Distracted Auditors: Evidence from Non-Accounting related Lawsuits against Audit Clients

Stavriana Hadjigavriel *

James C. Hansen †

Antonio B. Vazquez ‡

Abstract:

We exploit non-accounting related lawsuits against audit client-firms as an exogenous shock that shifts auditors' attention towards the sued client, to test how auditors allocate resources and time and its subsequent effect on audit quality. Adopting this identification strategy, we show that client firms whose offices are situated in a different city as compared to the auditor's office, experience more restatements in the years of the distraction as compared to client firms that have their offices in the same city as the auditor's offices. Results show that only firms situated in a different city experience a decline in their audit quality. Moreover, distracted audit offices are less likely to gain a new client. Results hold after a series of robustness checks.

Keywords: Audit quality; Restatements; Non-accounting lawsuits; Distracted auditors.

*Cunef (Colegio Universitario de Estudios Financieros). Calle de Leonardo Prieto Castro 6, 28040, Madrid (Spain). E-mail: stavriana.hadjigavriel@cunef.edu

†Weber State University Goddard School of Business and Economics. 1337 Edvalson St. Dept 3803, Ogden, UT 84408 (United States). E-mail: jameshansen2@weber.edu

‡Stockholm School of Economics. Sveavägen 65, 113 83 Stockholm (Sweden). E-mail: antonio.vazquez@hhs.se

1 Introduction

In this paper we examine how auditors allocate time and resources to their different clients and its subsequent effect on audit quality. The PCAOB has expressed concerns on whether professional skepticism could be undermined due to particular circumstances inherent in the audit environment (PCAOB [2012b]). Such circumstances involve heavy workloads and time pressures on audit teams that could eventually induce a precipitated completion of audits leading to lower audit quality.

Particularly, during busy seasons, auditors tend to deliver lower quality audits (Coram et al. [2004]; Heo et al. [2020]; Kelley and Margheim [1990]) because when stress exceeds an optimal threshold, performance starts to decline (Yerkes and Dodson [1908]). Experimental research conveys that auditors are inclined to reduce the number of tests when they face time budget constraints (Asare et al. [2000]; Houston [1999]; McDaniel [1990]). Other studies, proxy the workload imbalance using audit fees of clients that have the same fiscal year ends (López and Peters [2012]), audit delay (Lambert et al. [2017]) or audit engagements (Heo et al. [2020]). These studies, however, treat auditors' busyness as a short term deterrence effect on the quality they deliver. Further, auditors' time pressure is seen as a situation whose consequences will be evident in all of their clients. Similarly, the literature on audit offices argues that client firms that belong to the same portfolio of an audit office, tend to receive similar audit quality ([Chaney and Philipich, 2002], [Krishnan, 2005]) due to a contagion effect [Francis and Michas, 2013].

We depart from prior literature, and test how auditors allocate time and resources to the client firms that belong to the same portfolio.[1] Auditors act as gatekeepers and information providers, ensuring shareholders and investors that the financial statements are free of material errors and represent the true and fair view of the company (DeAngelo [1981]. For that, when auditors encounter workload imbalance, client-firms suffer as auditors' ability to adequately monitor all of their clients deteriorates and the value relevance of "time" on the audited financial statements for their different clients becomes more important.

[1] Following prior literature, audit offices are defined as the combination of audit firm and audit office location (Francis and Yu [2009]; Francis and Michas [2013]).

A decrease in the audit quality though, could either be associated with auditors' busyness, or with auditor's implicit quality. In this study, we employ an identification strategy to disentangle these two effects by exploiting distractions faced by an auditor due to some clients, that are exogenous to the other clients in question, whilst holding auditors' talent constant. Specifically, we exploit non-accounting related lawsuits against audit-clients. These suits are a plausibly exogenous shock that increases auditors' busyness as auditors need to comply with the accounting standards concerning litigation claims and assessments (AS 2505). Since time and resources are limited, at least for the short run, auditors that need to pay more attention to the sued client should shift time and resources away from its other clients and towards the firm that is sued.

We believe this distraction event is an appropriate research design for three reasons. First, non-accounting lawsuits are not directly related to the auditor. To ensure this, we exclude lawsuits that name the auditor as the defendant or are related to accounting irregularities. Hence, the increase in auditor's workload is due to reasons unrelated to the auditor's quality of audits.[2] Second, this distraction is exogenous to the other clients of the auditors' portfolio as it is unlikely that the other clients in question can affect decisions on lawsuits. Third, investigation on the case is not made publicly available until the docket is filed in court. Hence, audit offices' clients cannot anticipate the distraction for the auditor and thus decide to switch to a different auditor, or change their internal accounting and management. This eliminates the concern that the worst performing companies choose worse auditors.

When an audit-client receives a lawsuit, the auditor of the sued firm (distracted auditor) is confronted with more work. Specifically, the auditor faces work associated with the accounting standards (AS 2505). We believe that, when an audit office is confronted with more work, its reaction would be to shift away employees and time from some clients, towards the ones that need it more. This is because auditors' time and resources are limited. Following this logic,

[2]When we say that the auditor is not responsible for non-accounting related lawsuits, we specifically mean that the plaintiff will not name the auditor as the defendant and thus auditors are not involved in the litigation process themselves. However, when an audit client is involved in a litigation process, the auditor needs to comply with the relevant accounting standards (AS 2505). Our purpose is to use these suits as an exogenous shock to auditors' workload that is not related to auditors' quality.

when an audit client is sued, the auditors should shift their attention to the sued client, leaving their other (or some) clients partially neglected.

Using this identification strategy, we can observe the change in the audit quality when auditors face increased busyness, whilst keeping all else constant. We posit that a particular group of clients will suffer (more) from the lack of the auditor's attention. In particular, we expect that client firms whose offices are located in a different city (treatment group) as compared to the auditor's office city will be (more) affected by the distraction. Commuting to monitor the client will be regarded as a burdensome for an already busy auditor. On the contrary, client firms with offices in the same city (control group) as the auditor's office city will experience milder (if any) consequences.[3] Hence, we use non-accounting lawsuits to identify audit offices that face workload imbalance and we check the differences in the audit quality of different- and same-city clients. In our tests, sued clients are deleted. We expect the audit quality of the clients with offices in a different city than the auditor's office city to encounter a (greater) drop in their audit quality as compared to the clients of the same auditor with offices situated in the same city as the auditor's office city. [4]

Alternatively, ex-ante we are not aware as to whether a lawsuit against an audit client will distract the audit office to such an extent that it would cause a drop in the audit quality. Lawsuits are particularly common and one would expect audit offices to be well prepared, trained and ready to cope with such distractions. Further, audit offices that belong to the same national audit firm can exchange staff and allocate resources when one of them is in need (Francis and Yu [2009]). Travelling and commuting is also a common practice in audit offices, especially in the US. All these would work against us finding a reduction in the quality of audits of the firms that are situated away from the auditor's offices when the auditor is distracted.

Our results give support to our expectations. We proxy for audit quality using the propensity to restate the financial statements. We show that firms whose offices are situated in a differ-

[3] One way of thinking is that all clients will be neglected, but the level of negligence is unlikely to be the same for all the clients. Another assumption would be that some clients would be neglected and some not. We proceed into testing both of these arguments to rule out one of the two assumptions.

[4] We consider auditors that audit at least three firms, say firms X Y and Z. Firm Z receives the lawsuit and firm X (Y) belongs to the treated (control) group. The lawsuit event, offers an exogenous increase in the audit work related to firm Z which ultimately leaves the auditor distracted towards firm X. We test whether firm Y is also neglected.

ent city as compared to the auditor's office city bear more restatement announcements during the years of distraction. Specifically, different-city clients bear the negative costs of auditors' distraction as they see a decrease in the audit quality. To the contrary, the audit quality of the treatment group does not differ from that of the control group in years where the audit office is not distracted. We further test whether the audit quality of the two groups separately, is affected during the distraction year. We find that the treatment clients face more restatement announcements in the distraction years as compared to non-distracted years.[5] Contrary to this, the control group of clients does not suffer any impairment in the audit quality during distracted years as compared to non-distracted years. Further tests show that the treatment group of clients pay lower audit fees as compared to the control group during distraction years, evidence of less audit effort towards the treatment group of client firms. We also find that, audit offices are less likely to take/gain new clients during distraction years as compared to the time that are not distracted.

A concern arises as to the fact that the distraction happens at the audit-team level rather than the audit-office level. Even though it is true that a distraction event (e.g. SEC investigation against an audit client) directly affects the audit team who is involved with the audits of that client, the audit office as a whole is the one responsible for allocating resources, dealing with the clients, and delivering their audit opinion (Francis et al. [1999]). Hence, if an audit team faces extra work, the audit office will have to transfer audit members from other audit teams to the one that is overloaded. In this study we consider the workload of the audit office and not of the audit teams due to the unavailability of data. Nevertheless, we believe that results will not be biased as the audit office is indirectly affected by the extra work.

We contribute to the literature relating to audit busyness, workload imbalance and its impact on audit quality. Previous studies show that time- and resource-constraints cause a decrease in the audit quality of all the clients that belong to the same portfolio, as auditors are unable to adequately monitor all of their clients during busy seasons. In this study, we show that a particular group of clients suffers from this distraction. Specifically, client firms that are situated

[5]For the distracted and non distracted years, we use the same audit offices to avoid comparing audit offices that differ in unobservable characteristics.

in a different city compared to the auditor's office city face a decline in audit monitoring. We also show that client firms that are situated in the same city as the auditor's office city do not receive decreased attention. Our results hold for longer periods of time and not just during the time the auditor is distracted.

Our study is of interest to regulators, audit offices, national audit firms and also to an auditor's respective clients. Audit firms might invest in human capital so that they are able to absorb distraction shocks without undermining quality. Similarly, clients should be aware of how their relative importance and location can affect the respective quality of their audits. Further, regulators could set standards in such way to resolve city-level audit problems.

The rest of the paper proceeds as follows. In the next section, we discuss the related literature and we develop our hypothesis. Section 3 explains in detail our research design, presenting the empirical methods and the variables we use to capture audit quality. In Section 4 we discuss the main results. Robustness checks are presented in Section 5. Finally, in Section 6 we conclude.

2 Literature Review and Hypotheses Development

2.1 Institutional background:

Auditors are required to comply with auditing standards (PCAOB: AS 2505) when performing the audits of a company that is in the litigation process. The management of the prosecuted company is the one responsible for evaluating litigation assessment and claims to be included in the financial statements. The independent auditor, in turn, should obtain evidence relating to the period of the wrongdoing, the likelihood of an unfavourable outcome at the end of the litigation process, the range of the potential loss, and the existence of any situation that might render uncertain the possible losses arising from the litigation. Since the litigation procedure is under the control and knowledge of the management, the auditor must collect information regarding the specific approach implemented by the management in order to determine litigation claims and assessments as well as examine clients' documents concerning litigation and lawyers' invoices. The independent auditor should contact management to discuss the proce-

dures concerning litigation and claims, and also to be reassured, in writing, that the management has disclosed all the information asked by the lawyers of the investigating company.

Even though an auditor cannot make a legal assessment on the situation, the auditor is responsible for making sure litigation related information is properly disclosed. Thus, the auditor should read the minutes of the meetings of stockholders, board of directors, and audit committees. Also, the auditor should examine the contracts from governmental agencies and also communicate constantly with the clients' lawyer.

In summary, the auditor should be monitoring the litigation process, make sure that all relevant information and work is up to date in case of a change in the client's lawyer, and communicate constantly with the client's management and the lawyer to reassure both parties that all the necessary information and work is done.

2.2 Audit Office and Audit Quality

Even though a vast amount of research focuses on the national audit firm-level, literature on audit-offices provides evidence of an association between audit quality and certain audit office characteristics. For example, when the audit-client is large as compared to the audit-office, then auditors become more conservative (Reynolds and Francis [2000]). Similarly, Li [2009] finds that audit offices are more likely to issue going concern opinions to important clients that pay higher audit fees as compared to the audit-office's total audit fees. Industry specific expertise is also valued and priced resulting in a fee premium to the corresponding audit offices (Ferguson et al. [2003], Francis et al. [2017]).

An audit office is responsible for delivering audits to multiple clients at the same time. An audit failure within an audit office in a particular year, may demonstrate that either one audit engagement suffers from poor audit quality or that there is a more systematic failure across the audit office. Francis and Michas [2013] introduce the concept of contagion effect to the audit setting, suggesting that audit clients of a particular audit office tend to receive similar audit quality. They find that if at least one client faces an audit failure, as measured by a downward restatement of earnings, other clients of the same audit office also experience a drop in their audit quality.

Chaney and Philipich [2002] find that after the Enron scandal, other Arthur Andersen's clients experienced a negative market reaction. The effect was even more severe for the Houston's office clients which was the audit office responsible for Enron's audits. Similarly, Krishnan [2005] analyzes audit quality at the audit-office level and finds that clients of Arthur Andersen's Houston office present less timely reporting of bad news as compared to other Houston office clients audited by other Big 6 auditors.

Further literature analyzes the audit quality delivered by Big 4 audit offices. In particular, large audit offices, as proxied by Big 4 offices, tend to issue more going concern opinions and their clients are discouraged from engaging in opportunistic earnings management. The reason is that large audit offices will have more human capital in office and better in-house experience when dealing with public companies [Francis and Yu, 2009].

2.3 Workload and the Impact on Audit Quality

The auditing profession is characterized by strict deadlines, heavy workloads, and pressures where auditors are often required to operate with limited time and resources. In particular, during busy audit seasons, auditors have to complete a set of audit engagements for a majority of the clients they have in their portfolio, within a limited time [López and Peters, 2012]. Psychology theory, known as the Yerkes-Dodson Law, suggests that workload imbalance and performance have an inverted-U shaped relationship [Yerkes and Dodson, 1908]. At the beginning, as stress and arousal increase, the rate of learning (and thus performance) is stimulated, but when arousal exceeds the optimal level, performance starts suffering.

This has drawn considerable attention in the auditing environment. Rhode [1978] identified that more than 50% of surveyed auditors admitted compromising quality due to time pressures. The Public Company Accounting Oversight Board (PCAOB) has highlighted concerns on whether auditors can adequately monitor and offer high quality audits PCAOB [2012a]. Heo et al. [2020] find that during busy seasons, auditors supply lower quality audits as proxied by misstatements and discretionary abnormal accruals. In particular, during busy seasons, auditors experience excessive stress and anxiety which eventually cause performance to deteriorate (Coram et al. [2004] ; Heo et al. [2020]; Kelley and Margheim [1990]). Time constraints

might cause an auditor to deliver substandard work allowing managers therefore to engage in opportunistic earnings behaviour [Caramanis and Lennox, 2008] and to meet or beat earnings benchmarks [López and Peters, 2012]. Exploiting a SEC rule that caused a reduction in the number of days available to file quarterly or annual reports, Lambert et al. [2017] find that time limits are associated with lower audit quality.

Experimental research has shown that, when time constraints are present, auditors choose to reduce the number of tests they perform for a particular client, thus making final decisions based on fewer tests (Asare et al. [2000]; Houston [1999]), which reduces effectiveness (McDaniel [1990]).

2.4 Hypothesis Development

Following the rationale in the literature that focuses on work imbalance in the auditing profession, we hypothesize that, when an auditor faces a routine shock that increases workload, audit performance will suffer. This confirms that auditors' time is indeed valuable for their clients. To test this, we consider a shock to the auditors' time and resources when a particular client receives a non-accounting related lawsuit.[6] When an audit client is sued, then auditors would have to turn their attention to the client that provokes the distraction (i.e the sued client). Audit offices have limited resources, imposed time budgets, and strict deadlines that ultimately cause a reduction in the number of tests and thus overall audit performance. Hence, we believe that auditors that encounter a distraction would be forced to allocate more time to the sued client, which consequently leaves less time and attentioan available to allocate to their other clients.

However, audit office management do not allocate equal amounts of time and resources to all their clients. There would be clients that would be more affected from this distraction as compared to other clients. This idea posits a variation within the same audit-office and thus a variation in the relevance of time for the different clients that belong to the same portfolio. To capture this, we partition our sample between audit-client firms of the same distracted audit

[6]We recognize that auditors need to dedicate more time and allocate more resources when they deal with accounting related lawsuits. However, such actions affect audit quality as well, even though the auditor is not named as defendant. We find in untabulated analysis that the results are similar when we use accounting related suits.

office that would be more or less distracted by the lawsuit event. We thus partition our sample into client firms whose offices are located in the same city as the audit office city and clients whose offices are not situated in the same city as the audit office's city. Auditors, during their audit engagements, need to meet their clients in the client offices and talk with management and employees in person. This creates more successful engagement and communication, as in-person meetings are more effective and efficient for complex tasks and work. [7] Hence, if an already busy and distracted auditor should also commute as an additional task on top of everything else he/she had to do, then it is very likely that clients located in a different city would suffer (more) from the distraction event than clients that are situated in the same city as the audit-office city. Our prediction does not include what the actual change in the audit quality of the same-city clients will be during the distraction event. We examine this in our tests but we make no prediction on the size of the change. The argument leads us to formulate our prediction:

Hypothesis 1: *Audit-client firms of a distracted auditor that are located in a different city than the audit-office city will receive lower quality audits during distraction events as compared to client firms whose offices are in the same city as the auditor's offices.*

3 Sample Selection and Research Design

In order to test the prediction developed in section 2, we use a panel data set of US firms covering the years 2000 to 2019. We obtain data on misstated financial statements from Audit Analytics. We also obtain firm related characteristics from the Compustat database. As a distracting event to the auditor's work we use non-accounting lawsuits in our main analysis. We start with 28,583 (3,131 distinct observations per audit-office and year) unique non-accounting lawsuits from 2000 to 2019. We start our sample in the year 2000 since the coverage of lawsuits in Audit Analytics starts in that year and we end in 2019 to avoid COVID-related confounding

[7] After a phone call conversation with a senior auditor in Deloitte, London; we understand that commuting depends on the industry the client operates in. In general, financial services are situated in big cities close to audit offices. However, manufacturing and other industries could be situated anywhere in a country and thus auditors should be prepared to travel a lot.

effects. We keep companies that had an identified company code. We delete financial and utility firms, company-years with accounting irregularities, and company-years where the auditor is named as the defendant. We also drop observations of Big 4 audit offices when there is more than one office situated in the same city. This is because, we cannot identify the clients that are allocated to different audit offices of the same national firm and situated in the same city. [8] As a distraction year, we consider the year of the litigation process. We eventually drop all firms that received a non-accounting lawsuit as we are interested in the subsequent audit quality of the other clients of the distracted audit office. We just use the non-accounting lawsuits to identify distracted audit offices. We then use this dataset to estimate our main regression model:

$$Restatement = f(\beta_{0,t} + \beta_{i,1} Treated_{i,t} \times DistractionYear_{i,t} + \beta_{i,2} Controls_{i,t} + \alpha_t + \gamma_{industry} + \delta_{office} + \epsilon_{i,t}) \tag{1}$$

Our main dependent variable, Restatement,[9] takes the value of one if the year-end financial statements are restated, and zero otherwise. We believe this proxy is appropriate because it measures corrections of GAAP violations or errors, therefore capturing actual audit quality (DeFond and Zhang [2014]). It is also significantly associated with the measurements used by auditors and regulators to assess audit process deficiencies (Aobdia [2019].). In our main analysis, we use all occurrences for calculating restatements, i.e all the years that a restatement appears for a company. This approach provides the most inclusive measure of audit quality (Sellers et al. [2018]).[10]. We drop from our sample (i) merger related corrections, (ii) restatements due to changes in the accounting principles, and (iii) restatements associated with revisions for comparability.

Treatment and Control Group: The audit quality of an audit office could affect our results. Thus, if we compare audit clients of offices that receive a distraction event and audit clients of offices that do not face such a distraction we might attribute results to alternative expla-

[8] Appendix B shows the Big 4 audit offices that are situated in the same city and belong to the same national firm.

[9] In further robustness check we also use the unsigned discretionary accruals as an additional proxy of audit quality. We use restatements in our main analysis as we believe they have better explanatory power and are associated with proxies used in business practice (Aobdia [2019])

[10] We also use the length of the restatements as a dependent variable, i.e. the number of consecutive years the company issues a restatement, and also the first occurrences on restatements following Sellers et al. [2018].

nations associated with audit quality. In an attempt to tackle this concern, our treatment and control group include clients of the same audit office. This ensures that audit-related characteristics, such as reputation effects or talent, remain unchanged between the treatment and control groups, ultimately capturing variations within the portfolio of the same audit office. This helps us to rule out alternative explanations such as differences between the two groups.

When auditors are distracted, they have less time available than before for their clients. However, even though this is true for all of their clients, some of the clients will suffer more from this distraction. If the auditor needs to commute to reach the client's office, then it is likely that this client is (more) ignored as compared to a client that is located in the same city as the auditor.

Our treatment group is defined as those clients who are more likely to have audit quality impaired as a result of auditor's extra workload. We follow Dou and Zhang [2018] and consider our treatment group to be audit clients that have their offices in a different city than the distracted auditor's city. Similarly, our control group are the clients of the distracted audit office that have their offices in the same city as the auditor's office. The variable "Distraction Year" is a dummy that takes the value of one if in a particular year the audit office has a client that receives a non-accounting lawsuit, and zero otherwise. Hence the coefficient $\beta_{i,1}$ measures the change in the restatements of the different city clients (i.e. treatment group) compared to same city clients (i.e. control group) during distraction years as compared to non-distraction years. Note that in our analysis we only use offices that are distracted and we compare the results on restatements during distraction and non-distraction years. Based on our predictions, we expect a positive and significant $\beta_{i,1}$ coefficient.

"Controls" denotes a set of control variables to account for client-firm and audit-office characteristics that may have an impact on the incidence of misstatements. Following Choi et al. [2010] and Francis and Yu [2009] we include audit office characteristics such as office size and riskiness of the portfolio of audit clients. We also use firm control variables following Francis and Yu [2009] and Lennox and Li [2014]. All continuous variables are winsorized at the bottom and top 1% of the distribution. A complete list of all the variables used in this analysis can be

found in appendix A. A concern may arise as to the fact that some auditing firms may have more than one office in the same city. By not taking this into account we could contaminate our results as we allocate clients to incorrect audit offices. This is more common among the Big 4 offices. To alleviate the problem, we collect information on the Big 4 audit firms and their audit offices across the US. We then delete all observations of Big 4 firms that appear to have more than one office in the same city [11]. Finally, we include year fixed effects to account for shocks that may affect restatements similarly within a specific year (α_t), 2-digit SIC industry fixed effects ($\gamma_{industry,t}$) to capture factors that are common within a specific industry, and audit office fixed effects (δ_{office}) to capture factors that are common within an audit office. Standard errors are clustered at the audit office level.[12]

4 Results

4.1 Summary Statistics and Correlations

Table 1, Panel A, provides the summary statistics for the sample used in our models. The table shows that overall, our sample consists of small firms that, on average, have high returns but low performance. More than half of our sample is audited by a Big 4 auditor and in general, audit offices tend to be large in size. Also, more than half of the audit offices in our sample are regarded as city industry experts and are responsible for auditing 50 clients yearly on average. The incidence of restatements is 25.8%. We note that this is the most inclusive measurement and takes into consideration all restatement occurrences. In untabulated results, first occurrence restatements and restatement announcement dates only are 13.6% and 14.68%, respectively, consistent with prior literature (Lennox and Li [2014]). Panel B shows the summary statistics after splitting the sample into treatment and control group of firms, i.e. companies whose offices are situated in a different or the same city as compared to the auditors' office city. Even though the method of splitting the sample should not cause any statistically significant differences of the means at the firm and audit-office level characteristics of the two group of firms, Panel B

[11] All Big 4 audit firms that have more than one audit office in the same city can be found in Appendix B.

[12] In untabulated analysis, we also use two way clustering at the company and audit office level since we have the same company being audited by the same audit office in several years. Results remain the same.

shows that treatment and control client-firms differ in many observable characteristics. To rule out the possibility that our results would be affected by these differences, we use the propensity score matching method as a robustness check.

Table 2 shows the correlations between our main dependent variables, restatements and absolute value of discretionary accruals, and our control variables. Spearman (Pearson) correlation coefficients are presented above (below) the diagonal.

4.2 The Effect of Distraction Events on Restatements

Our analysis is based on the assumption that a distracted audit office now has less resources and time to allocate to its clients that are not sued. However, an audit office cannot allocate an equal amount of time and resources to all its clients. Therefore, some clients will suffer more or less by the distraction event. One way of testing this variation within the portfolio of clients for the distracted audit office is by separating the sample depending on how the clients' offices are situated in relation to the audit office. To test our hypothesis we run equation (1). Table 3 shows the results. The coefficient of the "Treated $\times$ Distraction Year" is positive and statistically significant indicating that during distraction years the clients who have their offices in a different city compared to the auditor office city, tend to face more restatements as compared to clients located in the auditor office city. The results hold even if we consider all occurrences of restatements (Rest AO), the length of the restatement (Rest Length), and first occurrence restatements (Rest FO). This is consistent with our prediction indicating that audit offices that are dealing with a sued client have less time and resources available to allocate to all their clients and thus tend to make more mistakes when their clients are located in a different city.

4.2.1 Are all clients ignored during distraction? Our prediction assumes that some audit clients will be (more) ignored as compared to other clients. Ex post, we are not certain as to the fact that all, or some will suffer from this distraction. For that, we limit the sample to the control group of clients to compare distraction years to non distraction years. Table 4, columns (1) and (2) contain these tests without and with audit office fixed effects, respectively. Similarly, in columns (3) and (4) we present the results for the treatment group of clients. We see that

during distraction years, the treatment group of clients are more likely to restate as compared to non-distraction years. However, same city clients do not suffer from the distraction event. In fact, they even show less incidence of material misstatements. This is an indication that only some clients, namely different-city clients, suffer from this distraction.

4.2.2 Are different city clients always ignored? It is possible that different city clients always receive less attention and resource due to commuting. To exclude this possibility, in Table 5 we separate the sample into the clients in distraction years (Columns 1 and 2) as compared to non distraction years (Columns 3 and 4). Table 5, columns (1) and (2) show that there is no statistically significant difference in restatements for the treatment and control groups during non-distraction years. However, in columns (3) and (4) we see that the treatment group of firms suffer more from the distraction as compared to the control group of firms. This indicates that different city clients suffer a drop in their audit quality only when the audit office faces resource and time constraints.

5 Robustness Checks

5.1 Alternative Distraction Effects

In the main analysis we have used the non-accounting related lawsuits as an event that will distract the auditor. However, any event that would demand the auditor to exert more effort and time should cause a similar distraction to the audit office. For that, we use as additional distraction events: (1) non-Accounting related class actions from the Audit Analytics database; (2) lawsuits obtained from the Federal Judicial Center database; (3) clients that are acquiring another company (SDC database); and (4) clients that are going through an IPO. Each of these event should cause the auditor to exert higher effort. Table 6 presents the results. Our main interaction term is still positive and statistically significant indicating that when auditors are distracted, different-city clients tend to be experience a drop in their audit quality.

5.2 Willingness (or Ability) to Gain New Clients

If auditors experience workload imbalance and pressure when their client receives a non-accounting lawsuit, then they should be reluctant to undertake the audits of any new client. In Table 7, we see that audit offices are less likely to gain new clients when they are distracted as compared to non distraction years. A limitation of this test, is that we cannot distinguish whether it is auditors' reluctance of contracting with more clients due to busyness or the potential clients themselves choose not to contract with the auditors. Nevertheless, the end result is that during distraction years, auditors are less likely to contract with a new client which reinforces our main prediction.

5.3 Propensity Score Matching

As reported in Table 1, Panel B, the treatment and control groups differ in several observable characteristics. To ensure that our results are not driven by these differences, we use propensity score matching (PSM). We match on the observable characteristics that are used as control variables in the regressions. We match on replacement at a 0.01 caliper, requiring each observation to be matched to the closest neighbor. Figure 1 displays the results from the PSM. The standardized bias of the covariates across the treatment and control group are close or equal to zero, which indicates that the PSM has been successful. In Table 8, we then check whether the main results still hold after PSM. We see that the coefficient of the Treated $\times$ Distraction Year is positive and statistically significant ensuring that our results are not biased by the difference in the observable characteristics.

5.4 Capacity Constraint Effect

Due to its nature, the consequences of such a distraction event should be more evident in small audit offices as compared to big offices. Big offices, have more resources and more employees to deal with budget and time constraints as they have "greater capacity and staffing flexibility to absorb shocks" (Francis et al. [2017], p.1963) To check this, we partition our sample into quartiles based on the yearly total fees an audit office earns, with Quartile 1 being the lowest audit fees and Quartile 4 the highest amount of audit fees. We follow Francis et al. [2017]

and define big audit offices as those that are in Quartile 4 and small audit offices are those in Quartiles 1-3. Table 9 shows the results. Indeed, big audit offices are more capable of absorbing the time and resource constraints as shown by an insignificant coefficient of the Treated $\times$ Distraction Year variable. However, small audit offices do not have the capacity to absorb these shocks without consequences. The audit quality of small audit offices is affected by the distraction event as evidenced by a positive and significant interaction term coefficient.

5.5 Alternative Measurement of Audit Quality: Discretionary Accruals

In our main analysis we use restatements as our measure of audit quality. To corroborate these results, we also use discretionary accruals as calculated by the modified Jones model (1991) as an alternative measure of audit quality. Consistent with our restatement results, we observe in Table 10 that different city clients experience more earnings management activities when audit offices are distracted compared to the same city clients. Results hold under the alternative distraction events as well.

5.6 Sued Firms and Attention Paid

Our tests and analysis are based on the assumption that an audit office with a client that receives a non-accounting related suit would shift resources and time away from its other clients, towards the one that is sued. If indeed the audit office is spending more time on the audit engagement with the sued client, then this specific client should pay higher audit fees as compared to the other clients. To test this assumption, we check whether the clients that received non-accounting lawsuits pay higher audit fees as compared to the non-sued clients. In Table 11 we find that sued clients pay higher audit fees indicating that the audit office is spending more time and attention on these clients.

5.7 Additional Analysis

To determine if our results are different based on the size of the audit firm, we ran our tests after separating our sample into Big 4/Non Big 4 auditors. In untabulated analysis, our results

remain consistent for both groups. Although, when we split Big 4 auditors into big and small offices as described in section 5.4, results only hold for the Big 4 small offices.

Prior literature has found that audit clients that are more than 100 kilometers from the audit office have lower audit quality. In untabulated analysis, we control for distance of the audit client from the audit office and add a continuous distance variable. We find that distance is negatively related to audit quality. We also add a dummy variable for clients that are 500 kilometers from the audit office and our results continue to hold.

We also examine restatement announcements in the year of the distraction event. In untabulated analysis, we find that restatement announcements are lower for different city clients in the year of the distraction event, as compared to same city clients. We interpret this as auditors of distant clients were not effective in detecting items that needed to be restated during the distraction event. Although, in subsequent periods following the distraction event, restatements that resulted from client actions during the distraction year are higher for different city clients.

Finally, in untabulated analysis we find that different city audit clients have significantly longer filing delays.

6 Conclusion

Can auditors' time, attention, and resource allocation be a determinant of audit quality? This study examines whether these factors (i.e. auditors' time, attention, and resource allocation) affect audit quality for an auditor's portfolio of clients. Prior literature suggests that auditors deliver lower quality audits during busy seasons (e.g. Heo et al. [2020]; López and Peters [2012]). According to the literature, clients that belong to the same audit office portfolio tend to receive similar audit quality. In this study we contribute to the broader literature by testing the importance of auditors' time. To do this, we exploit a shock that increases auditors workload, is not directly related to auditors' quality, and is exogenous to the other audit clients.

Specifically, we use non-accounting lawsuits as a shock to the auditor's attention. We believe that auditors with a sued client will turn their attention to that specific client leaving some or all other clients with less resources and time available. However, it is fairly unlikely, that auditors

will treat all other clients similarly. We believe that, if an auditor has to commute to reach the client's office (i.e. the client has an office in a different city than the auditor's office city), the auditor will have even less time to apportion to that specific client as compared to clients that have their offices in the same city as the auditor's office city.

To test our prediction, we split our sample into two groups: (1) auditors' clients that have their offices in a different city (treatment) as compared to the auditors' office city; and (2) auditors' clients that have their offices in the same city (control) as the auditors' office. For our tests, we eliminate all clients that received a lawsuit to avoid contaminating our results.

Results show that client firms that have their offices in a different city, face more restatement announcements during the distraction years (i.e. during the years that a client is facing a non-accounting lawsuit). We also find that only different-city clients suffer from this, which indicates that the lack of auditors' time can be costly for that particular group of clients. We also check the audit quality of these audit offices during non-distraction years. We see that neither different-city nor same-city clients suffer a decrease in the quality of audits when the audit office is not distracted.

Appendix A: Variables Definitions

Variables	Definition	Data source
Dependent Variables:		
Rest_AO	Dummy variable that takes the value of one for each year-end that the financial statements are restated and zero otherwise.	Audit Analytics
Rest_Length	The number of consecutive years the accounts have been restated.	Audit Analytics
Rest_FO	Dummy variable that takes the value of one if the year-end financial statements are firstly restated and zero otherwise.	Audit Analytics
Rest_AD	Dummy variable that takes the value of one if the restatement is being discovered and zero otherwise.	Audit Analytics
ABS(DA) Jones	The absolute value of discretionary accruals calculated using the modified Jones model (1991) as modified by Kothari et al. (2005).	Compustat
Test Variable:		
Treated	Dummy variable that takes the value of one if the client-firm's offices are situated in a different city than the auditor's office city and zero otherwise.	Audit Analytics
Distraction Events:		
Main distraction event	Dummy variable that takes the value of one if the audit office has a client that received a non-accounting lawsuit in that specific year and zero otherwise	Audit Analytics

Non-Acc Class actions	Dummy variable that takes the value of one if the audit office has a client that receives a non accounting class action lawsuit in that specific year and zero otherwise.	Audit Analytics
FJC	Dummy variable that takes the value of one if the audit office has a client that receives a lawsuit from the Federal Judicial Center in that specific year and zero otherwise.	Compustat
M&A	Dummy variable that takes the value of one if the audit office has a client that is acquiring another firm in an M&A in that specific year and zero otherwise.	Compustat
IPO	Dummy variable that takes the value of one if the audit office has a client that is participating in an Initial Public Offering in that specific year and zero otherwise.	Compustat
Distraction Year	Dummy variable that takes the value of one if the audit office is distracted in that specific year. The distraction event is indicated as above.	

Firm-Level Controls:

BM	Book Value of equity divided by the equity value of equity.	Compustat
Size	Natural log of total assets.	Compustat
Loss	Dummy variable that takes the value of one if the company had a net Loss in the particular year, and zero otherwise.	Compustat
Sales_Growth	Percentage growth in company's sales from year t-1 to year t.	Compustat

PPE_Growth	Percentage growth in company's net property, plant and equipment from year t-1 to year t.	Compustat
Leverage	Total debt divided by total equity.	Compustat
Foreign	Dummy variable that takes the value of one if the company has foreign activities and zero otherwise	Compustat
Liquidity	Current assets scaled by current liabilities	Compustat
Return	Percentage change in company's share price from year t-1 to year t.	Compustat
ROA	Net income scaled by total assets.	Compustat
Altman_Z	Probability of bankruptcy using the Altman Z score $[(0.717 \times \text{net working capital/assets}) + (0.847 \times \text{retained earnings/assets}) + (3.107 \times \text{earnings before interest and taxes/assets}) + (0.42 \times \text{book value of equity/liabilities}) + (0.998 \times \text{sales/assets})](Altman, 1983)$	Compustat
OCF	Cash Flow from Operations scaled by lagged total assets.	Compustat
M_A	Dummy variable that takes the value of one if the company is engaged in a M&A and zero otherwise.	Compustat
Big_N	Dummy variable that takes the value of one if the company is audited by a Big-4 auditing company and zero otherwise.	Compustat
fiscal month	Dummy variable that takes the value of one if company's fiscal year end, ends in december and zero otherwise.	Compustat
Ln_AF	Natural log of the dollar amount of the audit fees a company pays to the auditors.	Audit Analytics

Ln_NAF	Natural log of the dollar amount of the non audit fees a company pays to the auditors.	Audit Analytics
Auditor_Tenure	Difference between the date an auditor was appointed in the company and the date the auditor left the office. The we construct a dummy variable taking the value of 1 if the difference is above or equal to 3, and zero otherwise.	Audit Analytics
Litigate	Dummy variable that takes the value of one if the company operates in the following SIC codes: 2833-2836, 3570-3577, 3600-3674, 5200-5961, and 7370, and zero otherwise	Compustat
City_Industry_Expert	Dummy variable that takes the value of one if the company's auditor is the city industry leader and zero otherwise. The audit firm with the highest amount of audit fees within an industry and city-year is classified as the city industry expert. City is defined by Audit Analytics	Audit Analytics
Auditor Office-Level Controls:		
Office Size	Natural log of the total dollar amount of audit fees charged to all the clients in the portfolio within an auditor office. Audit Office locations are derived by Audit Analytics	Audit Analytics
Influence	Audit fees plus non-audit fees charged to a specific client, scaled by total audit fees charged by the auditor office.	Audit Analytics
Clients	Number of clients audited by the auditor office.	Audit Analytics

Appendix B: Multiple Big 4 offices across US:

1. **KPMG:**
   - Atlanta
   - Dallas
   - Denver
   - Knoxville
   - Montvale
   - New York
   - Phoenix
   - San Diego
2. **Deloitte:**
   - Deloitte
   - San Francisco
   - Washington
   - Lake Mary
   - Baltimore
   - Austin
3. **Ernst & Young:**
   - San Francisco
   - San Jose
   - Washington
   - Jacksonville
   - New Jersey
   - New York
   - Dallas
   - San Antonio
   - Seattle
4. **Pricewaterhouse Coopers:**
   - Los Angeles
   - Tampa
   - Chicago
   - New York

Bibliography

Aobdia, D. (2019). Do practitioner assessments agree with academic proxies for audit quality? evidence from pcaob and internal inspections. *Journal of Accounting and Economics*, 67(1):144–174.

Asare, S. K., Trompeter, G. M., and Wright, A. M. (2000). The effect of accountability and time budgets on auditors' testing strategies. *Contemporary Accounting Research*, 17(4):539–560.

Caramanis, C. and Lennox, C. (2008). Audit effort and earnings management. *Journal of Accounting and Economics*, 45(1):116–138.

Chaney, P. K. and Philipich, K. L. (2002). Shredded reputation: The cost of audit failure. *Journal of Accounting Research*, 40(4):1221–1245.

Choi, J.-H., Kim, C., Kim, J.-B., and Zang, Y. (2010). Audit office size, audit quality, and audit pricing. *Auditing: A Journal of Practice & Theory*, 29(1):73–97.

Coram, P., Ng, J., and Woodliff, D. R. (2004). The effect of risk of misstatement on the propensity to commit reduced audit quality acts under time budget pressure. *Auditing: A Journal of Practice & Theory*, 23(2):159–167.

DeAngelo, L. E. (1981). Auditor size and audit quality. *Journal of Accounting and Economics*, 3(3):183–199.

DeFond, M. and Zhang, J. (2014). A review of archival auditing research. *Journal of Accounting and Economics*, 58(2-3):275–326.

Dou, Y. and Zhang, E. J. (2018). Distracted auditors. *Working Paper, Monash Universty*.

Ferguson, A., Francis, J. R., and Stokes, D. J. (2003). The effects of firm-wide and office-level industry expertise on audit pricing. *The Accounting Review*, 78(2):429–448.

Francis, J. R., Mehta, M. N., and Zhao, W. (2017). Audit office reputation shocks from gains and losses of major industry clients. *Contemporary Accounting Research*, 34(4):1922–1974.

Francis, J. R. and Michas, P. N. (2013). The contagion effect of low-quality audits. *The Accounting Review*, 88(2):521–552.

Francis, J. R., Stokes, D. J., and Anderson, D. (1999). City markets as a unit of analysis in audit research and the re-examination of big 6 market shares. *Abacus*, 35(2):185–206.

Francis, J. R. and Yu, M. D. (2009). Big 4 office size and audit quality. *The Accounting Review*, 84(5):1521–1552.

Heo, J. S., Kwon, S. Y., and Tan, H.-T. (2020). Auditors' responses to workload imbalance and the impact on audit quality. *Contemporary Accounting Research*.

Houston, R. W. (1999). The effects of fee pressure and client risk on audit seniors' time budget decisions. *Auditing: A Journal of Practice & Theory*, 18(2):70–86.

Kelley, T. and Margheim, L. (1990). The impact of time budget pressure, personality, and leadership variables on dysfunctional auditor behavior. *Auditing: A Journal Of Practice & Theory*, 9(2):21–42.

Kothari, S. P., Leone, A. J., and Wasley, C. E. (2005). Performance matched discretionary accrual measures. *Journal of Accounting and Economics*, 39(1):163–197.

Krishnan, G. V. (2005). Did houston clients of arthur andersen recognize publicly available bad news in a timely fashion? *Contemporary Accounting Research*, 22(1):165–193.

Lambert, T. A., Jones, K. L., Brazel, J. F., and Showalter, D. S. (2017). Audit time pressure and earnings quality: An examination of accelerated filings. *Accounting, Organizations and Society*, 58:50–66.

Lennox, C. and Li, B. (2014). Accounting misstatements following lawsuits against auditors. *Journal of Accounting and Economics*, 57(1):58–75.

Li, C. (2009). Does client importance affect auditor independence at the office level? empirical evidence from going-concern opinions. *Contemporary Accounting Research*, 26(1):201–230.

López, D. M. and Peters, G. F. (2012). The effect of workload compression on audit quality. *Auditing: A Journal of Practice & Theory*, 31(4):139–165.

McDaniel, L. S. (1990). The effects of time pressure and audit program structure on audit performance. *Journal of Accounting Research*, 28(2):267–285.

PCAOB (2012a). Maintaining and applying professional skepticism in audits. staff audit practice alert no. 10.

PCAOB (2012b). Staff audit practice alert no. 10: Maintaining and applying professional skepticism in audits.

Reynolds, J. K. and Francis, J. R. (2000). Does size matter? the influence of large clients on office-level auditor reporting decisions. *Journal of Accounting and Economics*, 30(3):375–400.

Rhode, J. G. (1978). Survey on the influence of selected aspects of the auditor's work environment on professional performance of certified public accountants. *New York*.

Sellers, R. D., Meckfessel, M. D., Jadallah, J., and Moeini Chaghervand, A. (2018). Variability of accounting restatement measurement in audit quality research. *Available at SSRN 3216124*.

Yerkes, R. M. and Dodson, J. D. (1908). The relation of strength of stimulus to rapidity of habit-formation. *Journal of Comparative Neurology and Psychology*, 18(5):459–482.

Fig. 1: Sample Matching after Propensity Score Matching

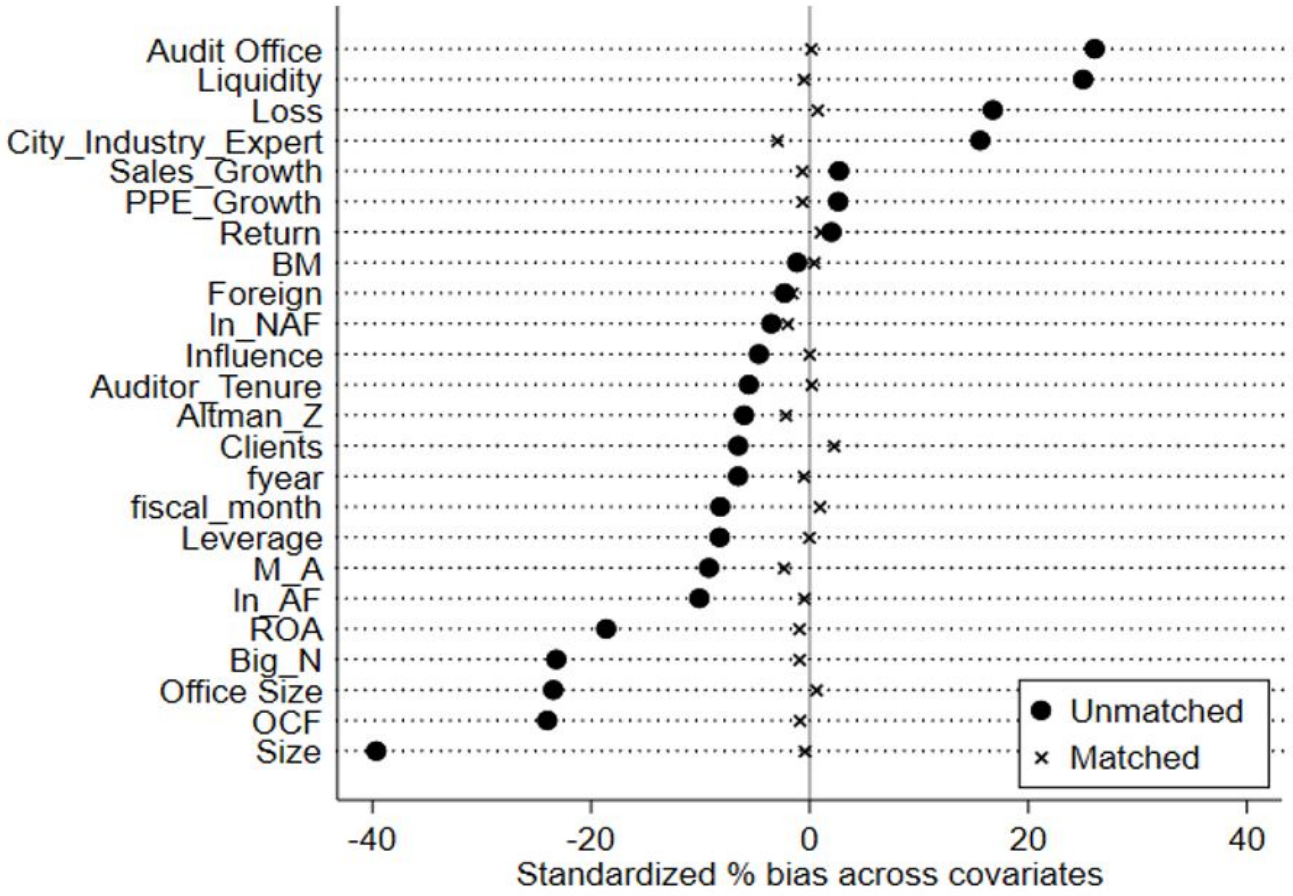

Figure 1 displays the effectiveness of the propensity score matching for the treated and control group of firms. We match on replacement and we require each observation of the firms that have their offices in a different city (treated) to be matched to the closest neighbour among the firms that have their offices in the same city (control) compared to the auditors' offices. The standardized bias between treated and control groups is close to zero achieving a similarity between the two groups.

Table 1: Summary Statistics

Panel A: Summary Statistics

	obs	mean	sd	min	p25	p50	p75	max
Rest_AO	109408	0.258	0.438	0.000	0.000	0.000	1.000	1.000
Sales_Growth	56330	0.153	0.569	-0.837	-0.038	0.064	0.195	4.347
PPE_Growth	57193	0.172	0.684	-0.755	-0.072	0.029	0.182	4.967
Loss	60723	0.384	0.486	0.000	0.000	0.000	1.000	1.000
Leverage	60428	0.644	2.241	-8.807	0.001	0.273	0.866	1.363
Return	57521	0.153	0.811	-0.880	-0.275	0.019	0.332	5.048
Big_N	60723	0.754	0.431	0.000	1.000	1.000	1.000	1.000
BM	60658	0.561	0.639	-1.399	0.230	0.437	0.741	3.854
ROA	60672	-0.077	0.313	-1.738	-0.077	0.024	0.067	0.263
Altman_Z	58116	1.393	3.409	-1.454	0.777	1.867	2.957	1.071
Size	60711	6.010	2.107	0.975	4.471	5.948	7.483	1.114
OCF	60652	0.010	0.237	-1.184	-0.003	0.070	0.124	0.336
fiscal_month	60723	0.698	0.459	0.000	0.000	1.000	1.000	1.000
ln_AF	88410	1.306	1.581	9.345	1.194	1.315	1.419	1.667
ln_NAF	88410	1.024	4.046	0.000	9.582	1.126	1.268	1.590
Auditor_Tenure	88410	0.945	0.228	0.000	1.000	1.000	1.000	1.000
Influence	88410	0.126	0.219	0.000	0.009	0.036	0.127	1.000
Clients	88410	49.284	6.289	1	9	21	63	321
Office Size	88410	16.576	1.983	5.617	15.241	16.926	18.136	20.235
M_A	60723	0.357	0.479	0.000	0.000	0.000	1.000	1.000
City_Industry_Expert	88410	0.683	0.465	0.000	0.000	1.000	1.000	1.000
Foreign	60723	0.455	0.498	0.000	0.000	0.000	1.000	1.000
Liquidity	59423	3.080	3.312	0.238	1.315	1.055	3.429	2.276
ABS(DA)	51488	-0.003	0.105	-0.764	-0.050	-0.001	0.045	0.762

Panel B: Summary Statistics of treated and control groups

	Treated			Control			
	obs	mean	sd	obs	mean	sd	Diff:
Rest_AO	59905	0.142	0.350	28505	0.131	0.338	0.011***
Sales_Growth	39468	0.157	0.586	16862	0.142	0.526	0.015***
PPE_Growth	40190	0.176	0.708	17003	0.161	0.623	0.015***
Loss	42756	0.406	0.491	17967	0.329	0.470	0.077***
Leverage	42562	0.599	2.178	17866	0.751	2.383	-0.152***
Return	40383	0.158	0.833	17138	0.142	0.756	0.016**
Big_N	42756	0.721	0.448	17967	0.832	0.374	-0.111***
BM	42726	0.565	0.642	17932	0.553	0.631	0.012**
ROA	42718	-0.092	0.328	17954	-0.042	0.270	-0.050***
Altman_Z	41287	1.341	3.553	16829	1.517	3.024	-0.176***
Size	42745	5.775	2.066	17966	6.571	2.097	-0.796***
OCF	42705	-0.005	0.250	17947	0.045	0.199	-0.050***
fiscal_month	42756	0.690	0.462	17967	0.715	0.451	-0.025***
ln_AF	59905	12.999	1.495	28505	13.202	1.741	-0.203***
ln_NAF	59905	10.166	4.008	28505	10.426	4.119	-0.260***
Auditor_Tenure	59905	0.940	0.238	28505	0.956	0.204	-0.017***
Influence	59905	0.131	0.224	28505	0.116	0.208	0.015***
Clients	59905	44.838	59.298	28505	58.628	68.909	-13.790***
Office Size	59905	16.354	1.993	28505	17.044	1.877	-0.690***
M_A	42756	0.347	0.476	17967	0.382	0.486	-0.036***
City_Industry_Expert	59905	0.707	0.455	28505	0.634	0.482	0.072***
Foreign	42756	0.453	0.498	17967	0.461	0.498	-0.008*
Liquidity	41885	3.280	3.487	17538	2.602	2.792	0.678***
ABS(DA)	36343	-0.002	0.108	15145	-0.005	0.095	0.003***

This table provides summary statistics for all the variables used in this analysis. "Restatement" is a dummy variable that takes the value of one if the year-end financial statements are restated and zero otherwise. In panel A. we show the statistics of all the variables and in panel B. we split the sample between the treated and control group of firms. All variables are winsorized at the top and bottom percentiles of the distribution. All variables are as defined in Appendix A.

Table 2: Pearson (Spearman) Correlations left (right) Corner

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)	(20)	(21)	(22)	(23)	(24)	(25)	(26)
(1) MB	1	**0.077**	**-0.173**	**0.221**	**0.173**	**-0.113**	**0.132**	**0.085**	**0.306**	**0.276**	**0.039**	**0.253**	0.026	**0.117**	**0.045**	-0.006	**0.123**	**0.093**	**0.143**	**0.040**	**0.066**	**-0.039**	**0.097**	**0.117**	-0.027	-0.008
(2) Size	0.003	1	**-0.342**	0.018	**0.160**	**0.400**	**0.397**	**-0.307**	**0.069**	**0.342**	**0.074**	**0.369**	**0.219**	**-0.187**	**0.103**	0.011	**0.810**	**0.656**	**0.471**	**0.497**	-0.023	**0.312**	**0.341**	**-0.187**	0.017	**-0.131**
(3) Loss	**-0.035**	**-0.395**	1	**-0.168**	**-0.216**	**-0.051**	**-0.189**	**0.067**	**-0.273**	**-0.842**	**-0.474**	**-0.631**	**-0.069**	**0.167**	**-0.062**	**0.086**	**-0.269**	**-0.219**	**-0.246**	**-0.142**	**0.090**	**-0.093**	**-0.127**	**0.167**	-0.003	**0.078**
(4) Sales Growth	**0.085**	**-0.083**	**0.036**	1	**0.388**	0.007	0.020	**0.040**	**0.158**	**0.209**	**0.096**	**0.180**	**0.101**	0.030	**-0.036**	0.023	**0.043**	-0.033	0.017	**-0.050**	**0.042**	**-0.043**	**0.088**	0.030	**0.039**	0.029
(5) PPE Growth	**0.072**	-0.005	-0.007	**0.289**	1	**0.093**	**0.050**	0.022	**0.041**	**0.243**	**0.155**	**0.242**	**0.132**	**-0.037**	-0.010	0.011	**0.112**	**0.064**	**0.096**	**0.065**	-0.028	0.016	**0.044**	**-0.037**	-0.004	-0.025
(6) Leverage	**-0.055**	**0.186**	0.010	**0.065**	**0.132**	1	0.002	**-0.395**	0.006	-0.008	**-0.335**	0.024	**0.136**	**-0.261**	**-0.043**	**0.099**	**0.261**	**0.227**	**0.118**	**0.257**	**-0.153**	**0.184**	0.007	**-0.261**	0.017	-0.012
(7) Foreign	**0.027**	**0.304**	**-0.176**	**-0.032**	-0.017	**-0.083**	1	0.005	**0.074**	**0.223**	**0.097**	**0.202**	**0.163**	0.020	**0.138**	**-0.076**	**0.509**	**0.369**	**0.209**	**0.265**	**0.082**	**0.054**	**0.262**	0.020	0.014	-0.020
(8) Liquidity	**0.033**	**-0.246**	**0.154**	**0.090**	**0.110**	**-0.232**	**-0.084**	1	0.018	-0.011	**0.311**	**-0.107**	**-0.040**	**0.221**	**0.051**	**-0.086**	**-0.262**	**-0.216**	**-0.052**	**-0.309**	**0.198**	**-0.196**	0.018	**0.221**	**-0.058**	**0.036**
(9) Return	**0.105**	**-0.038**	**-0.111**	**0.095**	0.015	**0.069**	0.006	-0.006	1	**0.295**	**0.149**	**0.227**	0.018	**-0.056**	**0.047**	**-0.048**	**0.082**	0.031	**0.085**	**-0.048**	0.030	-0.017	**0.127**	**-0.056**	-0.005	-0.021
(10) ROA	**0.037**	**0.459**	**-0.506**	**-0.046**	**0.035**	**-0.036**	**0.219**	-0.015	**0.093**	1	**0.573**	**0.748**	**0.043**	**-0.133**	**0.080**	**-0.112**	**0.283**	**0.221**	**0.265**	**0.128**	**-0.075**	**0.077**	**0.152**	**-0.133**	-0.023	**-0.050**
(11) Bankruptcy	**0.028**	**0.384**	**-0.358**	**-0.038**	**0.074**	**-0.178**	**0.168**	**0.212**	**0.028**	**0.764**	1	**0.492**	-0.017	**-0.080**	**0.080**	**-0.200**	0.018	**0.059**	**0.105**	-0.031	-0.013	**0.038**	**0.038**	**-0.080**	-0.028	**-0.106**
(12) CFO	0.008	**0.437**	**-0.467**	**-0.113**	**-0.082**	**-0.062**	**0.201**	**-0.167**	0.007	**0.684**	**0.595**	1	**0.084**	**-0.090**	**0.081**	**-0.085**	**0.280**	**0.239**	**0.249**	**0.148**	**-0.082**	**0.063**	**0.131**	**-0.090**	**-0.037**	**-0.113**
(13) M&A	0.022	**0.212**	**-0.064**	**0.028**	**0.060**	**0.112**	**0.156**	**-0.069**	-0.018	**0.086**	**0.064**	**0.092**	1	0.020	0.000	0.033	**0.241**	**0.171**	**0.078**	**0.135**	**-0.051**	**0.039**	**0.111**	0.020	-0.024	0.002
(14) Litigate	**0.058**	**-0.224**	**0.191**	**0.047**	**0.032**	**-0.219**	**0.063**	**0.213**	-0.024	**-0.173**	**-0.113**	**-0.145**	0.004	1	0.019	**-0.096**	**-0.135**	**-0.086**	**-0.057**	**-0.111**	**0.144**	**-0.146**	-0.004	**1.000**	-0.010	**0.040**
(15) BIG4	0.004	**0.147**	**-0.058**	**-0.054**	-0.018	**-0.046**	**0.078**	-0.004	-0.004	**0.098**	**0.112**	**0.112**	0.004	0.000	1	-0.027	**0.117**	**0.096**	**0.078**	**-0.115**	**0.134**	-0.016	**0.204**	0.019	**0.049**	-0.018
(16) Fiscal month	0.013	0.013	**0.075**	**0.059**	0.049	**0.102**	**-0.083**	**0.032**	-0.016	**-0.043**	**-0.058**	**-0.077**	0.011	**-0.084**	-0.016	1	**0.042**	**-0.060**	-0.008	0.008	**-0.040**	0.009	-0.001	**-0.096**	-0.025	**0.037**
(17) Ln (Audit Fees)	0.027	**0.799**	**-0.277**	**-0.053**	-0.014	**0.112**	**0.424**	**-0.275**	-0.025	**0.305**	**0.205**	**0.299**	**0.254**	**-0.131**	**0.150**	-0.006	1	**0.565**	**0.397**	**0.488**	-0.010	**0.313**	**0.489**	**-0.135**	**0.041**	**-0.061**
(18) Ln (non Audit Fees)	0.017	**0.624**	**-0.224**	**-0.099**	**-0.030**	**0.100**	**0.302**	**-0.205**	**-0.037**	**0.209**	**0.183**	**0.269**	**0.149**	**-0.104**	**0.104**	**-0.045**	**0.542**	1	**0.345**	**0.512**	**0.090**	**0.214**	**0.219**	**-0.086**	0.010	**-0.067**
(19) Tenure	**0.039**	**0.435**	**-0.246**	**-0.067**	**-0.054**	0.010	**0.176**	**-0.125**	-0.015	**0.185**	**0.133**	**0.168**	**0.056**	**-0.110**	**0.072**	**-0.032**	**0.360**	**0.298**	1	**0.195**	**0.035**	**0.156**	**0.210**	**-0.057**	**-0.034**	**-0.075**
(20) Influence	0.011	**0.359**	**-0.070**	**-0.047**	-0.012	**0.069**	**0.113**	**-0.158**	**-0.038**	**0.055**	**0.041**	**0.082**	**0.084**	**-0.077**	**-0.038**	0.004	**0.361**	**0.414**	**0.193**	1	**-0.532**	**0.391**	**-0.426**	**-0.111**	0.025	0.021
(21) Clients	0.021	**-0.055**	**0.086**	**0.031**	-0.012	**-0.128**	**0.099**	**0.157**	**0.032**	-0.001	**0.028**	-0.022	**-0.058**	**0.159**	**0.198**	**-0.033**	**-0.042**	**0.037**	-0.014	**-0.302**	1	**-0.229**	**0.598**	**0.144**	0.007	**-0.075**
(22) City_Industry_expert	-0.012	**0.312**	**-0.126**	**-0.051**	**-0.035**	**0.099**	**0.061**	**-0.165**	**-0.029**	**0.123**	**0.099**	**0.123**	**0.038**	**-0.171**	0.013	-0.007	**0.323**	**0.227**	**0.184**	**0.366**	**-0.210**	1	**-0.101**	**-0.146**	0.018	**-0.056**
(23) Office Size	0.019	**0.399**	**-0.140**	-0.006	**-0.030**	0.010	**0.234**	**-0.025**	0.007	**0.221**	**0.166**	**0.178**	**0.128**	-0.023	**0.289**	-0.021	**0.500**	**0.224**	**0.182**	**-0.316**	**0.522**	**-0.063**	1	-0.004	0.028	**-0.070**
(24) Litigate	**0.058**	**-0.224**	**0.191**	**0.047**	**0.032**	**-0.219**	**0.063**	**0.213**	-0.024	**-0.173**	**-0.113**	**-0.145**	0.004	**1.000**	0.000	**-0.084**	**-0.131**	**-0.104**	**-0.110**	**-0.077**	**0.159**	**-0.171**	-0.023	1	-0.010	**0.040**
(25) Restatement	-0.016	0.022	0.015	**0.039**	0.010	0.014	0.003	**-0.061**	-0.002	0.001	-0.002	-0.012	-0.005	-0.016	**0.041**	**-0.031**	**0.048**	0.012	**-0.038**	0.012	-0.002	**0.035**	0.009	-0.016	1	0.014
(26) Abs DA	0.003	**-0.217**	**0.121**	**0.155**	**0.111**	**0.180**	**-0.062**	-0.025	**0.125**	**-0.378**	**-0.357**	**-0.346**	**-0.029**	**0.048**	**-0.080**	**0.033**	**-0.136**	**-0.097**	**-0.082**	0.008	**-0.070**	**-0.047**	**-0.172**	**0.048**	-0.004	1

This table shows the correlation coefficients for all the variables used in this analysis. The left corner shows the Pearson correlation matrix whereas the right corner shows the Spearman correlation matrix. Bold correlation coefficients represent two-tailed significance at the 0.05 level. "Restatement" is a dummy variable that takes the value of one if the year-end financial statements are restated and zero otherwise. All variables are winsorized at the top and bottom percentiles of the distribution. All variables are as defined in Appendix A.

Table 3: Effect of distraction event on restatements

Dependent Variables:	Rest_AO	Rest_Length	Rest_FO
	(1)	(2)	(3)
Treated X Distraction Year	0.022**	0.110**	0.010**
	(2.490)	(2.235)	(2.111)
Sales_Growth	0.004	-0.005	0.002
	(1.069)	(-0.334)	(0.785)
PPE_Growth	0.008**	0.018	0.006**
	(2.083)	(1.147)	(1.983)
Loss	0.022***	0.040	0.011**
	(2.626)	(1.003)	(2.130)
Leverage	0.000	-0.001	-0.000
	(0.253)	(-0.145)	(-0.438)
Return	0.003	0.004	0.001
	(1.052)	(0.325)	(0.314)
Big_N	-0.081***	-0.320***	-0.050***
	(-3.115)	(-3.050)	(-2.628)
BM	0.002	-0.016	0.002
	(0.306)	(-0.588)	(0.617)
ROA	0.022	0.154**	-0.018
	(1.246)	(2.046)	(-1.220)
Altman_Z	-0.005**	-0.020***	-0.001
	(-2.583)	(-2.592)	(-0.733)
Size	0.012***	0.093***	0.001
	(3.316)	(4.477)	(0.398)
OCF	0.011	-0.004	0.021
	(0.443)	(-0.040)	(1.194)
fiscal_month	-0.038***	-0.211***	0.003
	(-4.320)	(-4.806)	(0.617)
ln_AF	0.007*	0.015	0.005***
	(1.817)	(0.814)	(2.924)
ln_NAF	0.001	0.005	-0.000
	(0.613)	(1.262)	(-0.652)
Auditor_Tenure	-0.013	0.028	-0.002
	(-0.867)	(0.423)	(-0.233)
Influence	0.054	-0.070	0.019
	(0.945)	(-0.254)	(0.633)
Clients	0.000	-0.000	0.000
	(0.017)	(-0.498)	(1.082)
Office Size	0.006	-0.026	-0.004
	(0.607)	(-0.404)	(-0.670)
M_A	0.003	-0.040	0.009**
	(0.376)	(-1.261)	(2.120)
City_Industry_Expert	0.018*	0.100*	-0.001
	(1.914)	(1.770)	(-0.178)
Foreign	0.004	0.021	0.000
	(0.426)	(0.499)	(0.095)
Liquidity	-0.002*	-0.003	-0.002***
	(-1.950)	(-0.409)	(-3.748)
Constant	-0.044	0.532	0.091
	(-0.259)	(0.522)	(0.929)
Year FE	Y	Y	Y
Industry FE	Y	Y	Y
Audit Office FE	Y	Y	Y
Observations	23,212	23,212	23,212
Adjusted R-squared	0.084	0.086	0.021

This table shows the effect of the distraction event on Restatements. "Treated" is a dummy variable that takes the value of one if the audit-client firm office are situated in a different city as compared to the audit-office and zero otherwise. "Distraction Year" takes the value of one if the office is distracted in that specific year and zero otherwise. Fixed effects are as indicated. Clustering of standard errors is at audit office level. T-statistics are reported in parentheses. An asterisk indicates significance at the 10% level; two indicate significance at the 5% level; three indicate significance at the 1% level.

Table 4: Effect of distraction years on restatements for treated and control groups

	Control		Treated	
Dependent variable: Rest_AO	(1)	(2)	(3)	(4)
Distraction Year	-0.024	-0.028*	0.019**	0.016*
	(-1.536)	(-1.772)	(2.302)	(1.906)
Sales_Growth	0.015**	0.010*	0.004	0.002
	(2.354)	(1.831)	(1.000)	(0.616)
PPE_Growth	0.006	0.001	0.014***	0.010**
	(1.035)	(0.188)	(3.779)	(2.808)
Loss	0.032**	0.019	0.034***	0.032***
	(2.727)	(1.506)	(5.161)	(4.735)
Leverage	0.003	0.003	0.001	0.001
	(1.250)	(1.254)	(0.624)	(0.958)
Return	0.004	0.002	0.002	0.001
	(1.187)	(0.621)	(0.783)	(0.552)
Big_N	-0.033	-0.002	-0.009	-0.032*
	(-1.721)	(-0.060)	(-0.595)	(-1.852)
BM	0.013	0.014	0.006	0.004
	(1.346)	(1.479)	(1.207)	(0.646)
ROA	0.018	0.016	0.008	0.016
	(0.623)	(0.520)	(0.396)	(0.824)
Altman_Z	0.001	0.000	-0.002	-0.002
	(0.386)	(0.113)	(-0.978)	(-1.052)
Size	-0.009	-0.009	-0.001	-0.002
	(-1.524)	(-1.528)	(-0.160)	(-0.342)
OCF	-0.013	0.011	0.032	0.015
	(-0.375)	(0.295)	(1.274)	(0.586)
fiscal_month	-0.032**	-0.036**	-0.041***	-0.042***
	(-2.789)	(-2.678)	(-3.905)	(-3.968)
ln_AF	0.019**	0.017**	0.025***	0.025***
	(2.186)	(2.162)	(4.573)	(4.585)
ln_NAF	0.000	0.002	-0.000	-0.000
	(0.334)	(1.443)	(-0.310)	(-0.551)
Auditor_Tenure	-0.027	-0.008	-0.038***	-0.028
	(-1.306)	(-0.337)	(-2.887)	(-1.603)
Influence	0.003	0.033	-0.018	-0.012
	(0.079)	(0.799)	(-0.826)	(-0.435)
Clients	0.000	0.000	-0.000	-0.000
	(0.053)	(0.677)	(-0.878)	(-0.717)
Office Size	0.012	0.042***	-0.004	0.003
	(1.324)	(3.025)	(-0.899)	(0.440)
M_A	0.003	0.004	0.004	0.005
	(0.382)	(0.494)	(0.653)	(0.899)
City_Industry_Expert	0.036**	0.020	0.017	0.007
	(2.291)	(1.289)	(1.696)	(0.715)
Foreign	-0.016	-0.014	0.008	0.008
	(-1.564)	(-1.113)	(1.391)	(1.183)
Liquidity	-0.006**	-0.002	-0.003*	-0.002*
	(-2.759)	(-1.046)	(-1.853)	(-1.831)
Constant	-0.189	-0.703***	-0.054	-0.151
	(-1.523)	(-3.133)	(-0.678)	(-1.056)
Year FE	Y	Y	Y	Y
Industry FE	Y	Y	Y	Y
Audit Office FE	N	Y	N	Y
Observations	13,550	13,468	34,665	34,476
Adjusted R-squared	0.046	0.131	0.039	0.089

This table shows the effect of the distraction event on Restatements separately for the treated and control group of firms. "Treated" is a dummy variable that takes the value of one if the audit-client firm office are situated in a different city as compared to the audit-office and zero otherwise. "Distraction Year" takes the value of one if the office is distracted in that specific year and zero otherwise. Columns (1)-(2) show the distraction effect on the control group and columns (3)-(4) show the effect on the treated group of firms. Fixed effects are as indicated. Clustering of standard errors is at audit office level. T-statistics are reported in parentheses. An asterisk indicates significance at the 10% level; two indicate significance at the 5% level; three indicate significance at the 1% level.

Table 5: Effect of restatements during distraction and non-distraction years

	Non Distraction Years		Distraction Years	
Dependent variable: Rest_AO	(1)	(2)	(3)	(4)
Treated	-0.014	0.003	0.021**	0.022**
	(-0.918)	(0.134)	(2.462)	(2.504)
Sales_Growth	0.010	0.011	0.007*	0.004
	(1.158)	(1.181)	(1.860)	(1.134)
PPE_Growth	0.005	0.004	0.012***	0.008**
	(0.795)	(0.519)	(2.968)	(2.175)
Loss	0.048***	0.027*	0.025***	0.021**
	(3.291)	(1.689)	(3.156)	(2.578)
Leverage	0.002	0.004	0.000	0.000
	(0.769)	(1.147)	(0.174)	(0.211)
Return	0.004	0.005	0.003	0.003
	(0.674)	(0.796)	(1.126)	(1.016)
Big_N	-0.031	-0.041	-0.038**	-0.079***
	(-1.562)	(-1.022)	(-2.509)	(-3.061)
BM	-0.004	-0.010	0.004	0.002
	(-0.517)	(-0.986)	(0.672)	(0.359)
ROA	-0.022	-0.038	0.024	0.025
	(-0.558)	(-0.843)	(1.367)	(1.376)
Altman_Z	0.002	0.000	-0.005***	-0.004**
	(1.032)	(0.148)	(-2.775)	(-2.538)
Size	0.012	0.015	0.007*	0.008*
	(1.534)	(1.466)	(1.858)	(1.920)
OCF	-0.015	-0.017	0.019	0.011
	(-0.318)	(-0.325)	(0.770)	(0.427)
fiscal_month	-0.037**	-0.036*	-0.040***	-0.039***
	(-2.502)	(-1.733)	(-4.822)	(-4.432)
ln_AF	-0.015	-0.002	0.023***	0.019***
	(-0.868)	(-0.096)	(3.310)	(2.725)
ln_NAF	-0.000	0.002	0.000	0.000
	(-0.150)	(0.918)	(0.055)	(0.469)
Auditor_Tenure	-0.052***	-0.059*	-0.032***	-0.013
	(-2.604)	(-1.830)	(-2.598)	(-0.917)
Influence	0.052	0.027	0.009	0.018
	(1.230)	(0.527)	(0.173)	(0.293)
Clients	0.001	0.000	-0.000	0.000
	(0.798)	(0.085)	(-0.827)	(0.096)
Office Size	0.020	0.035	0.002	0.003
	(1.127)	(1.401)	(0.377)	(0.289)
M_A	0.003	-0.005	0.000	0.002
	(0.205)	(-0.344)	(0.013)	(0.256)
City_Industry_Expert	0.003	0.009	0.031***	0.017*
	(0.197)	(0.395)	(3.318)	(1.886)
Foreign	-0.010	0.008	0.005	0.001
	(-0.656)	(0.342)	(0.634)	(0.125)
Liquidity	-0.003	-0.001	-0.002*	-0.002*
	(-1.398)	(-0.264)	(-1.853)	(-1.656)
Constant	0.037	-0.342	-0.180*	-0.126
	(0.270)	(-1.418)	(-1.932)	(-0.733)
Year FE	Y	Y	Y	Y
Industry FE	Y	Y	Y	Y
Audit Office FE	N	Y	N	Y
Observations	5,463	5,155	23,328	23,212
Adjusted R-squared	0.051	0.189	0.043	0.084

This table shows the effect of the distraction event on Restatements during distraction and non-distraction years. "Treated" is a dummy variable that takes the value of one if the audit-client firm office are situated in a different city as compared to the audit-office and zero otherwise. "Distraction Year" takes the value of one if the office is distracted in that specific year and zero otherwise. Columns (1)-(2) show the effect during non distraction years and columns (3)-(4) show the effect during distraction years. Fixed effects are as indicated. Clustering of standard errors is at audit office level. T-statistics are reported in parentheses. An asterisk indicates significance at the 10% level; two indicate significance at the 5% level; three indicate significance at the 1% level.

Table 6: Effect of other distraction events on Restatements

	Non-Acc Class actions	FJC	M&A	IPOS
Dependent variable: Rest_AO	(1)	(2)	(3)	(4)
Treated X Distraction Year	0.023**	0.020**	0.019**	0.022*
	(2.429)	(2.296)	(2.491)	(1.711)
Sales_Growth	0.003	-0.002	0.003	0.002
	(0.674)	(-0.608)	(1.095)	(0.513)
PPE_Growth	0.012***	0.009**	0.009***	0.011**
	(2.614)	(2.322)	(3.016)	(2.163)
Loss	0.029***	0.032***	0.034***	0.043***
	(3.050)	(4.339)	(5.973)	(4.271)
Leverage	0.001	0.001	0.002*	0.004**
	(0.451)	(0.944)	(1.652)	(2.049)
Return	0.004	0.002	0.002	-0.002
	(0.905)	(0.755)	(0.867)	(-0.541)
Big_N	-0.089***	-0.030	-0.036*	-0.181***
	(-2.617)	(-0.898)	(-1.791)	(-3.897)
BM	0.004	0.007	0.007	0.019**
	(0.581)	(1.329)	(1.544)	(2.175)
ROA	0.036*	0.023	0.026*	0.055**
	(1.662)	(1.408)	(1.815)	(1.968)
Altman_Z	-0.007***	-0.003	-0.002	-0.003
	(-3.128)	(-1.517)	(-1.226)	(-1.185)
Size	0.012***	0.007**	0.001	-0.003
	(2.826)	(2.115)	(0.505)	(-0.585)
OCF	0.021	0.014	0.010	0.018
	(0.645)	(0.561)	(0.496)	(0.546)
fiscal_month	-0.041***	-0.041***	-0.041***	-0.057***
	(-3.923)	(-4.288)	(-5.149)	(-3.795)
ln_AF	0.012***	0.009**	0.006**	0.016***
	(2.958)	(2.459)	(2.088)	(3.060)
ln_NAF	0.001	-0.000	0.001	0.001
	(0.836)	(-0.098)	(0.712)	(0.798)
Auditor_Tenure	-0.021	-0.013	-0.015	-0.106***
	(-1.187)	(-0.860)	(-1.254)	(-4.030)
Influence	0.019	0.012	0.029	-0.087
	(0.232)	(0.189)	(1.027)	(-0.962)
Clients	-0.000	-0.000	-0.000	-0.000
	(-0.250)	(-0.329)	(-0.490)	(-0.774)
Office Size	0.004	0.011	0.020**	0.015
	(0.257)	(0.888)	(2.520)	(0.842)
M_A	0.003	0.005	0.007	0.006
	(0.303)	(0.804)	(1.555)	(0.838)
City_Industry_Expert	0.016	0.014	0.011	-0.003
	(1.626)	(1.435)	(1.281)	(-0.239)
Foreign	-0.000	0.010	0.005	0.016
	(-0.008)	(1.141)	(0.734)	(1.480)
Liquidity	-0.001	-0.003**	-0.004***	-0.004*
	(-0.356)	(-2.570)	(-3.449)	(-1.925)
Constant	-0.040	-0.149	-0.223*	-0.003
	(-0.171)	(-0.704)	(-1.708)	(-0.009)
Year FE	Y	Y	Y	Y
Industry FE	Y	Y	Y	Y
Audit Office FE	Y	Y	Y	Y
Observations	17,334	27,090	44,897	15,442
Adjusted R-squared	0.086	0.069	0.078	0.099

This table shows the effect of different distraction events on restatements. The dependent variable is "Rest_AO". "Treated" is a dummy variable that takes the value of one if the audit-client firm office is in a different city as compared to the audit-office and zero otherwise. Fixed effects are as indicated. Clustering of standard errors is at the audit office level. T-statistics are reported in parentheses. An asterisk indicates significance at the 10% level; two indicate significance at the 5% level; three indicate significance at the 1% level.

Table 7: Ability to gain new clients:

Dependent Variable: Pr (gain)	(1)	(2)
Distraction year	-0.163***	-0.209***
	(-2.775)	(-2.994)
Sales Growth	-0.017	0.078**
	(-0.502)	(2.022)
PPE Growth	0.062	0.058
	(1.584)	(1.343)
Loss	0.004	-0.005
	(0.087)	(-0.080)
Leverage	-0.065	0.010
	(-0.831)	(0.113)
Return	0.080***	-0.013
	(3.294)	(-0.499)
Big4	0.022	-0.192***
	(0.528)	(-3.612)
MB	-0.005*	-0.002
	(-1.739)	(-0.535)
ROA	-0.221**	-0.009
	(-2.317)	(-0.080)
Bankruptcy	0.015**	-0.005
	(2.125)	(-0.609)
Size	0.052***	-0.011
	(2.665)	(-0.410)
CFO	0.225*	-0.013
	(1.868)	(-0.090)
fiscal month	-0.001	-0.036
	(-0.034)	(-0.685)
Ln (Audit Fees)	-0.336***	0.074
	(-9.038)	(1.496)
Ln (Non Audit Fees)	0.122***	0.013
	(8.876)	(0.787)
Litigate	-0.096**	0.011
	(-2.346)	(0.160)
Tenure	-0.114**	-0.034
	(-2.228)	(-0.571)
Influence	-0.611***	-1.399***
	(-2.739)	(-5.124)
Clients	0.077***	0.093***
	(30.628)	(26.695)
Office Size	-0.129***	-0.057
	(-3.668)	(-1.338)
M_A	-0.362***	0.026
	(-7.725)	(0.442)
City_Industry_expert	0.034	-0.044
	(0.789)	(-0.769)
Foreign	-0.200***	-0.100*
	(-4.711)	(-1.872)
Liquidity	-0.035***	-0.002
	(-4.054)	(-0.204)
Constant	5.219***	-7.250***
	(12.412)	(-8.728)
Year FE	N	Y
Industry FE	N	Y
Observations	21,556	21,510
Pseudo R-squared	0.178	0.355

This table shows the effect of the distraction event on the probability of gaining a new client. The dependent variable takes the value of one if the audit office gains a new client the following year. "Treated" is a dummy variable that takes the value of one if the audit-client firm office is in a different city as compared to the audit-office and zero otherwise. Fixed effects are as indicated. Clustering of standard errors is at the audit office level. Z-statistics are reported in parentheses. An asterisk indicates significance at the 10% level; two indicate significance at the 5% level; three indicate significance at the 1% level.

Table 8: Effect of distraction event after PSM

Dependent variable: Rest_AO	(1)	(2)
Treated X Distraction Year	0.016*	0.020**
	(1.748)	(2.245)
Sales_Growth	0.006*	0.004
	(1.827)	(1.014)
PPE_Growth	0.001	0.009**
	(0.240)	(2.223)
Loss	0.024***	0.021**
	(2.996)	(2.581)
Leverage	0.001	0.000
	(0.391)	(0.250)
Return	0.008***	0.004
	(2.607)	(1.128)
Big_N	0.015	-0.075***
	(1.088)	(-2.893)
BM	0.005	0.002
	(0.918)	(0.389)
ROA	0.010	0.023
	(0.560)	(1.301)
Altman_Z	-0.002	-0.005**
	(-1.093)	(-2.511)
Size	0.006	0.007*
	(1.539)	(1.787)
OCF	0.058**	0.015
	(2.310)	(0.584)
fiscal_month	-0.044***	-0.039***
	(-4.943)	(-4.354)
ln_AF	0.002***	0.020***
	(3.075)	(2.814)
ln_NAF	-0.004	0.000
	(-0.621)	(0.467)
Auditor_Tenure	-0.025**	-0.013
	(-2.067)	(-0.860)
Influence	-0.001	0.020
	(-0.020)	(0.322)
Clients	0.000	0.000
	(0.380)	(0.001)
Office Size	-0.006	0.005
	(-0.980)	(0.504)
M_A	0.007	0.001
	(0.915)	(0.175)
City_Industry_Expert	0.022**	0.017*
	(2.396)	(1.844)
Foreign	-0.008	-0.000
	(-1.016)	(-0.029)
Liquidity	-0.006***	-0.002
	(-5.335)	(-1.547)
Constant	0.281***	-0.178
	(3.573)	(-1.024)
Year FE	N	Y
Industry FE	N	Y
Audit Office FE	N	Y
Observations	22,901	22,785
Adjusted R-squared	0.011	0.083

This table shows the effect of the distraction event on Restatements after propensity score matching. Matching is based on a 1% caliper method matching on the closest neighbour with replacement. "Treated" is a dummy variable that takes the value of one if the audit-client firm office are situated in a different city as compared to the audit-office and zero otherwise. Fixed effects are as indicated. Clustering of standard errors is at the audit office level. T-statistics are reported in parentheses. An asterisk indicates significance at the 10% level; two indicate significance at the 5% level; three indicate significance at the 1% level.

Table 9: Capacity constraints during distraction years

	Small offices		Big Offices	
Dependent variable: Rest_AO	(1)	(2)	(3)	(4)
Treated × Distraction Year	0.020**	0.025***	0.002	0.004
	(2.001)	(2.739)	(0.139)	(0.154)
Sales_Growth	0.002	0.001	0.020**	0.017*
	(0.542)	(0.292)	(2.211)	(1.818)
PPE_Growth	0.002	0.014***	-0.006	-0.012
	(0.458)	(3.106)	(-0.786)	(-1.593)
Loss	0.026***	0.027***	0.016	0.002
	(2.882)	(2.941)	(0.965)	(0.086)
Leverage	0.001	0.001	-0.005	-0.004
	(0.804)	(0.472)	(-1.285)	(-0.950)
Return	0.008**	0.004	0.007	0.000
	(2.167)	(1.156)	(1.152)	(0.073)
Big_N	0.017	-0.100***	0.008	-0.068*
	(1.013)	(-3.011)	(0.415)	(-1.714)
BM	0.009	0.006	-0.004	-0.008
	(1.345)	(0.803)	(-0.460)	(-0.726)
ROA	0.017	0.032	0.011	0.018
	(0.755)	(1.452)	(0.375)	(0.580)
Altman_Z	-0.003	-0.007***	-0.000	0.002
	(-1.424)	(-3.098)	(-0.102)	(0.616)
Size	0.002	0.005	0.020***	0.021**
	(0.412)	(1.009)	(2.749)	(2.280)
OCF	0.073**	0.033	-0.005	-0.057
	(2.346)	(1.081)	(-0.126)	(-1.339)
fiscal_month	-0.050***	-0.048***	-0.024*	0.001
	(-4.881)	(-4.727)	(-1.716)	(0.076)
ln_AF	0.000	0.026***	-0.006	0.001
	(0.001)	(3.289)	(-0.394)	(0.077)
ln_NAF	0.002**	-0.000	0.003*	0.003*
	(2.504)	(-0.240)	(1.923)	(1.779)
Auditor_Tenure	-0.022	-0.015	-0.037*	-0.006
	(-1.486)	(-0.845)	(-1.772)	(-0.210)
Influence	-0.078	0.010	0.092	0.027
	(-0.979)	(0.123)	(1.090)	(0.270)
Clients	0.000	0.000	0.002**	0.001
	(0.761)	(0.171)	(1.996)	(0.322)
Office Size	-0.016**	-0.007	-0.007	0.007
	(-1.997)	(-0.471)	(-0.437)	(0.282)
M_A	0.007	0.001	0.002	0.002
	(0.922)	(0.094)	(0.141)	(0.140)
City_Industry_Expert	0.023**	0.013	0.032**	0.031
	(2.143)	(1.302)	(2.061)	(1.500)
Foreign	-0.001	0.005	-0.034**	-0.028
	(-0.134)	(0.489)	(-2.340)	(-1.528)
Liquidity	-0.006***	-0.001	-0.005***	-0.004**
	(-4.466)	(-0.857)	(-3.158)	(-2.111)
Constant	0.420***	0.009	0.228	-0.075
	(3.964)	(0.035)	(1.253)	(-0.230)
Year FE	N	Y	N	Y
Industry FE	N	Y	N	Y
Audit Office FE	N	Y	N	Y
Observations	18,818	18,794	4,510	4,380
Adjusted R-squared	0.013	0.081	0.016	0.151

This table shows the effect of the distraction event on restatement announcements after splitting the sample into small and big sized offices based on total audit fees they earn. We construct quartiles and we assign big offices to the quartile with the highest audit fees. Small offices are assigned to all other quartiles. "Treated" is a dummy variable that takes the value of one if the audit-client firm office is in a different city as compared to the audit-office and zero otherwise. Columns (1) and (2) show the results on the small size offices and columns (3) and (4) of the big size offices. Fixed effects are as indicated. Clustering of standard errors is at the audit office level. T-statistics are reported in parentheses. An asterisk indicates significance at the 10% level; two indicate significance at the 5% level; three indicate significance at the 1% level.

Table 10: Effect of distraction event on discretionary accruals

	Non-Acc Lawsuit	Non-Acc Class action	FJC	M&A	IPO
Dependent variables: Abs(DA) Jones	(1)	(2)	(3)	(4)	(5)
Treated X Distraction Year	0.005**	0.005**	0.004**	0.004***	0.006***
	(2.285)	(2.332)	(2.154)	(2.607)	(2.601)
Lag Controls	Y	Y	Y	Y	Y
Year FE	Y	Y	Y	Y	Y
Industry FE	Y	Y	Y	Y	Y
Audit Office FE	Y	Y	Y	Y	Y
Observations	19,466	14,780	23,096	38,236	13,235
Adjusted R-squared	0.005	-0.002	0.006	0.012	0.009

This table shows the effect of the distraction event on earnings management. The dependent variable is the absolute value of discretionary accruals using the modified Jones model (1991) and as it was further modified by Kothari et al. [2005]. Fixed effects are as indicated. Clustering of standard errors is at the audit office level. T-statistics are reported in parentheses. An asterisk indicates significance at the 10% level; two indicate significance at the 5% level; three indicate significance at the 1% level.

Table 11: Effort made to the sued firms

Dependent Variables: ln_AF	(1)	(2)	(3)
Sued_Firm	0.097***	0.082***	0.051***
	(9.052)	(9.658)	(8.339)
Sales_Growth	-0.041***	-0.026***	-0.007*
	(-6.582)	(-5.259)	(-1.927)
PPE_Growth	-0.021***	-0.036***	-0.019***
	(-3.978)	(-8.055)	(-5.218)
Loss	0.069***	0.058***	0.024***
	(6.401)	(6.541)	(3.505)
Leverage	-0.002	0.002**	0.001
	(-1.236)	(2.091)	(0.556)
Return	0.003	0.009***	0.002
	(0.889)	(3.389)	(0.990)
Big_N	-0.390***	-0.122***	-0.069*
	(-13.575)	(-3.254)	(-1.853)
BM	-0.084***	-0.033***	-0.006
	(-10.769)	(-5.230)	(-0.933)
ROA	-0.042*	-0.152***	-0.133***
	(-1.818)	(-6.901)	(-6.812)
Altman_Z	-0.015***	-0.008***	-0.009***
	(-5.815)	(-3.479)	(-3.727)
Size	0.363***	0.373***	0.309***
	(53.626)	(56.923)	(38.477)
OCF	-0.192***	-0.066**	0.012
	(-5.183)	(-2.313)	(0.469)
fiscal_month	0.015	0.062***	0.088**
	(1.205)	(5.574)	(2.005)
ln_AF	-0.002*	0.009***	0.003**
	(-1.804)	(7.764)	(2.309)
ln_NAF	0.228***	0.103***	0.146***
	(9.386)	(5.688)	(6.883)
Auditor_Tenure	1.824***	1.750***	1.534***
	(38.213)	(30.714)	(30.011)
Influence	-0.003***	-0.001***	-0.001***
	(-6.410)	(-3.316)	(-2.880)
Clients	0.442***	0.370***	0.362***
	(35.479)	(23.322)	(21.693)
Office Size	0.107***	0.059***	0.015***
	(10.902)	(7.369)	(2.950)
M_A	0.076***	0.034***	-0.016
	(3.299)	(2.746)	(-1.148)
City_Industry_Expert	0.359***	0.226***	0.093***
	(21.324)	(19.140)	(7.397)
Foreign	-0.021***	-0.033***	-0.019***
	(-8.927)	(-20.012)	(-12.373)
Liquidity	3.748***	4.678***	5.277***
	(22.271)	(19.185)	(19.682)
Constant	N	Y	Y
	N	Y	N
Year FE	N	Y	Y
Industry FE	N	N	Y
Audit Office FE	53,816	53,616	52,878
Observations	0.821	0.873	0.922

This table shows the audit fees paid by the clients that are sued. The dependent variable is the natural logarithm of audit fees. Sued_Firm is a dummy variable that takes the value of one if the client is sued for a non accounting lawsuit, and zero otherwise. Fixed effects are as indicated. Clustering of standard errors is at the audit office level. T-statistics are reported in parentheses. An asterisk indicates significance at the 10% level; two indicate significance at the 5% level; three indicate significance at the 1% level.