Market-Based Incentives for Audit Quality*

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This version: January 2, 2026

Abstract

We examine how investors respond to public inspection reports issued by the U.S. audit regulator. Our analysis exploits variation in company identifiability, where small client portfolios make inspection outcomes quasi company-specific. Using hand-collected publication dates and an event-study design, we find that identifiable companies experience positive abnormal returns following non-deficient inspection outcomes and negative returns following deficient ones. In contrast, companies that cannot be linked to specific inspection results show no price response. The return differentials persist across a battery of robustness tests and are stronger when inspection information is more timely. Overall, our findings show that markets incorporate audit-quality information when inspection outcomes can be credibly mapped to individual companies, suggesting that greater transparency enhances the informational role of audit oversight and strengthens market-based incentives for audit quality.

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

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1 Introduction

The market for public-company audits in the U.S. historically relied on self-regulation, with private mechanisms presumed sufficient to ensure audit quality.[1] The collapse of Enron and other high-profile auditing and governance failures exposed two weaknesses of self-regulation: audit quality is inherently unobservable to investors, and dispersed shareholders have weak incentives to acquire and act upon audit-quality information. In response, Congress adopted a hybrid regime that introduced a public audit regulator to replace peer review oversight, but did not fully centralize auditing in public capital markets.[2] A central feature of this new regime is the publication of the regulator's inspection reports that summarize audit-firm inspection outcomes but withhold the identities of the public companies whose audits were inspected. Two decades on, it remains unclear whether such anonymized reports effectively convey valuable signals about audit quality to investors.

If inspection reports explicitly identified inspected companies, investors could directly update their assessments of each company's financial reporting credibility. Under the current regime, however, inspection results are aggregated at the audit-firm level without naming individual companies whose engagements were inspected. This likely leads investors to interpret deficiencies as pooled averages across the audit firm's entire portfolio of public company audits. Accordingly, theory (Lambert et al., 2007) yields a clear and testable prediction: if company-specific inspection information is valuable, equity prices should differ systematically between deficient and non-deficient outcomes when individual companies are quasi-identifiable. Conversely, equity price reactions should be muted when company identities remain anonymous.

We test this prediction by isolating cases in which inspection reports are quasi company-

[1] Following DeFond and Zhang (2014), we assume that audit quality is higher when there is "greater assurance that the financial statements faithfully reflect the firm's underlying economics, conditioned on its financial reporting system and innate characteristics."

[2] The auditing profession continues to oversee key private self-regulatory functions, including CPA licensure via state boards and the AICPA's administration of professional standards and ethics. The hybrid model contrasts with a predominantly centralized audit and enforcement system such as the Internal Revenue Service's tax-examination program (DeBacker et al., 2018).

specific. Specifically, we study triennially inspected audit firms, defined as those auditing 100 or fewer public companies per year. As with annually inspected firms, their reports disclose the number of engagements reviewed and the share deemed deficient but do not name the underlying companies whose engagements were inspected. Thus, investors' ability to infer company-specific outcomes depends on the size of an audit firm's portfolio. When a firm audits only a few companies, the inspection results convey information that closely approximates company-specific information, whereas a larger client base makes deficiencies appear as pooled averages that cannot be attributed to individual clients. This variation in the potential for company identifiability forms the basis for our tests of whether markets respond to inspection reports when investors can plausibly map inspection outcomes to individual companies.

To implement this empirical strategy, we examine inspection reports publicly released by the primary U.S. audit regulator from 2006 to 2022 for triennially inspected audit firms. Using publicly available data sources, we identify the release date of each report and link it to the public companies audited by the corresponding audit firm in the inspected year. Our sample comprises 3,151 company-inspection observations, of which 2,157 (68.5%) involve inspection reports disclosing at least one deficient engagement. We classify observations as *identifiable* when the audit firm audited three or fewer SEC-registered companies during that year and as *non-identifiable* otherwise. This classification yields 183 identifiable and 2,968 non-identifiable observations, involving 260 unique audit firms and 1,489 distinct SEC-registered companies in our sample.

Before turning to our primary market tests, we verify two necessary conditions for observing meaningful investor reactions to inspection reports. First, because the regulator does not preannounce inspection report releases, investors must be able to acquire and process these disclosures immediately upon publication to trade on company-specific information (Blankespoor et al., 2020). Using proprietary data that tracks daily web traffic to the regulator's website, we find that inspection reports associated with identifiable companies are

promptly accessed by market participants following their release. Second, to establish that the information is economically meaningful, we examine whether identifiable deficient outcomes have observable consequences for audit firms. We find that identifiable companies are 16 percentage points more likely to switch auditors within two years following a deficient outcome than after a non-deficient one. Together, these findings indicate that company-level inspection information is both timely consumed and economically relevant, motivating our analysis of whether such information is priced in equity markets.

Building on these validation results, we test our primary hypothesis using abnormal equity returns in narrow windows around the release of inspection reports. Because the regulator often releases multiple inspection reports on the same day, we cluster standard errors by report-release date to account for potential cross-sectional correlation in returns. For companies audited by firms with four or more public-company engagements, abnormal returns do not differ significantly between deficient and non-deficient inspection reports. This pattern suggests that when company identifiability is low, investors cannot draw company-specific inferences from the information contained in inspection reports.

In contrast, companies audited by firms with three or fewer public-company engagements exhibit pronounced market reactions to inspection reports. These companies experience positive abnormal returns following non-deficient reports and negative abnormal returns following deficient ones. The difference in abnormal returns between non-deficient and deficient outcomes is economically meaningful, ranging from 2.0% to 2.6%, depending on the asset pricing model and the event window we use to measure market reactions. These results are consistent with investors revising their assessments of financial reporting quality when inspection outcomes are quasi company-specific, which aligns with the theoretical predictions in Lambert et al. (2007).

The main advantage of our empirical design is that it isolates a subset of companies for which the information released by the U.S. regulator is quasi company-specific. This provides a unique setting to assess the potential relevance of greater transparency in audit oversight.

The primary challenge, however, is that this identification strategy relies on a small set of companies that tend to be smaller in size and may have equities with relatively low liquidity. These firm characteristics raise the concern that a few outlier observations could influence the observed market reactions. To address this concern, we conduct a series of robustness tests that evaluate the stability of our baseline results and, more broadly, the reliability of the inferences drawn from our event-study framework.

First, we test the sensitivity of our results to individual observations. Focusing on the sample of identifiable companies, we sequentially remove each observation and re-estimate the differences in abnormal returns between deficient and non-deficient events. The estimated effect remains stable and statistically significant at conventional levels. We then randomly exclude five and ten observations, repeating the procedure 10,000 times and re-estimating the same return differential. The difference in abnormal returns are statistically indistinguishable from zero in only 0.2% and 1.5% of the draws, respectively. These simulations highlight the stability of our baseline results and suggest that the documented market reaction to inspection reports is unlikely to be driven by a small number of outlier observations.

Second, we conduct a placebo test to assess whether the observed market reactions are attributable to random variation in stock prices. For each inspection report, we randomly assign a placebo date between the start of the regulator's inspection and the report's publication. To preserve the structure of our data, we assign that placebo date to all companies audited by the same firm. We repeat this random procedure 1,000 times and re-estimate abnormal returns around the placebo dates for both identifiable and non-identifiable companies. The resulting distributions are centered around zero for all groups, including identifiable and non-identifiable companies and, within the identifiable subset, both deficient and non-deficient inspection outcomes. In approximately 95% of simulations across all groups, the estimated betas are statistically insignificant, which is consistent with random variation due to placebo treatment. Therefore, the return differentials in our baseline analysis are unlikely to arise by statistical chance.

Third, we assess whether our results could be affected by concurrent company-specific news unrelated to the inspection reports. Using companies' filings to the U.S. Securities and Exchange Commission (SEC), we identify events where a company filed periodic or event-driven reports within the week surrounding the inspection report release date. Excluding these overlapping events does not materially affect our results when we remove either type of filing separately. When both types are excluded simultaneously, statistical significance weakens, consistent with the loss of power from a smaller sample. Overall, the results remain largely robust to potential confounding events, indicating that the observed market reactions are unlikely to reflect responses to unrelated company disclosures rather than to the release of inspection reports by the regulator.

Fourth, we evaluate whether our results depend on key assumptions underlying the event-study design, particularly the timeliness and accuracy of the inspection-report disclosures. We investigate timeliness by examining whether delays in releasing inspection reports reduce their relevance to investors. Timely audit-quality information should be more decision-useful in capital markets, whereas stale disclosures are likely to be discounted. Consistent with this expectation, return differentials between deficient and non-deficient outcomes are larger when reports are released sooner after the inspection period ends.

Measuring market reactions requires precise identification of when inspection results reach investors. We hand-collect and verify the actual publication dates from the regulator's website and find that a commonly used dataset had structurally misreported these dates. Using the misreported and inaccurate dates as an additional placebo yields no significant effects, which shows that our findings depend on correctly capturing when inspection information becomes public. Together, these additional analyses further suggest that the market reactions to inspection reports reflect investor responses to timely and accurately dated disclosures of audit-quality information.

Finally, we explore how inspection report releases affect bid-ask spreads and return volatility. Most notably, we find evidence of greater bid-ask spreads and return volatility

when audit deficiencies are reported, but the related companies are not identifiable. These results suggest that the current practice of anonymizing companies may lead to increased investor uncertainty following inspection report releases.

Our study contributes to the literature on audit regulation and informational effects of oversight in capital markets. Prior research shows that public audit oversight enhances the credibility of financial reporting. For example, Gipper et al. (2020) document that the shift from self-regulation to public oversight increases earnings informativeness, while other work finds that inspections generate audit-market benefits for inspected audit firms (Aobdia and Shroff, 2017) and capital-market benefits for inspected foreign companies (Shroff, 2020). Related studies show that inspection findings influence auditor behavior, leading to improvements in subsequent audit quality.[3] We extend this literature by directly examining how investors react to the inspection reports themselves, which is the regulator's main channel for communicating audit-quality information. Our results provide evidence that audit quality improvements can be demanded by investors through stock price effects as opposed to being driven through other channels, such as auditors' regulatory, litigation, or reputation concerns. Further, we show that investors price inspection outcomes only when they can be credibly mapped to individual companies, which suggests that the informational role of audit oversight is influenced by the granularity and timeliness of public disclosure.

Our findings also have potential policy implications: Before the Sarbanes-Oxley Act of 2002 (SOX), oversight of audit quality in the U.S. relied on a self-regulated peer-review program.[4] SOX introduced a public oversight regime in which the regulator conducts inspections and publishes reports. However, these inspection reports are released at the audit-firm level and do not identify the specific company engagements that were inspected. A more transparent design would disclose the identities of inspected companies, allowing markets to directly price company-level information about audit quality. Our study approximates this

[3]For example, Aobdia (2018) find that audit firms and individual auditors respond to deficiencies by improving audit quality in future engagements, which has capital market benefits for their portfolio clients.

[4]Although the peer-review system was replaced, evidence in Hilary and Lennox (2005) indicates it provided credible information about audit-firm quality.

counterfactual by examining triennially inspected audit firms with very few public-company clients, where audit-firm reports are quasi company-specific. In this setting, we find positive abnormal returns following non-deficient outcomes and negative abnormal returns following deficient ones. Taken together, the evidence suggests that when inspection results can be credibly linked to individual companies, public disclosure of inspection outcomes can enhance market-based incentives for audit quality.

These policy implications, however, should be interpreted with caution. Our inferences are based on a sample of relatively small public companies that typically have lower institutional ownership, limited analyst coverage, and less liquid publicly traded equities. Furthermore, in the absence of other governance mechanisms (e.g., large institutional ownership and equity analyst coverage), external auditing may play a comparatively larger role for these companies (e.g., Roychowdhury and Srinivasan, 2019). Accordingly, the effects of increased inspection transparency observed in our setting may not generalize to larger companies that are subject to stronger external monitoring through greater institutional ownership, analyst coverage, and other governance mechanisms.

2 Institutional Background

2.1 The Statutory Origins of Audit Regulation

The SEC has required companies with publicly listed securities to file audited financial statements since 1934 for those listed on a major exchange (e.g., Stigler, 1964; Benston, 1973) and since 1964 for public companies registered with the SEC and quoted on the over-the-counter (OTC) markets (e.g., Greenstone et al., 2006). While managers are responsible for producing these financial reports for investors, they have both pecuniary and reputational incentives to withhold unfavorable information and overstate positive performance (Jensen and Meckling, 1976). As companies grew larger and more complex, agency conflicts intensified and investors began demanding voluntary independent audits of financial statements

(Watts and Zimmerman, 1983). This demand ultimately laid the foundation for the statutory audit requirements established under the Securities Exchange Act of 1934 (Bourveau et al., 2025a).

Audits are intended to enhance the credibility of financial statements by providing reasonable assurance that they are free from material misstatements. Historically, the U.S. audit profession was self-regulated, and audit quality was evaluated through a peer review program governed by the American Institute of Certified Public Accountants (AICPA) (Hilary and Lennox, 2005; DeFond, 2010; Anantharaman, 2012). Although the program provided some credible signals of audit quality (Hilary and Lennox, 2005), self-regulation ultimately failed to prevent cases of inadequate auditor effort, insufficient technical expertise, and acquiescence to client pressure despite reputation concerns (DeAngelo, 1981; Antle, 1984; Ronen, 2010; Causholli and Knechel, 2012). In response to these shortcomings and following a series of high-profile corporate scandals, Congress enacted SOX, which established an independent public audit regulator to strengthen oversight of auditors of public-companies through recurring inspections and public reporting of inspection outcomes.

2.2 The Regulatory Audit Inspection Process and Reports

The U.S. audit regulator's inspection reports contain two main components: (i) Part I findings, which detail deficiencies identified in company audits during inspections and are always made public, and (ii) Part II findings, which address audit firm-wide quality control weaknesses. Part II findings are drafted concurrently with Part I but are only publicly disclosed if the audit firm fails to remediate the identified criticisms within 12 months of the inspection report date.[5]

Draft inspection reports are first shared with the audit firm to allow review and response before the regulator formally approves a final version for public release. Once finalized, the reports are published on the regulator's website and a notice is distributed via email to

[5]For further details on the U.S. audit regulator's inspection process, see, e.g., DeFond and Lennox (2017), Aobdia (2018), Aobdia (2020), and Gipper et al. (2020).

subscribers. These reports summarize the inspection outcomes, including the number and nature of deficient engagements during the inspection cycle. However, the identities of the companies whose audits were inspected remain confidential, likely due to legal constraints under SOX.[6]

The frequency of inspections depends on the size of the audit firm's public company portfolio. Firms performing more than 100 public company audits annually, such as the Big Four accounting firms, are inspected every year, whereas firms auditing 100 or fewer public companies are inspected at least once every three years. Our analysis focuses on these smaller audit firms, which are commonly referred to as triennially inspected firms.

For these smaller audit firms with limited client portfolios, the regulator often inspects all or nearly all of their public company engagements, with an average coverage rate of approximately 70% (Swanquist, 2014).[7] When coupled with only a few public company clients, this high inspection coverage rate likely enables investors to plausibly infer which companies were inspected based on publicly available information. Even without explicit disclosure, inspection report details such as the nature of deficiencies, industry specialization, or subsequent financial restatements can help investors identify the companies involved.

3 Conceptual Background

Economic theory predicts that reducing information asymmetry and investor uncertainty improves market efficiency and raises equity values for public companies (Leland and Pyle,

[6]We do not find evidence that audit firms systematically disclosed their engagement-level inspection outcomes. However, larger audit firms do provide firm-level inspection information in their voluntary transparency reports (e.g., Johl et al., 2021). Because these disclosures are voluntary and tend to be provided by the largest audit firms, they would not allow investors to identify the issuers whose engagements were inspected.

[7]Using the constructions employed by this study described in Section 4.2.1, we estimate audit firms with one to three public company clients have roughly 87% of their clients selected for inspection on average, with 100% at the median. Audit firms with four to six clients have 47% of their clients selected for inspection, on average, and those with seven to 100 clients have approximately 18% selected for inspection. Using Swanquist (2014)'s construction—but over the inspection years of 2006 to 2022—we observe roughly 66%, on average, for clients of audit firms with two to five public company clients, and 10% for clients of audit firms with 70 to 100. These figures indicate our analysis is aligned with that reported by Swanquist and also that the choice of one to three clients improves the identifiability and matching probability substantively.

1977; Verrecchia, 2001; Lambert et al., 2007). Publicly revealing company-specific audit inspection results could therefore allow investors to better assess the credibility of financial reporting and incorporate this information into stock prices. However, the theoretical literature in accounting and auditing provides limited direct insights into how disclosures about audit inspection outcomes at the company level influence capital markets. One notable exception is Attar-Niggemann et al. (2024), who posit that publicly disclosing company-level audit deficiencies can enhance audit quality by increasing auditors' legal and reputational exposure. Their model predicts that traceable deficiencies strengthen accountability and discipline auditor behavior. However, it does not address whether equity markets incorporate such information into stock prices or whether companies have incentives to adjust their demand for audit quality in response to greater transparency.

Empirical research likewise offers limited evidence as to how capital markets respond to public audit inspection disclosures. Despite the theoretical importance of these disclosures, only a handful of studies examine whether this information shapes investor perceptions of audit quality and, in turn, affects equity valuations. Most prior work instead focuses on how oversight influences the credibility of financial reporting – rather than direct market reactions to the release of inspection reports. For example, Gipper et al. (2020) document that the transition from auditor self-regulation to public oversight increased earnings informativeness, suggesting that investors perceive financial reporting as more credible in the post-reform environment. Similarly, Erinc and Zach (2024) shows that investors discount earnings surprises when those earnings are more likely to be influenced by audit deficiencies identified in inspection reports, suggesting that oversight information shapes perceptions of financial reporting quality. While these studies highlight the informational role of audit oversight, they examine how inspection signals interact with subsequent earnings news rather than how investors react to the inspection reports themselves.

An unpublished paper by Offermanns and Peek (2011) attempts to directly examine market reactions to the release of audit inspection reports. The study uses the "stamp" dates

from Audit Analytics as proxies for the actual publication dates and posits that inspection reports may affect market volatility. However, this approach relies on approximate event timing and broad event windows, as the stamp dates often differ from the true public release dates of the inspection reports.

In sum, although prior research recognizes that regulatory audit oversight can shape investor perceptions and market outcomes, direct evidence on how equity markets respond to public release of inspection reports remains limited. Our study fills this gap by providing direct evidence on the market's reaction to these disclosures and the conditions that make them informative. By precisely identifying report release dates, accounting for company identifiability, and examining the role of inspection report timeliness, we offer new evidence on how regulatory transparency about audit quality is incorporated into equity prices. These findings contribute to a broader understanding of how regulatory design and disclosure practices can affect the information environment of capital markets.

We start with the assumption that audit quality is not fully observable and that investors are dispersed and have limited incentives to gather information on audit quality. Thus, investors may learn audit quality information from a regulator's inspections of audits. If audit quality is lower than investors anticipate, companies' stock prices will decline. This price decline can incentivize companies to work together with investors to demand higher audit quality.

We build on the model in Lambert et al. (2007) to infer how information about audit quality from inspection reports issued by the U.S. regulator may affect companies' stock prices, even when investors hold diversified portfolios. In their model, Lambert et al. (2007) reformulate the Capital Asset Pricing Model (CAPM) in terms of cash flows rather than returns and show that accounting information can affect a company's cost of capital through two channels: a direct effect and an indirect effect.

The direct effect arises because accounting quality affects investors' perceptions of how a company's cash flows co-vary with the cash flows of other companies in the market. Lower-

quality accounting information increases this perceived covariance, raising the company's systematic risk exposure and reducing the present value of its expected cash flows in a manner analogous to a higher-beta stock. The indirect effect occurs because lower quality accounting information can distort managers' behavior, such as increasing their propensity to make inefficient investments or misappropriate assets. These distortions reduce expected cash flows and, consequently, the company's stock price.[8]

Applying this framework to our setting, we expect information about audit quality in the U.S. regulator's inspection reports to influence investors' assessments of accounting quality. Specifically, inspection deficiencies should generally lead investors to infer lower accounting quality, resulting in negative price revisions, whereas non-deficient outcomes should reinforce confidence in financial reporting, producing positive price reactions. Price reactions to non-deficient or better-than-expected outcomes, however, may be muted because investors cannot observe the PCAOB's procedures, making it difficult to determine if the audit is higher quality or if the PCAOB did not examine the deficient portions of the audit. If PCAOB inspection reports do not contain useful information about audit quality, if investors are insufficiently able to attribute audit quality information to specific companies, or if investors are able to anticipate audit quality information from other sources, we would not observe a price reaction to inspection report releases.

4 Data & Empirical Design

4.1 Data Sources and Sample Period

We use data from widely available commercial databases for our analysis. Equity returns are collected from the Center for Research in Security Prices (CRSP), financial information

[8]While our definition of accounting quality relates to how financial statements reflect an company's underlying economics (DeFond and Zhang, 2014), in the indirect effect, audit quality also changes the underlying economics of the company. It is still audit quality, however, that is changing investors' perceptions of the value of the company. This interpretation is consistent with other work (e.g., Aobdia et al., 2015; Gipper et al., 2020) that finds audit quality affects investors' perceptions of company value.

from Compustat, and auditor-client data from Audit Analytics. We obtain data on analyst coverage from I/B/E/S, and institutional ownership from Thomson 13F. SEC filing information is from WRDS SEC Analytics Suite. Information on the release of inspection reports is obtained directly from the U.S. audit regulator, the Public Company Accounting Oversight Board (PCAOB), through archival records, email announcements, and the inspection release website.[9] We obtained the inspection release dates from the PCAOB because the 'issuance date' in the Audit Analytics does not reflect the date the report is publicly distributed and posted on the PCAOB website.[10] Collectively, these sources provide a comprehensive and replicable foundation that reflects the information environment available to investors.

Our sample period is selected to ensure consistency and comparability across time. To ensure data reliability, we focus on inspection releases from inspection year 2006 onward, when complete and verifiable release-date information first becomes available. This omits the earliest inspection years. However, these initial inspections were limited in scope and the PCAOB was still developing its inspections processes (Gipper et al., 2020). An "inspection year" refers to the year of the inspection cycle as reported on the PCAOB's website, which does not necessarily align with the companies' fiscal years or the calendar year of report releases. Our final sample covers inspection releases with inspection years from 2006 to 2022. Reports released during this period typically contain the audit firm's identity, the number of public company audits performed and inspected, the proportion of engagements identified as deficient, and narrative descriptions of those deficiencies. Focusing on this period provides a consistent and comparable dataset suitable for analyzing market reactions to inspection disclosures.

[9]Email records are consistently available after 2011. For earlier years, we rely on the PCAOB's archival record of report release dates and, where available, cross-validate those dates with the inspection release website. In mid-2025, the PCAOB established a web service (available at https://pcaobus.org/news-events/news-releases?topics=Inspections) that provides facsimiles of more recent release notices distributed by email, which we used to verify the archival record.

[10]Table IA1 in the online appendix summarizes the discrepancies between the actual inspection report release dates and those originally reported by Audit Analytics. We recommend that researchers use the inspection report release dates on the PCAOB's website (https://pcaobus.org/news-events/news-releases?topics=Inspections) for the dates the reports are released to the public.

4.2 Sample

4.2.1 Sample Construction

To examine market reactions to inspection reports, we first match each report to the companies audited by the corresponding audit firm using Audit Analytics' record of audit opinions. We replicate the information set available to investors by including both inspected and non-inspected companies because the regulator does not disclose which specific engagements were reviewed. Companies are identified using a one-year lookback window, relative to the inspection report release date, based on the signature date of the audit opinion. Each company-inspection observation represents a public company linked to a specific inspection report for its auditor in the corresponding inspection year.

Beginning with 3,503 raw inspection reports and dropping three reports for missing release information, we have 3,500 reports and 166,598 raw opinions from Audit Analytics with a fiscal year after 2003. Merging the opinions with the reports using the lookback results in 87,404 opinions and a loss of 889 inspection reports for a remainder of 2,611 reports. After joining relevant identifier links for Compustat and CRSP we lose an additional 27,100 opinions and 1,074 reports, resulting in a sample of 1,537 reports covering 60,304 opinions for 8,897 unique companies.[11]

We remove investment companies and depository receipts. Further, we drop observations that do not have observable covariates for book-to-market, total assets, or leverage, resulting in 50,612 observations. Lastly, we restrict the sample to clients of U.S. audit firms and each company-inspection observation is retained only if complete trading data are available for all days within the estimation window used in the market models, resulting in a sample of 42,182 company-inspection observations.

Table 1 summarizes our sample construction by sub-groups. Panel A reports the number

[11]Because we rely on opinions available in the Audit Analytics record, we naturally exclude employee benefit plans, which many smaller audit firms primarily audit. In addition, companies traded over-the-counter and not listed on major exchanges are generally absent from CRSP and therefore excluded from our analysis, further reducing the number of observations because smaller firms audit a higher proportion of over-the-counter companies (Bourveau et al., 2025b).

of inspection events and matched company-inspection observations for all audit firms and for the subset of triennially inspected firms. Across all audit firms, we identify 886 inspection events corresponding to 42,182 company-inspection observations. Because our analyses rely on comparing identifiable and non-identifiable companies, we focus on triennially inspected firms (i.e., those issuing 100 or fewer audit opinions for public companies in a given year) for which comparability across groups is most meaningful.[12] Restricting the sample to triennially inspected firms yields 732 inspection events and 3,151 company-inspection observations.

[Insert Table 1 here]

Panel B disaggregates these observations by deficiency status and identifiability. We classify events as *deficient* when the inspection report identifies at least one Part I deficiency and as *non-deficient* when no deficiencies are reported. Among all company-inspection observations, 97.6% (41,160 out of 42,182) have at least one deficiency. For triennially inspected firms, the share of deficient company-inspection observations declines to 68.5% (2,157 out of 3,151).

We define a company as *identifiable* if its auditor reports three or fewer public company audit clients in the inspection year, and as *non-identifiable* otherwise.[13] Panel B shows that only 0.4% of all company-inspection observations (183 out of 42,182) involve identifiable companies. All 183 identifiable observations occur among triennially inspected firms, representing 5.8% of that subsample.

4.2.2 Descriptive Statistics

We next examine key characteristics of the 3,151 company-inspection observations for triennially inspected audit firms. Company size is measured by *market capitalization*, defined

[12] We form the classification based on PCAOB's listing of the number of company audit clients as reported by the audit firms. On occasion, due to timing differentials as noted in the reports, the number of audit clients reported may be fewer than those reviewed or may be listed as zero due to a loss of clients in the interim period of the inspection. In such instances, we replace the number of public company clients with the number reviewed. In general, our classification is similar to Swanquist (2014).

[13] Alternative thresholds for identifiability, such as two or fewer clients, were tested, and the results remain consistent both qualitatively and quantitatively.

as the total market value of common stock at the prior fiscal year end (in millions of U.S. dollars) from CRSP. *Leverage* is calculated as long-term debt plus long-term debt in current liabilities, scaled by total assets, from Compustat. Profitability is captured by *return-on-assets* (ROA), measured as operating income before depreciation divided by total assets, also from Compustat. *Company age* is the number of years since the company's initial public offering, measured up to the inspection report release date, from Compustat. *Book-to-market* (BTM) is computed as the book value of stockholders' equity plus balance-sheet deferred taxes and investment tax credits, adjusted for preferred stock at redemption, liquidation, or par value when available (e.g., Daniel and Titman, 2006). *Turnover* captures equity liquidity and is calculated as the average daily trading volume scaled by market capitalization over the 180-day estimation window used in the factor models.

To capture variation in external monitoring, we also examine analyst coverage and ownership by institutional investors. *Analyst following* is the number of analysts providing annual earnings forecasts for the company from I/B/E/S for the month closest to the inspection report release date, set to zero when unavailable. *Institutional ownership* is the percentage of shares held by institutional investors, based on 13-F filings from Thomson. Table 2 reports descriptive statistics for these variables.

[Insert Table 2 here]

Panel A presents descriptive statistics for both identifiable and non-identifiable companies (the pooled sample). The average company has a *market capitalization* of approximately $210 million, *leverage* of 13%, and negative profitability, with a mean *ROA* of −9%. The typical company has been publicly traded for just over 13 years and has a *BTM* ratio close to one. The average company exhibits equity *turnover* of 1.43% per day. On average, companies in the sample have coverage from just over one analyst and roughly 20% *institutional ownership*.

Panel B reports differences in company characteristics between identifiable and non-identifiable companies. Identifiable companies are significantly smaller, with an average *market capitalization* of $115 million compared to $216 million for non-identifiable companies,

and this difference of −$101 million is statistically significant ($t = -5.86$). *Analyst following* and *institutional ownership* are also significantly lower for identifiable companies ($t = -8.02$, $t = -3.55$, respectively). *Leverage* is slightly lower for identifiable companies, averaging 11% compared to 13% for non-identifiable companies, and this difference of two percentage points is statistically significant ($t = -2.52$). Profitability, however, is higher among identifiable companies, with an average *ROA* of 1% versus −10% for non-identifiable companies ($t = 6.53$). *Turnover* is significantly lower ($t = -4.50$) for identifiable companies with an average daily turnover of 0.61%, indicating these smaller companies are less liquid, on average.

In contrast, *Company age* and *BTM* ratios do not differ significantly between the two groups ($t = 1.19$ for *Company age* and $t = 1.29$ for *BTM*). Overall, these results indicate that identifiable companies tend to be smaller, more profitable, and have less leverage and external monitoring, while otherwise remaining comparable and within consistent magnitudes to non-identifiable companies along some key characteristics.

4.3 Event-Study Design

To estimate market reactions to the release of audit inspection reports, we employ a standard event-study framework (Fama et al., 1969; Kothari and Warner, 2007). We compute abnormal returns using two approaches: (i) market-adjusted model and (ii) the Fama-French three-factor model (*FF-3*). For the FF-3 model, we estimate factor loadings over a 180-day window ending before the inspection report release date. Cumulative abnormal returns (*CARs*) are then calculated as the sum of daily abnormal returns over the [0,1] and [0,2] windows surrounding the release date, where day 0 denotes the publication date of the inspection report on the regulator's website.

An important institutional detail of our setting is that the regulator often releases multiple inspection reports on the same day. These contemporaneous releases can induce cross-company correlation in returns if investors respond jointly to the aggregate news. Figure 1 illustrates the extent of these simultaneous releases.

[Insert Figure 1 here]

The figure reports the frequency of simultaneous release events by the number of reports included in each batch. The regulator most commonly releases between nine and 12 reports at a time, with releases containing between 17 and 27 reports being the next most frequent. Although relatively uncommon, the regulator may release up to 44 reports in a single event. Anecdotally, the regulator often releases reports for annual audit firms in separate releases from triennial batches. Because of this institutional feature, we cluster all standard errors by report-release date to account for correlated company-level reactions to same-day disclosures (Thompson, 2011). We discuss alternative clustering adjustments in Section 6.

4.4 Validation of Information Relevance and Timeliness

A potential concern with our event-study design is that inspection report releases may not convey information that is both acquired and economically meaningful to market participants. Before turning to the market-reaction tests, we conduct two descriptive analyses to assess these necessary conditions.

First, investors must be able to observe and process inspection reports promptly upon release for the disclosures to generate detectable price responses (Blankespoor et al., 2020). Unlike earnings announcements, the regulator does not preannounce publication dates. To gauge whether market participants actively acquire the information contained in inspection reports, we use proprietary data tracking daily web traffic to the regulator's website. Following the methodology in Inget et al. (2025), we measure information acquisition using inspection report-specific web clicks. Focusing on releases associated with identifiable companies, we find that these inspection reports receive concentrated web traffic immediately following their release. This untabulated evidence indicates that market participants access inspection disclosures in a timely manner as they become available.

Second, even if inspection reports are promptly accessed, investors must also view the information as economically relevant to company value. To evaluate whether inspection out-

comes have real consequences for audit firms and their clients, we examine auditor turnover following the publication of inspection reports. In untabulated results, we find that identifiable companies are approximately 16 percentage points more likely to switch auditors within two years after a deficient inspection outcome than after a non-deficient one. This result suggests that inspection findings may influence auditor-client contracting decisions and that audit committees and investors respond to credible, company-specific signals of audit quality conveyed by the regulator.

Together, these two empirical facts indicate that company-level inspection report information is both timely consumed and economically meaningful. This supports the premise that inspection reports can influence capital-market outcomes.

5 Main Results

5.1 Baseline Results

Having established that inspection reports are both observable and economically meaningful, we next examine market reactions to their release. Specifically, we test whether investors price inspection outcomes differently for identifiable and non-identifiable companies. Table 3 presents the results, and Figure 2 illustrates the dynamics of market reactions around inspection report releases.

[Insert Table 3 here]

Panel A of Table 3 shows that for non-identifiable companies, CARs around inspection report releases are economically small and statistically indistinguishable from zero across models and event windows. For example, under the market-adjusted model, the [0,1] CARs are 0.03% for non-deficient companies ($t = -0.12$) and 0.04% for deficient companies ($t = 0.13$). The difference in returns (-0.07%) is not statistically significant ($t = -0.19$). Results are similarly muted for the [0,2] window under both the market model and the FF-3 model.

These patterns indicate that when company identities cannot be inferred from the inspection report, investors do not differentiate between deficient and non-deficient outcomes.

Panel B presents the corresponding results for identifiable companies. In contrast to Panel A, we observe clear evidence of differential market reactions. Abnormal returns for non-deficient identifiable companies are positive, whereas those for deficient identifiable companies are negative across all specifications. Under the market-adjusted model, for example, non-deficient companies exhibit average CARs of 0.95% ($t = 1.28$), compared with -1.65% ($t = -2.12$) for deficient companies over the [0,1] window. The resulting difference of 2.60% is statistically significant at the 5% level ($t = 2.48$). The pattern remains similar for the [0,2] window under the market-adjusted model, where the return differential is 2.56%, also significant at the 5% level ($t = 2.25$). Results using the FF-3 model are comparable in both magnitude and direction.

Figure 2 visualizes these patterns by plotting the CAR differences between deficient and non-deficient reports over a longer [–10,10] trading-day window. Panel A of the figure presents results from the market-adjusted model, and Panel B presents the FF-3 results. Both panels show pronounced divergence around day 0 for identifiable companies, whereas non-identifiable companies exhibit less movement.

[Insert Figure 2 here]

Taken together, the results in Table 3 and Figure 2 indicate that market reactions to inspection reports depend on whether investors can plausibly infer the specific companies whose audits were inspected. The results are consistent with investors revising their assessments of financial reporting quality when inspection outcomes are quasi company-specific.

5.2 Robustness Tests

The baseline results show that identifiable companies exhibit significant return differentials around inspection report releases, whereas non-identifiable companies do not. The key benefit of this setting is that it allows us to isolate cases where inspection reports are quasi

company-specific, which provides a clean test of whether markets respond to regulatory information about audit quality. A corresponding drawback is that the setting includes only 183 company-inspection observations and 107 unique public companies, which tend to be smaller and less liquid on average. These characteristics raise the concern that the documented market reactions could be influenced by a few outlier observations. To address this concern, we conduct three robustness tests that evaluate the stability of our findings.

5.2.1 Influence of Individual Observations

Our first robustness tests examines whether the baseline results are driven by a small number of influential observations. Focusing on the 183 identifiable company-inspection observations, we sequentially omit one observation at a time and re-estimate the difference in abnormal returns between deficient and non-deficient outcomes over the [0,1] event window. Panel A of Figure 3 plots the resulting distribution of coefficients. The estimates remain tightly clustered around the baseline effect reported in Table 3, indicating that individual observations have little influence on the estimated return differential. Most draws fall within the darkest gray band, corresponding to statistical significance at the 1% level, while only a smaller number fall within the medium and light gray bands, indicating significance at the 5% and 10% levels, respectively. This pattern shows that the main finding is stable and not driven by any single company-inspection observation.

[Insert Figure 3 here]

We next assess whether our results are stable when multiple observations are excluded simultaneously. Specifically, we randomly remove five and ten observations from our sample, perform 10,000 draws for each scenario, and re-estimate the return differential between deficient and non-deficient identifiable companies. Panels B and C of Figure 3 display the resulting distributions. In Panel B (leave-out five), only 19 of 10,000 draws (0.19%) yield a t-statistic below 1.96. In Panel C (leave-out ten), only 153 of 10,000 draws (1.53%) are statistically insignificant at the 5% level. In both cases, the coefficient distributions are nar-

rowly centered around the baseline estimate, indicating that the observed market reactions are highly stable and unlikely to be driven by a small subset of outliers.

5.2.2 Placebo Test

Our second robustness test is a placebo test. For each inspection report in our main sample of companies audited by a triennially-audited firm, we randomly select a date that falls between the beginning of the inspection and the report's publication date.[14] To maintain the structure of our baseline analysis, we assign the same random placebo date to all companies audited by the same inspection-year firm and cluster standard errors accordingly. We then re-estimate the abnormal returns around these placebo dates and repeat the procedure 1,000 times. The results are reported in Figure 4.

[Insert Figure 4 here]

Panel A plots the distributions of estimated abnormal returns for identifiable and non-identifiable companies. Both are centered tightly around zero, which indicates there is no systematic market reaction when the inspection report release date is replaced with a random placebo date. Panel B repeats the analysis for identifiable companies after partitioning between deficient and non-deficient inspection outcomes using their actual classifications. Again, both distributions are centered around zero, with no discernible differences between the two groups. Together, these tests suggest that the baseline market reactions are not driven by random variation in returns or systematic differences in trading behavior between identifiable and non-identifiable companies, or between those linked to deficient and non-deficient inspection outcomes.

5.2.3 Confounding Events

Our third robustness test examines whether the market reactions reflect concurrent company-specific news rather than the release of the inspection reports themselves. Specif-

[14] If the start date of the inspection is unknown, we use the signature-capture start date following the look-back procedure described in Subsection 4.2.1.

ically, we assess whether the baseline results could be influenced by overlapping regulatory filings that coincide with the inspection report releases and convey correlated information (e.g., bad news around deficient outcomes and good news around non-deficient outcomes).

To test this possibility, we obtain companies' regulatory filing data from WRDS SEC Analytics Suite and identify cases in which a company filed a Form 8-K, 10-Q, or 10-K within a one-week window centered on the inspection report release date.[15] We report results for identifiable companies over the [0,2] event window using both the market-adjusted and FF-3 models. For each model, we sequentially exclude (i) events with concurrent current-report filings (*Excluded 8-K Filings*), (ii) events with concurrent periodic filings (*Excluded 10-Q/K Filings*), and (iii) all events involving any of these concurrent filings (*Excluded All Filings*). We then re-estimate the baseline event-study models after excluding these overlapping events. The results are presented in Table 4.

[Insert Table 4 here]

Among the market-adjusted models, identifiable companies with non-deficient inspection outcomes continue to exhibit positive and statistically significant abnormal returns, whereas those with deficient inspection reports show negative but generally insignificant reactions. The difference in CARs between the two groups remains statistically significant at the 5% level when excluding the 8-K or 10-Q/K filings, and although it becomes statistically insignificant when all filings are excluded, the estimated effect remains positive and of a comparable magnitude. In this latter specification, the sample size also declines by approximately 50% to fewer than 100 observations, which substantially reduces statistical power.

Results based on the FF-3 model show a similar pattern. In two of the three specifications, abnormal returns for non-deficient identifiable companies are indistinguishable from zero, while in one specification, returns for the deficient identifiable companies are negative and marginally significant at the 10% level. Across all specifications, the difference in CARs between the two groups remains positive, although it only reaches marginal significance in

[15] Form 8-K reports material corporate events or other current developments, while Forms 10-Q and 10-K provide periodic financial statements and management disclosures for quarterly and annual reporting periods, respectively. See, e.g., Lerman and Livnat (2010).

one test (excluding 10-Q/K filings). The weakest results occur in the specification with the largest reduction in sample size, again consistent with diminished statistical power rather than an absence of effect.

6 Additional Analyses

In the previous section, we document differential market responses to deficient versus non-deficient inspection reports for identifiable companies. In this section, we conduct four additional analyses to corroborate the baseline inferences and address concerns of Type I error. These tests examine the role of information timeliness, the accuracy of the inspection report release dates, and the effect of alternative standard error adjustments. We also explore the effects of inspection report releases on bid-ask spread and return volatility.

6.1 Information Timeliness

We first test whether the timeliness of inspection disclosures affects market reactions. Figure 5 shows the distribution of elapsed days between the inspection period and report publication. Panel A plots time from inspection start to publication, and Panel B plots time from inspection end to publication. In both panels, inspection reports for identifiable companies exhibit shorter turnaround times on average than those for non-identifiable companies. The distributions show that inspections of identifiable companies are typically completed and released within about one year, whereas inspections of non-identifiable companies display longer and more variable delays.

[Insert Figure 5 here]

Building on this evidence, we partition the identifiable company-inspection observations based on the time between the start of the inspection and the publication date of the report. Consistent with the typical annual audit cycle, we use one year as the cutoff to distinguish more timely from less timely disclosures. The *less than a year* group includes 124 observations

in which the report was released within one year of the inspection's start date. The *over a year* group includes the remaining 53 identifiable observations, where the time between the inspection start and report release exceeds one year, implying a longer lag between the audit work and disclosure of its evaluation. For each group, we estimate abnormal returns over the [0,2] window around the report publication date, with results presented in Table 5.

[Insert Table 5 here]

We find that both subsamples exhibit the same directional pattern of market responses, with negative reactions to deficient inspection outcomes and positive reactions to non-deficient outcomes. However, the magnitude of the return differential is notably larger when the inspection report is released within one year of the inspection start. The differential in CARs is positive and significant at the 5% level for both the market-adjusted and FF-3 models (2.67 and 2.65, respectively). For reports released more than a year after the inspection began, the corresponding differentials (2.24 and 0.97) are smaller and not statistically significant. These results indicate that market reactions are stronger when inspection findings are disclosed more promptly, consistent with investors placing greater weight on timely audit-quality information.

6.2 Accuracy of Inspection Report Dates

Next, we examine whether the accuracy of inspection report release dates affects the results. As discussed in Subsection 4.1, the release dates reported in the Audit Analytics dataset often differ from the regulator's actual publication dates, which we verify and hand-collect for this study. To evaluate the importance of this adjustment, we repeat the analysis using the uncorrected dates from the original Audit Analytics dataset.[16]

When we use the unadjusted dates from Audit Analytics, the returns and return differentials between deficient and non-deficient events are small and statistically insignificant across both sets of event definitions and across models. These findings indicate that our

[16]Results for this analysis are reported in Table IA2 of the Internet Appendix.

main results depend on correctly identifying the public release dates of inspection reports. They also suggest that the documented market reactions are more consistent with investor responses to the true timing of disclosures rather than artifacts of the event-study design.

6.3 Alternative Clustering of Standard Errors

We also assess whether alternative standard error adjustments affect our inferences. Relative to the baseline that clusters by report-release date, we re-estimate the abnormal return differential using (i) standard heteroskedasticity-robust standard errors with no clustering, (ii) two-way clustering by report-release date and audit firm, and (iii) two-way clustering by report-release date and company.[17] In all three cases, the statistical significance of the differential for identifiable companies is unchanged or stronger, indicating that our conclusions are not sensitive to the choice of standard error adjustment.

6.4 Alternative Proxies for Market Response

Finally, we explore how inspection report releases relate to other measures of market response to better understand investors' reactions to the information in the reports. Specifically, we examine market response in terms of bid-ask spread and return volatility. These measures are typically used in the finance and accounting literatures to reflect information asymmetry (e.g., Beyer et al., 2010; Blankespoor et al., 2014). We consider these analyses to be more exploratory in nature because we do not have clear predictions on how inspection report information will affect investor uncertainty.

In untabulated analyses, we find evidence that inspection releases affect bid-ask spread and return volatility. We find an increase in bid-ask spreads for non-identifiable companies with deficient auditors, and some weak evidence of a decrease in bid-ask spreads for deficient identifiable companies. The first result is consistent with increased information asymmetry between insiders who know whether their audit was inspected by the PCAOB and is deficient

[17] Results for alternative standard error adjustment are reported in Table IA3 of the Internet Appendix.

or not, and the public who cannot infer which engagement of the inspected auditor is deficient but now recognize that an inspection occurred. The second result is consistent with a reduction of information asymmetry, as the public is aware of the company's low audit quality. In contrast, we do not find evidence to suggest that there is a change in the bid-ask spread for non-deficient companies. One possibility is that a non-deficient PCAOB inspection is a more ambiguous signal relative to a deficient inspection because the PCAOB only inspects a limited number of areas in an audit, typically three. Thus, in contrast with a deficient inspection, which is a clear signal that the work conducted by the auditor was not sufficient to support the audit opinion, a non-deficient inspection is a noisy signal as to whether the audit was properly conducted.

Our evidence on abnormal return volatility is generally consistent with the interpretation of the bid-ask spread results. We observe higher abnormal return volatility for non-identifiable companies with deficient auditors. Abnormal return volatility is also high when the PCAOB does not find audit deficiencies for identifiable companies, consistent with investor confusion or disagreement about how to interpret this information.

Overall, our results indicate that releasing inspection reports for deficient auditors with non-identifiable companies is associated with greater information asymmetry and return volatility. These findings have potential implications for policy makers. The current practice of disclosing that audit deficiencies were found, but not specifying which companies had deficient audits, may unintentionally create investor uncertainty.

7 Conclusion

This study highlights the significant role that company identifiability plays in shaping equity market reactions to audit inspection reports. When inspection outcomes can be credibly mapped to individual public companies, stock prices tend to move in the expected direction: positive for non-deficient outcomes and negative for deficient ones. When company

identities are not inferable, we observe no differential price response.

These findings are consistent with the theoretical prediction that company-specific information about audit quality affects stock prices (Lambert et al., 2007). We provide evidence that when inspection outcomes are quasi company-specific, investors differentiate between deficient and non-deficient audits, which strengthens market-based incentives to demand higher audit quality. In contrast, when inspection information cannot be linked to individual companies, the pricing mechanism weakens. As a result, companies whose audits are not identifiable derive lower valuation benefits from a non-deficient outcome, which diminishes their incentive to demand higher audit quality. Further, we find that inspection reports that disclose audit deficiencies, but do not identify the affected companies, may create investor uncertainty.

Our study is not without limitations. The small sample and the characteristics of identifiable companies may limit the generalizability of our findings. These companies are typically smaller, have less liquid stock, and are audited by triennially inspected audit firms. Additionally, the greater uncertainty surrounding smaller companies may amplify their sensitivity to new audit-quality information, which could help explain the strong reactions documented in our setting. Thus, while theoretical arguments suggest that similar reactions might occur for larger companies, our findings may not capture the market dynamics of larger companies whose auditors are inspected annually. Future research could explore how factors like analyst coverage, institutional ownership, and potentially lower variance in audit quality among large companies might influence these outcomes.

Importantly, our findings do not support concerns that naming companies in inspection reports would lead to broad declines in stock prices. Instead, the evidence suggests that providing audit-quality information at the company-engagement level, rather than at the audit-firm level, could strengthen market-based discipline by allowing investors to directly assess audit quality. Greater transparency at this level could also increase the reputational stakes for audit firms, thereby increasing incentives to deliver higher-quality audits (e.g.,

Coates and Srinivasan, 2014; Roychowdhury and Srinivasan, 2019). However, we emphasize that our analysis does not imply that regulators should necessarily identify companies in inspections reports. Such policy decisions involve legal (e.g., Public Company Accounting Oversight Board, 2012), institutional, and political-economy considerations that fall outside the scope of this paper and are a subject of active debate (e.g., Investor Advisory Group – Subcommittee on Inspections & Data Transparency, 2023).

Future research could explore alternative mechanisms for increasing transparency in audit inspection outcomes. Possible avenues include disclosing only positive inspection results, identifying engagement partners rather than audit firms, or developing opt-in transparency programs for audit firms or their portfolio companies. Such mechanisms could be tailored to balance stakeholder interests, including investors' demand for decision-useful audit information and audit firms' concerns about reputational risk. Further work could also consider potential spillover effects, such as whether greater transparency promotes broader improvements in audit quality across the market (e.g., Johnson, 2020).

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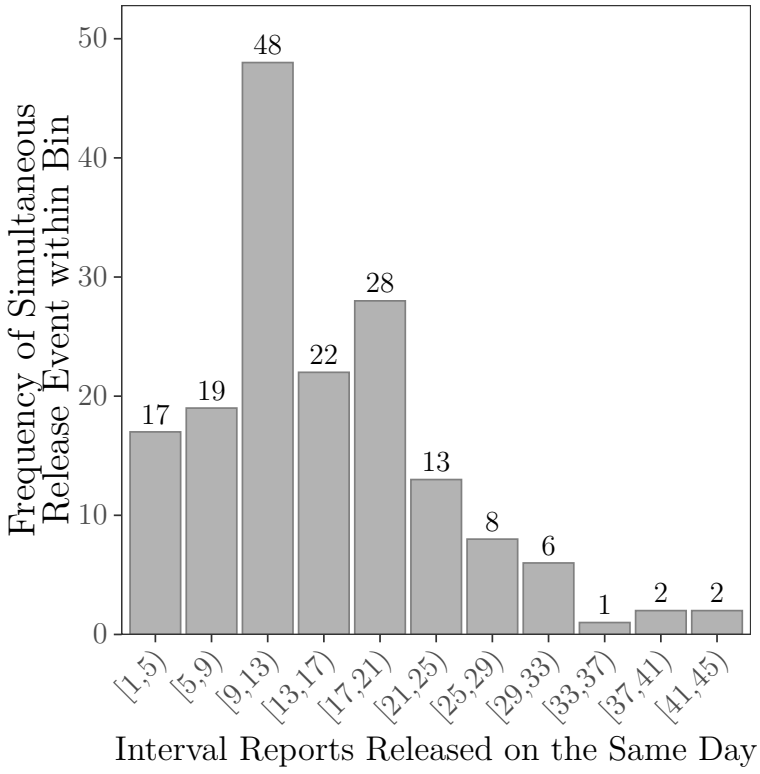


Figure 1: Simultaneous Release of Audit Inspection Reports
This figure plots the frequency of inspection report release events grouped into bins based on the number of reports published on the same day. For example, $[1, 5)$ reflects one to four reports released simultaneously, with 17 such events.

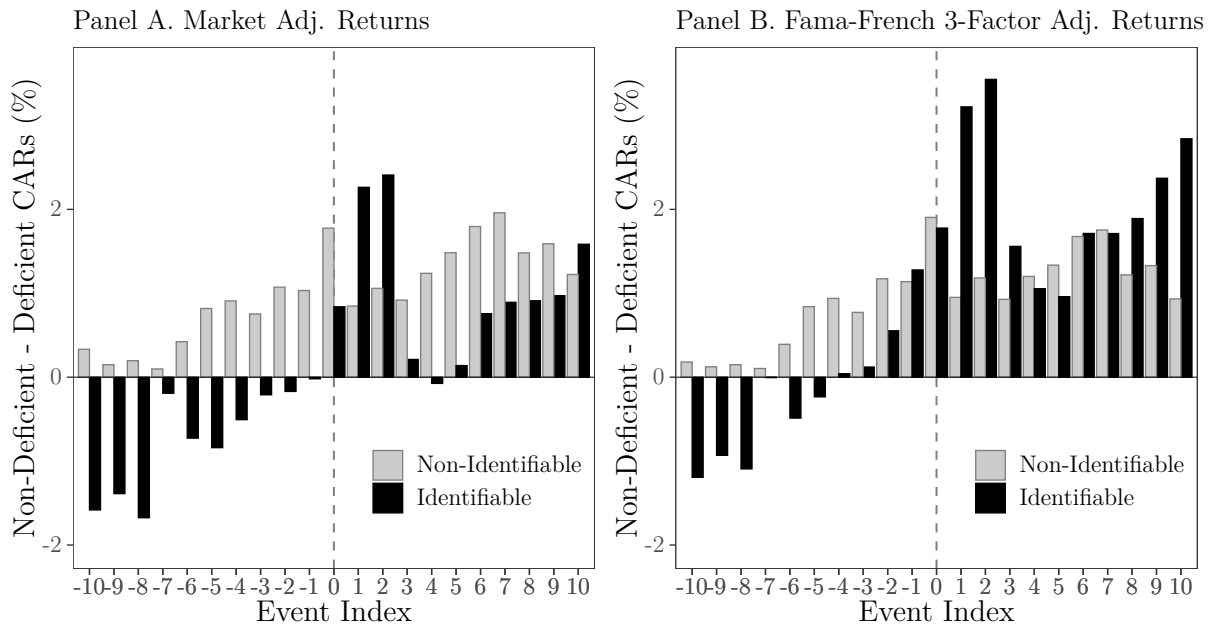
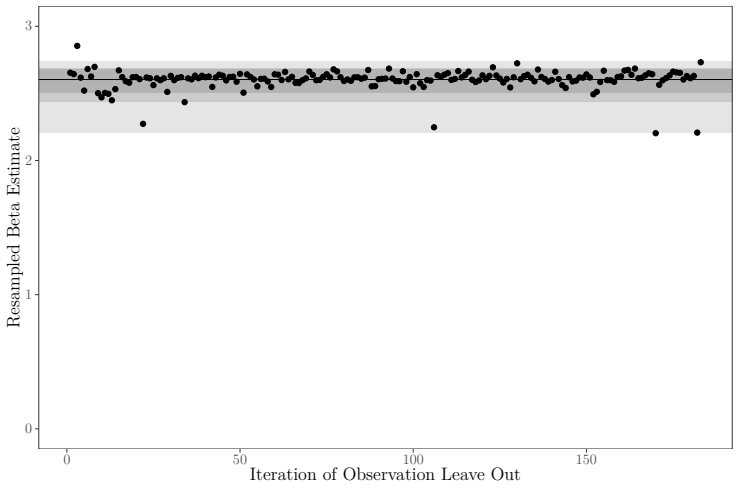


Figure 2: Market Reaction to Inspection Reports by Company Identifiability
This figure presents cumulative abnormal returns (CARs) for non-deficient and deficient inspection reports, segmented by company identifiability (Identifiable versus Non-Identifiable), over a [-10,10] trading day event window. *Panel A* presents the CARs based on market-adjusted excess returns, while *Panel B* uses the Fama-French 3-factor model for risk adjustment.

Panel A. Iterative, Leave-out-one Observation



Panel B. Permutation, Leave-outs of 5 and 10

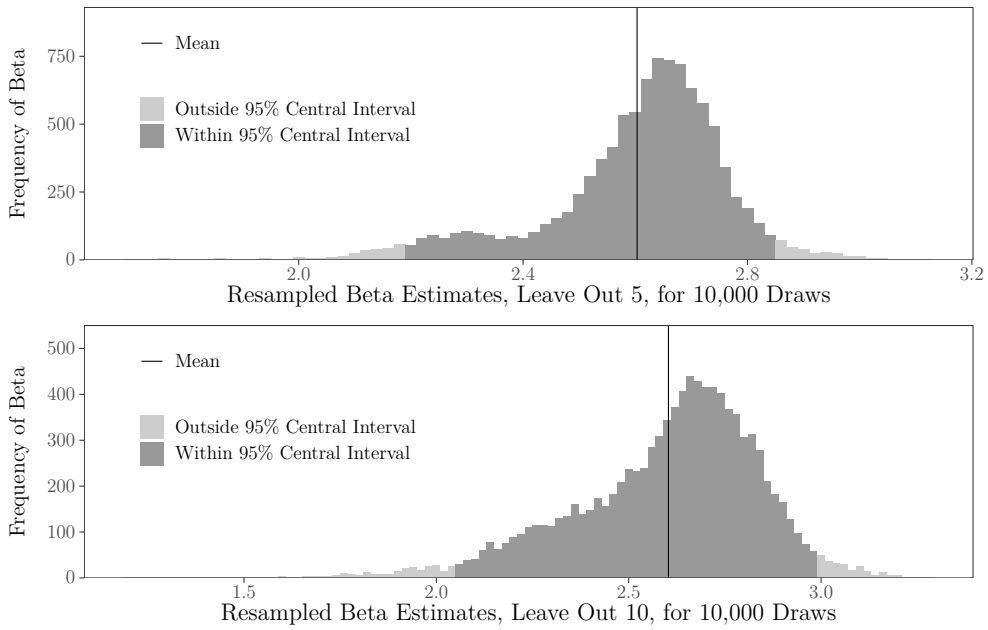
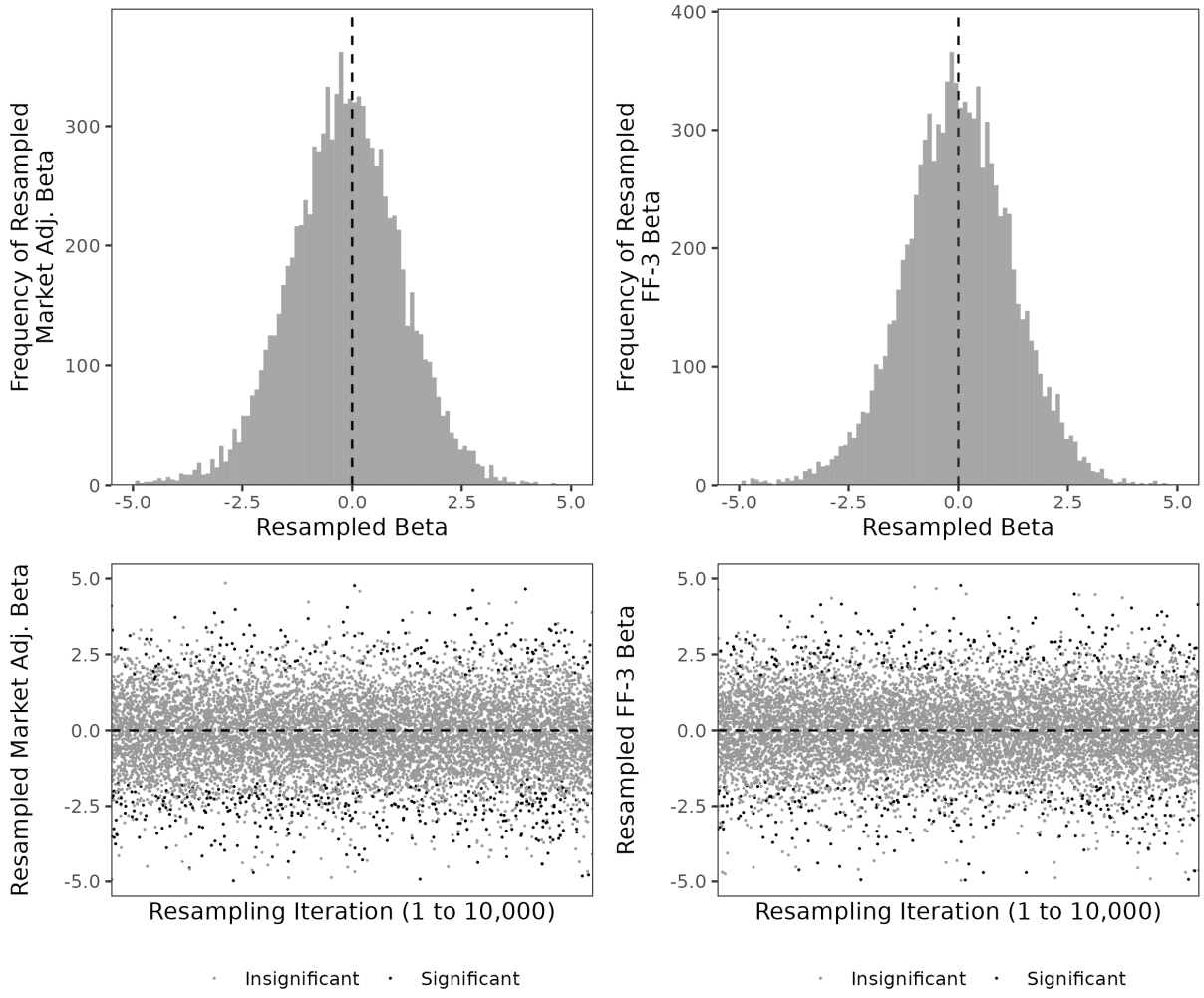


Figure 3: Randomized Exclusion Test of Cumulative Abnormal Returns
We re-estimate the two-day ($[0, 1]$) cumulative abnormal return (CAR) difference (*Non-Deficient* minus *Deficient*) by iteratively excluding either one, five, or ten observations. *Panel A* reports a leave-out-one iteration, where we iterate over every observation within the *Identifiable* sample of companies. *Panel B* reports the results when excluding five or ten observations. In this set, we permute the randomized exclusion of observations over 10,000 draws and report the distribution for leave-out-five in the top figure of *Panel B*, and the distribution for leave-out-ten in the bottom figure. In *Panel A*, we shade the 90, 95, and 99 percent central intervals. We shade the 95 percent central interval in the figures in *Panel B*. The mean of the distributions are reported in all figures as a solid line.



Beta Significance	(%)
t-stat <= -1.96	3.5%
t-stat >= 1.96	1.7%
Insignificant	94.8%

Beta Significance	(%)
t-stat <= -1.96	2.4%
t-stat >= 1.96	2.2%
Insignificant	95.3%

Figure 4: Cumulative Abnormal Returns under Placebo Test
The figure reports placebo tests for the [0,2] CARs estimated using randomized release dates. The release dates are randomized and selected between the end of the inspection fieldwork and the actual release date of the report. In order to retain the structure of our data, the randomly selected date is the same for all company-inspection observations linked to a given report. In the left side of the figure we report the placebo results for the market-adjusted model, and we report the results for the Fama-French 3 factor model on the right side. Both placebos are iterated 10,000 times with their level of significance at the traditional 5% level displayed in the tables.

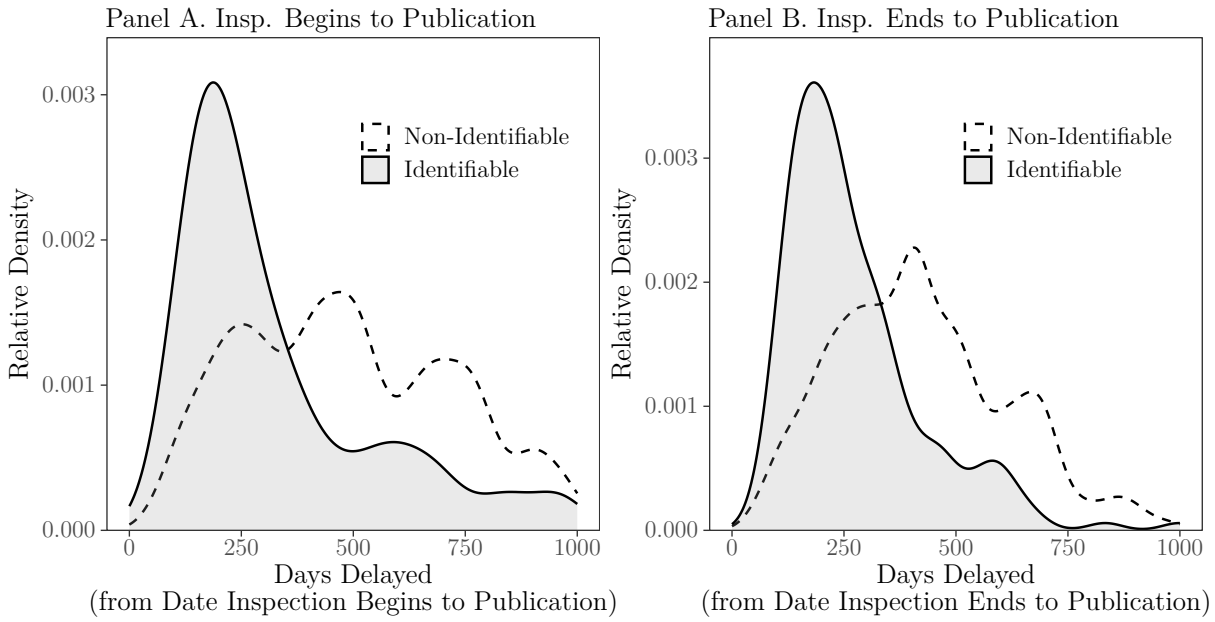


Figure 5: Time between Inspection Period and Report Publication
Panel A shows the distribution of days from inspection start to publication. *Panel B* shows days from inspection end to publication. *Identifiable*-company reports exhibit shorter turnarounds, on average, relative to *Non-Identifiable*, consistent with smaller client bases and faster inspection cycles.

Table 1: Sample Selection

This table details the counts of audit inspection reports matched to the available companies for all firms and triennial firms within our sample. In Panel A, we present the counts of the inspection events (i.e., the reports) on the left, and the counts of the matched companies on the right. In Panel B, we present the disaggregation of the sample into the relevant categories of deficient and identifiable. We classify an event as *Deficient* if the audit report for the auditor, and of the company, had at least one Part I deficiency, and is recorded as *Non-deficient* if the report is clean, i.e., with no deficiency. We classify an auditor's clients as *Identifiable* if the auditor reports three or fewer public company audit clients to the PCAOB – as reflected in the report – with *Non-Identifiable* reflecting audit firms with four or more public company audit clients. Extended discussion on the definitions for each can be found in Section 4.2.1.

Panel A: Triennial Events and Company Sampling

	N		N
Total inspection events	886	Total inspected company events	42,182
Less: annually inspected audit events	154	*Less*: companies audited by annually inspected firms	39,031
Total triennial audit firm inspection events	732	Total triennially inspected company events	3,151

Panel B: Number of Observations by Deficient and Identifiable

	All	Triennial
Total deficient company events	41,160	2,157
Total non-deficient company events	1,022	994
Total inspection events	42,182	3,151

	All	Triennial
Total non-identifiable company events	41,999	2,968
Total identifiable company events	183	183
Total company events	42,182	3,151

Table 2: Descriptive Statistics

This table reports descriptive statistics for the sample of company–inspection observations linked to triennially inspected audit firms. Panel A presents counts, the mean, 25th percentile, median, 75th percentile, and standard deviation (SD). Variable definitions are as follows. *Market capitalization* is the total market value of common equity at the prior fiscal year end (millions of U.S. dollars). *Leverage* is long-term debt plus long-term debt in current liabilities, scaled by total assets. *Return-on-assets* (ROA) is operating income before depreciation divided by total assets. *Company age* is years since the company's initial public offering, measured up to the inspection report release date. *Book-to-market* (BTM) is the book value of stockholders' equity (plus balance-sheet deferred taxes and investment tax credits, adjusted for preferred stock at redemption, liquidation, or par value when available) divided by the market value of equity. *Turnover* is the 180-day average of daily dollar volume divided by market capitalization formed over the same period as the factor model estimation windows, reported as a percent. *Analyst following* is the number of analysts providing annual earnings forecasts for the month closest to the inspection report release date, set to zero when unavailable. *Institutional ownership* is the percentage of shares held by institutional investors. Panel B reports mean differences between identifiable and non-identifiable companies. Two-tailed t-statistics are shown; *, **, and *** denote significance at the 10%, 5%, and 1% levels, respectively.

Panel A: Pooled Sample of Companies

	N	Mean	25th	Median	75th	SD
Market capitalization ($M)	3,151	209.85	27.72	66.90	186.79	464.78
Leverage	3,151	0.13	0.01	0.08	0.19	0.16
ROA	3,145	−0.09	−0.08	0.02	0.07	0.40
Company age (years)	1,446	13.20	4.96	12.83	19.56	8.68
BTM	3,151	0.98	0.37	0.71	1.11	1.35
Turnover (%)	3,150	1.43	0.11	0..26	0.72	176.55
Analyst following	3,151	1.10	0.00	0.00	1.00	1.92
Institutional ownership	3,151	0.20	0.00	0.09	0.33	0.27

Panel B: Identifiable and Non-Identifiable Companies

	Identifiable	Non-Identifiable	Difference	t-stat
Market capitalization ($M)	114.86	215.71	−100.84	−5.86***
Leverage	0.11	0.13	−0.02	−2.52**
ROA	0.01	−0.10	0.11	6.53***
Company age (years)	14.44	13.13	1.31	1.19
BTM	1.07	0.98	0.09	1.29
Turnover (%)	0.61	1.48	−0.87	−4.50***
Analyst following	0.46	1.13	−0.67	−7.94***
Institutional ownership	0.15	0.20	−0.05	−3.51***

Table 3: Cumulative Returns around Inspection Releases

This table reports the average Cumulative Abnormal Returns (CAR) (%) of clients of U.S. triennially inspected auditors around an inspection report release event. *Non-Deficient* indicates the reporting of zero Part I audit deficiencies in the inspection report, whereas *Deficient* indicates all other inspection events. The index column displays the event-time horizons of the measurement period of the returns. For instance, [0,1] represents the event starting at the first trading date coinciding with the time of the inspection release and ends at the next trading day (i.e., $t+1$). Market-Adjusted CAR uses simple market-adjusted returns (daily abnormal return is stock return minus market returns), whereas FF-3 CAR uses returns adjusted using the Fama French 3-factor model. Panel A presents the results for *Non-Identifiable* companies, which are inspection reports for an auditor with four or more public company clients. Panel B reports tests for *Identifiable* companies, which are inspection reports for an auditor with three or fewer public company clients. Standard errors (reflected in the *t*-stats) are corrected by clustering on the date of the inspection report release. *, **, *** indicate significance at the 90%, 95%, and 99% confidence levels, respectively.

Panel A: Non-Identifiable Companies

Model Index	Non-Deficient			Deficient			Difference	
	CAR	*t*-stat	N	CAR	*t*-stat	N	CAR	*t*-stat
Market-Adjusted								
$[0,1]$	-0.03	-0.12	873	0.04	0.13	2,076	-0.07	-0.19
$[0,2]$	-0.07	-0.20	872	-0.06	-0.16	2,093	-0.01	-0.02
FF-3 Factor								
$[0,1]$	0.07	0.29	873	0.15	0.64	2,076	-0.09	-0.27
$[0,2]$	0.03	0.11	872	0.07	0.23	2,093	-0.03	-0.09

Panel B: Identifiable Companies

Model Index	Non-Deficient			Deficient			Difference	
	CAR	*t*-stat	N	CAR	*t*-stat	N	CAR	*t*-stat
Market-Adjusted								
$[0,1]$	0.95	1.28	122	-1.65^{**}	-2.12	61	2.60^{**}	2.48
$[0,2]$	1.29^{**}	1.99	122	-1.27	-1.33	61	2.56^{**}	2.25
FF-3 Factor								
$[0,1]$	0.44	0.61	122	-1.71^{**}	-2.38	61	2.15^{**}	2.11
$[0,2]$	0.60	0.91	122	-1.46	-1.58	61	2.06^{*}	1.79

Table 4: Cumulative Returns around Inspection Releases – Concurrent Events

This table reports the average Cumulative Abnormal Returns (CAR) (%) of clients of U.S. triennially inspected auditors around an inspection report release event for three subsets on the exclusion of concurrent company filings. The table explores this analysis only for *Identifiable* companies, defined as companies with an auditor with an inspection report disclosing three or fewer public company clients. *Non-Deficient* indicates the reporting of zero Part I audit deficiencies in the inspection report, whereas *Deficient* indicates all other inspection events. The index column displays the event-time horizons of the measurement period of the returns of $[0, 2]$, representing the event starting at the first trading date coinciding with the time of the inspection release and ends two trading days following (i.e., $t + 2$). Market-Adjusted CAR uses simple market-adjusted returns (daily abnormal return is stock return minus market returns), whereas FF-3 CAR uses returns adjusted using the Fama French 3-factor model. *Excluded 8-K Filings* represents the exclusion of company-level inspection report release events conflicting with concurrent 8-K filings (for that company) within a ± 3 day window of the filing date. *Excluded 10-Q/K* and *Excluded All Filings* similarly represent the exclusion within a three day window of 10-Q and 10-K filings or all potential filings, respectively. Standard errors (reflected in the t-stats) are corrected by clustering on the date of the inspection report release. *, **, *** indicate significance at the 90%, 95%, and 99% confidence levels, respectively.

Model Index	Non-Deficient			Deficient			Difference	
	CAR	t-stat	N	CAR	t-stat	N	CAR	t-stat
Market-Adjusted $[0, 2]$								
Excluded 8-K Filings	1.81^{***}	2.66	95	-0.04	-0.07	45	1.85^{**}	2.19
Excluded 10-Q/K Filings	1.43^{*}	1.90	96	-1.46	-1.50	52	2.89^{**}	2.38
Excluded All Filings	1.69^{**}	2.09	63	0.60	1.48	33	1.08	1.18
FF-3 Factor $[0, 2]$								
Excluded 8-K Filings	0.95	1.51	95	-0.25	-0.42	45	1.21	1.38
Excluded 10-Q/K Filings	0.74	1.00	96	-1.59^{*}	-1.68	52	2.34^{*}	1.91
Excluded All Filings	1.31^{*}	1.67	63	0.54	0.93	33	0.77	0.79

Table 5: Returns around Inspection Releases and Information Timeliness

This table reports the Cumulative Averaged Abnormal Returns (CAR) (%) of clients of U.S. triennially inspected auditors around an inspection report release event for two subsets of inspection report timeliness based on the time elapsed between of the beginning of the inspection (using the earliest date reported in inspection reports) and the publication of the report. The table explores this analysis only for *Identifiable* companies, defined as companies with an auditor with an inspection report disclosing three or fewer public company clients. *Non-Deficient* indicates the reporting of zero Part I audit deficiencies in the inspection report, whereas *Deficient* indicates all other inspection events. The index column displays the event-time horizons of the measurement period of the returns of $[0, 2]$, representing the event starting at the first trading date coinciding with the time of the inspection release and ends two trading days following (i.e., $t + 2$). Market-Adjusted CAR uses simple market-adjusted returns (daily abnormal return is stock return minus market returns), whereas FF-3 CAR uses returns adjusted using the Fama French 3-factor model. We define *Less than a year* as the group of events where the time elapsed between the start of the inspection process and the publication date of the report is less than one year. Reports with delays greater than one year classified are *Over a year*. Standard errors (reflected in the t-stats) are corrected by clustering on the date of the inspection report release. *, **, *** indicate significance at the 90%, 95%, and 99% confidence levels, respectively.

Model Index	Non-Deficient			Deficient			Difference	
	CAR	t-stat	N	CAR	t-stat	N	CAR	t-stat
Market-Adjusted $[0, 2]$								
Less than a year	1.50^{*}	1.97	97	-1.17	-1.33	27	2.67^{**}	2.46
Over a year	0.86	0.54	20	-1.37	-0.84	33	2.24	0.99
FF-3 Factor $[0, 2]$								
Less than a year	0.91	1.20	97	-1.73^{**}	-2.00	27	2.65^{**}	2.27
Over a year	-0.25	-0.14	20	-1.22	-0.78	33	0.97	0.42

Internet Appendix: Supplementary Tables and Figures

Table IA1: Date Differentials between Actual Inspection Report Releases and Audit Analytics Data

This table summarizes the inspection date discrepancy between the actual regulatory audit inspection release dates minus the dates recorded in Audit Analytics. The columns represent bins of differences (from -1,000 or less to over 1,000 or more) in the number of day difference in the two data items. The gray highlights the number of observations where the two dates approximately agree. The final row reports the number of inspections released by year. Following the public dissemination of an earlier draft of this study, Audit Analytics took action to improve their data and published a reformed data set in April 2025. This table reflects the old unadjusted data.

Insp. Year	>-1,000 days	-1,000 to -100 days	-100 to -10 days	-10 to -1 days	-1 to 1 days	1 to 10 days	10 to 100 days	100 to 1,000 days	Null or Unde-fined	Insp. Reports
2022							142	6	4	152
2021							135		6	141
2020							102	49	1	152
2019		1					172		3	176
2018							124	39	5	168
2017				1	1	2	156	34	1	195
2016					17		101	77	3	198
2015					111		67	29	8	215
2014				1	207		6	2	3	219
2013				1	198		29			228
2012		2	8	1	217		22		3	253
2011	1		7		126	16	60	1	1	212
2010			1	9	153	20	64		5	252
2009		1		42	212	5	25		2	287
2008				95	130	17	5	2	3	252
2007			1	117	76	33	3		2	232
2006			1	68	85	14	1		2	171
Total	1	4	18	335	1,533	107	1,214	239	52	3,503
%	0.03	0.11	0.51	9.56	43.76	3.05	34.66	6.82	1.48	

Table IA2: Returns around Inspection Releases with Unadjusted Release Dates

This table reports the average Cumulative Abnormal Returns (CAR) (%) of clients of U.S. triennially inspected auditors around an inspection report event using the file date (Panel A) or issuance date (Panel B) as reported in Audit Analytics' PCAOB inspection reports data set. Following the public dissemination of an earlier draft of this study, Audit Analytics took action to improve their data and published a reformed data set in April, 2025. This table reflects the old, unadjusted data in order to preserve the environment experienced by the nascent research on inspection report releases. *Non-Deficient* indicates the reporting of zero audit deficiency in the inspection report, whereas *Deficient* indicates all other inspection events. The index column displays the event-time horizons of the measurement period of the returns. For instance, [0,1] is for the event starts at the first trading date coinciding with the time of the inspection release and ends at the next trading day. Market-Adjusted CAR uses simple market-adjusted returns (daily abnormal return is stock return minus market returns), whereas FF-3 CAR uses the returns adjusted using the Fama French 3-factors model. Panel A presents the results for *Identifiable* companies, which are inspection reports for an auditor with three or fewer public company clients and using the old, unadjusted 'file' date. Panel B reports tests for *Identifiable* companies and using the old, unadjusted issuance date. Standard errors (reflected in the t-stats) are corrected by clustering on the date of the inspection report release. *, **, *** indicate significance at the 90%, 95%, and 99% confidence levels, respectively.

Panel A: Identifiable Companies – Audit Analytics 'Old' File Date

Model Index	Non-Deficient			Deficient			Difference	
	CAR	t-stat	N	CAR	t-stat	N	CAR	t-stat
Market-Adjusted								
$[0,1]$	0.49	0.81	113	0.62	0.53	52	−0.13	−0.10
$[0,2]$	1.39	1.65	113	1.51	0.92	52	−0.12	−0.06
FF-3 Factor								
$[0,1]$	0.38	0.68	113	0.72	0.58	52	−0.33	−0.25
$[0,2]$	1.07	1.31	113	1.68	0.99	52	−0.61	−0.31

Panel B: Identifiable Companies – Audit Analytics 'Old' Issuance Date

Model Index	Non-Deficient			Deficient			Difference	
	CAR	t-stat	N	CAR	t-stat	N	CAR	t-stat
Market-Adjusted								
$[0,1]$	0.50	0.94	129	−0.22	−0.19	61	0.72	0.58
$[0,2]$	0.62	1.02	129	0.40	0.25	61	0.22	0.13
FF-3 Factor								
$[0,1]$	0.51	1.01	129	0.09	0.08	61	0.42	0.34
$[0,2]$	0.63	1.10	129	0.68	0.43	61	−0.04	−0.02

Table IA3: Returns around Inspection Releases with Alternative Clustering

This table reports the average Cumulative Abnormal Returns (CAR) (%) of clients of U.S. triennially inspected auditors around an inspection report event for two types of error corrections, standard robust and twoway clustering. The table explores this analysis only for *Identifiable* companies, defined as companies with an auditor with an inspection report disclosing three or fewer public company clients. *Non-Deficient* indicates the reporting of zero audit deficiencies in the inspection report, whereas *Deficient* indicates all other inspection events. The index column displays the event-time horizons of the measurement period of the returns. For instance, [0,1] is for the event starts at the first trading date coinciding with the time of the inspection release and ends at the next trading day (i.e., $t + 1$). Market-Adjusted CAR uses simple market-adjusted returns (daily abnormal return is stock return minus market returns), whereas FF-3 CAR uses returns adjusted using the Fama French 3-factor model. Panel A presents the results for *Identifiable* companies and using robust standard errors in the calculation of *t*-stats. Panel B reports tests for *Identifiable* companies and corrects standard errors using two-way clustering on the date of the inspection report release and of the audit firm. Panel C reports tests for *Identifiable* companies and corrects standard errors using two-way clustering on the date of the inspection report release and of the company. *, **, *** indicate significance at the 90%, 95%, and 99% confidence levels, respectively.

Panel A: Robust Standard Errors

Model Index	Non-Deficient			Deficient			Difference	
	CAR	*t*-stat	N	CAR	*t*-stat	N	CAR	*t*-stat
Market-Adjusted								
[0, 1]	0.95	1.47	122	-1.65^{**}	-2.20	61	2.60^{***}	2.63
[0, 2]	1.29^{*}	1.89	122	-1.27	-1.37	61	2.56^{**}	2.23
FF-3 Factor								
[0, 1]	0.44	0.69	122	-1.71^{**}	-2.39	61	2.15^{**}	2.24
[0, 2]	0.60	0.89	122	-1.46	-1.63	61	2.06^{*}	1.83

Panel B: Twoway-Clustering by Date and Audit firms

Model Index	Non-Deficient			Deficient			Difference	
	CAR	*t*-stat	N	CAR	*t*-stat	N	CAR	*t*-stat
Market-Adjusted								
[0, 1]	0.95	1.33	122	-1.65^{**}	-2.02	61	2.60^{**}	2.44
[0, 2]	1.29^{**}	2.25	122	-1.27	-1.12	61	2.56^{**}	2.11
FF-3 Factor								
[0, 1]	0.44	0.64	122	-1.71^{**}	-2.25	61	2.15^{**}	2.10
[0, 2]	0.60	1.01	122	-1.46	-1.32	61	2.06^{*}	1.68

Panel C: Twoway-Clustering by Date and Company

Model Index	Non-Deficient			Deficient			Difference	
	CAR	t-stat	N	CAR	t-stat	N	CAR	t-stat
Market-Adjusted								
$[0, 1]$	0.95	1.35	122	-1.65^{**}	-2.02	61	2.60^{**}	2.49
$[0, 2]$	1.29^{**}	2.17	122	-1.27	-1.17	61	2.56^{**}	2.15
FF-3 Factor								
$[0, 1]$	0.44	0.64	122	-1.71^{**}	-2.23	61	2.15^{**}	2.11
$[0, 2]$	0.60	0.98	122	-1.46	-1.39	61	2.06^{*}	1.73

Table IA4: Returns around Inspection Releases for Auditors with Four to Six Clients

This table reports the average Cumulative Abnormal Returns (CAR) (%) of clients of U.S. triennially inspected auditors around an inspection report release event for auditors with four to six public company clients. *Non-Deficient* indicates the reporting of zero Part I audit deficiencies in the inspection report, whereas *Deficient* indicates all other inspection events. The index column displays the event-time horizons of the measurement period of the returns. For instance, [0,1] represents the event starting at the first trading date coinciding with the time of the inspection release and ends at the next trading day (i.e., $t+1$). Market-Adjusted CAR uses simple market-adjusted returns (daily abnormal return is stock return minus market returns), whereas FF-3 CAR uses returns adjusted using the Fama French 3-factor model. Standard errors (reflected in the t-stats) are corrected by clustering on the date of the inspection report release. *, **, *** indicate significance at the 90%, 95%, and 99% confidence levels, respectively.

Model Index	Non-Deficient			Deficient			Difference	
	CAR	t-stat	N	CAR	t-stat	N	CAR	t-stat
Market-Adjusted								
$[0,1]$	1.19	1.64	61	−0.04	−0.08	88	1.23	1.45
$[0,2]$	1.09	1.14	61	0.21	0.39	88	0.88	0.79
FF-3 Factor								
$[0,1]$	1.58**	2.19	61	0.14	0.30	88	1.44*	1.82
$[0,2]$	2.00**	2.06	61	0.04	0.08	88	1.96*	1.85