Audit Committee Responsibilities and Implications for Legal Liability

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ABSTRACT:

This study investigates the audit committee responsibilities, compositional characteristics, and related disclosures that are associated with restatement-related litigation against U.S. audit committee members. While audit committee members are more likely than other board members to be named as defendants in class action litigation (Brochet and Srinivasan 2014), prior research has not explored the specific audit committee responsibilities and characteristics that are associated with this increased risk. Using a sample of restatement-related litigation in the U.S. over the period 1999-2012, we find that the likelihood of audit committee litigation is higher in the post-SOX time period when financial reporting and auditor oversight responsibilities were significantly increased. We also find that audit committee litigation risk is increasing in the severity of the restatement. Contrary to the perceptions of many officers and directors, audit committee chairs and financial experts are no more likely to be named as defendants than other audit committee members. However, serving on both the audit committee and the compensation committee increases litigation risk. Overall, our study supports concerns that increased audit committee responsibility post-SOX has resulted in higher litigation risk and implies that the recruiting and retention of audit committee members may become more difficult.

Keywords: audit committee litigation, financial statement restatements, financial expertise

Data Availability: All data is publicly available from sources identified in the study.

JEL Codes: K22, K41, M40, M48

Audit Committee Responsibilities and Implications for Legal Liability

1. Introduction

The responsibility of audit committees to ensure high-quality financial reporting has significantly increased in the United States in the last fifteen years following rules and regulations implemented by the SEC, stock exchanges, and the Sarbanes-Oxley Act (SOX) of 2002 (Beasley, Carcello, Hermanson and Neal 2009; NYSE 2004; SOX 2002; Blue Ribbon Committee 1999). In particular, these regulations have changed the audit committee's composition, increased audit committee disclosure requirements and assigned the audit committee full responsibility for hiring, compensating, and overseeing work performed by the external audit firm. In addition, the audit committee is now responsible for handling complaints related to accounting, internal control, and auditing matters.

These additional audit committee regulations were intended to strengthen audit committee independence and oversight of financial reporting and evidence suggests that audit committee effectiveness in the U.S. has improved (Pandit et al. 2005, Hanson 2013). However, the increased responsibility could also result in greater audit committee legal liability, thereby reducing the pool of qualified candidates willing to serve (e.g., Linck, Netter and Yang 2009; Veasey 2005). In addition to the increase in oversight duties, the increase in disclosures related to audit committee responsibilities may make the audit committee's responsibility for financial reporting failures more salient and provide a roadmap for plaintiffs' attorneys to argue that the audit committee failed to fulfill these duties. Further, due to investors' and regulators' increased focus on disclosures related to internal controls over financial reporting (ICFR), assigning ICFR oversight responsibility to the audit committee could increase the perception that the audit committee is partially responsible for a financial reporting failure that is coupled with a disclosed

internal control failure. In this study, we investigate factors, including audit committee responsibilities, audit committee-related disclosures, and compositional characteristics, which could expose audit committees, and their members, to restatement-related litigation.

Prior to 2001, director and officer insurance policies typically protected directors from personal monetary penalties. However, the potential for audit committee legal liability was made more salient when the WorldCom and Enron directors settled claims and had to pay out-of-pocket damages following disclosed instances of fraud in 2001 and 2002 (Veasey 2005). Due to these highly visible cases, plaintiffs and their lawyers may now believe the likelihood of success at trial is higher when pursuing litigation against audit committee defendants. In addition, investors' expectations of audit committee members' responsibility for financial reporting oversight increased following the WorldCom and Enron cases. For example, Leone (2002) notes that "several institutional investors now want audit committees to examine off-balance-sheet transactions and special purpose entities, as well as decipher those complicated footnotes." As a result, litigants may now perceive that audit committees play a greater role in the financial reporting process and this belief could, in turn, increase the perceived strength of case against the audit committee in the event of a financial reporting failure.

On the other hand, there are reasons to believe that increasing the responsibilities of the audit committee will not increase audit committee legal liability. First, from a legal perspective, audit committee obligations to the company and its shareholders, including the audit committee's duties of loyalty, care, obedience, and disclosure to a company and its shareholders, have not changed following these recent regulations (Waldron 2014). In addition, increasing the diligence and expertise of the audit committee could result in greater perceived audit committee effectiveness or perceived proactivity in investigating and resolving financial reporting issues.

Furthermore, for the audit committee member designated as a financial expert, the SEC stated that such designation is not intended to increase legal liability (SEC Release Nos. 33-8177; 34-47235, 2003). Finally, under Section 301 of the Sarbanes-Oxley Act, the audit committee has the authority to engage independent counsel when they deem it necessary to fulfill their responsibilities, which may provide evidence that they are fulfilling their fiduciary duties.

Our study first investigates factors that expose audit committees, as a whole, to litigation following restatements disclosed from January 1, 1999 to December 31, 2012. We focus our analysis on lawsuits filed subsequent to restatement announcements because the audit committee's primary responsibility is financial reporting and auditor oversight. Thus, when a prior material misstatement is revealed, investors may perceive that the audit committee failed in its fiduciary duties. Specifically, for a sample of 212 restatement-related lawsuits, we examine whether the likelihood of an audit committee member being named as a defendant is greater in the post-SOX period and is associated with (1) audit committee-related disclosures included in SEC company filings and (2) the magnitude and severity of the restatement.

Second, our study investigates whether and why certain individual audit committee members are exposed to greater restatement-related litigation risk than other audit committee members. In particular, we examine whether the audit committee chair or the designated "financial expert" faces a greater likelihood of being named as a defendant in restatement-related litigation, despite the claim that such responsibilities should not result in greater legal liability. In addition, we examine whether audit committee members also serving on the compensation committee, as disclosed in the proxy statement, face greater litigation exposure. To perform the director-level analysis, we identify all directors serving on the audit committee during the class

action period using proxy statements. For the 212 unique complaints, we identify a total of 902 audit committee members.

We find that, at the company level, at least one audit committee member is named as a defendant in forty percent of restatement-related class action lawsuits in our sample. In multivariate analysis, we find that the likelihood of at least one audit committee member being named a defendant is significantly higher in the post-SOX period. In addition, the naming of an audit committee member is more likely when the restatement is due to stock option backdating. When we exclude the stock option backdating cases at the firm level, we find that an audit committee member is more likely to be named for more severe restatements as measured by a more negative drop in stock price, and also when the restatement relates to a registration statement. We do not find any evidence that disclosures of audit committee responsibilities such as charters, investigations, and the number of meetings are associated with the likelihood of being named a defendant.

At the individual director level, we do not find any evidence that the audit committee chair or the designated financial expert face a greater likelihood of being named a defendant relative to other audit committee members. Thus, we do not find any evidence to support concerns that investors and plaintiffs' attorneys hold those directors to a higher standard in the event of a financial statement restatement. We do however find evidence that an audit committee member who also serves on the compensation committee is more likely to be named as a defendant, even in the non-stock option backdating cases. To the extent that serving on the compensation committee is perceived as a competing role (e.g. determining the compensation mix that may have incentivized management to misstate results), the requirement to disclose other committee involvement may have resulted in increased litigation exposure.

Overall, our results support the notion that audit committee members face increased litigation risk in the post-SOX period after controlling for audit committee disclosures, restatement severity and other firm-specific characteristics. This finding suggests that greater awareness exists of the audit committee's role in the financial reporting process and that such awareness, in turn, increases the perceived strength of a case against the audit committee in the event of a financial reporting failure. We also find that audit committee litigation risk is greater when a restatement results from stock option backdating or results in a more significant loss in wealth at the time of the restatement announcement. In other words, audit committees are held accountable for failure to diligently fulfill their financial reporting oversight responsibilities. Our findings at the individual director level suggest that audit committee chairs and financial experts do not face a greater risk of litigation relative to other audit committee members; however serving on the both the audit committee and the compensation committee increases the likelihood of being named a defendant. It is important to note that our results relate to litigation that arises following a financial statement restatement. We are unable to provide evidence on whether audit committee litigation risk, in general, has increased post-SOX.

Our findings are relevant to boards of directors concerned with legal liability and the public interest. To the extent that the threat of greater legal liability, or reputational damages, results in fewer individuals being willing to serve in the audit committee's oversight role, companies could experience difficulty recruiting and maintaining qualified directors to serve. Our results also suggest that there is variation in the likelihood of litigation against individual audit committee members both across and within firms. This finding suggests that some audit committee members could require greater compensation to bear this increased litigation risk. While Brochet and Srinivasan (2014) report that audit committee members are more likely to be

named as defendants in securities class action lawsuits, our study identifies the specific responsibilities of the audit committee and its individual directors that are associated with this increased risk. This innovation is important given concerns that audit committee financial experts or chairs may face greater liability than other audit committee members. Our preliminary results suggest that the SEC's adoption of a safe harbor from increased liability for audit committee financial experts has sheltered audit committee financial experts from liability.

The remainder of our study is organized as follows. In section 2 we discuss corporate governance reforms related to the audit committee, as well as prior research, and then develop our hypotheses. In section 3, we discuss our data and method of testing. Results are discussed in section 4, and we provide a discussion of our findings and conclusion in section 5.

2. Institutional background, prior research and hypotheses

In this section, we first discuss the composition and responsibilities of the audit committee and how these have changed following the Sarbanes-Oxley Act of 2002 (SOX). We classify audit committee characteristics and responsibilities into the following broad categories: (1) general responsibilities; (2) independence and expertise, and (3) financial reporting and auditor oversight.[1] We then discuss how the audit committee composition and responsibilities could impact perceptions about culpability in the event of a financial statement restatement, and develop our hypotheses related to the likelihood of audit committee members being named as defendants in a restatement-related lawsuit.

[1] These roles are similar to the post-SOX audit committee duties noted by Buchalter and Yokomoto (2006), which include adopting an audit committee charter; monitoring the financial reporting process; hiring, compensating and overseeing the external auditor; and interacting with top management. Carcello et al. (2002) classify the duties and responsibilities of audit committees as generally disclosed in audit committee charters and reports as follows: (1) general audit committee issues and duties; (2) audit committee size, meetings and composition; (3) audit committee member independence, financial literacy and financial expertise, (4) financial reporting oversight; and (5) auditor oversight.

2.1 Audit committee composition and responsibilities

The audit committee's general responsibilities include adopting and disclosing an audit committee charter, as well as having regular meetings in order to oversee the company's financial reporting, code of conduct or ethics, and related compliance programs. The SEC requires an audit committee to adopt and disclose an audit committee charter at least once every three years (SEC 1999a, 1999b, 1999c). The audit committee charter governs the operations of the audit committee and sets forth the audit committee's general duties and responsibilities. In addition, the SEC requires a report of the audit committee in the proxy statement indicating whether or not they fulfilled their duties (SEC 1999a). As a result of SOX Section 301, the audit committee's general duties were expanded to include investigative rights and the ability of the audit committee to engage independent counsel or other advisors to fulfill such investigative duties.

The composition of the audit committee also changed following the passage of SOX which imposed stricter audit committee independence and financial expertise requirements. While audit committee independence was encouraged prior to SOX, Section 301 of SOX requires a fully independent audit committee. In addition, Section 407 of SOX requires that a company disclose whether or not there is a financial expert on the audit committee, and if not, discuss the reasons why there is no expert. Subsequent to this SOX-imposed disclosure requirement, the stock exchanges in turn implemented new rules requiring that at least one member of the audit committee have accounting or related financial management expertise, as interpreted by the board (e.g. NYSE 2004). Interestingly, Linck et al. (2008) find that not only are there more financial experts serving on boards following SOX, but there are also more

lawyers serving as directors, as opposed to executives from other companies. Linck et al. (2008) suggest the increase in lawyers may be due to the increased legal liability faced by board members.

Finally, and most significantly, financial reporting and auditor oversight responsibilities of the audit committee increased post-SOX. Oversight of the financial reporting process now requires the audit committee to monitor internal controls over financial reporting, the company's risk assessment process, and to be informed by the auditor about the critical accounting policies. Section 301 gave the audit committee direct responsibility for the appointment, compensation and oversight of the external auditor and also requires the audit committee to be directly responsible for receiving and handling complaints regarding internal controls, accounting , or auditing matters.[2]

In the next section, we discuss how the financial reporting and auditor oversight roles and responsibilities are likely to affect investor perceptions about audit committee members' culpability following a financial reporting failure (i.e., restatement). Understanding audit committee members' perceived legal liability is important due to concerns that the additional responsibilities resulting from SOX increased the liability exposure of audit committee members which could, in turn, decrease the pool of qualified board members willing to serve in this important oversight role.

2.2 Legal liability, investor perceptions, and development of hypotheses

2.2.1 Legal liability of audit committees

[2] Carcello et al. (2002) note that 91% of the audit committee charters in their sample state the audit committee is responsible for reviewing internal controls. In addition, audit committee responsibilities related to internal controls have increased as a result of external auditor requirements. For example, PCAOB Auditing Standards Nos. 2 and 5 require the independent auditors to discuss significant deficiencies and material weaknesses with the audit committee. Thus, the audit committee is at least indirectly involved with the determination of whether a control deficiency is a significant deficiency or a material weakness.

Under company law, audit committees have fiduciary duties to the company and shareholders that include the duty of care, duty of loyalty, and duty to make informed judgments. When a financial statement restatement is announced, investors and their attorneys can initiate litigation against the audit committee if they believe they can present a convincing case that the audit committee failed in its fiduciary duties to oversee financial reporting. In assessing whether or not to initiate litigation, investors' attorneys will assess the likelihood of success at trial and the perceived strength of the case against the defendant (Priest and Klein 1984). Because financial reporting failures suffer from joint causation (i.e., multiple party involvement), plaintiffs can hold audit committees liable, even if the audit committee was not primarily at fault, if plaintiffs perceive that the audit committee violated its fiduciary duties. The recent mandated increase in audit committee responsibility, new compositional requirements, and additional audit committee disclosures may increase litigants' perception that financial restatements are the result of the audit committee failing in its fiduciary duties.

Prior research has examined the likelihood of directors being named as defendants in a lawsuit. Brochet and Srinivasan (2013) document that independent directors are named as defendants in approximately 11% of class action lawsuits in a sample of litigation over the 1996-2010 time period, and the likelihood of being named a defendant is higher for audit committee members relative to other independent directors. However, Black, Cheffins and Klausner (2006) note that, while outside directors are frequently named as defendants in corporate or securities lawsuits and are frequently parties to a settlement, they rarely pay out-of-pocket costs because the costs are covered by the company or directors' and officers' liability insurance. In the last decade however, there have been cases resulting in substantial payments made by directors out

of their own pockets, possibly indicating that present-day directors may suffer significant loss of wealth in the event of a lawsuit (Linck et al. 2008).

The increase in audit committee responsibilities post-SOX has led to a concern that qualified individuals will be reluctant to serve on audit committees due to potential legal liability and/or reputation damage. For example, Leone (2002) quotes a CFO and former audit committee member as stating "recruiting directors for the audit committee is like calling them on deck for a kamikaze attack." While increasing the liability of the audit committee members may result in them being more diligent in their financial reporting oversight role (Cohen, Krishnamoorthy and Wright 2010), Black, Cheffins and Klausner (2006) argue that directors already have sufficient incentives to fulfill their duties. Specifically, share ownership, personal reputation, social norms, and the potential hassle of litigation, even if they do not pay out-of-pocket litigation costs, could be sufficient to induce high quality audit committee performance.

2.2.2 Investor perceptions and development of hypotheses

In the event of a financial statement restatement, investors will assess whether various parties, including the audit committee, were negligent or reckless in fulfilling their fiduciary duties. While the audit committee's general responsibility for financial reporting oversight did not change following SOX, the legislation increased and clarified the audit committee's financial reporting oversight role thereby potentially informing the court of the specific and appropriate standard of care to be provided by the audit committee. In addition, disclosures related to the audit committee's new responsibilities and compositional changes may have made the committee's role more salient and thus increased litigation risk for audit committee members. In fact, Linck et al. (2008) report that median director and officer insurance premiums increased

more than 150% from the pre- to post-SOX period, consistent with an increase in director liability following SOX.[3] Thus, we pose our first hypothesis at the company level as follows:

H1: The likelihood that an audit committee member is named as a defendant in a lawsuit is greater in the post-SOX period relative to the pre-SOX period.

Our next hypothesis relates to specific audit committee disclosures regarding audit committee activity that may increase the perception that an audit committee failed to fulfill its oversight role. While evidence of an engaged audit committee could be perceived as diligence, it could also be perceived as negligence if one believes the audit committee should have prevented the financial statement misstatement in the first place.

The first disclosure we consider is the requirement that the audit committee disclose their charter at least once every three years. Disclosing an audit committee charter that details the duties and responsibilities of the audit committee may provide plaintiffs' attorneys with a "roadmap" to argue the committee did not fulfill these duties. In particular, Carcello et al. (2002, 292) note "tremendous concern over the potential liability risk" that could arise from disclosing audit committee charters, suggesting that audit committee charter disclosures could be associated with higher risk of litigation against an audit committee member. However, Carcello et al. (2002) also note that liability concerns often result in the use of boilerplate language in the charters and reports, suggesting that the charter disclosure may have an opposite effect on litigation risk. Second, we consider the audit committee's annual reporting of meeting frequency. A large number of audit committee meetings may be viewed as evidence of audit committee diligence if plaintiffs perceive that the audit committee was actively attempting to prevent or correct the financial reporting failure. On the other hand, a large number of meetings could

[3] Linck, Netter and Yang's (2008) conclusions related to increases in legal liability are based on the subsample of companies that disclose Director and Officer insurance premiums.

indicate audit committee ineffectiveness if the audit committee was still unable to prevent the financial reporting failure.

Finally, we consider disclosures announcing the initiation of audit committee investigations. It is not clear whether the disclosed initiation of an investigation will increase or decrease the likelihood of audit committee litigation in the event of restatement-related litigation. On the one hand, if the audit committee oversees an investigation related to financial reporting matters, this may be viewed as fulfilling their investigative responsibilities and result in a lower likelihood of litigation. On the other hand, it is possible that an investigation is an acknowledgement of problems that the audit committee failed to prevent or discover on a timely basis, thereby resulting in an increase in the likelihood of litigation. For example, Files (2012) finds that firms conducting an independent investigation into a restatement are more likely to be sanctioned by the SEC but incur lower monetary penalties. Because it is unclear whether observable audit committee activity increases or decreases the risk of litigation, we state our hypothesis in the null form.

H2: Ceteris paribus, disclosures related to audit committee duties are not associated with the likelihood that an audit committee member is named as a defendant in a restatement-related lawsuit.

Our final hypothesis at the company level relates to the audit committee's financial reporting oversight role. We expect the likelihood of at least one audit committee member being named as a defendant in a restatement-related lawsuit to be increasing in the severity and magnitude of the restatement. Restatements involving fraud, revenue recognition issues, having a greater financial statement impact or extending for a longer period of time could increase the perception that the audit committee failed in their financial reporting oversight role. Accordingly, our final hypothesis related to financial reporting is as follows.

H3: Ceteris paribus, the likelihood that an audit committee member is named as a defendant in a restatement-related lawsuit is increasing in the severity of the restatement.

Our hypotheses above are all at the company level and investigate whether at least one audit committee member is named as a defendant. Next, we consider factors that affect whether certain individual audit committee members face greater exposure to restatement-related litigation risk than other audit committee members because, if so, the board of directors may need to compensate these directors for bearing this additional risk. For example, the audit committee chair, as the "CEO of the audit committee" (Ernst and Young 2011) and the "focal point for the committee's relations with the board, the CFO, and the internal and external auditors" (PricewaterhouseCoopers 2003) is the member who has the greatest responsibility for overseeing the company's financial reporting process. The audit committee chair also has the right to represent the entire audit committee in certain circumstances (e.g. in interim reporting matters) (Carcello et al. 2002), and thus may be exposed to greater legal liability.

In addition, the audit committee "financial expert" could be held to a higher standard of care than other audit committee members due to his/her additional skills and knowledge. For example, Leone (2002) notes that many companies were searching for audit committee financial experts who could assess off-balance-sheet transactions in the wake of Enron, suggesting that many companies expected a high level of expertise and monitoring from designated "financial experts." In response to expressed legal liability concerns to the SEC's original "financial expert" proposal, the SEC specifically states that designating an individual as a financial expert is not meant to increase their liability beyond that of any other directors, and that the individual is not considered an expert by legal definitions (Asare, Cunningham and Wright 2007). The question remains, however, whether courts would hold a "financial expert" to a higher "duty of

care" than other audit committee members. For these reasons, we propose that audit committee chairs and audit committee financial experts may face greater legal liability than other audit committee members.

H4: The likelihood that the audit committee chair is named as a defendant in a lawsuit is greater relative to other audit committee members.

H5: The likelihood that the financial expert member of the audit committee is named as a defendant in a lawsuit is greater relative to other audit committee members.

Given the requirements that compensation committees and nominating committees also consist of independent directors (Linck et al. 2009; SEC Release Nos. 34-48745), it is often the case that the independent directors serving on the audit committee also serve on one or more other committees. Linck et al. (2009) note the percentage of directors serving on all three of the audit, compensation and nominating committees has increased post-SOX. Specifically, they report that 9% of the independent directors in their sample serve on all three committees in 2005 as compared to 1.5% in 1998, and that the percentage is higher for small firms who have fewer independent directors. Involvement on other board committees may result in increased legal liability for audit committee members. On one hand, plaintiffs may view directors' involvement on other committees as a conflict of interest with their financial reporting and auditor oversight roles, or as indicating a lack of independence. In addition, serving on several committees could increase the perceived responsibility of the board member for preventing the misstatement. In particular, audit committee members who serve on the compensation committee could be perceived as enabling the financial reporting failure to occur because these directors were responsible for determining the CEOs compensation that may have incentivized the fraud. On the other hand, serving on additional committees may improve audit committee performance in fulfilling their roles as directors. For example, Laux and Laux (2008) conclude that

compensation committees whose members also serve on the audit committee reduce CEO equity compensation to lower litigation risk and reduce the extent of required monitoring in their roles as audit committee members. Despite the arguments to the contrary, we argue the perception of a lack of independence will increase legal liability and thus we pose Hypothesis 6 as follows.

H6: The likelihood of an audit committee member who serves on the compensation committee being named as a defendant in a restatement-related lawsuit is greater relative to audit committee members who do not serve on the compensation committee.

3. Research Design

3.1 Sample Selection

To construct our sample, we identify all U.S. class action litigation arising from restatements disclosed between January 1, 1999 and December 31, 2012. We focus on restatement-related litigation because financial restatements relate closely to the audit committee's responsibility for financial reporting and auditor oversight whereas securities class action litigation due to, for example, an unprofitable merger or insider trading, does not directly call into question the audit committee's fiduciary responsibilities to shareholders. We begin the restatement sample in 1999 because this is the first year that the U.S. stock exchanges (NYSE, AMEX, and NASDAQ) required issuer firms to appoint an audit committee. We end the sample in 2012 because this was the last year of available data at the time we compiled the sample.

We use Audit Analytics to identify all restatements disclosed between January 1, 2000 and December 31, 2012 and the Government Accountability Office (GAO) restatement database to identify restatements announced in 1999. We use two procedures to identify restatements resulting in class action litigation. For restatements announced between 2000 and 2012, we use the Audit Analytics litigation module to identify securities class action litigation filed within 90

days of a restatement announcement. For restatements announced in 1999, we search the Stanford Securities Class Action Database for complaints filed within 90 days of the restatement announcement.[4] We identify 313 complaints based on these procedures. We then reviewed the court complaints in the Stanford Class Action database for all 313 cases and eliminate 28 complaints that were not directly related to the restatement, five complaints because we could not locate the court documents, and one complaint because the document files in the Stanford Class Action database are corrupted and not readable. We eliminate 62 complaints missing data to calculate the independent variables. Finally, the sample size decreases by five restatements where the complaint includes two restatements announced by the same firm within a short time period. The final sample of restatement-related litigation equals 212 complaints.

3.2 Multivariate Models

3.2.1. Firm Level Analysis

We conduct our analysis at the firm level to test Hypotheses 1 through 3. In the firm-level model, we estimate a logistic regression model where the dependent variable equals one if the court complaint or court docket names at least one audit committee member as a defendant (*AC_DEFEND*), and zero otherwise.[5] Model 1 is as follows:

$$\Pr(AC_DEFEND=1) = \alpha + \beta_1 POST_SOX + \beta_2 CHARTER + \beta_3 MEETINGS + \beta_4 INVESTIG + \beta_{5\text{-}10}\, Restatement\ Severity + \beta_{11\text{-}15} CONTROLS + \varepsilon$$

[4] We assume that litigation filed after 90 days is unrelated to the restatement announcement because most restatement-related litigation is filed soon after the restatement announcement. (Rogers and Van Buskirk 2009; Bardos et al. 2013)

[5] The defendants are identified by name, but not always identified in the court complaint as a member of the audit committee. After reviewing all complaint documents, we find 27 complaints that name an audit committee member without specifying that the named defendant served on the audit committee.

To test our hypothesis that the likelihood of audit committee litigation is higher in the post-SOX period (H1), we include an indicator variable that equals one if the restatement announcement is made in 2004 or later (*POST-SOX*). We begin the post-SOX period in 2004 because public companies were required to be in compliance with the new audit committee requirements under SOX as of the earlier of the first annual shareholders meeting after January 15, 2004 or October 31, 2004 (SEC 2003a). We expect a positive coefficient for *POST-SOX*.

We include three measures to test Hypothesis 2 examining whether audit committee disclosures are associated with the likelihood of litigation. First, we include an indicator variable equal to one if the firm disclosed an audit committee charter during the misstated period and equal to zero otherwise (*CHARTER*). Second, we include the number of audit committee meetings in the last misstated year, as reported in the firm's proxy statement (*MEETINGS*) as a measure of audit committee diligence. While more frequent meetings may reflect a diligent audit committee and could be associated with a lower likelihood of litigation, frequent meetings could indicate that the audit committee was aware of ongoing financial reporting problems. Third, to test whether an audit committee investigation is associated with the likelihood of audit committee litigation, we set an indicator variable equal to one if the firm's restatement announcement discloses an investigation (*INVESTIG*) and equals zero if the firm discloses no investigation.[6]

To test Hypothesis 3, we include several measures of restatement severity because audit committee culpability is likely perceived to be higher following a more severe financial reporting oversight failure. First, it is possible that the likelihood of audit committee litigation is higher when the restatement involved fraudulent financial reporting. For this reason, we include an

[6] Our inferences are not sensitive to excluding investigations that do not specifically assign responsibility for the investigation to the audit committee.

indicator variable equal to one if the restatement is classified as resulting from a fraud in the Audit Analytics database.[7] We also include five controls for restatement severity following Palmrose et al. (2004) and Palmrose and Scholz (2004): 1) the number of accounts misstated (*NUM_ACCTS*); 2) the natural log of the misstated time period in days (*LnLENGTH*); 3) an indicator variable equal to one if the restated accounts included revenue (*REVENUE*); 4) an indicator variable equal to one if the restatement corrected misstatements arising due to stock option backdating (*BACKDATE*); and 5) three day (-1, 1) cumulative abnormal returns surrounding the restatement announcement date calculated as the firm return less the CRSP value-weighted return (*CAR*). All restatement severity measures are calculated using Audit Analytics data or hand collected from restated filings for the firm-years prior to Audit Analytics data availability (i.e. the GAO sample).

Finally, we include several control variables in the model. We control for audit committee independence by setting an indicator variable equal to one if all directors serving on the audit committee in the last misstated period are outside directors (*AC_INDEP*), and zero otherwise. A lack of independence on the committee may be perceived as a violation of fiduciary duties, even prior to the requirement that the audit committee consist entirely of independent directors. In addition, prior to the fully-independent audit committee requirement, company insiders serving on the audit committee may be more likely to be named as defendants due to their other responsibilities, such as the CEO or CFO, that would be perceived as impairing their ability to fulfill their oversight responsibilities. Next, because the likelihood of audit committee litigation could be higher when the independent auditor is named as a defendant, we include an indicator variable equal to one if the firm's external auditor is named as a defendant in the

[7] For restatements announced in 1999, we set *FRAUD* equal to one if Hennes et al. (2008) categorize the restatement as an irregularity.

complaint (*AUDITOR_NAMED*). Because prior studies indicate that litigation is more likely for defendants with "deep pockets" (i.e., Lennox 2003), we control for firm size using the natural log of the market value of equity (*LnMVE*). We also include an indicator variable equal to one if the firm is a foreign issuer (*FOREIGN*) and an indicator variable equal to one if the complaint mentions a registration statement (*REGISTRATION*) due to greater plaintiff legal liability under the 1933 Securities and Exchange Act. Finally, we include industry indicator variables to control for litigation-prone industries and cluster standard errors by firm to control for within-sample correlation among observations for firms subject to multiple complaints during the sample period.

3.2.2. Director Level Analysis

To perform the director-level analysis and test Hypotheses 4 through 6, we use company proxy statements to identify all directors serving on the audit committee during the class action period. We identify a total of 927 audit committee members serving during the class period from the 212 firm-level complaints. We exclude 25 directors because a small number of firms did not file proxy statements in all sample years and we could not identify what percent of the class period the director served, leaving a final sample of 902 audit committee members.

We estimate a logistic regression model where the dependent variable equals one if the individual director is named as a defendant in the complaint or in the court docket and equals zero otherwise (*DIR_NAMED*). We estimate Model 2 as follows:

$$\Pr(DIR_NAMED = 1) = \alpha + \beta_1 POST_SOX + \beta_2 AC_CHAIR + \beta_3 FIN_EXPERT + \beta_4 CC_COMM + \beta_{5\text{-}7} AuditCommitteeCharacteristics + \beta_{8\text{-}12} RestatementSeverity + \beta_{13\text{-}16} CONTROLS + \varepsilon$$

Hypotheses 4 and 5 propose that audit committee chairs and financial experts face greater litigation risk than other directors. We set indicator variables equal to one if the individual director is identified as an audit committee chair (*AC_CHAIR*) or audit committee financial expert (*FIN_EXPERT*) during the class action period. Many firms disclose that a director serves as the chair or financial expert without identifying that director by name. For these firms, we set *AC_CHAIR* and/or *FIN_EXPERT* equal to zero and include additional untabulated indicator variables equal to one in Model 2 to control for these instances.[8] To test Hypothesis 6 proposing that audit committee members face increased litigation risk from serving on other board committees, we set an indicator variable equal to one if the director served on the compensation committee (*CC_COMM*) as reported in the proxy statements.[9]

We also include several additional control variables. Because selling shares during the class action period is associated with an increased likelihood of litigation, we include the number of net shares sold for each director as reported in Thomson Reuters (*NET_SHARES_SOLD*). We set *NET_SHARES_SOLD* equal to zero for directors who are not listed as trading shares during the class action period or for directors with net acquisitions during the class action period. We control for the percentage of the class action period during which the director served on the audit committee (*PERCENT_SERVED*).[10] We also include an indicator variable equal to one if the director is an outside or independent director *(DIR_INDEP).* Finally, we include all firm level variables in Model 1 to control for audit committee responsibilities, restatement severity and

[8] Our inferences are not sensitive to excluding observations where either the audit committee chair or financial expert is not identified by name in the proxy statements.
[9] While audit committee members may sit on multiple board committees, we focus on compensation committee membership because directors on the compensation committee are more likely to be held accountable in cases of option backdating (Ertimur et al. 2012). Thus, audit committee members may be more likely to be held liable when they were also directly responsible for setting executive compensation incentives for financial misreporting. In contrast, the link between nominating new directors to the board and responsibility for financial misreporting is indirect.
[10] We terminate the board tenure length if a director leaves the audit committee prior to the end of the class period.

firm-level controls except that we exclude *AC_INDEP* as we instead measure independence at the director level as noted above. Finally, we include industry indicator variables and cluster standard errors by firm.

4. Empirical Results

4.1 Descriptive Statistics

Table 2 presents descriptive statistics on the frequency of audit committee litigation and named audit committee defendants by year. Table 2, Panel A presents the number of restatements resulting in litigation and percentage of complaints naming at least one audit committee defendant by year. On average, 40 percent of restatement-related lawsuits name at least one audit committee member during the sample period. The percentage of complaints naming an audit committee defendant varies substantially by year, ranging from zero in 2012 to 75 percent in 2006. Figure 1 reports these statistics graphically, showing the number of class actions filed per year and the corresponding number of complaints that name at least one audit committee member. In general, these statistics indicate that audit committee members are commonly named as defendants in restatement-related litigation. Table 2, Panel B presents descriptive statistics for the individual directors serving on the audit committee during the class action period among firms where at least one audit committee member was named as a defendant. On average, 4.73 unique directors served on the audit committee during the class action period and 3.25 directors were named as defendants. In addition, 71 percent of audit committee members are named as defendants on average and in 42 percent of cases naming at least one audit committee member, all directors serving on the audit committee were named in the lawsuit.

Table 3 presents univariate tests of mean differences between complaints naming versus not naming audit committee defendants. Table 3, Panel A presents univariate statistics for the variables included in Model 1. A higher proportion of the complaints with at least one audit committee member named as a defendant are in the post-SOX period, consistent with the trend noted in Table 2. With respect to restatement severity, mean misstatement length is significantly longer when audit committee members are named as defendants ($p<0.05$) and stock option backdating allegations are significantly more likely ($p<0.01$) when audit committee members are named, however *REVENUE* is significantly lower when audit committee members are named as defendants. None of the audit committee disclosures or characteristics (*CHARTER*, *MEETINGS*, *INVESTIG*, *AC_INDEP*) are significantly different between the two groups. However, the auditor is significantly more likely to be named as a defendant when at least one audit committee member is named in the lawsuit. Finally, mean firm size is larger ($p<0.05$) and firms are more likely to have restated a registration statement ($p<0.01$) when audit committee members are named as defendants.

Table 3, Panel B presents descriptive and univariate statistics at the director level. *SHARES_SOLD* is significantly higher among directors named as defendants ($p<0.01$) as is *FIN_EXPERT* ($p<0.05$). We identify no other significant univariate differences between directors named versus not named as defendants.

4.2 Firm-Level Multivariate Analysis

Table 4 presents the results of estimating Model 1 examining litigation against audit committee members at the firm level. Column 1 presents coefficient estimates for the full sample of 212 observations and Column 2 presents coefficients for 181 observations which exclude stock option backdating allegations. We estimate the results separately without the stock option

backdating cases as these are unique cases involving board-level decisions that may not be representative of other financial statement restatement cases. The area under the receiver-operator curve (ROC) exceeds 0.70 in both models, indicating adequate model discrimination. Consistent with H1 which proposes that the likelihood of at least one audit committee member being named as a defendant is higher in the post-SOX period, the coefficient for *POST-SOX* is positive and significant in both columns. H2 examines whether audit committee disclosures are associated with the likelihood of litigation against an audit committee member. None of the variables of interest – *CHARTER*, *MEETINGS*, or *INVESTIGATION*, have statistically significant coefficients in Column 1 and only *CHARTER* is significant in Column 2 (negative, $p<0.10$). In general, these results suggest that audit committee liability for restatements is not associated with disclosed audit committee responsibilities at the firm level. With respect to restatement severity (Hypothesis 3), the coefficient for *BACKDATE* is positive and significant in Column 1 ($p<0.05$) but no other restatement severity measures have significant coefficients. Because this result suggests that at least one audit committee member is more likely to be named as a defendant in stock option backdating cases, and as noted above these cases may not be representative of other restatement-related litigation, we re-estimate Model 1 in Column 2 without backdating cases. After excluding backdating observations, the coefficient for *CAR* is negative and significant ($p<0.05$), indicating that audit committee members are significantly more likely to be named as defendants as the stock price reaction to a restatement announcement is more negative.

Finally, with respect to firm characteristics, firm size is associated with a higher likelihood that at least one audit committee member is named as a defendant in Column 1 ($p<0.10$) and in Column 2, the likelihood of an audit committee defendant is higher when the

lawsuit relates to a registration statement (*REGISTRATION*, p<0.10). This result is consistent with directors' higher standard of liability under the 1933 Exchange Act than the 1934 Act.

4.3 Director-level analysis

Table 5 presents the results of the director level analysis. Column 1 reports coefficient estimates including all observations, Column 2 presents coefficient estimates excluding observations with stock option backdating allegations, and Column 3 presents coefficient estimates for the post-SOX period only in order to test H5 related to financial experts since this disclosure was not required in the pre-SOX period. The model ROC in all three columns exceeds 0.70, indicating adequate discrimination. The coefficients for *POST_SOX* are positive and significant in both Columns 1 and 2, consistent with the inferences from Table 4 which indicate that audit committee members are more likely to be named as defendants in the post-SOX period.

Hypotheses 4 and 5 propose that the audit committee chair and financial expert are more likely to be named as defendants in class action litigation. The coefficients for *AC_CHAIR* and *FIN_EXPERT* are not statistically significant. While financial experts were more likely to be named as a defendant in univariate comparisons, after controlling for other director and firm characteristics, the difference is no longer significant. These results suggest that directors serving in these roles are no more or less likely to be perceived as responsible for a restatement. These findings stand in contrast to concerns that audit committee chairs and financial experts may be held to a higher liability standard by plaintiffs even though they bear no additional legal liability. Finally, consistent with Hypothesis 6, the coefficients for *CC_COMM* are positive and significant in all three columns, including in Column 2 when stock option backdating

observations are removed. This result suggests that audit committee members who also serve on the compensation committee are more likely to be perceived as liable for a restatement.

With respect to restatement severity, the coefficients for *CAR* are negative in Columns 1 and 2, again indicating that the likelihood of an individual audit committee member being named as a defendant is increasing in severity as measured by a more negative stock price reaction. Other restatement severity measures are not consistently significant across models. Finally, the coefficient for *NET_SHARES_SOLD* is positive and significant in all three columns ($p<0.05$), indicating that audit committee members with net selling activity during the class action period are significantly more likely to be named as defendants. Overall, these results suggest that individual audit committee members are significantly more likely to be named as defendants in class action litigation when they serve competing roles on the board of directors (i.e., both the audit committee and the compensation committee), when there is a more significant stock price drop, and when their insider trades of company stock put them in a net selling position during the class action period.

5. Conclusion

This study investigates the audit committee responsibilities, disclosures, and compositional characteristics that are associated with restatement-related litigation against audit committees and their members. While audit committee members are more likely to be named as defendants in class action litigation (Brochet and Sriviasan 2014), prior research has not explored the specific responsibilities that are associated with this increased risk. Using a sample of restatement-related litigation over the period 1999-2012, we find evidence to suggest that litigation risk has increased in the post-SOX period for audit committee members. Litigation risk is greater for restatements related to stock option backdating and when there is a more negative

stock price drop at the time of the restatement announcement, but is not associated with disclosures of audit committee responsibilities such as charters and investigations. Contrary to the perceptions of many officers and directors, we do not find any evidence to support the concern that audit committee chairs or financial experts will face greater litigation risk. However, we do find evidence that audit committee members also serving on the compensation committee face greater risk.

Our findings are relevant to current and prospective directors concerned with legal liability surrounding audit committee service. Of particular concern, the greater likelihood that audit committee members will be named as defendants could result in fewer individuals being willing to serve in the audit committee's oversight role, leading to difficulty recruiting and maintaining qualified directors to serve. While our results indicate that audit committee litigation has increased in the post-SOX period, our findings also suggest that there is variation in the likelihood of litigation against individual audit committee members both across and within firms. This finding suggests that some audit committee members could require greater compensation to bear this increased litigation risk. Our study also contributes to the literature on securities class action litigation by identifying the specific responsibilities of the audit committee and its individual directors that are associated with increased litigation risk. This innovation is important given concerns that audit committee financial experts or chairs may face greater liability than other audit committee members. Finally, our preliminary results suggest that the SEC's adoption of a safe harbor from increased liability for audit committee financial experts may be effective in protecting audit committee financial experts from liability.

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APPENDIX A

Variable Definitions

Dependent Variables

AC_DEFEND	Equals one if the court complaint or court docket names at least one audit committee member as a defendant, and zero otherwise
DIR_NAMED	Equals one if the individual director is named as a defendant in the court complaint or court docket, and zero otherwise

Independent Variables:

AC INDEP	Equals one if all directors serving on the audit committee in the last misstated period are outside directors, and zero otherwise
AUDITOR NAMED	Equals one if the firm's external auditor is named as a defendant in the court complaint or court docket, and zero otherwise
BACKDATE	Equals one if the restatement relates to stock option back-dating, and zero otherwise.
CAR	Equals the three-day cumulative abnormal return surrounding the restatement announcement date calculated as the firm return less the CRSP value-weighted return.
CHARTER	Equals one if the firm disclosed an audit committee charter during the misstated period, and zero otherwise
FIN_EXPERT	Equals one if the firm reports a designated financial expert during the class action period in the corresponding proxy statements, and zero otherwise.
FOREIGN	Equals one if the firm is a foreign issuer, and zero otherwise
FRAUD	Equals one if the restatement is classified as fraud in the Audit Analytics database, and zero otherwise
INVESTIG	Equals one if the firm's restatement announcement discloses and audit committee investigation and zero if the firm either discloses no investigation or discloses an investigation without assigning responsibility for the investigation to the audit committee.
LN_LENGTH	Equals the natural log of the misstated time period
LNMVE	Equals the natural log of the firm's market value of equity

MEETINGS	Equals the number of audit committee meeting held in the last misstated year
MW	Equals one if the firm disclosed a material weakness in internal control over financial reporting on the same day as the restatement announcement, and zero otherwise
NUM_ACCTS	Equals the number of misstated accounts according to the Audit Analytics database
POST-SOX	Equals one if the restatement is made in 2004 or later, and zero otherwise
REGISTRATION	Equals one if the complaint mentions a registration statement, and zero otherwise
REVENUE	Equals one if the restated accounts include revenue

Additional Independent Variables for Director-Level Analysis:

NET_SHARES_SOLD	Equals the number of net shares sold during the class action period in millions per Thomson Reuters and equals zero for directors with no reported transactions or with net acquisitions during the class action period.
CC_COMM	Equals one if the director served on the compensation committee as reported in the proxy statements, and zero otherwise.
AC_CHAIR	Equals one if the director serves as an audit committee chair during the class action period , and zero otherwise
FIN_EXPERT	Equals one if the director serves as an audit committee financial expert during the class action period, and zero otherwise
DIR_INDEP	Equals one if the director is an outside or independent director, and zero otherwise
PERCENT_SERVED	Equals the percentage of the class action period during which the director served on the audit committee

TABLE 1
Sample Selection

Restatements announced during 1999 – 2012 with litigation filed within 90 days of the announcement date	313
Less: Complaints unrelated to the restatement	(28)
Less: Missing or corrupted court documents	(6)
Less: Missing data in Compustat and CRSP	(62)
Less: Multiple restatements per complaint	(5)
Restatements in firm level analysis	212
Audit committee directors serving during the class action period	927
Less: Directors among firms with inadequate disclosure to collect director-level data	(25)
Audit committee directors in director-level analysis	902

TABLE 2
Descriptive Statistics at the Firm Level

Panel A: Firm level audit committee litigation by year

Restatement Disclosure Year	Number of restatements resulting in litigation	# Complaints Naming at least one Audit committee Member	% Complaints Naming at least one Audit committee Member
1999	26	12	46%
2000	5	1	20%
2001	9	4	44%
2002	17	7	41%
2003	20	6	30%
2004	27	2	7%
2005	21	9	43%
2006	32	24	75%
2007	16	7	43%
2008	15	5	33%
2009	12	5	41%
2010	2	1	50%
2011	7	2	28%
2012	3	0	0%
	212	85	40%

Panel B: Firm-level descriptive statistics among firms where at least one audit committee member was named

Average number of audit committee members named as defendants	3.25
Average number of audit committee members serving during the class action period	4.73
Average percent audit committee members named as defendants	71%
Percent of cases where 100% of audit committee members are named as defendants	42%

TABLE 3
Univariate Statistics at the Firm and Director Level

Panel A: Univariate Statistics of firm level variables

	AC_DEFEND=0		*AC_DEFEND*=1		
	Mean	Std. Dev.	Mean	Std. Dev.	Test Statistic
POST-SOX	0.433	0.497	0.624	0.487	**2.75*** **
CHARTER	0.724	0.449	0.694	0.464	0.48
MEETINGS	1.877	0.488	1.882	0.621	0.07
INVESTIG	0.465	0.501	0.471	0.502	0.09
FRAUD	0.134	0.342	0.129	0.338	0.09
NUM_ACCTS	2.409	1.498	2.553	1.367	0.71
LN_LENGTH	6.530	0.862	6.838	0.910	**2.49** **
REVENUE	0.575	0.496	0.424	0.497	**2.17** **
BACKDATE	0.071	0.258	0.259	0.441	**3.91*** **
CAR	-0.136	0.164	-0.165	0.189	1.15
AC INDEP	0.827	0.380	0.800	0.402	0.49
AUDITOR NAMED	0.220	0.416	0.435	0.499	**3.40*** **
LNMVE	6.503	1.604	7.094	1.918	**2.42** **
FOREIGN	0.031	0.175	0.071	0.258	1.32
REGISTRATION	0.165	0.373	0.318	0.468	**2.62*** **
MW	0.008	0.089	0.204	0.152	0.94
Obs	127		85		

Panel A: Univarate comparisons of director-level variables

	DIR_NAMED=0		*DIR_NAMED*=1		
	Mean	Std. Dev.	Mean	Std. Dev.	Test Statistic
AC_CHAIR	0.235	0.424	0.268	0.444	1.07
FIN_EXPERT	0.225	0.418	0.297	0.458	**2.31** **
CC_COMM	0.458	0.499	0.493	0.501	0.95
SHARES_SOLD	0.094	0.361	0.290	0.811	**5.04*** **
PERCENT SERVED	1.050	5.127	0.800	0.295	0.81
DIR_INDEP	0.872	0.334	0.859	0.349	0.55
Observations	626		276		

*** p<0.01, ** p<0.05. * p<0.10 based on two tailed tests. Refer to Appendix A for variable definitions.

TABLE 4

Logistic Regression Analysis – Firm Level

	Hypothesis	(1) All Obs *AC_DEFEND*	(2) Excluding backdating *AC_DEFEND*
POST-SOX	H1	1.089**	0.988*
		(2.167)	(1.860)
Audit Committee Disclosures			
CHARTER	H2	-0.815	-0.912*
		(-1.559)	(-1.754)
MEETINGS	H2	-0.803	-0.527
		(-1.609)	(-0.999)
INVESTIG	H2	-0.149	-0.441
		(-0.389)	(-1.066)
Restatement Severity			
FRAUD	H3	-0.199	0.160
		(-0.411)	(0.321)
NUM_ACCTS	H3	0.001	0.127
		(0.006)	(0.785)
LN_LENGTH	H3	0.394	0.342
		(1.463)	(1.199)
REVENUE	H3	-0.346	-0.151
		(-0.966)	(-0.404)
BACKDATE	H3	1.280**	
		(2.308)	
CAR	H3	-1.318	-2.466**
		(-1.284)	(-2.335)
Controls			
AC INDEP		-0.492	-0.532
		(-0.825)	(-0.909)
AUDITOR NAMED		0.641	0.570
		(1.618)	(1.277)
LNMVE		0.191*	0.155
		(1.681)	(1.220)
FOREIGN		0.966	0.922
		(1.264)	(1.270)
REGISTRATION		0.649	0.777*
		(1.557)	(1.714)
Constant		-3.657**	-3.673**
		(-2.194)	(-2.049)
Observations		212	181
ROC		0.794	0.777

***p<0.01, ** p<0.05, * p<0.10 based on two tailed tests. Z-statistics are presented in parentheses. See Appendix A for variable definitions. Standard errors are clustered by firm. Industry indicators are included but omitted for brevity.

TABLE 5

Logistic regression analysis – director level

	Hypothesis	(1) Full sample *DIR_NAMED*	(2) Excluding Backdating *DIR_NAMED*	(3) Post-SOX only *DIR_NAMED*
POST_SOX		0.739**	0.736*	
		(2.060)	(1.771)	
AC_CHAIR	H4	0.166	0.088	0.087
		(1.397)	(0.666)	(0.380)
FIN_EXPERT	H5			0.357
				(1.266)
CC_COMM	H6	0.359*	0.371*	0.515**
		(1.882)	(1.721)	(2.206)
Audit Committee Characteristics				
NET_SHARES_SOLD		0.494***	0.596***	0.668**
		(2.722)	(3.004)	(2.113)
PERCENT_SERVED		-0.015	0.014	-0.024*
		(-1.318)	(0.830)	(-1.899)
DIRINDEP		-0.465	-0.239	-0.501
		(-1.318)	(-0.389)	(-0.648)
Restatement Severity				
FRAUD		-0.417	-0.258	-0.191
		(-0.836)	(-0.507)	(-0.255)
NUM_ACCTS		-0.032	0.117	-0.087
		(-0.265)	(0.811)	(-0.587)
LN_LENGTH		0.317	0.236	0.526*
		(1.507)	(1.017)	(1.833)
REVENUE		-0.615*	-0.456	-0.615
		(-1.924)	(-1.306)	(-1.378)
BACKDATE		0.524		0.790
		(1.235)		(1.441)
CAR		-1.818*	-2.695**	-1.959
		(-1.790)	(-2.468)	(-1.425)
Controls				
AUDITOR NAMED		0.445	0.460	0.492
		(1.313)	(1.059)	(1.026)
LNMVE		0.208**	0.171	0.211
		(2.091)	(1.375)	(1.435)
FOREIGN		0.523	0.725*	0.452
		(1.493)	(1.899)	(0.950)
REGISTRATION		0.003	0.163	-0.801
		(0.006)	(0.250)	(-1.237)

TABLE 5 (continued)

	(1)	(2)	(3)
Constant	-6.234***	-6.138***	-6.938***
	(-3.442)	(-3.009)	(-3.090)
Observations	902	730	462
ROC	0.793	0.774	0.816

Column 1 presents estimates of Model 2. Column 2 presents estimates of Model 2 excluding stock option backdating cases. Column 3 presents estimates of Model 2 in the post-SOX period only. ***$p<0.01$, **$p<0.05$, *$p<0.10$ based on two tailed tests. See Appendix A for variable definitions. Standard errors are clustered by firm. Industry indicators are included but omitted for brevity.

FIGURE 1

Frequency of restatement related litigation and restatement related litigation naming audit committee members during the sample period