0	3	0	0	1	0	0	0
Australia	0	0	0	0	3	5	1	0	1
Bermuda	0	0	2	0	0	0	0	0	0
Brazil	0	0	0	0	4	0	0	0	0
Canada	0	3	3	0	3	2	0	0	0
Cayman Islands	0	0	0	0	1	1	1	0	1
Chile	0	0	2	1	0	0	0	0	0
Colombia	0	0	0	1	0	1	0	0	0
Germany	0	0	0	0	0	0	0	2	2
Greece	0	0	0	0	0	2	0	0	0
Hong Kong	0	0	0	0	1	0	0	0	0
India	0	0	1	0	0	4	2	0	2
Indonesia	0	0	0	0	0	2	0	0	0
Ireland	0	0	0	0	0	2	0	0	0
Israel	0	0	1	1	4	3	0	0	0
Japan	0	0	0	0	1	4	1	1	0
Malaysia	0	0	0	0	0	4	0	0	0
Mexico	0	0	1	2	2	1	0	0	0
Netherlands	0	0	0	0	0	0	0	2	2
New Zealand	0	0	1	0	0	0	1	0	0
Norway	0	0	0	0	0	1	1	1	1
Papua New Guinea	0	0	0	0	0	1	0	0	0
Peru	0	0	0	0	0	1	1	0	0
Philippines	0	0	0	0	0	3	1	0	1
Russia	0	0	0	0	3	1	1	0	0
Singapore	0	0	0	0	0	4	1	0	0
South Africa	0	0	0	0	3	1	2	1	0
South Korea	0	0	0	0	1	4	0	0	0
Spain	0	0	0	0	0	0	0	0	1
Switzerland	0	0	0	0	0	0	0	0	2
Taiwan	0	0	2	0	1	1	0	0	0
Thailand	0	0	0	0	0	1	0	0	0
Turkey	0	0	0	0	0	0	0	0	1
United Arab Emirates	0	0	0	0	0	2	0	0	0
United Kingdom	1	0	1	1	1	1	0	2	2
Total	1	3	17	6	28	53	13	9	16

Notes: Panel A (B) in this table presents the distribution of the number of company-year observations, the number of inspection fieldwork end dates, the number of inspection report disclosures, the number of inspection reports disclosed containing at least one engagement-level deficiency (Part I Finding), the number of inspection reports disclosed containing a *non-public* quality control deficiency (Part II Finding), and the number of inspection reports with quality control criticisms publicly disclosed by country (year). Panel C presents the distribution of the number of *initial* auditor inspection reports disclosed by country and year. The descriptive statistics in Panels A and B include both the initial and subsequent inspections of each auditor.

TABLE 3
Descriptive Statistics

Variables	Mean	SD	P25	P50	P75	N
<u>External financing & investment proxies</u>						
<i>CAPEX</i>	0.049	0.057	0.013	0.031	0.062	52,329
<i>EXTERNAL FINANCING</i>	0.026	0.118	-0.021	0.000	0.045	52,329
<i>DEBT ISSUANCE</i>	0.007	0.086	-0.025	0.000	0.029	52,329
<i>EQUITY ISSUANCE</i>	0.019	0.079	0.000	0.000	0.000	52,329
<u>Inspection report characteristics (company-year level)</u>						
<i>INSPECTION</i>	0.195	0.396	0.000	0.000	0.000	52,329
<i>INSPECTION × PART I FINDINGS</i>	0.148	0.355	0.000	0.000	0.000	52,329
<i>INSPECTION × NP PART II FINDINGS</i>	0.164	0.371	0.000	0.000	0.000	52,329
<i>REPORT</i>	0.287	0.452	0.000	0.000	1.000	52,329
<i>REPORT × PART I FINDINGS</i>	0.144	0.351	0.000	0.000	0.000	52,329
<i>REPORT × NP PART II FINDINGS</i>	0.179	0.383	0.000	0.000	0.000	52,329
<u>Inspection report characteristics (report level)</u>						
<i>PART I FINDINGS</i>	0.554	0.498	0.000	1.000	1.000	276
<i>NP PART II FINDINGS</i>	0.685	0.465	0.000	1.000	1.000	276
<i>PUBLIC PART II FINDINGS</i>	0.025	0.158	0.000	0.000	0.000	276
<i>DAYS BTW INSPECTION & REPORT</i>	568.8	363.2	307.8	450.0	819.8	276
<u>Company characteristics</u>						
<i>NO. OF INSPECTION</i>	2.158	0.676	2.000	2.000	3.000	52,329
<i>TOBIN'S Q</i>	1.160	1.198	0.571	0.812	1.254	52,329
<i>SALES GROWTH</i>	0.090	0.338	-0.044	0.045	0.155	52,329
<i>CFO</i>	0.064	0.108	0.023	0.067	0.116	52,329
<i>ROA</i>	0.020	0.122	0.004	0.031	0.069	52,329
<i>DIVIDEND INDICATOR</i>	0.566	0.496	0.000	1.000	1.000	52,329
<i>LN(MVE)</i>	7.822	2.936	5.767	8.073	9.796	52,329
<i>CASH</i>	0.172	0.157	0.059	0.125	0.235	52,329
<i>LEVERAGE</i>	0.208	0.184	0.039	0.178	0.329	52,329
<i>ASSET TANGIBILITY</i>	0.306	0.211	0.137	0.277	0.437	52,329
<i>MISSING DUMMY</i>	0.519	0.500	0.000	1.000	1.000	52,329
<i>BIG4</i>	0.911	0.284	1.000	1.000	1.000	52,329

Notes: This table presents a number of descriptive statistics for my sample companies. The variable definitions are available in Appendix A.

TABLE 4
Effect of PCAOB Inspections on External Financing

Panel A: Static Analyses

Dependent Variable:	<i>EXTERNAL FINANCING</i>			
	(1) Coefficient <i>t</i> -Statistic	(2) Coefficient <i>t</i> -Statistic	(3) Coefficient <i>t</i> -Statistic	(4) Coefficient <i>t</i> -Statistic
<i>INSPECTION</i> [A]	0.001 (0.51)	0.002 (0.49)	0.001 (0.14)	0.001 (0.13)
<i>REPORT</i> [B]	0.007* (1.86)	0.014*** (3.25)	0.012*** (2.59)	0.014*** (2.86)
<i>INSPECTION</i> × <i>PART I FINDINGS</i> [C]		-0.002 (-0.28)		-0.004 (-0.71)
<i>REPORT</i> × <i>PART I FINDINGS</i> [D]		-0.011** (-2.57)		-0.012** (-2.30)
<i>INSPECTION</i> × <i>NP PART II FINDINGS</i> [E]			0.000 (0.07)	0.004 (0.57)
<i>REPORT</i> × <i>NP PART II FINDINGS</i> [F]			-0.008* (-1.81)	0.001 (0.27)
<i>TOBIN'S Q</i>	0.040*** (18.61)	0.040*** (18.61)	0.040*** (18.60)	0.040*** (18.61)
<i>SALES GROWTH</i>	0.002 (0.63)	0.002 (0.61)	0.002 (0.62)	0.002 (0.61)
<i>ROA</i>	0.021 (1.38)	0.022 (1.41)	0.021 (1.39)	0.022 (1.41)
<i>DIVIDEND INDICATOR</i>	0.011*** (4.71)	0.011*** (4.66)	0.011*** (4.71)	0.011*** (4.65)
<i>CFO</i>	-0.085*** (-6.17)	-0.085*** (-6.18)	-0.085*** (-6.17)	-0.085*** (-6.18)
<i>LN(MVE)</i>	-0.022*** (-9.80)	-0.022*** (-9.81)	-0.022*** (-9.80)	-0.022*** (-9.81)
<i>CASH</i>	-0.079*** (-6.39)	-0.079*** (-6.38)	-0.079*** (-6.39)	-0.079*** (-6.38)
<i>LEVERAGE</i>	-0.375*** (-29.39)	-0.375*** (-29.40)	-0.375*** (-29.35)	-0.375*** (-29.40)
<i>ASSET TANGIBILITY</i>	0.040*** (2.90)	0.040*** (2.91)	0.040*** (2.90)	0.040*** (2.92)
<i>MISSING DUMMY</i>	-0.056*** (-15.62)	-0.056*** (-15.62)	-0.056*** (-15.62)	-0.056*** (-15.62)
Significance of the sum of coefficients		<i>p</i> Value	<i>p</i> Value	<i>p</i> Value
[A] + [C]		0.81		0.65
[B] + [D]		0.48		0.83
[A] + [E]			0.66	0.38
[B] + [F]			0.20	0.00
Country × Industry × Year Indicators	Included	Included	Included	Included
Company Indicators	Included	Included	Included	Included
Adjusted R-Squared	39.4%	39.4%	39.4%	39.4%
No. of Observations	52,329	52,329	52,329	52,329

TABLE 4 (continued)

Panel B: Dynamic Analyses

Dependent Variable:	EXTERNAL FINANCING			
	(1)		(2)	
	Coefficient t	t-Statistic	Coefficient	t-Statistic
<i>REPORT [-4]</i>	-0.005	-1.32	-0.002	-0.34
<i>REPORT [-3]</i>	0.000	0.12	0.002	0.36
<i>REPORT [-2]</i>	-0.002	-0.33	-0.002	-0.26
<i>REPORT [-1]</i>	-0.004	-0.87	0.002	0.34
<i>REPORT [0]</i>	0.002	0.30	0.023**	2.18
<i>REPORT [1]</i>	0.004	0.88	0.015**	2.51
<i>REPORT [2]</i>	0.006	1.30	0.018**	2.58
<i>REPORT [3]</i>	0.011**	2.06	0.024***	2.83
<i>REPORT [4+]</i>	0.006	0.83	0.023**	2.28
<i>REPORT [-4] × PART I FINDINGS</i>			-0.005	-0.63
<i>REPORT [-3] × PART I FINDINGS</i>			-0.012	-1.37
<i>REPORT [-2] × PART I FINDINGS</i>			0.016	0.91
<i>REPORT [-1] × PART I FINDINGS</i>			-0.005	-0.60
<i>REPORT [0] × PART I FINDINGS</i>			-0.031***	-2.77
<i>REPORT [1] × PART I FINDINGS</i>			-0.018**	-2.58
<i>REPORT [2] × PART I FINDINGS</i>			-0.014*	-1.89
<i>REPORT [3] × PART I FINDINGS</i>			-0.016*	-1.91
<i>REPORT [4+] × PART I FINDINGS</i>			-0.025**	-2.00
			<i>p</i> -Value	
<i>REPORT[-4]+REPORT[-4]× PART I FINDINGS</i>			0.492	
<i>REPORT[-3]+REPORT[-3]× PART I FINDINGS</i>			0.466	
<i>REPORT[-2]+REPORT[-2]× PART I FINDINGS</i>			0.365	
<i>REPORT[-1]+REPORT[-1]× PART I FINDINGS</i>			0.599	
<i>REPORT[0]+REPORT[0]× PART I FINDINGS</i>			0.193	
<i>REPORT[1]+REPORT[1]× PART I FINDINGS</i>			0.529	
<i>REPORT[2]+REPORT[2]× PART I FINDINGS</i>			0.567	
<i>REPORT[3]+REPORT[3]× PART I FINDINGS</i>			0.180	
<i>REPORT[4+]+REPORT[4+]× PART I FINDINGS</i>			0.879	
Control Variables	Included		Included	
Country × Industry × Year Indicators	Included		Included	
Company Indicators	Included		Included	
Adjusted R-Squared	39.4%		39.4%	
No. of Observations	52,329		52,329	

Notes: This table presents the results from regressions of the amount of external capital raised on indicator variables capturing the periods following PCAOB auditor inspections, the content of the inspection reports, and control variables. The regressions in Panel A estimate a single post-treatment indicator and the regressions in Panel B estimate separate coefficients for each of the four years immediately before and after the disclosure of a PCAOB inspection report. See Appendix A for variable definitions. The *t*-statistics are clustered at the country-auditor level. ***, **, and * denote statistical significance at the two-tailed 1, 5, and 10 percent levels, respectively.

TABLE 5
Effect of PCAOB Inspections on Capital Expenditures

Panel A: Static Analyses

Dependent Variable:	CAPEX			
	(1) Coefficient <i>t</i> -Statistic	(2) Coefficient <i>t</i> -Statistic	(3) Coefficient <i>t</i> -Statistic	(4) Coefficient <i>t</i> -Statistic
<i>INSPECTION</i> [A]	0.001 (0.56)	0.000 (0.13)	0.001 (0.32)	0.001 (0.25)
<i>REPORT</i> [B]	0.002* (1.70)	0.005*** (3.44)	0.005*** (2.81)	0.005*** (3.07)
<i>INSPECTION</i> × <i>PART I FINDINGS</i> [C]		0.000 (0.22)		0.001 (0.50)
<i>REPORT</i> × <i>PART I FINDINGS</i> [D]		-0.005*** (-3.04)		-0.004* (-1.75)
<i>INSPECTION</i> × <i>NP PART II FINDINGS</i> [E]			-0.000 (-0.14)	-0.001 (-0.37)
<i>REPORT</i> × <i>NP PART II FINDINGS</i> [F]			-0.004** (-2.37)	-0.001 (-0.37)
<i>TOBIN'S Q</i>	0.009*** (13.02)	0.009*** (13.02)	0.009*** (13.02)	0.009*** (13.02)
<i>SALES GROWTH</i>	0.002** (2.14)	0.002** (2.12)	0.002** (2.12)	0.002** (2.12)
<i>CFO</i>	0.046*** (10.53)	0.046*** (10.55)	0.046*** (10.53)	0.046*** (10.55)
<i>LN(MVE)</i>	0.001 (0.90)	0.001 (0.90)	0.001 (0.91)	0.001 (0.90)
<i>CASH</i>	0.043*** (10.91)	0.043*** (10.93)	0.043*** (10.93)	0.043*** (10.94)
<i>LEVERAGE</i>	-0.052*** (-14.61)	-0.052*** (-14.60)	-0.052*** (-14.58)	-0.052*** (-14.58)
<i>ASSET TANGIBILITY</i>	-0.001 (-0.11)	-0.001 (-0.10)	-0.001 (-0.11)	-0.001 (-0.10)
Significance of the sum of coefficients		<i>p</i> Value	<i>p</i> Value	<i>p</i> Value
[A] + [C]		0.55		0.58
[B] + [D]		0.99		0.74
[A] + [E]			0.69	0.80
[B] + [F]			0.50	0.05
Country × Industry × Year Indicators	Included	Included	Included	Included
Company Indicators	Included	Included	Included	Included
Adjusted R-Squared	57.3%	57.4%	57.4%	57.4%
No. of Observations	52,329	52,329	52,329	52,329

TABLE 5 (continued)

Panel B: Dynamic Analyses

Dependent Variable:	CAPEX			
	(1)		(2)	
	Coefficient	<i>t</i> -Statistic	Coefficient	<i>t</i> -Statistic
<i>REPORT</i> [-4]	-0.001	-0.63	-0.000	-0.05
<i>REPORT</i> [-3]	0.000	0.28	0.002	0.77
<i>REPORT</i> [-2]	-0.001	-0.83	-0.000	-0.20
<i>REPORT</i> [-1]	-0.001	-0.38	-0.001	-0.50
<i>REPORT</i> [0]	-0.002	-1.30	0.002	0.60
<i>REPORT</i> [1]	0.001	1.24	0.005**	2.13
<i>REPORT</i> [2]	0.004***	2.64	0.009***	3.99
<i>REPORT</i> [3]	0.005***	2.67	0.011***	3.50
<i>REPORT</i> [4+]	0.007**	2.23	0.014***	3.61
<i>REPORT</i> [-4] × <i>PART I FINDINGS</i>			-0.002	-0.66
<i>REPORT</i> [-3] × <i>PART I FINDINGS</i>			-0.003	-1.16
<i>REPORT</i> [-2] × <i>PART I FINDINGS</i>			-0.002	-0.28
<i>REPORT</i> [-1] × <i>PART I FINDINGS</i>			0.005	1.31
<i>REPORT</i> [0] × <i>PART I FINDINGS</i>			-0.005	-1.36
<i>REPORT</i> [1] × <i>PART I FINDINGS</i>			-0.005**	-1.99
<i>REPORT</i> [2] × <i>PART I FINDINGS</i>			-0.008**	-2.45
<i>REPORT</i> [3] × <i>PART I FINDINGS</i>			-0.010***	-2.70
<i>REPORT</i> [4+] × <i>PART I FINDINGS</i>			-0.013**	-2.53
			<i>p</i> -Value	
<i>REPORT</i> [-4]+ <i>REPORT</i> [-4]× <i>PART I FINDINGS</i>			0.256	
<i>REPORT</i> [-3]+ <i>REPORT</i> [-3]× <i>PART I FINDINGS</i>			0.344	
<i>REPORT</i> [-2]+ <i>REPORT</i> [-2]× <i>PART I FINDINGS</i>			0.675	
<i>REPORT</i> [-1]+ <i>REPORT</i> [-1]× <i>PART I FINDINGS</i>			0.335	
<i>REPORT</i> [0]+ <i>REPORT</i> [0]× <i>PART I FINDINGS</i>			0.287	
<i>REPORT</i> [1]+ <i>REPORT</i> [1]× <i>PART I FINDINGS</i>			0.635	
<i>REPORT</i> [2]+ <i>REPORT</i> [2]× <i>PART I FINDINGS</i>			0.448	
<i>REPORT</i> [3]+ <i>REPORT</i> [3]× <i>PART I FINDINGS</i>			0.486	
<i>REPORT</i> [4+]+ <i>REPORT</i> [4+]× <i>PART I FINDINGS</i>			0.824	
Control Variables	Included		Included	
Country × Industry × Year Indicators	Included		Included	
Company Indicators	Included		Included	
Adjusted R-Squared	57.4%		57.4%	
No. of Observations	52,329		52,329	

Notes: This table presents the results from regressions of capital expenditures on indicator variables capturing the periods following PCAOB auditor inspections, the content of the inspection reports, and control variables. The regressions in Panel A estimate a single post-treatment indicator and the regressions in Panel B estimate separate coefficients for each of the four years immediately before and after the disclosure of a PCAOB inspection report. See Appendix A for variable definitions. The *t*-statistics are clustered at the country-auditor level. ***, **, and * denote statistical significance at the two-tailed 1, 5, and 10 percent levels, respectively.

TABLE 6
Cross-Sectional Test: Conditioning on the Degree of Financing Constraints

Panel A: External Financing

Dependent Variable:	<i>EXTERNAL FINANCING</i>			
	(1)	(2)	(3)	(4)
	Coefficient <i>t</i> -Statistic	Coefficient <i>t</i> -Statistic	Coefficient <i>t</i> -Statistic	Coefficient <i>t</i> -Statistic
	<i>Financially constrained</i>	<i>Financially unconstrained</i>	<i>Financially constrained</i>	<i>Financially unconstrained</i>
<i>INSPECTION</i> [A]	0.001 (0.19)	0.001 (0.20)	0.015 (0.91)	0.003 (0.50)
<i>REPORT</i> [B]	0.012** (1.98)	0.006* (1.93)	0.032** (2.24)	0.015*** (3.82)
<i>INSPECTION</i> × <i>PART I FINDINGS</i> [C]			-0.018 (-1.04)	-0.003 (-0.56)
<i>REPORT</i> × <i>PART I FINDINGS</i> [D]			-0.030* (-1.85)	-0.013*** (-3.06)
<i>TOBIN'S Q</i>	0.049*** (13.18)	0.039*** (13.74)	0.049*** (13.17)	0.039*** (13.74)
<i>SALES GROWTH</i>	0.005 (1.04)	-0.000 (-0.03)	0.005 (1.02)	-0.000 (-0.05)
<i>ROA</i>	-0.023 (-0.77)	0.057*** (2.98)	-0.022 (-0.75)	0.058*** (3.02)
<i>DIVIDEND INDICATOR</i>	0.012* (1.87)	0.011*** (4.10)	0.012* (1.87)	0.010*** (4.04)
<i>CFO</i>	-0.051* (-1.89)	-0.083*** (-5.04)	-0.051* (-1.89)	-0.083*** (-5.05)
<i>LN(MVE)</i>	-0.047*** (-8.46)	-0.019*** (-7.89)	-0.048*** (-8.49)	-0.019*** (-7.90)
<i>CASH</i>	-0.142*** (-5.39)	-0.056*** (-3.74)	-0.142*** (-5.40)	-0.056*** (-3.73)
<i>LEVERAGE</i>	-0.435*** (-14.10)	-0.383*** (-27.40)	-0.435*** (-14.13)	-0.383*** (-27.40)
<i>ASSET TANGIBILITY</i>	0.156*** (3.99)	0.019 (1.27)	0.158*** (4.02)	0.019 (1.28)
<i>MISSING DUMMY</i>	-0.089*** (-11.27)	-0.043*** (-12.91)	-0.089*** (-11.28)	-0.043*** (-12.90)
	<i>p</i> Value		<i>p</i> Value	
Difference in coefficient for [B]	0.095		0.081	
Difference in coefficient for [D]			0.160	
[A] + [C]			0.615	0.798
[B] + [D]			0.803	0.678
Country × Industry × Year Indicators	Included	Included	Included	Included
Company Indicators	Included	Included	Included	Included
Adjusted R-Squared	53.0%	37.0%	53.0%	37.0%
No. of Observations	11,943	40,386	11,943	40,386

TABLE 6 (continued)

Panel B: Capital Expenditures

Dependent Variable:	CAPEX			
	(1) Coefficient <i>t</i> -Statistic	(2) Coefficient <i>t</i> -Statistic	(3) Coefficient <i>t</i> -Statistic	(4) Coefficient <i>t</i> -Statistic
	<i>Financially constrained</i>	<i>Financially unconstrained</i>	<i>Financially constrained</i>	<i>Financially unconstrained</i>
<i>INSPECTION</i> [A]	0.001 (0.47)	0.000 (0.38)	0.005 (1.06)	-0.000 (-0.06)
<i>REPORT</i> [B]	0.005* (1.70)	0.001 (1.04)	0.013*** (2.77)	0.004*** (2.81)
<i>INSPECTION</i> × <i>PART I FINDINGS</i> [C]			-0.005 (-0.91)	0.001 (0.28)
<i>REPORT</i> × <i>PART I FINDINGS</i> [D]			-0.012** (-2.23)	-0.005*** (-2.82)
<i>TOBIN'S Q</i>	0.008*** (6.37)	0.011*** (10.89)	0.008*** (6.37)	0.011*** (10.90)
<i>SALES GROWTH</i>	-0.002 (-1.08)	0.003** (2.35)	-0.002 (-1.09)	0.003** (2.33)
<i>CFO</i>	0.033*** (4.35)	0.046*** (8.23)	0.033*** (4.39)	0.047*** (8.27)
<i>LN(MVE)</i>	-0.001 (-0.84)	0.002* (1.93)	-0.002 (-0.91)	0.002* (1.93)
<i>CASH</i>	0.033*** (4.33)	0.040*** (8.48)	0.033*** (4.35)	0.040*** (8.51)
<i>LEVERAGE</i>	-0.047*** (-5.24)	-0.055*** (-12.89)	-0.047*** (-5.26)	-0.055*** (-12.88)
<i>ASSET TANGIBILITY</i>	-0.058*** (-3.45)	0.004 (0.68)	-0.058*** (-3.41)	0.005 (0.69)
	<i>p</i> Value		<i>p</i> Value	
Difference in coefficient for [B]	0.115		0.040	
Difference in coefficient for [D]			0.101	
[A] + [C]			0.927	0.661
[B] + [D]			0.828	0.654
Country × Industry × Year Indicators	Included	Included	Included	Included
Company Indicators	Included	Included	Included	Included
Adjusted R-Squared	61.7%	59.0%	61.7%	59.0%
No. of Observations	11,943	40,386	11,943	40,386

Notes: Panel A (B) of this table presents the results from regressions of the amount of external capital raised (capital expenditures) on indicator variables capturing the periods following PCAOB auditor inspections, the content of the inspection reports, and control variables, conditional on the degree of financing constraints. A company-year is classified as being *financially constrained* if they are below median in age and below median in size within each country-year group. See Appendix A for variable definitions. The *t*-statistics are clustered at the country-auditor level. ***, **, and * denote statistical significance at the two-tailed 1, 5, and 10 percent levels, respectively.

TABLE 7
Cross-Sectional Test: Conditioning on Local Institutional Environment

Panel A: External Financing

Dependent Variable:	<i>EXTERNAL FINANCING</i>							
	(1) Coefficient <i>t</i> -Statistic	(2) Coefficient <i>t</i> -Statistic	(3) Coefficient <i>t</i> -Statistic	(4) Coefficient <i>t</i> -Statistic	(5) Coefficient <i>t</i> -Statistic	(6) Coefficient <i>t</i> -Statistic	(7) Coefficient <i>t</i> -Statistic	(8) Coefficient <i>t</i> -Statistic
	<i>High corruption</i>	<i>Low corruption</i>	<i>Weak rule of law</i>	<i>Strong rule of law</i>	<i>Low regulatory qty</i>	<i>High regulatory qty</i>	<i>Low private credit</i>	<i>High private credit</i>
<i>INSPECTION</i> [A]	-0.001 (-0.80)	0.007 (0.98)	-0.003 (-1.20)	0.005 (0.99)	-0.002 (-0.97)	0.001 (0.61)	-0.006 (-0.58)	0.005 (0.68)
<i>REPORT</i> [B]	0.004 (0.74)	0.025*** (3.01)	0.003 (0.61)	0.028*** (3.27)	0.004 (0.86)	0.029*** (2.72)	0.021* (1.95)	0.022*** (2.81)
<i>INSPECTION</i> × <i>PART I FINDINGS</i> [C]	0.005 (0.72)	-0.003 (-0.39)	0.001 (0.19)	-0.002 (-0.43)	0.001 (0.52)	-0.001 (-0.07)	-0.007 (-0.52)	-0.002 (-0.31)
<i>REPORT</i> × <i>PART I FINDINGS</i> [D]	0.001 (0.13)	-0.022*** (-2.91)	-0.003 (-0.55)	-0.021*** (-2.76)	-0.002 (-0.47)	-0.022** (-2.51)	-0.022** (-2.23)	-0.019*** (-2.60)
	<i>p</i> Value		<i>p</i> Value		<i>p</i> Value		<i>p</i> Value	
Difference in coefficient for [B]	0.027		0.009		0.027		0.910	
Difference in coefficient for [D]	0.015		0.045		0.043		0.821	
[A] + [C]	0.212	0.353	0.287	0.419	0.462	0.292	0.217	0.511
[B] + [D]	0.502	0.648	0.999	0.305	0.655	0.574	0.915	0.513
Control variables	Included	Included	Included	Included	Included	Included	Included	Included
Country × Industry × Year Indicators	Included	Included	Included	Included	Included	Included	Included	Included
Company Indicators	Included	Included	Included	Included	Included	Included	Included	Included
Adjusted R-Squared	29.1%	43.0%	27.9%	42.6%	31.1%	41.3%	26.8%	43.4%
No. of Observations	27,185	25,144	25,765	26,564	35,780	16,549	6,643	36,957

TABLE 7 (continued)

Panel B: Capital Expenditures

Dependent Variable:	CAPEX							
	(1) Coefficient <i>t</i> -Statistic	(2) Coefficient <i>t</i> -Statistic	(3) Coefficient <i>t</i> -Statistic	(4) Coefficient <i>t</i> -Statistic	(5) Coefficient <i>t</i> -Statistic	(6) Coefficient <i>t</i> -Statistic	(7) Coefficient <i>t</i> -Statistic	(8) Coefficient <i>t</i> -Statistic
	<i>High corruption</i>	<i>Low corruption</i>	<i>Weak rule of law</i>	<i>Strong rule of law</i>	<i>Low regulatory qty</i>	<i>High regulatory qty</i>	<i>Low private credit</i>	<i>High private credit</i>
<i>INSPECTION</i> [A]	-0.003 (-1.09)	0.002 (1.00)	-0.003 (-1.07)	0.002 (0.97)	-0.003 (-1.33)	0.002 (0.87)	-0.004 (-0.92)	0.002 (0.70)
<i>REPORT</i> [B]	0.003 (1.35)	0.007*** (2.68)	0.003* (1.65)	0.006*** (2.61)	0.003* (1.84)	0.006** (2.30)	0.009* (1.96)	0.006** (2.53)
<i>INSPECTION</i> × <i>PART I FINDINGS</i> [C]	0.002 (0.83)	-0.002 (-0.61)	0.003 (0.81)	-0.002 (-0.58)	0.003 (1.48)	-0.001 (-0.30)	-0.003 (-0.46)	-0.001 (-0.23)
<i>REPORT</i> × <i>PART I FINDINGS</i> [D]	-0.003 (-1.23)	-0.006** (-2.06)	-0.003 (-1.48)	-0.006** (-1.99)	-0.003 (-1.47)	-0.007** (-2.11)	-0.007 (-1.42)	-0.006** (-2.17)
	<i>p</i> Value		<i>p</i> Value		<i>p</i> Value		<i>p</i> Value	
Difference in coefficient for [B]	0.257		0.293		0.376		0.583	
Difference in coefficient for [D]	0.522		0.518		0.316		0.840	
[A] + [C]	0.608	0.492	0.984	0.515	0.596	0.556	0.283	0.300
[B] + [D]	0.898	0.410	0.942	0.588	0.742	0.843	0.688	0.674
Control variables	Included	Included	Included	Included	Included	Included	Included	Included
Country × Industry × Year Indicators	Included	Included	Included	Included	Included	Included	Included	Included
Company Indicators	Included	Included	Included	Included	Included	Included	Included	Included
Adjusted R-Squared	50.4%	62.8%	49.1%	62.1%	52.4%	61.9%	47.5%	61.8%
No. of Observations	27,185	25,144	25,765	26,564	35,780	16,549	6,643	36,957

Notes: Panel A (B) of this table presents the results from regressions of the amount of external capital raised (capital expenditures) on indicator variables capturing the periods following PCAOB auditor inspections, the content of the inspection reports, and control variables, conditional on several institutional features of the local country. *High corruption/Low corruption* partitions the sample each year based on whether a company operates in a country that is above/below median on the Kaufmann et al. (2009) corruption index. *Weak rule of law/Strong rule of law* partitions the sample each year based on whether a company operates in a country that is below/above median on the Kaufmann et al. (2009) rule of law index. *Low regulatory qty/High regulatory qty* partitions the sample each year based on whether a company operates in a country that is below/above median on the Kaufmann et al. (2009) regulatory quality index. These data are available in the Worldwide Governance Indicators dataset: <http://info.worldbank.org/governance/wgi/index.aspx#home>. Finally, *Low private credit/High private credit* partitions the sample each year based on whether a company operates in a country that is below/above median on the distribution of the ratio of domestic credit to the private sector by banks as a percent of GDP. See Appendix A for variable definitions. The *t*-statistics are clustered at the country-auditor level. ***, **, and * denote statistical significance at the two-tailed 1, 5, and 10 percent levels, respectively.

TABLE 8
Additional Analyses: Effect of PCAOB Inspections on Debt Contracts

Dependent Variable:	<i>YIELD SPREAD</i>	<i>MATURITY</i>	<i>NO. FINANCIAL COVENANTS</i>
	Coefficient <i>t</i> -Statistic	Coefficient <i>t</i> -Statistic	Coefficient <i>t</i> -Statistic
<i>INSPECTION</i> [A]	-0.318 (-0.04)	-0.916 (-0.39)	0.075 (0.69)
<i>REPORT</i> [B]	-4.800 (-0.99)	5.421*** (2.85)	0.268** (2.04)
<i>INSPECTION</i> × <i>PART I FINDINGS</i> [C]	0.524 (0.05)	1.322 (0.35)	-0.088 (-0.58)
<i>REPORT</i> × <i>PART I FINDINGS</i> [D]	15.584** (2.27)	-1.399 (-0.65)	-0.486** (-2.23)
<i>LOAN AMOUNT</i>	-13.156*** (-3.74)	5.144*** (2.89)	0.108 (1.17)
<i>SECURED</i>	16.640*** (3.96)	8.610*** (3.52)	0.099 (0.77)
<i>PERFORMANCE PRICING</i>	50.763** (2.46)	1.835 (0.35)	0.319 (1.60)
<i>TOBIN'S Q</i>	-0.969 (-0.20)	1.631 (1.28)	-0.160* (-1.98)
<i>SALES GROWTH</i>	6.546 (0.74)	-3.705 (-0.96)	0.217 (1.30)
<i>CFO</i>	-10.595 (-0.41)	-26.499** (-2.17)	-0.835 (-1.04)
<i>ROA</i>	-167.405** (-2.58)	33.883 (1.37)	0.026 (0.03)
<i>DIVIDEND INDICATOR</i>	-17.399 (-1.51)	-2.021 (-0.30)	0.290 (0.88)
<i>LN(MVE)</i>	2.471 (0.96)	-1.385 (-1.23)	-0.139** (-2.48)
<i>CASH</i>	29.990 (1.12)	16.220 (1.47)	-0.415 (-0.84)
<i>LEVERAGE</i>	27.581 (1.19)	12.059 (1.59)	-0.611 (-1.33)
<i>ASSET TANGIBILITY</i>	9.878 (0.50)	4.020 (0.72)	0.153 (0.35)
<i>YIELD SPREAD</i>		-0.068** (-2.49)	0.000 (0.10)
<i>MATURITY</i>	-0.332** (-2.33)		-0.003 (-0.96)
<i>NO. FINANCIAL COVENANTS</i>	0.256 (0.10)	-1.051 (-0.91)	
<i>NO. NON-FINANCIAL COVENANTS</i>	10.738** (2.06)	6.544*** (5.26)	0.371*** (6.95)
[A] + [C]	0.983	0.916	0.580
[B] + [D]	0.188	0.135	0.312
Country × Industry × Year Indicators	Included	Included	Included
Adjusted R-Squared	56.1%	44.2%	34.5%
No. of Observations	401	401	401

Notes: This table presents the results from regressions of four debt contract characteristics on indicator variables capturing the periods following PCAOB auditor inspections, the content of the inspection reports, and control variables. *YIELD SPREAD* is the All-in-Drawn-Spread measure reported by DealScan. This measure is equal to the amount the borrower pays in terms of basis points in excess of the LIBOR rate. *MATURITY* is the natural log of the number of months between the loan issue date and maturity date. *NO. FINANCIAL COVENANTS* is the number of covenants based on accounting numbers included in the contract. *NO. NON-FINANCIAL COVENANTS* is the number of non-accounting-based covenants included in the contract. *LOAN AMOUNT* is the natural log of the loan amount. *SECURED* is an indicator variable equal to one if the loan is backed by collateral. *PERFORMANCE PRICING* is an indicator variable equal to one if the loan contract includes a performance pricing option. See Appendix A for all other variable definitions. The *t*-statistics are clustered at the country-auditor level. ***, **, and * denote statistical significance at the two-tailed 1, 5, and 10 percent levels, respectively.