The Effect of the Federal Judicial System on Public Enforcement: Evidence from SEC Enforcement Actions

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Abstract

This study examines whether the efficiency of federal district courts affects the likelihood of SEC enforcement. The results indicate that the SEC is less likely to initiate enforcement actions against firms in less efficient federal district courts. In addition, the study examines the implications of court efficiency for firms' financial reporting quality. The evidence suggests that firms residing in more efficient federal districts have higher financial reporting quality and the effect is stronger in subsamples with weak private enforcement regimes. Additional analysis of the choice of venue suggests that the SEC's decision to file in the District Court for D.C. is not affected by local court efficiency. Collectively, this study highlights the importance of an efficient federal judicial system for public enforcement.

Keywords: SEC enforcement, public enforcement, financial reporting quality, securities law, venue shopping

JEL Classification: G18, M48, M41, K22, K41

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1. Introduction

The primary purpose of securities laws is to police disclosures on which investors can rely to make well-informed investment decisions. However, the existence of securities laws *per se* does not eliminate financial misconduct (Bhattacharya and Daouk 2002; Holthausen 2009; Christensen, Hail, and Leuz 2013, 2016). In the U.S., enforcement actions brought by the Securities and Exchange Commission (SEC) enable the safeguarding of investors. One important mechanism that the SEC has to enforce federal securities laws is to seek civil monetary penalties in federal courts. Given the intricate relationship between the SEC and federal courts, an important yet unanswered question is whether the SEC enforcement process depends on the efficiency of the federal judicial system.

This study examines whether the efficiency of federal district courts affects the likelihood that the SEC will initiate an enforcement action in a federal district court (i.e., civil action). The answer to this question is *ex ante* unclear. The SEC's objective is to minimize the sum of enforcement costs and damage to capital markets, subject to resource constraints (Stigler 1970; Becker and Stigler 1974; Polinsky and Shavell 1992). On one hand, a less efficient court may be associated with higher enforcement costs, thus reducing the likelihood of an SEC enforcement action against a firm located in a less efficient federal district. There is significant variation in efficiency among federal district courts. For example, in California's Southern District, the average time a case takes to move through is about 200 days, while in Georgia's Northern District, that time is significantly longer at about 1,020 days. This variation in the efficiency of federal district courts may be directly associated with the costs that the SEC incurs in prosecuting firms.

On the other hand, the SEC may be more likely to bring enforcement actions against firms located in jurisdictions with less efficient federal district courts. Investors rely on the federal court

system to file class actions, so court inefficiency is also costly for private enforcement. The high legal costs associated with less efficient federal district courts may discourage aggrieved investors from pursuing a class-action lawsuit, leading to greater capital damage for these investors. Meanwhile, compared to investors, the SEC may be less susceptible to the costliness of justice due to its mission to protect the investing public and minimize social damage. As a result, the SEC may prioritize cases and scale up enforcement intensity in inefficient districts to protect public interests.

Conversely, there exist at least four potential stories implying that court efficiency is not associated with SEC enforcement likelihood. First, under the Securities Exchange Act of 1934 (the Exchange Act), the SEC has the flexibility to choose from multiple federal district courts to file a complaint, a practice known as "venue shopping." This behavior allows the SEC to avoid local judicial inefficiency by bringing a case against a firm located in an inefficient federal district to a different federal district, potentially leading to no association between court efficiency and SEC enforcement likelihood. Given this tension, I conduct further analysis of the choice of venue in Section 6.1. The results suggest that the U.S. District Court for the District of Columbia (D.D.C.) is the court outside of the firms' headquarters with which the SEC most frequently files complaints. Notably, the SEC's choice to file in D.D.C. is not significantly correlated with local court efficiency. Second, the SEC may present settlement terms sufficiently favorable for the defendant to accept, thus expediting the resolution process and alleviating the enforcement costs associated with inefficient judiciaries. Consequently, court efficiency might not affect SEC enforcement. Section 2.2 provides additional discussion and evidence on settlement and SEC leniency. Third, in situations when the SEC is not aware of timely changes in court efficiency or makes inaccurate estimates of efficiency, court efficiency may not be reflected in SEC enforcement decisions (see

Internet Appendix IA.5). Lastly, in situations without resource constraints, the SEC does not need to consider costs arising from inefficiency of courts in its enforcement decisions. Taken together, the relation between the efficiency of local federal district courts and the likelihood that the SEC will initiate a civil action is an open empirical question.

In the primary analysis, I examine whether court efficiency is associated with the likelihood of enforcement against firms that announced restatements between 1995 and 2010. The sample period ends in 2010 because prior to the enactment of the Dodd-Frank Act, the SEC could seek monetary penalties against public firms and their employees *only* through civil actions in federal district courts. I use three measures to proxy for court efficiency — (1) the number of days between filing and termination of a case, (2) case backlog per judge, and (3) the number of weighted filings per judge. In addition, a composite score of the three court efficiency measures is constructed using the principal factor analysis. The court efficiency measures are computed at the federal district court level. Specifically, I use a firm's headquarters location to identify its corresponding federal district court. The results suggest that there is a significantly negative relation between the three court efficiency measures and the likelihood of SEC enforcement. The magnitude of economic significance is also meaningful. An increase of one standard deviation in the average time from filing to termination decreases the probability of SEC enforcement by 1.6%, which is 17.1% of the mean probability of enforcement.

To further understand the SEC's cost-benefit considerations, I conduct a cross-sectional test to examine the benefit of enforcement by exploring the severity of restatements. The SEC garners additional benefits in severe cases, as reflected by its goal to prioritize cases involving damages to shareholders (Bonsall, Holzman, and Miller 2024; Holzman, Marshall, and Schmidt 2023). In more severe cases, the benefits of enforcement are more likely to outweigh the costs due to court

efficiency because the SEC is less sensitive to costs (Chen, Jia, Martin, and Silveira, 2024). Thus, a stronger correlation between the court efficiency measures and the likelihood of SEC enforcement is expected in the subsample with less severe restatements. To mitigate concerns about omitted correlated variables, I conduct a second cross-sectional test using the SEC's budget constraints. Enforcement costs due to court inefficiency are more likely to be binding in the SEC's cost-benefit decisions given budgetary constraints. I therefore expect to find a more prominent result when the SEC faces tighter budgets. The findings are consistent with my prediction and can strengthen the hypothesis because any omitted correlated variables would need to explain both the effect of court efficiency on SEC enforcement and the variation of this effect in light of SEC budgetary constraints.

I use judicial vacancies caused by death as an exogenous shock to court efficiency to further strengthen the results, because judicial vacancies are unlikely to be influenced by firms' operational decisions or the SEC's enforcement actions. Specifically, I examine the effect of judicial vacancies due to death on the likelihood of SEC enforcement using two cross-sectional variations: the total number of judgeships in a federal district court and the productivity of outgoing judges. The results indicate that judicial vacancies have a stronger effect on the likelihood of SEC enforcement in courts with fewer judgeships as well as with more productive outgoing judges.

For the second hypothesis, I examine how federal district court efficiency affects firms' financial reporting quality (FRQ). Efficient courts lower firms' perceived costs of SEC enforcement because the SEC is less likely to litigate in less efficient federal districts. The results suggest that firms residing in federal districts with more efficient courts have a lower level of abnormal accruals and a lower likelihood of ineffective internal controls. In addition to the direct effect of SEC enforcement on FRQ, there is an indirect channel through which strengthening SEC

enforcement may decrease private enforcement intensity, leading to a lower level of FRQ. The strategic interactions between public and private enforcement are illustrated in Schantl and Wagenhofer (2020, hereafter SW), which suggest that the ultimate change in FRQ after strengthening public enforcement depends on the intensity of private enforcement. Motivated by the theoretical findings in SW, the third hypothesis posits that the intensity of private enforcement diminishes the relation between SEC enforcement and FRQ. I document that the effect of court efficiency on FRQ is stronger in subsamples with weak private enforcement regimes.

The Dodd-Frank Act allows the SEC to impose monetary penalties on public firms and their employees through administrative proceedings. A natural question to ask is whether the SEC is more likely to initiate administrative proceedings when respondent firms are in less efficient federal districts post Dodd-Frank. It is possible that the SEC may avoid inefficient federal district courts and favor administrative proceedings. The baseline result shows no significant relation between court efficiency measures and the likelihood of administrative proceedings (see Section 6.2); whereas, when the regional offices face heavy backlogs, the SEC is more likely to use administrative proceedings against firms located in less efficient federal district courts. Despite the SEC's ability to seek monetary penalties via administrative proceedings after Dodd-Frank, the results in this paper remain relevant for three key reasons. First, civil actions and administrative actions are not perfect substitutes. Civil actions generally lead to greater media attention, which is important to the SEC because it wants to showcase its enforcement activities (Zheng 2021). Although administrative proceedings have increased since the Dodd-Frank Act, the SEC still heavily relies on civil actions. For example, the SEC prosecuted 720 defendants in federal district courts and 748 defendants in administrative court in 2018 (SEC 2018). Second, the administrative court has a limited number of judges — currently five. This restriction on judicial capacity means

the SEC cannot route all cases to its internal court and must still rely on the federal judicial system. Lastly, there is a perception of unfairness with respect to the use of administrative proceedings due to a lack of procedural safeguards (Eaglesham 2015; Hurd and Newman 2022), potentially leading to the SEC preferring civil actions to restore fairness in its proceedings. Thus, it remains important to study SEC civil actions and their related determinants, as they may be used to generate policies to remove bottlenecks in enforcement actions.

This paper contributes to three streams of literature. First, it adds to the literature examining the influence of the legal environment on capital markets by focusing on the mechanism of public enforcement. In international settings, La Porta, Lopez-de-Silanes, Shleifer, and Vishny (1997) show that the characteristics of legal rules (e.g., civil law and common law) affect the size and breadth of capital markets across 49 countries. This paper also complements other research in international settings (La Porta, Lopez-de-Silanes, Shleifer, and Vishny 1998; Jackson and Roe 2009). In domestic settings, some studies focus on state law such as contract law or foreclosure law (Honigsberg, Katz, and Sadka 2014; Minnis and Sutherland 2017), while others examine the influence of judges' characteristics (e.g., judicial ideology and judges' social networks) on corporate decisions (Huang, Hui, and Li 2019; Huang, Roychowdhury, Sletten, and Xu 2024). These papers tend to focus on private enforcement as the channel through which the judicial system influences capital markets because judges' characteristics affect the outcomes of class actions. However, as noted by Huang et al. (2019), "there is little evidence of the economic impact of the judicial system, which is heavily relied upon to enforce the securities laws." This paper aims to add to this growing literature by showing the effect of the judicial system on capital markets through SEC enforcement, a public enforcement mechanism.

Second, this study relates to prior research on the SEC's regulatory activities under scenarios of limited resources (Holzman et al. 2023; Donelson, Kubic, and Toynbee 2023). Ege, Glenn, and Robinson (2020) examine the quality of SEC comment letters when the volume of transactional filings is abnormally high, while Holzman et al. (2023) find that the SEC tends to enforce more easily identified cases when its offices have heavy case backlogs. This paper adds to prior studies by examining federal court efficiency, one of the SEC's constraining factors, and the interactive dynamics between court efficiency and other constraining factors.

Lastly, this paper contributes to the research on the determinants of financial reporting quality. As stated in Ball (2008), "[a]ccounting rules do not fully determine financial reporting practice" because firms' actions "are affected by a range of individuals and institutions, both internally and externally." Examples of external factors are "auditors, analysts, press…courts, [and] regulators." Most of these external factors have been well studied, but few studies examine courts. This paper fills this gap by focusing on one aspect — court efficiency. Examining the interactive effect of private and public enforcement on financial reporting, this study further adds to prior theoretical studies (Schantl and Wagenhofer 2020) by empirically testing several theoretical predictions.

This paper also relates to and complements concurrent findings by Bonsall et al. (2024, hereafter BHM), who find that SEC office backlog is associated with a lower likelihood of a restatement leading to an investigation. SEC office backlog has numerous determinants, with judicial efficiency likely being a factor. In this regard, these two studies may overlap in some dimensions. However, institutional differences exist between investigations — the dependent variable in BHM — and civil actions, which are the primary focus of the current study. An investigation may not necessarily lead to a civil action. Even if the SEC decides to litigate in a federal court, it has the flexibility to choose in which federal district to file a complaint. Thus, the

tension established in my hypothesis cannot be directly ruled out by the findings in BHM and my paper examines the role that federal court efficiency plays in the choice of venue and forum, further complementing BHM to provide a more comprehensive understanding of SEC enforcement outcomes.

2. Institutional Setting

2.1 SEC Enforcement Process

In the following section, I discuss the SEC enforcement process, which is relevant to the research design in this paper. Figure 1 illustrates the SEC's investigation and enforcement process. An SEC investigation can be triggered by various events, such as accounting restatements and late filings of 10-K reports (Karpoff, Koester, Lee, and Martin 2017). After the investigation, if the SEC proceeds with an enforcement action, the agency may send the target firm a Wells Notice. The firm under investigation can respond by rebutting violation charges. If the SEC staff agrees with the rebuttal, the matter is closed; otherwise, the staff will draft an enforcement recommendation for the commissioners to vote on.

If the firm does not submit an offer of settlement, the staff will present an Action Memorandum with recommendations to the commissioners. Should the commissioners decide to litigate, the SEC will either file a civil complaint in a federal district court or commence an administrative proceeding. Before the Dodd-Frank Act, the SEC had to file a civil complaint with a federal district court to seek civil monetary penalties against public firms and their employees.[1] Alternatively, if the firm submits an offer of settlement at this stage, the staff will include a recommendation

[1] The SEC could seek monetary penalties against regulated persons or entities that are broker-dealers, persons associated with broker-dealers participating in an offering of a penny stock, municipal securities dealers, government securities broker-dealers, and clearing agencies and transfer agents via administrative proceedings prior to the Dodd-Frank Act. Public companies and their employees are not considered regulated persons or entities.

regarding settlement in the Action Memorandum. The commissioners then decide whether to settle or litigate. If they accept the firm's offer of settlement, the SEC will either file a civil complaint together with a consent judgment with a federal district court or file an administrative proceeding along with the settlement agreement. After filing the complaint with a federal district court, a federal judge will review the proposed settlement to ensure it is fair.[2] If the settlement is filed with the administrative court, approval by an administrative law judge (ALJ) is not required. Instead, an ALJ will usually issue an Order Instituting Proceeding to announce the settlement.

2.2 Litigation vs. Settlement

When deciding between settlement and litigation, the SEC considers the resources to be devoted to a full trial and the likelihood of a better outcome after trial (Shavell 1982; Priest and Klein 1984). A settlement requires fewer resources and less time than a full trial, enabling the SEC to initiate new investigations. Regarding the second factor, the SEC also considers the consequences of a possible loss in court, which can be avoided through settlement. However, this factor is less important because "the SEC is most successful when it is pursuing its core areas of enforcement, such as standard account[ing] fraud cases" (Johnson 2007). Theoretical models on settlement (Bebchuk 1984; P'ng 1983) suggest that a plaintiff (i.e., the SEC) will accept a settlement offer if the settlement amount equals or exceeds the payoff from going to trial, minus litigation costs. This payoff is affected by the likelihood of the defendant being found liable and the compensation recovered. Conceptually, *ceteris paribus*, if an accounting fraud results in

[2] After reviewing the complaint and consent judgment, if a judge deems the facts furnished inadequate, she can request additional facts. For example, in *SEC vs. Hohol* (2014), the court declined to approve the SEC's settlement and ordered more factual predicates to show the proposed settlement was fair. The court raised questions such as how the proposal settlement amount was determined, why it was higher or lower than a previous similar case, and how the proposed penalty would have meaningful deterrent effects.

extensive damage, the amount recovered from litigation ought to be high, resulting in a greater settlement amount demanded by the SEC. In contrast, high litigation costs, possibly due to factors such as court inefficiency, will reduce the SEC's net payoff from litigation. As a result, the SEC may seek lower settlement amounts, and the probability of settlement would be higher (Cooter, Marks, and Mnookin 1982; Bebchuk 1984; Priest and Klein 1984).

From the firm's (i.e., the defendant's) perspective, the decision to settle depends on the rational expectation of the likelihood of enforcement and potential liabilities if the lawsuit goes to trial and the firm loses. If the firm believes the SEC is unlikely to initiate enforcement due to questionable merits of the case, the firm is unlikely to propose a settlement. The firm is also less likely to do so if it knows the case would be too costly for the SEC to pursue for such reasons as case complexity and court inefficiency. Assuming the SEC avoids pursuing lawsuits with negative net payoffs, defendants will not settle when the SEC's enforcement costs outweigh the benefits. In essence, the SEC's threat to proceed to trial must be credible to obtain a settlement offer from the defendant.

The SEC has been criticized by the media for excessive leniency towards large firms (Hamburger 2012). Perceived leniency may stem from the high costs involved in enforcement against large firms, such as higher political costs because of firms' lobbying activities and political donations (Correia 2014; Mehta and Zhao 2020). Also, litigation costs are high in such cases because they are more difficult to build, as large firms are deep pocketed with access to sophisticated lawyers. In addition, the revolving door of SEC lawyers might affect settlement decisions, as the "rent-seeking hypothesis" predicts that SEC lawyers might cater to large firms that will likely be their future employers (deHaan, Kedia, Koh, and Rajgopal 2015).

Collectively, if the SEC's litigation costs outweigh the benefits, a firm is unlikely to propose a settlement because litigation is not a credible threat. In such cases, the SEC would ultimately

drop the case without enforcement action as it is unlikely to induce a settlement. Conversely, when litigation is a credible threat, the SEC and the firm are more inclined to reach a settlement in an amount that is theoretically lower if the SEC faces higher litigation costs (Bebchuk 1984).[3] In addition to the theoretical discussions, Figure 1 illustrates a similar point. The "enforcement" or "no enforcement" decision node precedes the "settlement" decision agreed upon by the SEC and the firm. The firm will only propose a settlement when it believes the SEC is likely to initiate an enforcement action, which is itself a function of court efficiency. Although court efficiency may seem irrelevant after the SEC settles, a firm's settlement decision requires SEC enforcement to be a credible threat. Therefore, I study *Pr (SEC Civil Action | Restatement)* as the dependent variable, abstract away from the distinction between settlement and litigation, and consider both settlement via federal courts and litigation via federal courts as "SEC civil action," which is circled in Figure 1.

3. Literature Review and Hypothesis

3.1 Legal-process Literature on Court Efficiency

The literature on legal process finds that high court efficiency is an important consideration and widely desired by litigants, attorneys, and policymakers (Flanders 1977). Long delays in personal injury cases impose severe hardship for the injured, and delays in criminal cases lead to lengthy pretrial incarceration without regard to the defendants' guilt (Gillespie 1976). Slow bankruptcy courts increase the costs of financial distress and reduce recovery values (Müller 2022; Iverson 2018). The legal process literature shows that many factors affect court efficiency,

[3] In untabulated results, I do not find a significant relation between the court inefficiency measures and settlement likelihood. However, additional analysis suggests that court inefficiency significantly reduces the total size of fines imposed on employees, providing evidence for the SEC leniency argument.

including the skills of judges and lawyers, the availability of courtrooms and supporting personnel (e.g., law clerks or staff attorneys), and the case mix (Gillespie 1976; Flanders 1977).

3.2 Hypothesis Development

3.2.1. SEC Civil Action

With the objective of minimizing enforcement costs and damages subject to resource constraints (Stigler 1970; Becker and Stigler 1974; Polinsky and Shavell 1992), the SEC needs to carefully select enforcement actions so as to reduce enforcement costs. One type of enforcement cost involves the length of time needed to investigate and litigate a case. Kedia and Rajgopal (2011) show that the SEC is more likely to investigate firms located closer to its regional offices because of reduced travel time and greater familiarity with local firms, resulting in shorter investigation time. In addition, Files (2012) finds that the SEC is more likely to bring enforcement actions against firms who cooperate because enforcement costs are lower when firms supply information promptly. The greater complexity of the firm and the case also increases enforcement costs. Peterson (2012) finds that the accounting complexity of the firm reduces the incidence of AAERs related to restatements because highly complex cases require more investigation time.

I argue that the SEC is less likely to bring enforcement actions against firms located in less efficient federal district courts due to higher enforcement costs arising from court inefficiency. Lower court efficiency corresponds to a heavier case backlog, which thus leads to a longer time from filing to termination. As a case is prolonged, the SEC staff needs to reopen files repeatedly to refresh their memories, thus increasing enforcement preparation time. In addition, the short tenure of SEC staff increases the difficulty of building a strong case. Cox and Thomas (2003) find that the average tenure of SEC staff members in 1999 was about 2.5 years. The transfer of an

ongoing case from an experienced staff member to a new one costs additional time for the new member to become familiar with the facts and legal issues in the case. Thus, pursuing enforcement actions with lower judicial efficiency increases the SEC's enforcement costs. I conjecture that the court efficiency measures are negatively correlated with SEC enforcement likelihood.

The first hypothesis is not without tension as the relation between federal court efficiency and SEC enforcement likelihood might be positive. First, the SEC might prioritize enforcement in inefficient courts due to considerations of constrained shareholder protection and potentially higher losses borne by aggrieved investors, suggesting a positive relation between the court efficiency measures and the likelihood of SEC enforcement. Investors heavily rely on the federal judicial system for private enforcement (Huang et al. 2019; Huang et al. 2024), but an inefficient judicial system increases litigation cost.[4] Consequently, shareholders' ability to protect themselves is limited, resulting in more significant capital damage. Despite being resource constrained, the SEC may still decide to bring an enforcement action in a less efficient court to protect investors. This enforcement choice aligns with the SEC's overarching mission to pursue social objectives and minimize social damage. The evidence from structural estimation in Chen et al. (2022) is consistent with this view: the SEC values social costs (i.e., the external costs of financial misconduct) more than enforcement costs. Therefore, the SEC can be more immune to the costliness of justice than private investors, and enforcement likelihood in inefficient districts might increase.

[4] An aggrieved investor can strategically select the venue for filing a complaint to avoid busy courts. However, the plaintiff's power of "venue shopping" is not unlimited (Cox, Thomas, and Bai 2009; Huang et al 2019). A defendant can challenge this, and a court can decide the appropriate venue at its discretion. Specifically, 28 U.S.C. § 1404(a) codifies the doctrine of *forum non conveniens* to allow a federal district court to transfer a case to another federal district court for "the convenience of parties and witnesses" and in "the interest of justice."

In addition, there are four plausible explanations suggesting that SEC enforcement likelihood may not be associated with federal court inefficiency. First, the SEC may engage in "venue shopping," which could result in no association between court efficiency and enforcement. As per 15 U.S.C. § 78aa, the SEC is authorized to bring suits pertaining to the Exchange Act and regulations promulgated thereunder in the district of the United States wherein the defendant (1) "is found," (2) "is an inhabitant," or (3) "transacts business." Given this flexibility, the SEC is authorized by the Exchange Act to potentially file a complaint with multiple federal district courts and that the SEC may choose a venue that avoids local judicial inefficiency.[5] In fact, various factors influence a lawyer's choice of court, such as, court efficiency, judicial expertise, favorable precedent, and differences in jury body (Miller 1992; Willging and Wheatman 2005). Holzman et al. (2023) find that investigation rates have a significantly positive (negative) relation with the promotion (turnover) of SEC lawyers. Meanwhile, the formal resolution of investigations does not significantly affect SEC attorneys' career outcomes, suggesting that SEC attorneys tend to prioritize the initiation of new investigations over their resolution. Consequently, court efficiency may be a primary motivation for venue shopping because a shorter lifespan of an enforcement action in a more efficient court frees up resources for SEC attorneys to initiate new investigations quickly. In this paper, because of the strong likelihood that a firm and its employees can be found, reside, and transact business in the federal district where the firm's headquarters is located, I use the firm's headquarters location to identify the corresponding federal district court where the SEC

[5] For example, in *SEC vs. Affiliated Computer Services, Inc.*, despite the defendant being headquartered in Dallas, Texas, the SEC states that D.D.C. is an appropriate venue because "certain of the acts alleged herein constituting violations of the Securities Act and the Exchange Act occurred in this District, including, [the defendant]'s filing of materially false and misleading annual and quarterly reports, and other documents with the Commission in the District of Columbia."

would file the civil action. However, the "venue shopping" theory potentially mitigates the effect of local court inefficiency on SEC enforcement.

Second, as extensively discussed in Section 2.2, the SEC may offer to settle on sufficiently friendly terms that a defendant is more likely to accept, leading to quicker resolution. This strategic choice could alleviate the costliness of inefficient judiciaries, ultimately reducing overall litigation costs. In this regard, the inefficiency of local courts may not be associated with the SEC's enforcement decision. Third, the SEC may not be aware of the variation in court efficiency from one court to another. Information on court efficiency is less salient, and acquiring timely information can be costly if the SEC has not recently interacted with a specific court. In essence, court efficiency may not affect SEC enforcement actions if the SEC is uninformed about or makes inaccurate estimations of court efficiency.

Lastly, in the scenario when the SEC is not resource constrained, court inefficiency is not associated with SEC enforcement likelihood because costs due to court inefficiency are not considered. Collectively, the relation between the efficiency of federal district courts and the likelihood that the SEC will initiate a civil action is unclear and thus remains an empirical question.

3.2.2. Financial Reporting Quality

As an extension of the first hypothesis, I examine financial reporting quality (FRQ) as a second hypothesis. Before committing a violation, a firm will trade off the penalty with the benefit of the violation (Becker 1968). For example, firms located closer to the SEC perceive a higher cost of violation because managers are more aware of the SEC's enforcement agenda; thus, they have higher FRQ (Kedia and Rajgopal 2011). Similarly, the cost of violation is higher due to Sarbanes-Oxley (SOX) regulations, resulting in fewer income-increasing accruals after SOX. (Cohen, Dey,

and Lys 2008). I argue that court efficiency also affects FRQ because it is associated with the likelihood of SEC enforcement. In my analysis, abnormal accruals and ineffective internal controls are used as proxies for FRQ.[6] I expect to find that firms with a lower perceived cost of SEC enforcement have greater abnormal accruals and a higher likelihood of ineffective internal controls.

Relying on theoretical predictions, the third hypothesis aims to understand how the level of private enforcement interacts with SEC enforcement in determining FRQ. Managers' financial reporting decisions are affected by both private litigation and public enforcement actions. Because of the strategic interactions between these two types of enforcement, the effect of enhancing public enforcement to improve the level of FRQ depends on private enforcement intensity (Schantl and Wagenhofer 2020; SW henceforth). In particular, SW find that when the private enforcement regime is weak (strong), increasing public enforcement can lead to a higher (lower) level of FRQ.[7] SW identify two channels through which public enforcement may affect FRQ. First, increased public enforcement directly increases the level of FRQ (i.e., "direct effect"). On the other hand, the second channel states that an increased level of public enforcement may crowd out private enforcement. The lower level of private enforcement leads to a lower level of FRQ (i.e., "crowding-out effect"). Ultimately, the level of FRQ depends on the net effect of these two channels. Motivated by SW's theoretical findings, I hypothesize that less court efficiency, which reduces SEC enforcement, leads to a lower level of FRQ when the private enforcement regime is weak so that the "direct effect" is more likely to outweigh the "crowding-out effect."

4. Research Design

[6] I examine internal accounting controls because Section 13(b)(2)(b) of the Exchange Act requires that firms "devise and maintain a system of internal accounting controls."
[7] See Proposition 2(ii)(a) and Proposition 2(ii)(b) in Schantl and Wagenhofer (2020) for additional details.

4.1 SEC Enforcement Actions

This study examines the likelihood of an SEC civil action upon restatements (i.e., *Pr (SEC Civil Action | Restatement*)). An SEC civil action subsequent to a restatement is defined as litigations initiated against the restating firm and/or its employees due to the firm's alleged misconduct that results in the restatement. If an enforcement action involves filing a complaint with a federal district court, this action is considered an "SEC civil action," regardless of whether any of its accompanying cases are filed with the SEC's administrative court.[8] Oftentimes, both civil actions and administrative proceedings are used together to address the same misconduct. The set of complaints is collectively considered an "SEC civil action" as long as at least one complaint is filed with a federal district court.

Restatements are widely used as one of the trigger events for SEC enforcement. The sample selection begins with all restatements announced between 1995 and 2010, obtained from the Audit Analytics Financial Restatements database. Following prior studies (Files 2012; Correia 2014; Bonsall et al. 2024), I do not restrict the sample to a specific type of restatement (e.g., income-decreasing restatements), but control for the characteristics and variation in the severity of the restatements.[9] I use the SEC enforcement data in Call, Martin, Sharp, and Wilde (2018), relating to financial reporting litigations, which consists of violations of Section 13(b) provisions of the

[8] Considering the enforcement action against Fleming Companies, Inc. (Fleming) for earnings management as an example, there were six defendants associated with Fleming in total, with Shapiro (former chief accounting officer and senior vice president of finance and operations) being prosecuted in both a civil action and an administrative proceeding. Five defendants were prosecuted in civil actions in 2005, including Shapiro, Murphy (former vice president), Dahlen, Jr. (former president of Fleming Retail Group), Abbood (forever vice president in Fleming's wholesale procurement group), and Thatcher, (vice president of Fleming Retail Group). Two defendants, Fleming and Shapiro, were prosecuted through administrative proceedings.

[9] The sample includes all types of restatements for two reasons. First, excluding certain types of restatement imposes an additional assumption on the SEC's objective function. However, this assumption may not be reasonable, as Bonsall et al. (2024) point out that "based on our conversation with a former SEC staff member, all restatements are reviewed by the SEC." Second, excluding specific types of restatement eliminates the opportunity to examine how the SEC trades off costs and benefits in their enforcement actions, a research question examined in the cross-sectional tests.

Exchange Act and associated regulations. Because I examine SEC enforcement before the Dodd-Frank Act, I look at enforcement actions initiated before 2011. I then merge the SEC enforcement actions to restatements that occurred within four years of the restatement announcement dates.[10] Lastly, I merge the court efficiency measures to restatements based on the year of restatement announcement and the location of the firm's headquarters.

4.2 Measures for Court Efficiency

I collect the number of case backlogs, new filings, weighted filings, cases terminated, judgeships, and vacant judgeship months from 1994 to 2019 for each federal district court. There are fifty states and four territories in the Federal Court Management Statistics. Figure 2 illustrates the geographic boundaries of the U.S. federal district courts — ninety-four in total. Based on the zip codes of the firms' headquarters locations, I use the "Federal Court Finder" webpage of the United States Courts to identify the firms' corresponding federal district courts.[11]

The three court efficiency measures are (1) the average time from filing to termination (*Termination Time*), (2) case backlog per judge (*Case Backlog*), and (3) the number of weighted filings per judge (*Weighted Filings*). The three measures complement each other in depicting the efficiency of federal district courts. Conceptually, the higher the court efficiency measures are, the less efficient a federal district court is.

Termination Time (in months) is computed as twelve over the case turnover ratio:

[10] For example, a firm announced a restatement in 1998. In 2000, the SEC initiated a 13(b) enforcement action against this firm. This enforcement action is matched to the 1998 restatement because it was filed within four years of the restatement announcement. I choose four years because the statute of limitations provides that the SEC must file a lawsuit no later than four years after the nonfraudulent misconduct occurs. This timing is consistent with the findings in Table 2 of Files (2012), which shows that the average time from the first public release of restatements to the initial release of SEC enforcement actions was about 3.4 years in 1997 and 1998, and about 3 years in 1999 and 2000.

[11] <https://www.uscourts.gov/federal-court-finder/search>

$$Termination\ Time_t = \frac{12}{\frac{Number\ of\ Cases\ Terminated_t}{(Number\ of\ Pending\ Cases_t + Number\ of\ Pending\ Case_{t-1})/2}}$$

The case turnover ratio is computed as the total number of cases terminated in year *t* divided by the average number of pending cases. I use 12 as the numerator to obtain the termination time in months.[12] A longer termination time indicates a less efficient court.

Case Backlog is computed as the number of pending cases over the total number of available judges:

$$Case\ Backlog_t = \frac{Number\ of\ Pending\ Cases_t}{Number\ of\ Judgeships_t - Number\ of\ Judgeship\ Vacancy\ Months_t/12}$$

The calculation for the total number of available judges uses both the total number of judgeship vacancy months and the total number of judgeships. For example, if there are five judgeships in a given federal district court this year, but one judge is absent for two months and another judge retires after six months, then the total number of judge vacancy months is eight. Accordingly, the total number of available judges is 4.3 (5 - (8/12)).

Weighted Filings is computed as the number of weighted filings over the total number of available judges:

$$Weighted\ Filings_t = \frac{Number\ of\ Weighted\ Filings_t}{Number\ of\ Judgeships_t - Number\ ofJudgeship\ Vacancy\ Months_t/12}$$

The weight on each filing is assigned by the Federal Judiciary based on the estimated time that judges would spend on a case.[13] Under the current weighting system, "average civil cases or criminal defendants each receive a weight of approximately 1.0"; higher weights are assigned to

[12] 365 can be used as the numerator if one wants to obtain the termination time in days.
[13] See "Explanation of Selected Terms," available at <https://www.uscourts.gov/sites/default/files/explanation-of-selected-terms-september-2014_0.pdf>, and Table 1 in "2003 –2004 District Court Case-Weighting Study," available at <https://www.fjc.gov/sites/default/files/2012/CaseWts0.pdf>, for additional information.

more time-consuming cases (e.g., an antitrust case is assigned a weight of 3.45); lower weights are assigned to less time-consuming cases (e.g., a foreclosure of personal property case is assigned a weight of 0.32); and SEC, CFTC, and similar enforcement actions are assigned a weight of 2.08.

The choice of court efficiency measures is motivated by the SEC's objective function. Because the SEC has limited resources and is obligated to report its enforcement statistics each year (e.g., the number of cases filed and closed), it needs to be selective in enforcement cases to minimize enforcement costs and social damage while achieving certain performance metrics (Holzman et al. 2023). Thus, the SEC is most likely to focus on the duration of an enforcement case, which not only depends on the complexity of the enforcement case itself, but also the efficiency of the court. Prior studies (Ponticelli and Alencar 2016; Iverson 2018; Müller 2022) use case backlogs at bankruptcy courts to capture the degree of busyness. A higher case backlog per judge means a longer waiting time for the judges to clear up prior cases before they can adjudicate new cases. Case backlog is especially relevant for the SEC, which is authorized by law to engage in only civil lawsuits, because the SEC cannot "cut in line" while criminal cases can be expedited under the Speedy Trial Act (18 U.S.C. § 3165).

However, a shortcoming of the case backlog measure is that judges at federal district courts adjudicate all types of cases, which differ in complexity and time intensiveness. Given the variability in time intensiveness of each case, a higher case backlog of easy cases does not necessarily lead to a longer waiting time. Second, the Speedy Trial Act forces judges to focus on criminal cases. When courts face a high backlog, the emphasis on criminal cases further delays the resolution of cases filed by the SEC. Therefore, I construct a time-related measure (i.e., *Termination Time*) to capture another perspective of court efficiency. This time-related measure is critical to the SEC as the Division of Enforcement frequently uses timeliness and resolution time

as one of the performance indicators. Prior studies have similar duration-related measures for court efficiency. For example, Djankov, La Porta, Lopez-de-Silanes, and Shleifer (2003) use the lawyers' estimated average time from filing to resolution to capture the efficiency of the legal system across 109 countries.

To further address case length discrepancies, I use a weighted measure (i.e., *Weighted Filings*) to capture the effect of case mixes and particularly, variation in time for different cases. This measure can precisely capture the amount of time that a court needs to devote, even though it does not capture the processing speed of the court. Given the merits and shortcomings of each measure, I also construct a composite score using the first principal component of the three court efficiency measures as a comprehensive measure.

Panels A, B, and C of Figure 3 show the cross-sectional variation of *Termination Time*, *Case Backlog*, and *Weighted Filings* from 1995 to 2010 for each federal district on the map. The Eastern District of Pennsylvania has the longest *Termination Time*, the Middle District of Louisiana has the heaviest *Case Backlog*, and the Eastern District of California has the greatest number of *Weighted Filings*.[14] Panel A of Table 1 shows the correlation between district/state-level characteristics and court efficiency measures. All three court efficiency measures are positively correlated with each other. The court efficiency measures are also correlated with the district-level macroeconomic conditions, such as *Unemploy*. The level of crime affects court efficiency as well, as evidenced by the significantly positive correlation between the court efficiency measures and the rate of violent crime (*Violence*). Given significant correlations between court efficiency and macroeconomic and social trends, I control for various district/state-level characteristics in all the

[14] Table IA.2 in the Internet Appendix presents additional statistics for these three measures, including median and standard deviations. Figure 1A.1 in the Internet Appendix illustrates the time-series variation of *Termination Time* for the federal district courts in three states with the largest number of public firms (California, New York, and Texas).

regressions. Lastly, the negative correlations in row (11) provide preliminary evidence that less court efficiency reduces SEC enforcement likelihood.

As discussed earlier, I construct a composite score (*InefficiencyScore*) using the first principal component of the three court efficiency measures. Panel B of Table 1 presents the factor loadings. *Case Backlog* has a factor loading greater than 0.6, which indicates a strong association. The factor loadings of *Termination Time* and *Weighted Filings* are 0.52 and 0.53, respectively, indicating a moderately strong association. The eigenvalue of the first principal component is 1.89, which explains 63.10% of the total variation in the data.

4.3 Model: *Pr (SEC Civil Action | Restatement)*

The following model is estimated, with firms indexed by *i* and years indexed by *t*:

$$Pr(SEC\ Civil\ Action|\ Restatement)_{it} = \beta_1 Federal\ Court\ Efficiency_{it} + \sum_k \gamma_k RestatementControls_{it} + \sum_k \delta_k FirmControls_{it} + \sum_k \psi_k DistrictControls_{it} + State\ FE + Industry\ FE + SEC\ Regional\ Office\ FE + Year\ FE + \varepsilon_{it} \quad (1)$$

To control for the severity of restatements, I use variables such as the 5-day abnormal returns around restatement announcement dates (*Restate Ret*) and the dummy for revenue recognition related restatements (*Revenue Recognition*). Following Files (2012), I use the length of time from the end of the restatement to the restatement announcement date (*Timeliness*) to control for the timeliness of the restatement announcement. For firm characteristics, I use *Distance* as a control for traveling and investigation costs of SEC enforcement (Kedia and Rajgopal 2011). I control for the number of employees (*Employee*) based on the findings in Heese (2019) that large employers are less likely to face enforcement proceedings due to political influence. I also include additional controls for firm characteristics, such as age (*Age*), book-to-market ratio (*BTM*), and leverage (*Lev*).

For district-level controls, I use the personal income growth (*IncomeGR*) and unemployment rate (*Unemploy*), aggregated across counties, to control for the financial condition of each district. I also control for state-level social norm or culture that might affect both court efficiency and the SEC's enforcement decisions. Specifically, I control for non-financial related misconduct because it can affect the prevalence of financial misconduct (Parsons, Sulaeman, and Titman 2018). The SEC may focus more on regions with such non-financial related misconduct, as they are more likely to have financially motivated crimes, and the marginal deterrence effect can be greater. Meanwhile, misconduct unrelated to accounting also affects court efficiency. I use *Property* and *Violence* to control for non-accounting misconduct in a region. I also control for *Religion* because it affects social norms and FRQ (McGuire, Omer, and Sharp 2012). Following Huang et al. (2019), I use each state's vote in presidential elections to control for the political leaning of a state (*BlueState*). Lastly, I also use industry, state, and SEC office fixed effects to control for time-invariant industry, state, and SEC office unobservable factors. I use year fixed effects to capture macroeconomic changes, trends in lawsuit filings, and shifts in political affiliation of SEC chairs. In the alternative specification, I include SEC office-year fixed effects because Bonsall et al. (2024) show that SEC case backlog affects the likelihood of investigation. The SEC office-year fixed effects can capture annual variations in case backlog, budget, and staffing across offices, as well as changes in office technology and structures.[15] Eq. (1) is estimated using OLS and standard errors are clustered by federal district courts.[16]

[15] The SEC elevated six district offices to the regional level in March 2007, which affected the procedures of investigation and enforcement. The use of SEC office-year fixed effects can potentially capture this structural change.
[16] Non-linear models, such as Logit or Probit, combined with fixed effects may yield inconsistent point estimates (Woodridge 2002; Angrist and Pischke 2009). As a robustness check, I use a non-linear model, Logit, and obtain similar results.

5. Empirical Results

5.1 Descriptive Statistics

The descriptive statistics of variables are reported in Table 2. In this sample, there are 3,571 restatements from 1995 to 2010, 9.24% of which are accompanied by subsequent SEC civil actions, which is consistent with the small percentage of enforcement actions found in prior studies.[17] The average *Termination Time* is 13.28 months. The average backlog per judge is 493.20 cases and the average weighted filings per judge is 530.40 cases. On average, the length of the misstatement period (*Restated Period*) is 761.31 days. The average number of items restated (*Num Issues*) is 2.25, and 19.32% of the restatements are related to *Revenue Recognition*. The average *Restate Ret* is about -2.49%.

Table 3 reports the distribution of restatements and SEC enforcement actions from 1995 to 2010. A potential concern may be that the SEC only takes enforcement actions in certain districts, thus, results are driven by enforcement activities in only a few districts. Column (2) of Table 3 shows the percentage of restatements associated with SEC enforcement actions. In addition to the top three states with the most public firms (i.e., California, Texas, and New York), the SEC also engages in enforcement activities in federal district courts such as the District of Massachusetts (16.87%), Middle District of Tennessee (10.00%), and the Western District of Washington (4.29%). SEC enforcement activities are widely distributed among districts, providing assurance that the SEC's enforcement activities in a particular region are not driving the main results.

5.2 Tests of SEC Enforcement Decisions

[17] The SEC enforcement likelihood of 9.24% in this sample is comparable to 10.16% in Files (2012), which uses 1,249 restatements from 1997 to 2005 and has 127 corresponding SEC enforcement actions.

Table 4 reports the results of Eq. (1). I use three measures for court efficiency — *Termination Case Backlog*, and *Weighted Filings* — in addition to the composite score (*InefficiencyScore*). Columns (1), (3), (5), and (7) show the results with state, industry, SEC regional office, and year fixed effects. Consistent with the first hypothesis, there are significantly negative relations between the court efficiency measures and the likelihood of SEC enforcement. Since a longer *Termination Time* indicates less court efficiency, the negative coefficient in column (1) implies that the more efficient a federal court is, the higher the SEC enforcement likelihood upon restatements.[18] Similarly, in column (3), there is a significantly negative correlation between *Case Backlog* and the likelihood of SEC enforcement, and in column (5), between *Weighted Filings* and SEC enforcement likelihood. Lastly, *InefficiencyScore* in column (7) has a significantly negative correlation with SEC enforcement likelihood. The economic significance is also meaningful. For example, I find that an increase of one standard deviation in *Termination Time* decreases the probability of SEC enforcement by 1.6%, which is 17.1% of the mean probability of enforcement.

Several control variables also have predictable relations that are consistent with prior studies. For example, measures that reflect restatement severity, such as *Res Adverse* and *Num Issues*, are all significantly correlated with SEC enforcement likelihood. For firm characteristics, I find a positive relation between *Size* and SEC enforcement likelihood, which is consistent with prior studies (Kedia and Rajgopal 2011). In columns (2), (4), (6), and (8), I use state, industry, and SEC regional office-year fixed effects and find consistent results.

5.3 Cross-Sectional Tests

[18] As an alternative measure to *Termination Time*, I use the "median time from filing to disposition," as provided in the Federal Court Management Statistics. Consistent results are obtained using the raw values, but results are not robust after winsorizing this variable.

The SEC trades off costs and benefits when making enforcement decisions. To understand what specific costs and benefits the SEC considers in its cost-benefit analysis, I examine how enforcement costs due to court efficiency interact with the severity of a restatement as the proxy for benefits of enforcement. Table 5 reports the cross-sectional results. Columns (1) and (2) show the results of restatement returns below the median (i.e., more severe restatements) and above the median (i.e., less severe restatements), respectively. When a restatement involves significant harm to investors, the benefits of enforcement are more likely to outweigh the costs due to court efficiency because the SEC's primary objective is to protect investors. Therefore, I expect to find a stronger relation between *InefficiencyScore* and SEC enforcement likelihood in the subsample of less severe restatements. Column (1) shows that the coefficient on *InefficiencyScore* is significantly negative in the subsample with more severe restatements, which is inconsistent with my prediction. One plausible explanation is that more severe restatements are more complicated, requiring additional time to investigate and enforce. Therefore, the costs related to court efficiency are more likely to matter. Indeed, Bonsall et al. (2024) show that when the SEC regional offices have a large backlog, they are less likely to investigate more severe restatement cases because such cases demand a longer investigation time. The results in columns (1) and (2) are consistent with findings in Bonsall et al. (2024), suggesting that the SEC sometimes is unable to prioritize investor harm when it faces resource constraints.

To strengthen the results and mitigate concerns that the findings are explained by omitted correlated variables, I conduct a second cross-sectional test using budget constraints of the SEC as a cross-sectional cut.[19] I expect the correlation between *InefficiencyScore* and SEC enforcement likelihood to be stronger in years when the SEC has more binding budgetary constraints. The SEC

[19] The SEC's budget constraint is determined at the year in which the restatement was announced.

can pursue as many enforcement actions as it wishes without budgetary constraints as long as these actions have positive net benefits. It is only when the SEC faces budgetary constraints that it needs to assess the net benefits of each enforcement action and choose firms against which such actions should be taken. Columns (3) and (4) show the results for the years with above-median budget constraints (i.e., more binding budget constraints) and below-median budget constraints (i.e., less binding budget constraints). The significantly negative coefficient on *InefficiencyScore* in the subsample with more binding budget constraints is consistent with my prediction. This test can strengthen the results because any alternative explanation based on omitted correlated variables would need to account for not only why court efficiency affects SEC enforcement actions, but also why the relation varies with the tightness of the SEC's budgetary constraints.

5.4 Judicial Vacancy Tests

An underlying assumption in the primary analysis is that an average firm's operational choices do not affect federal court efficiency. However, extremely impactful lawsuits resulting from firms' operational choices may arise, affecting the entire local economy and leading to class actions by employees, suppliers, shareholders, creditors, etc. To address endogeneity concerns, I explore how judicial vacancies due to exogenous reasons affect SEC enforcement likelihood.

I use judicial vacancies due to the death of judges. Unless an appointment to fill a judicial vacancy due to the death of a judge is confirmed, all judicial vacancies due to the death of judges in a given year are counted and defined as *Num Vacancy*.[20] In the baseline results shown in column (1) of Table 6, I do not find a significant coefficient on *Num Vacancy*. In columns (2) and (3), I

[20] For example, if one judge died last year but the position has not been filled this year, and another judge dies this year, the number of judge vacancies due to the death of judges this year is two.

explore two cross-sectional variations. First, I examine whether the effect of *Num Vacancy* is stronger for courts with fewer judgeships because the decline in caseload per judge is larger. There is a significant variation in the total number of judgeships in each federal district court. For example, the federal district court in Vermont has two judgeships, the court in Maryland has ten, and the Central District of California has 28. In all, the average number of judgeships is about seven, and *Low Num Judges* equals one if a court has fewer than seven judgeships. The coefficient of the interactive variable in column (2) is significantly negative at the 5% level, which is consistent with the prediction. Next, I explore variations in the productivity of outgoing judges. I collect the number of dockets for each judge via Westlaw and then compute each judge's productivity by dividing the number of the judge's dockets by the total number of cases filed in that district court.[21] I expect the effect of *Num Vacancy* to be stronger for judges who are more productive before they leave the position. The coefficient of the interactive variable in column (3) is significantly negative at the 10% level, confirming my prediction. In sum, the aforementioned results present a negative relation between the court efficiency measures and SEC enforcement likelihood, thus supporting the first hypothesis. [22]

5.5 Tests of Financial Reporting Quality

To test the second hypothesis, I examine the relation between abnormal accruals (ineffective internal controls) and the average composite score (*Avg InefficiencyScore*) of the current and previous years. In column (1) of Table 7, I find a significantly positive correlation between *Avg*

[21] The sample starts after 2000 due to data availability in Westlaw.

[22] In Internet Appendix IA.4, I obtain consistent results by using the variation in the number of pension-eligible judges at each federal district court to capture exogenous variation in court efficiency due to retirement in senior status (Yang 2016).

InefficiencyScore and abnormal accruals (*AbAcc*).[23] Column (2) of Table 7 presents the results of ineffective internal controls. *Avg InefficiencyScore* is positively correlated with ineffective internal controls (*ICW*), which indicates a lower level of FRQ in inefficient districts. These results collectively provide evidence for the importance of an efficient federal judicial system on capital markets.

For the third hypothesis, I empirically test the theoretical prediction in Schantl and Wagenhofer (2020), which suggests that when the private enforcement regime is weak (strong), increasing public enforcement can lead to a higher (lower) level of FRQ. I conduct two sets of cross-sectional tests to examine this hypothesis and present the results in columns (3)-(6) of Table 7. In the first set of cross-sectional tests, I use the level of private enforcement intensity in each federal district in year *t-1* to capture the strength of the private enforcement regime and examine the relation between court efficiency and FRQ in year *t*. This intensity measure is calculated by dividing the total number of federal securities class actions filed in a federal district by the total number of firms headquartered in that district. Column (3) of Table 7 restricts the sample to firms in districts with a below-median proportion of class actions, while column (4) restricts the sample to firms in districts with an above-median proportion of class actions. According to the theoretical findings in SW, the positive relation between *Avg InefficiencyScore* and *AbAcc* in column (1) of Table 7 primarily derives from the low private enforcement regime where the "crowding-out effect" is weak. Consistent with SW, there is a significantly positive coefficient on *Avg InefficiencyScore* in column (3) when the "direct effect" is the dominant channel.

[23] The sample period spans from 1996 to 2019 for the tests on abnormal accruals. Because the "Sox 404-Internal Controls" database begins after 2004, the sample period for the tests on internal controls is from 2004 to 2019.

The second set of cross-sectional results is based on federal judge ideology. Huang et al. (2019) find that the level of class actions is higher in more liberal Courts of Appeals (i.e., circuit courts) because judges appointed by Democrat presidents tend to be more antibusiness. Following Huang et al. (2019), I focus on Court of Appeals judges and calculate the proportion as the total number of Democrat-appointed judges in a Court of Appeals over the total number of judges in that court. This measure is computed at the circuit court level because the circuit courts set case precedents, and decisions made by district court judges undergo mandatory and routine assessments by circuit courts. Consequently, district court judges are inclined to factor in the likelihood of their decisions being reviewed and reversed by circuit courts. Column (5) restricts the sample to firms in federal circuit with a below-median proportion of Court of Appeals judges appointed by Democrat presidents, which are thus considered conservative. Column (6), on the other hand, restricts the sample to firms in federal circuits with an above-median proportion of Court of Appeals judges appointed by Democrat presidents, indicating that they are liberal. I expect the positive relation between *Avg InefficiencyScore* and *AbAcc* to be more pronounced in the subsample of firms located in less liberal federal circuits where the private litigation regime is weak. The significantly positive coefficient on *Avg InefficiencyScore* in column (5) for less liberal courts is again consistent with the theoretical findings in SW, and the difference between *Avg InefficiencyScore* in columns (5) and (6) is significant at the 10% level. Collectively, these results support prior theoretical findings that public and private enforcement actions interact with each other in determining the ultimate level of financial reporting quality.

6. Additional Analysis and Robustness Tests

6.1 Venue Shopping

Under the Exchange Act, the SEC is allowed to choose from multiple federal district courts to file a complaint. In doing so, the SEC could select a venue that circumvents local judicial inefficiencies. The "venue shopping" story represents a tension within the first hypothesis. To examine the "venue shopping" story, I examine 439 SEC civil actions against domestic companies initiated from 1995 to 2010. Approximately 73% of the lawsuits were filed with federal districts where the defendants' headquarters were located, and around 18% of the lawsuits were filed with D.D.C. The SEC may easily establish jurisdiction in D.D.C. because financial reports are filed with the SEC in its headquarters in D.C. In sum, 91% (73% + 18%) of the lawsuits were filed with either the federal district court where the headquarters was located or with D.D.C.

One possible explanation for why most of the lawsuits are brought in federal district courts where firms are headquartered may be that the plaintiff's discretion in "venue shopping" is not unrestricted (Cox et al. 2009; Huang et al. 2019).[24] In addition, the SEC is at its best when prosecuting such cases as standard accounting fraud cases (Johnson 2007), regardless of the venue. Another possible explanation is the stickiness of investigation and litigation (i.e., a regional office that initiates an investigation is most likely to also litigate the case).[25] I find that approximately 75% of the investigations initiated by one of the eleven regional offices that ultimately resulted in Section 13(b) enforcement actions were litigated in federal district courts within the jurisdiction of the same regional office. The descriptive evidence suggests the regional office that initiates the investigation tends not to pass on the cases to other offices, and that the litigation is fairly "sticky" within the office that initiates the investigation. Similarly, when an investigation conducted by the

[24] See 28 U.S.C. § 1404(a) and further explanations in footnote 4.
[25] The SEC investigation data from Blackburne, Kepler, Quinn, and Taylor (2021) is used to determine the offices that initiated the investigations.

SEC headquarters leads to an enforcement action, it is more likely that such an action will be litigated by the SEC headquarters.[26]

Given the descriptive evidence that the majority of cases are filed in districts where the firms' headquarters are located and D.D.C., which is the court outside of the firms' headquarters with which the SEC most frequently files complaints, I examine the SEC's choice of local federal district court vs. D.D.C. and the results are presented in Table IA.7 of the Internet Appendix. I find no significant relation between regional judicial efficiency and the choice to file with D.D.C. Despite the flexibility in choosing a venue, these results collectively suggest that the decision to file with D.D.C. is not primarily affected by court efficiency. Instead, it seems to be based on other factors, such as geographic convenience or the attorney's honest assessment of the optimal venue.

6.2 Administrative Proceedings versus Civil Actions

The Dodd-Frank Act expanded the SEC's authority to seek monetary penalties by allowing it to pursue such monetary penalties in administrative proceedings against any person, including public firms and their employees. Therefore, post Dodd-Frank, the SEC can impose monetary penalties upon public firms and their employees through either civil actions or administrative proceedings. An interesting question arises: in the post-Dodd-Frank period, with administrative proceedings as an option, is the SEC more likely to undertake them in the case of firms in less efficient federal districts?

Compared to administrative proceedings, civil proceedings can provide more accessible court records, have higher public visibility, cause greater reputational damage, and have a stronger

[26] Approximately 83% of the investigations initiated by the SEC headquarters that ultimately resulted in Section 13(b) enforcement actions were litigated by the SEC headquarters. The descriptive evidence also implies that while the SEC headquarters may play a role as a centralized decision maker, the SEC regional offices retain a good level of autonomy in investigation and enforcement. I thank an anonymous reviewer for suggesting this "stickiness" explanation.

deterrence effect. In addition, higher public visibility can help the SEC maximize political capital and secure future congressional support (Zheng 2021).[27] On the other hand, administrative proceedings, which are resolved 17 times faster than civil actions, are quicker due to simplified procedures (Zheng 2021). Using SEC enforcement pursuant to the Section 13(b) provisions from 2011 to 2018, I conduct an analysis and present the results in Table IA.8 of the Internet Appendix.[28] For the baseline result, I do not find a significant relation between the court efficiency measures and the likelihood of administrative proceedings. IA.9 of the Internet Appendix provides several possible factors that contribute to the lack of baseline results. For example, in 2017, the SEC issued guidance ordering reconsideration of all pending administrative proceedings and remanded cases with initial decisions. The solid line in Figure 4 shows a drop of almost 25% in the use of administrative proceedings, from about 80% in 2017 to 60% in 2018. This reduced efficiency of the administrative court could introduce bias against finding the relation in question.

Despite the insignificant baseline result and empirical challenges, I further examine this research question using a cross-sectional test to explore the interaction between federal district court inefficiency and the case backlog of SEC regional offices, as many SEC investigation and litigation decisions are made by the SEC regional offices. Following Bonsall et al. (2024), I use the number of open cases at each SEC regional office as a proxy for busyness. Because administrative proceedings are less costly and time-consuming, an SEC regional office may be more sensitive to court inefficiency when it already has a high case backlog in hand. Therefore, I expect a positive coefficient on the interactive term. The result in column (2) of Table IA.8 shows

[27] Zheng (2021) examines the determinants of administrative court proceedings after the Dodd-Frank Act and finds that significant cases (e.g., fraud and bribery) are more likely to be filed in federal district courts. In addition, cases brought against politically connected defendants are more likely to be filed in administrative court.

[28] The sample ends in 2018 as the data for SEC regional office backlog spans from 2000 to 2017, and lagged values are used in the analysis. As in Zheng (2021), the observation is at the defendant level, but the sample used in this paper only involves Section 13(b) violations. In contrast, Zheng (2021) examines a wider range of violations, such as insider trading.

a significant positive coefficient on the interaction between court efficiency (*InefficiencyScore*) and the backlog of each regional office (*RegionalOff Backlog)*. This provides evidence that the SEC indeed considers switching to administrative proceedings when courts have significant inefficiencies and the SEC regional offices face a heavy backlog. This set of tests in the post-Dodd Frank period suggests that the administrative court can partially alleviate federal district court inefficiency.

6.3 Alternative Events — Late Filings

In the primary analysis, I follow prior research (Correia 2014; Bonsall et al. 2024) and use restatements as trigger events. As a robustness check, I use late filings of 10-K and 10-Q reports as alternative trigger events for SEC investigations because late filings frequently reveal accounting and auditing issues (Cao, Chen, and Higgs 2016; Karpoff, Lee, and Martin 2008). Table 8 shows a negative correlation between *InefficiencyScore* and SEC enforcement conditional on late filings, which is consistent with previous results.

6.4 State-Year Fixed Effects

An alternative explanation is that the SEC's objectives may vary by state. For instance, the SEC might avoid enforcing cases in certain "important" states to gain congressional support from senators in those states (Mehta and Zhao 2020; Heese 2019). Despite controlling for a series of state-level and district-level variables, time-variant state-level omitted correlated variables could still affect the results. To address this concern, I examine the sensitivity of the main results to state-year fixed effects. Exploring state-year fixed effects is feasible because some states, such as Missouri and Arkansas, have multiple federal district courts. However, in other states that have

only one federal district court, the court efficiency measures are collinear with the state-year fixed effects and thus, are dropped. The untabulated results remain similar. This robustness test further strengthens the main results and mitigates concerns related to state-specific factors.

7. Conclusion

The SEC faces resource constraints and therefore needs to carefully select enforcement actions to minimize enforcement costs. When the SEC files a civil complaint with a federal district court, the speed of the case resolution depends on the efficiency of the federal judicial system. I provide evidence that more court inefficiency leads to a lower likelihood of SEC enforcement. Additionally, I find that more efficient courts are correlated with a lower level of abnormal accruals and a lower likelihood of ineffective internal controls. Examining the interaction between private and public enforcement, I show that more efficient courts are correlated with higher FRQ in regions with weak private enforcement regimes. Though most government agencies (e.g., the EPA, CFTC, and DOJ) rely on federal district courts to pursue enforcement actions, there are differences in organizational structures and enforcement priorities across agencies. I caution the reader from overinterpreting the results as the evidence in this study is limited to SEC enforcement actions. Collectively, these findings contribute to the literature that examines the influence of the legal environment on capital markets.

Appendix A: Variable Definitions

Variable	Definition
Dependent Variables	
SEC Civil Action	An indicator variable set to one if the SEC issues a civil enforcement action against the firm. The data is from Call, Martin, Sharp, and Wilde (2018), obtained from the *JAR* online supplements and datasheets.
AbAcc	Residuals from cross-sectional estimations of the performance-adjusted model in Kothari, Leone, and Wasley (2005). Industry-year regressions are estimated based on the two-digit SIC industry classification with more than 15 industry peers.
ICW	An indicator variable set to one for the period in which the firm reports ineffective internal controls in the "SOX 404- Internal Controls" database of Audit Analytics.
Court Efficiency Measures	
Termination Time	Twelve over the case turnover ratio, which is computed as the number of cases terminated divided by the average number of pending cases. Measured at the federal district court level.
Case Backlog	The number of pending cases over available judges, which is computed as the (number of judgeships - total number of judge vacancy months/12). Measured at the federal district court level.
Weighted Filings	The number of weighted filings over available judges, which is computed as the (number of judgeships - total number of judge vacancy months/12). The weight on each filing is assigned by the Federal Judiciary based on the estimated time that judges would spend. Measured at the federal district court level.
InefficiencyScore	First principal component using *Termination Time*, *Case Backlog*, and *Weighted Filings*. Measured at the federal district court level.
Restatement Control Variables	
Restated Period	Length of the restated period in days. Data are obtained from the Audit Analytics Financial Restatements.
Revenue Recognition	An indicator variable set to one if the restatement relates to revenue recognition.
Num Issues	The number of items restated identified in Audit Analytics.
Restate Ret	Market adjusted returns over (-2, +2) the interval around the restatement announcement.
Res Adverse	An indicator variable set to one if the restatement has adverse effects on the financial statement.

Restate Ret Sqr	Square of the market adjusted returns over (-2, +2) interval around the restatement announcement.
Timeliness	The number of days between the end of the restated period and the restatement announcement date.
Firm Control Variables	
BigFour	An indicator variable set to one if the firm-year is audited by a big four auditor.
BTM	Book value of equity divided by market value of equity.
Lev	Long-term debt plus the current portion of long-term debt divided by total assets.
Size	Natural log of total assets.
ln(Age)	Natural log of the number of years the firm has appeared in Compustat.
In(Distance)	Natural log of the distance from the firm's headquarters to an SEC regional office.
In(Employee)	Natural log of the firm's total number of employees.
Loss	An indicator variable set to one if net income is less than zero.
ROA	Operating income before depreciation divided by total assets.
Small	An indicator variable set to one if the firm's market capitalization is less than $300 million.
District/ State Control Variables	
IncomeGrowth	Percentage change in the per capita personal income for the federal district where the firm's headquarters is located. County-level data are aggregated to the federal district level. Data are obtained from the BEA.
Unemploy	The unemployment rate of the federal district where the firm's headquarters is located. County-level data are aggregated to the federal district level. Data are obtained from the BLS.
In(Population)	Log of the population of the federal district where the firm's headquarters is located. County-level data are aggregated to the federal district level. Data are obtained from the BEA.
Violence	Violent crime rate (per 100,000 inhabitants) in the state where the firm's headquarters is located. Data are obtained from the FBI Uniform Crime Reporting (UCR) Program.
Property	Property crime rate (per 100,000 inhabitants) in the state where the firm's headquarters is located. Data are obtained from the FBI Uniform Crime Reporting (UCR) Program.
Religion	Proportion of religious affiliates in the federal district where the firm's headquarters is located. County-level data are aggregated to the federal district level. Data are

	obtained from Religious Congregations and Membership Study.
BlueState	An indicator variable set to one if the state where the firm's headquarters is located favored a Democratic candidate in the previous presidential election before year *t*.
Judicial Vacancies Control Variables	
Num Vacancy	The total number of judicial vacancies due to death.
Low Num Judges	An indicator variable set to one if a court has fewer than seven judgeships.
High Productivity	An indicator variable set to one if the judge's productivity, defined as the total number of dockets in the prior year before he/she left the position over the total number of fillings of the district court in that year, is above the median. The number of dockets for each judge is collected from Westlaw.
Cross-Sectional Analysis Variables	
Budget Constraints	Computed as actual spending minus enacted budget, divided by enacted budget. Data is collected from: <https://www.sec.gov/foia-services/frequently-requested-documents-2/budget-history-ba-vs-actual-obligations-000s>.
Private Enforcement	Computed as the total number of federal class actions filed in a federal district divided by the total number of firms headquartered in that district.
Liberal Courts	Computed as the total number of Democrat-appointed judges in a Court of Appeals over the total number of judges in that court.

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Figure 1: SEC Enforcement Process

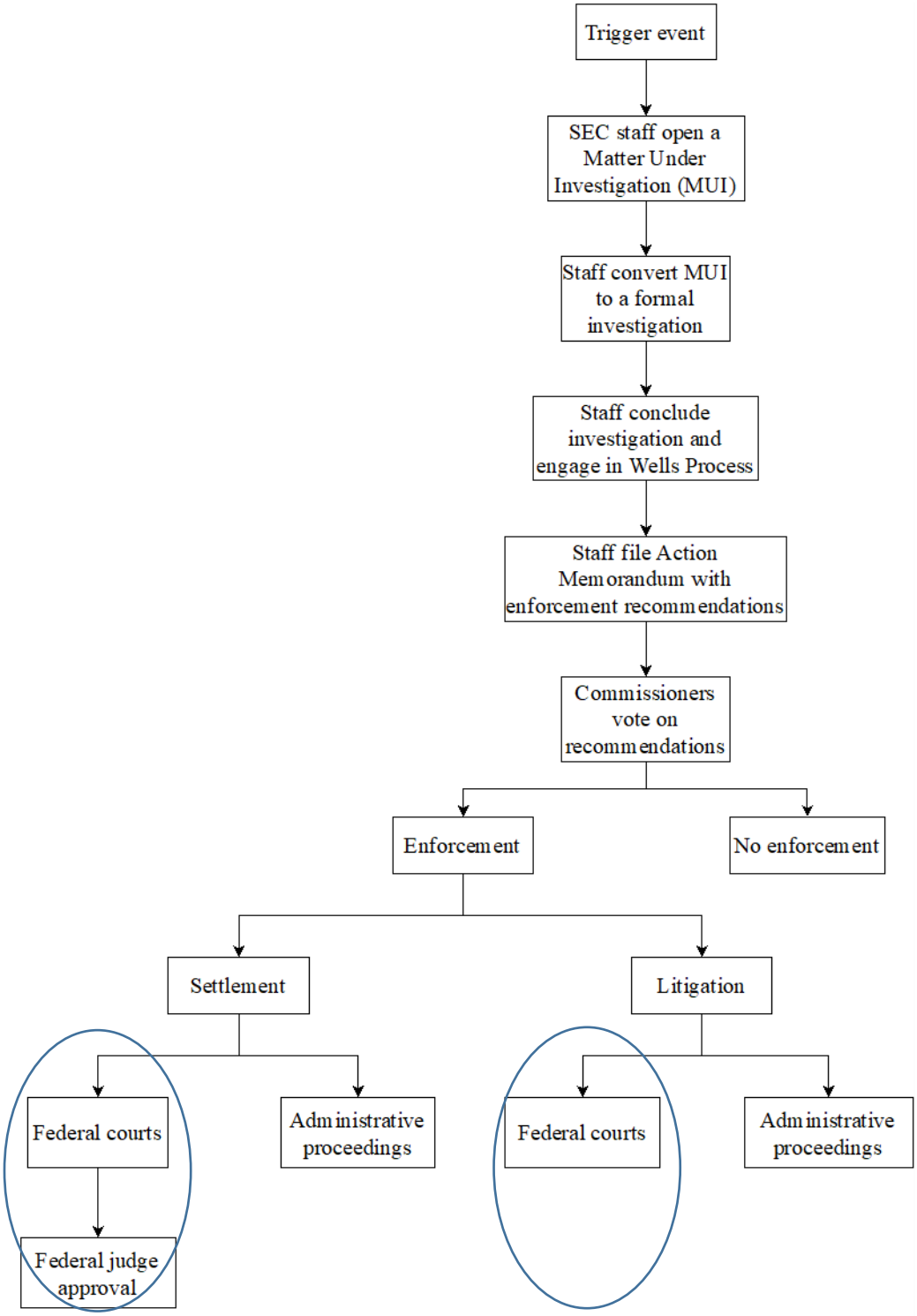
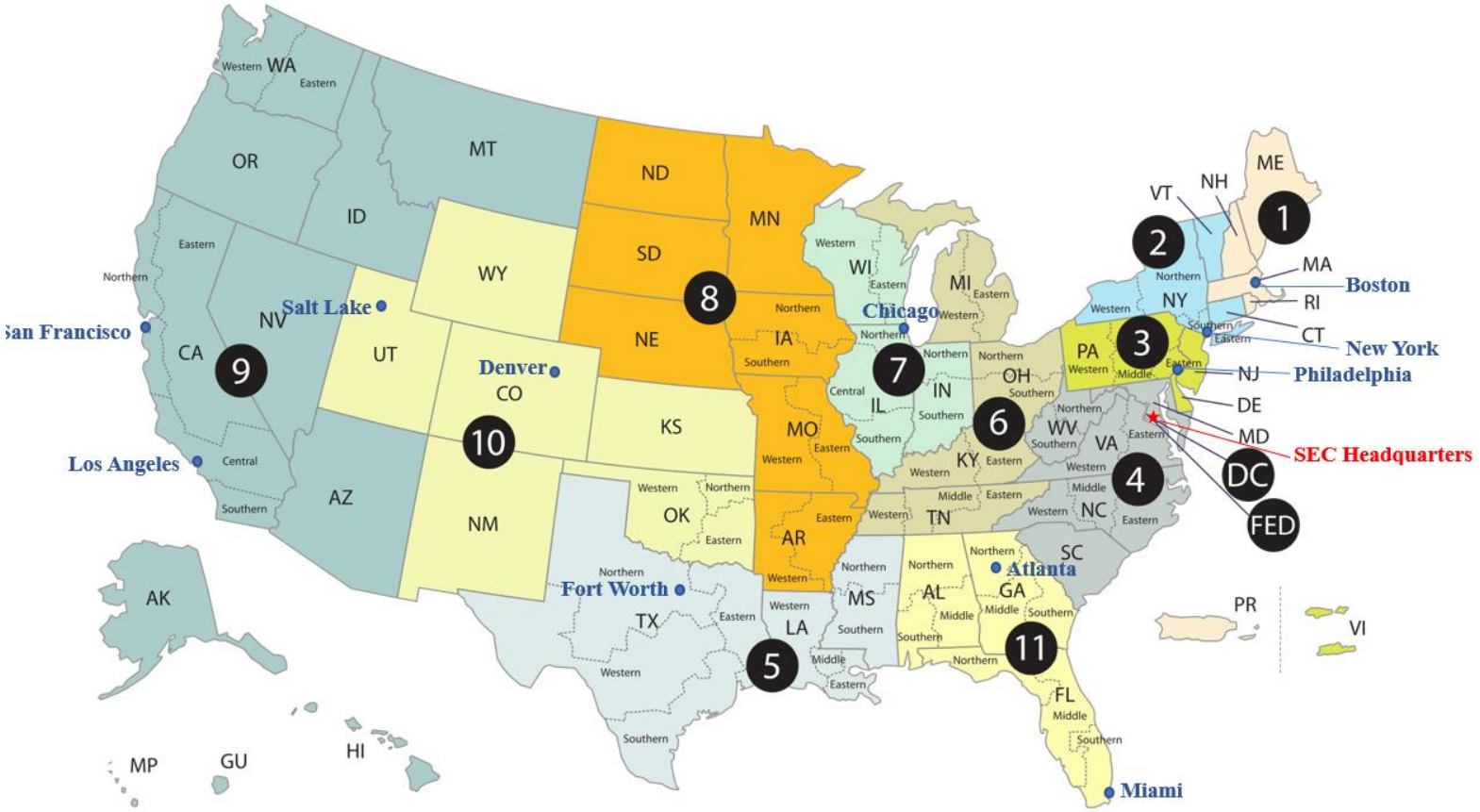


Fig.1. SEC Enforcement Process. This figure shows the decision tree of an SEC enforcement action. The venues circled represent "SEC civil action."

Figure 2: Geographical Boundaries of U.S. Courts of Appeals and District Courts and SEC Regional Offices

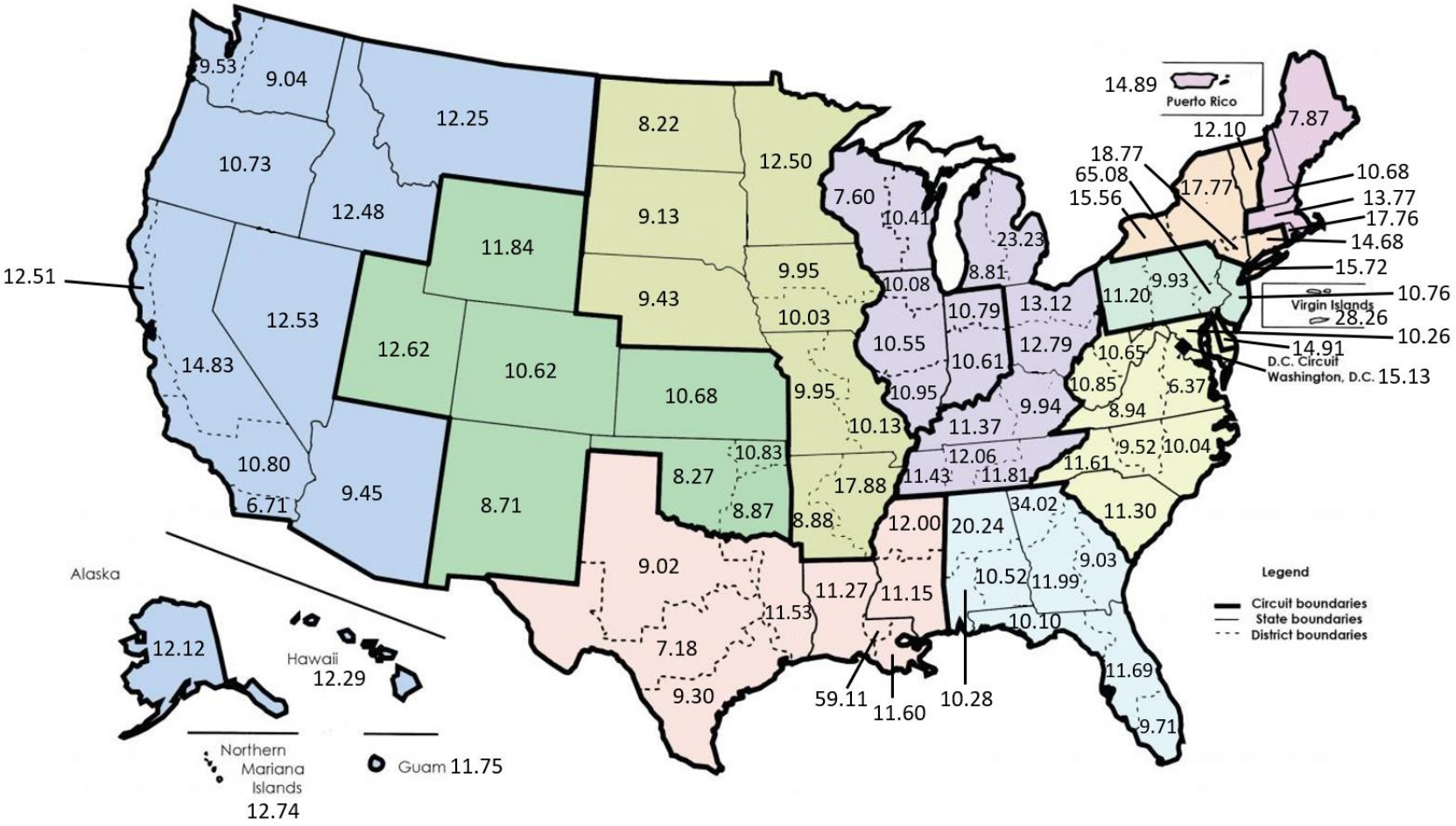


Atlanta Regional Office	**Fort Worth Regional Office**	**Philadelphia Regional Office**
GA, NC, SC, TN, AL	*TX, OK, AR, KS*	*DE, MD, PA, VA, WV, DC*
Boston Regional Office	**Los Angeles Regional Office**	**Salt Lake Regional Office**
CT, ME, MA, NH, VT, RI	*AZ, HI, GU, NV, Southern CA*	*UT*
Chicago Regional Office	**Miami Regional Office**	**San Francisco Regional Office**
IL, IN, IA, KY, MI, MN, MO, OH, WI	*FL, MS, LA, VI, PR*	*WA, OR, AK, MT, ID, Northern CA*
Denver Regional Office	**New York Regional Office**	
CO, KS, NE, NM, ND, SD, WY	*NY, NJ*	

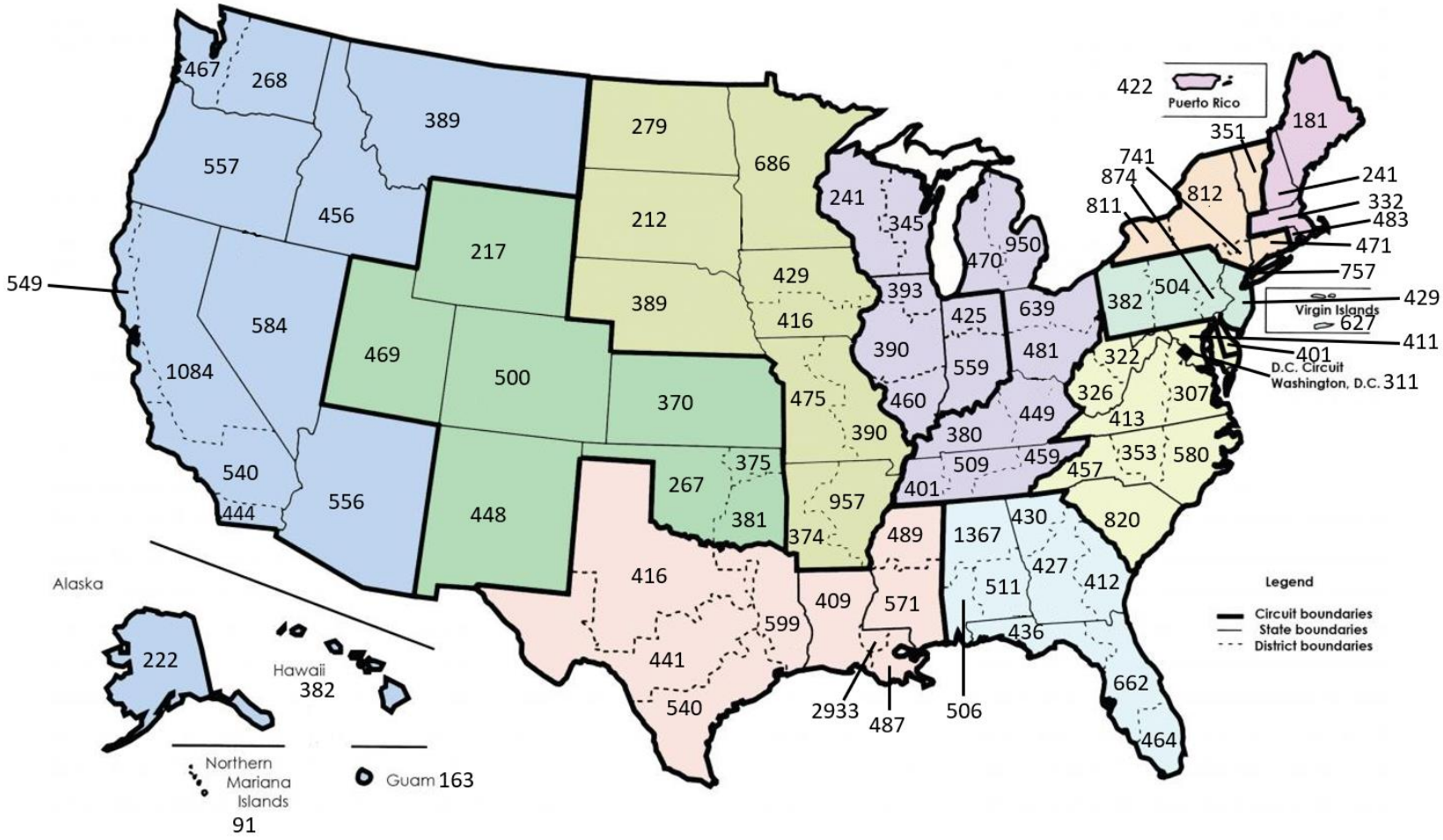
Sources: < http://www.uscourts.gov/sites/default/files/u.s._federal_courts_circuit_map_1.pdf>; <https://www.sec.gov/page/sec-regional-offices>

Figure 3: Court Efficiency Measures on the Map

Panel A: Average *Terminiation Time* across Federal Districts



Panel B: Average *Case Backlog* Per Judge across Federal District



Panel C: Average *Weighted Filings* Per Judge across Federal District

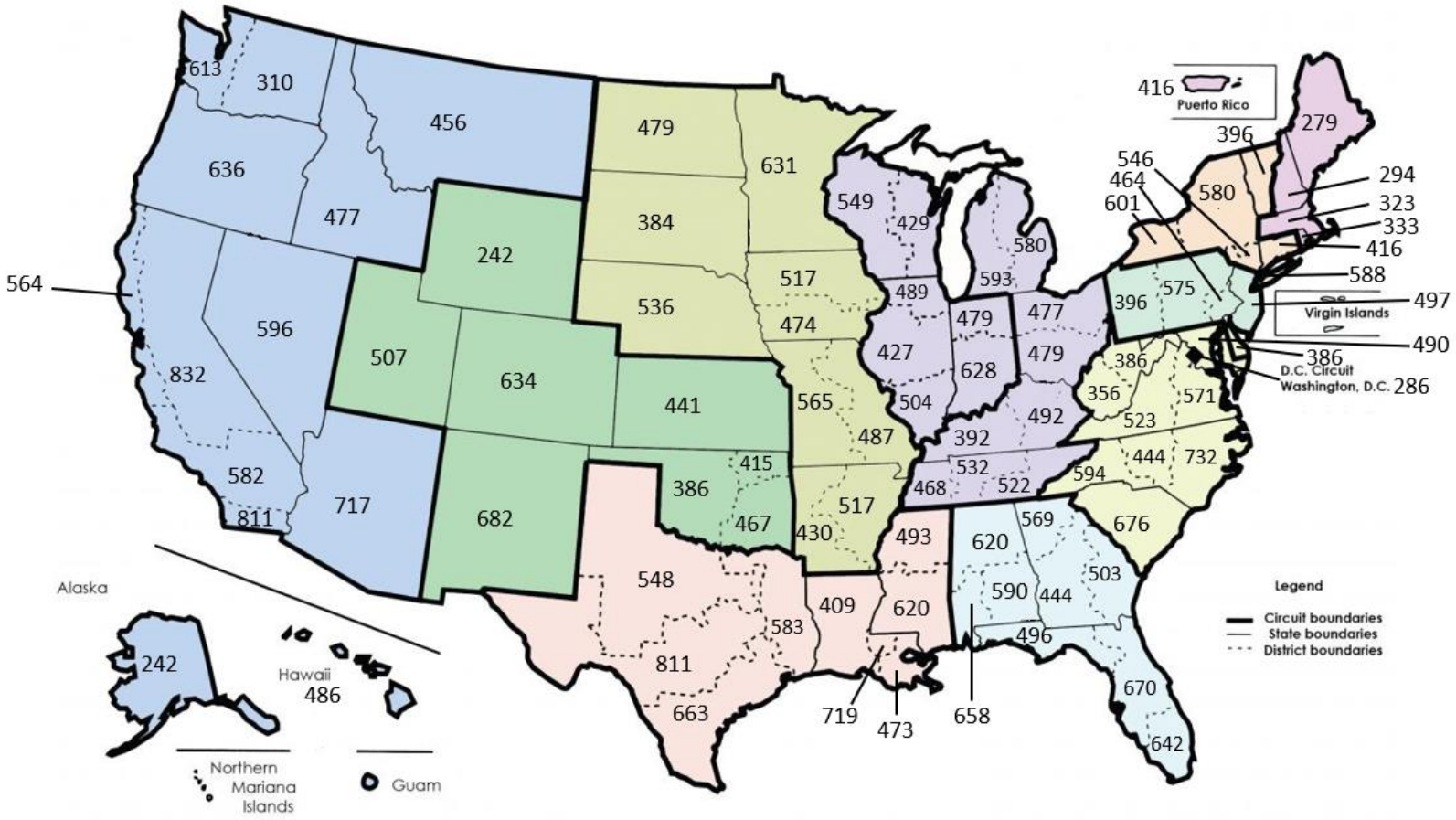


Fig. 3. Court Efficiency Measures on the Map. These figures illustrate the average *Termination Time* (in months), *Case Backlog* per judge, and *Weighted Filings* per judge for 94 federal district courts from 1995 to 2010. For demonstration purposes, court efficiency measures presented in these figures are rounded.

Figure 4: Percentage of "Issuer Reporting and Disclosure" Violations Pursued as Administrative Proceedings

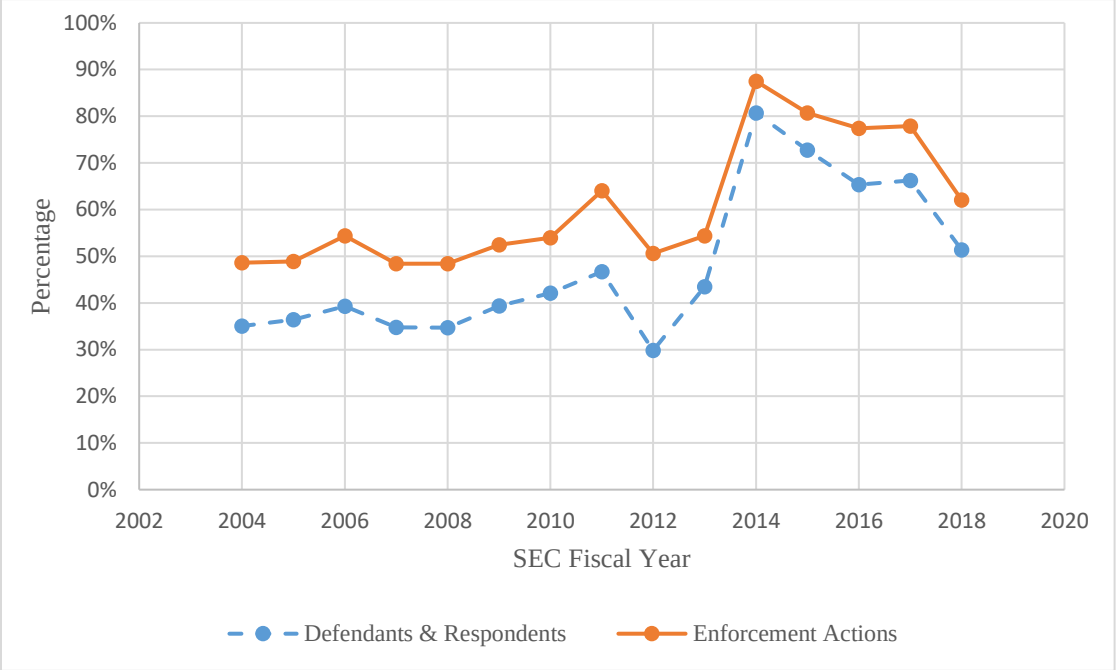


Fig. 4. Percentage of "Issuer Reporting and Disclosure" Violations Pursued as Administrative Proceedings. This figure illustrates the percentage of "Issuer Reporting and Disclosure" violations pursued as administrative proceedings from 2004 to 2018. The solid line is the number of stand-alone administrative proceedings divided by the total number of enforcement actions. The total number of enforcement actions is the sum of stand-alone administrative proceedings and civil actions. The dotted line is computed as the number of defendants and respondents prosecuted in stand-alone administrative proceedings divided by the total number of defendants and respondents prosecuted in all enforcement actions. Enforcement actions in this figure exclude follow-on administrative proceedings.

Table 1. Court Efficiency Measures

Panel A: Correlations

	(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*	*(7)*	*(8)*	*(9)*	*(10)*	*(11)*
(1)Termination Time		**0.475**	-0.010	**-0.074**	**0.159**	0.032	0.012	**-0.099**	**0.093**	0.094	0.040
(2)Case Backlog	**0.657**		**0.690**	**-0.119**	**0.262**	**-0.040**	**0.397**	-0.021	**0.198**	0.019	0.029
(3)Weighted Filings	**0.032**	**0.545**		**-0.050**	**0.094**	**-0.068**	**0.449**	**0.178**	**0.217**	-0.025	0.050
(4)IncomeGrowth	-0.033	**-0.035**	-0.021		**-0.344**	**0.054**	-0.015	**0.173**	**0.088**	**0.037**	0.057
(5)Unemploy	**0.072**	**0.097**	**0.054**	**-0.359**		**-0.121**	**0.103**	**-0.076**	**0.077**	**0.050**	**-0.077**
(6)Religion	**0.035**	-0.002	**-0.039**	**0.048**	**-0.111**		-0.035	-0.011	0.031	**-0.160**	**0.065**
(7)In(Population)	0.002	**0.144**	**0.343**	-0.029	**0.096**	-0.026		**-0.072**	**0.139**	**0.282**	**0.232**
(8)Property	-0.019	**-0.062**	**0.064**	**0.112**	0.001	0.012	**-0.117**		**0.614**	**-0.227**	**0.073**
(9)Violence	**0.082**	**0.070**	**0.082**	**0.065**	**0.091**	**0.077**	**0.022**	0.648		**-0.039**	**0.114**
(10)BlueState	0.019	0.005	-0.027	0.019	0.059	-0.167	**0.283**	**-0.157**	**0.055**		0.020
(11)EnfPct	-0.015	**-0.053**	-0.042	0.048	**-0.125**	0.041	0.020	**0.098**	**0.081**	-0.043	

This table displays the correlations between the three court efficiency measures and district/state-level control variables. Pearson (Spearman) correlations are reported in the lower left (upper right) corner. Bold correlations are significant at the 0.10 level. *EnfPct* is the percentage of restatements that result in SEC civil actions in each federal district. See Appendix A for variable definitions.

Panel B: Principal Component Analysis: Factor Loadings

Components	Factor Loadings
Termination Time	0.52
Case Backlog	0.67
Weighted Filings	0.53

This table reports the factor loadings on the first principal factor using the principal component analysis. The eigenvalue is 1.89, and the first principal factor based on *Termination Time*, *Case Backlog*, and *Weighted Filings* explains 63.10% of the total variation in the data.

Table 2. Descriptive Statistics

Variable	N	Mean	S.D.	p25	p50	p75
SEC Civil Action	3,571	0.092	0.290	0.000	0.000	0.000
Termination Time	3,571	13.277	7.901	9.400	11.059	13.653
In(Case Backlog)	3,571	6.201	0.381	5.987	6.159	6.353
In(Weighted Filings)	3,571	6.274	0.237	6.154	6.297	6.415
Restated Period	3,571	761.312	677.736	272.000	637.000	1094.000
Revenue Recognition	3,571	0.193	0.395	0.000	0.000	0.000
Num Issues	3,571	2.248	1.672	1.000	2.000	3.000
Restate Ret	3,571	-0.025	0.116	-0.066	-0.013	0.027
Restate Ret Sqr	3,571	0.016	0.043	0.000	0.002	0.010
Res Adverse	3,571	0.840	0.367	1.000	1.000	1.000
Timeliness	3,571	195.268	136.562	119.000	143.000	223.000
Size	3,571	5.861	2.008	4.481	5.836	7.161
In(Age)	3,571	2.602	0.715	2.079	2.565	3.091
BTM	3,571	0.656	0.680	0.275	0.518	0.855
Small	3,571	0.535	0.499	0.000	1.000	1.000
Loss	3,571	0.379	0.485	0.000	0.000	1.000
In(Employ)	3,571	1.078	1.108	0.219	0.661	1.630
Lev	3,571	0.286	0.318	0.037	0.209	0.409
BigFour	3,571	0.698	0.459	0.000	1.000	1.000
ROA	3,571	0.034	0.227	0.016	0.077	0.134
In(Distance)	3,571	3.899	1.633	2.874	3.701	5.412
IncomeGrowth	3,571	3.769	3.048	2.238	4.062	5.614
Unemploy	3,571	5.483	1.856	4.407	5.047	6.269
Religion	3,571	0.506	0.097	0.418	0.517	0.577
In(Population)	3,571	15.507	0.614	15.153	15.590	15.860
Property	3,571	3.254	0.996	2.630	3.321	4.029
Violence	3,571	0.477	0.132	0.370	0.491	0.545
BlueState	3,571	0.664	0.473	0.000	1.000	1.000

This table presents the summary statistics for the variables used in equation (1). The three court efficiency measures: *Termination Time*, *Case Backlog*, and *Weighted Filings* are measured at the federal district court level. All of the continuous variables are winsorized at the 1% and 99% levels. All variables are defined in Appendix A.

Table 3. Distribution of Restatements and SEC Civil Actions

District	Restatements	*EnfPct*	District	Restatements	*EnfPct*	District	Restatements	*EnfPct*
D.Alaska	3	0.00%	D.Kan.	26	15.38%	N.D.Ohio	39	15.38%
M.D.Ala.	1	0.00%	E.D.Ky.	10	0.00%	S.D.Ohio	57	7.02%
N.D.Ala.	26	3.85%	W.D.Ky.	12	0.00%	E.D.Okla.	1	0.00%
S.D.Ala.	7	0.00%	E.D.La.	5	60.00%	N.D.Okla.	14	21.43%
E.D.Ark.	9	0.00%	M.D.La.	10	0.00%	W.D.Okla.	8	37.50%
W.D.Ark.	6	0.00%	W.D.La.	7	0.00%	D.Or.	37	16.22%
D.Ariz.	59	10.17%	D.Mass.	166	16.87%	E.D.Pa.	93	7.53%
C.D.Cal.	244	6.56%	D.Md.	49	8.16%	M.D.Pa.	15	20.00%
E.D.Cal.	9	0.00%	D.Me.	3	0.00%	W.D.Pa.	29	13.79%
N.D.Cal.	285	10.18%	E.D.Mich.	50	12.00%	D.R.I.	5	0.00%
S.D.Cal.	54	1.85%	W.D.Mich.	8	0.00%	D.S.C.	13	0.00%
D.Colo.	99	5.05%	D.Minn.	63	6.35%	D.S.D	5	60.00%
D.Conn.	79	13.92%	E.D.Mo.	39	10.26%	E.D.Tenn.	15	0.00%
D.D.C.	9	22.22%	W.D.Mo.	15	6.67%	M.D.Tenn.	30	10.00%
D.Del.	15	0.00%	N.D.Miss.	3	0.00%	W.D.Tenn.	9	22.22%
M.D.Fla.	83	7.23%	S.D.Miss.	1	0.00%	E.D.Tex.	27	22.22%
N.D.Fla.	4	0.00%	D.Mont.	1	0.00%	N.D.Tex.	163	10.43%
S.D.Fla.	110	10.00%	E.D.N.C.	28	32.14%	S.D.Tex.	174	7.47%
M.D.Ga.	5	0.00%	M.D.N.C.	15	0.00%	W.D.Tex.	47	10.64%
N.D.Ga.	110	10.00%	W.D.N.C.	36	5.56%	D.Utah	29	13.79%
S.D.Ga.	2	50.00%	D.N.D.	0	0.00%	E.D.Va.	95	3.16%
D.Haw.	8	0.00%	D.Neb.	15	6.67%	W.D.Va.	17	5.88%
N.D.Iowa	4	0.00%	D.N.H.	14	7.14%	D.Vt.	3	0.00%
S.D.Iowa	10	10.00%	D.N.J.	175	2.86%	E.D.Wash.	12	0.00%
D.Idaho	6	0.00%	D.N.M.	5	0.00%	W.D.Wash.	70	4.29%
C.D.Ill.	3	0.00%	D.Nev.	45	8.89%	E.D.Wis.	32	3.13%
N.D.Ill.	163	14.11%	E.D.N.Y.	41	14.63%	W.D.Wis.	11	0.00%
S.D.Ill.	1	0.00%	N.D.N.Y.	14	7.14%	N.D.W.Va.	3	0.00%
N.D.Ind.	17	35.29%	S.D.N.Y.	185	8.65%	S.D.W.Va.	7	0.00%
S.D.Ind.	32	12.50%	W.D.N.Y.	16	0.00%	D.Wyo.	0	0.00%

This table presents the total number of restatements and the percentage of SEC civil actions against restating firms (*EnfPc*t) across the federal district courts of 50 states over the sample period 1995 to 2010.

Table 4. SEC Civil Actions and Court Efficiency

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
VARIABLES					*SEC Civil Action*			
Termination Time	-0.002***	-0.002***						
	(-2.843)	(-2.864)						
In(Case Backlog)			-0.051***	-0.065***				
			(-2.831)	(-3.355)				
In(Weighted Filings)					-0.064*	-0.076**		
					(-1.930)	(-2.299)		
InefficiencyScore							-0.017***	-0.019***
							(-4.042)	(-4.304)
Restated Period	0.000***	0.000***	0.000***	0.000***	0.000***	0.000***	0.000***	0.000***
	(3.735)	(3.682)	(3.744)	(3.698)	(3.802)	(3.734)	(3.745)	(3.675)
Revenue Recognition	0.079***	0.075***	0.080***	0.075***	0.079***	0.074***	0.079***	0.075***
	(5.810)	(5.521)	(5.873)	(5.570)	(5.790)	(5.473)	(5.842)	(5.538)
Num Issues	0.008**	0.008**	0.008**	0.008**	0.008**	0.008**	0.008**	0.008**
	(2.176)	(2.377)	(2.153)	(2.371)	(2.124)	(2.348)	(2.154)	(2.374)
Restate Ret	-0.244***	-0.241***	-0.244***	-0.240***	-0.248***	-0.245***	-0.245***	-0.241***
	(-4.830)	(-4.970)	(-4.801)	(-4.917)	(-4.878)	(-4.999)	(-4.831)	(-4.955)
Restate Ret Sqr	0.842***	0.820***	0.842***	0.824***	0.840***	0.813***	0.845***	0.824***
	(6.384)	(6.145)	(6.360)	(6.149)	(6.355)	(6.166)	(6.386)	(6.170)
Res Adverse	0.030***	0.032***	0.030***	0.032***	0.030***	0.032***	0.030***	0.032***
	(2.924)	(3.136)	(2.892)	(3.123)	(2.928)	(3.112)	(2.930)	(3.150)
Timeliness	-0.000	-0.000	-0.000	-0.000	-0.000	-0.000	-0.000	-0.000
	(-0.552)	(-0.582)	(-0.579)	(-0.629)	(-0.650)	(-0.741)	(-0.568)	(-0.609)
Size	0.033***	0.031***	0.033***	0.030***	0.033***	0.030***	0.033***	0.031***
	(4.424)	(4.213)	(4.412)	(4.145)	(4.437)	(4.124)	(4.433)	(4.175)
In(Age)	-0.013	-0.015	-0.013	-0.015	-0.013	-0.015	-0.013	-0.015
	(-1.364)	(-1.523)	(4.412)	(4.145)	(4.437)	(4.124)	(4.433)	(4.175)

BTM	-0.008	-0.009	-0.013	-0.015	-0.013	-0.015	-0.013	-0.015
	(-1.274)	(-1.447)	(-1.402)	(-1.555)	(-1.365)	(-1.514)	(-1.398)	(-1.548)
Small	0.031	0.027	-0.008	-0.009	-0.008	-0.009	-0.008	-0.009
	(1.520)	(1.348)	(-1.256)	(-1.418)	(-1.276)	(-1.492)	(-1.288)	(-1.460)
Loss	-0.002	-0.001	0.030	0.027	0.031	0.027	0.031	0.027
	(-0.146)	(-0.048)	(1.514)	(1.318)	(1.533)	(1.338)	(1.529)	(1.337)
In(Employee)	0.002	0.002	-0.002	-0.000	-0.003	-0.001	-0.002	-0.000
	(0.183)	(0.191)	(-0.126)	(-0.006)	(-0.192)	(-0.063)	(-0.134)	(-0.019)
Lev	0.001	0.010	0.002	0.003	0.002	0.002	0.002	0.002
	(0.037)	(0.411)	(0.270)	(0.302)	(0.219)	(0.256)	(0.185)	(0.206)
BigFour	-0.011	-0.012	0.002	0.011	0.003	0.012	0.001	0.010
	(-0.836)	(-0.917)	(0.073)	(0.458)	(0.130)	(0.500)	(0.047)	(0.425)
ROA	0.002	0.007	-0.012	-0.012	-0.011	-0.013	-0.011	-0.012
	(0.081)	(0.299)	(-0.866)	(-0.926)	(-0.839)	(-0.941)	(-0.819)	(-0.896)
In(Distance)	0.010*	0.009*	0.003	0.008	0.002	0.008	0.002	0.007
	(1.880)	(1.774)	(0.134)	(0.333)	(0.097)	(0.317)	(0.092)	(0.291)
IncomeGrowth	-0.002	-0.008	0.012**	0.011**	0.013**	0.012**	0.011**	0.010**
	(-0.663)	(-1.607)	(2.560)	(2.443)	(2.531)	(2.471)	(2.215)	(2.054)
Unemploy	-0.008	-0.010	-0.002	-0.007	-0.002	-0.008	-0.002	-0.008
	(-1.269)	(-1.154)	(-0.631)	(-1.383)	(-0.585)	(-1.507)	(-0.658)	(-1.600)
Religion	-0.035	-0.135	-0.007	-0.007	-0.006	-0.008	-0.007	-0.008
	(-0.234)	(-0.761)	(-1.038)	(-0.762)	(-1.007)	(-1.003)	(-1.165)	(-0.914)
In(Population)	0.023	0.027	-0.049	-0.196	-0.027	-0.164	-0.054	-0.173
	(1.207)	(1.372)	(-0.318)	(-1.074)	(-0.177)	(-0.940)	(-0.351)	(-0.970)
Property	0.019	0.024	0.029	0.037*	0.022	0.028	0.026	0.031
	(0.579)	(0.441)	(1.407)	(1.756)	(1.205)	(1.503)	(1.351)	(1.603)
Violence	0.039	0.144	0.021	0.037	0.017	0.038	0.020	0.032
	(0.204)	(0.639)	(0.641)	(0.694)	(0.522)	(0.696)	(0.633)	(0.581)
BlueState	0.062**	0.064	0.050	0.169	0.008	0.051	0.029	0.130
	(2.015)	(1.647)	(0.254)	(0.741)	(0.041)	(0.229)	(0.152)	(0.576)

Constant	-0.579*	-0.603*	-0.406	-0.440	-0.195	-0.174	-0.646**	-0.706**
	(-1.871)	(-1.788)	(-1.310)	(-1.319)	(-0.570)	(-0.491)	(-2.085)	(-2.095)
State FE	Y	Y	Y	Y	Y	Y	Y	Y
2-Digit SIC FE	Y	Y	Y	Y	Y	Y	Y	Y
SEC office FE	Y	-	Y	-	Y	-	Y	-
Year FE	Y	-	Y	-	Y	-	Y	-
SEC office-Year FE	-	Y	-	Y	-	Y	-	Y
Observations	3,571	3,557	3,571	3,557	3,571	3,557	3,571	3,557
Adjusted R-squared	0.141	0.148	0.142	0.150	0.140	0.148	0.142	0.149

This table presents the coefficient estimates of the OLS equation (1). The dependent variable, *SEC Civil Action*, equals one if the SEC issues a civil enforcement action against the restating firm. The independent variable of interest is one of the four proxies for court efficiency: *Termination Time*, *Case Backlog*, *Weighted Filings*, and *InefficiencyScore*. All variables are defined in Appendix A. Standard errors are clustered at the federal district court level, and *t*-statistics are reported in parentheses. *, **, and *** indicate two-tailed significance at the 0.1, 0.05, and 0.01 levels, respectively.

Table 5. SEC Civil Actions and Court Efficiency in Subsamples

	Below Median Returns	Above Median Returns	More Binding Budget Constraints	Less Binding Budget Constraints
	(1)	(2)	(3)	(4)
VARIABLES	*SEC Civil Action*	*SEC Civil Action*	*SEC Civil Action*	*SEC Civil Action*
InefficiencyScore	-0.026***	-0.005	-0.018***	-0.009
	(-4.500)	(-1.412)	(-3.044)	(-0.832)
Controls	Y	Y	Y	Y
State FE	Y	Y	Y	Y
2-Digit SIC FE	Y	Y	Y	Y
SEC Office FE	Y	Y	Y	Y
Year FE	Y	Y	Y	Y
Difference (F-stats)	10.69***		0.44	
Observations	1,780	1,780	1,698	1,866
Adjusted R^2	0.198	0.058	0.171	0.141

This table presents the coefficient estimates of the OLS equation (1) on different partitions of the overall sample. The dependent variable, *SEC Civil Action*, is equal to one if the SEC issues a civil enforcement action against the restating firm. The independent variable of interest is *InefficiencyScore.* Column (1) restricts the sample to restatements with a below median *Restate Ret*, and column (2) restricts the sample to restatements with an above median *Restate Ret*. Column (3) restricts the sample to restatements filed in years when the SEC had an above median budget constraint, computed as (actual spending – enacted budget)/enacted budget, and column (4) restricts the sample to restatements filed in years when the SEC had a below median budget constraint. Appendix A provides variable definitions. Standard errors are clustered at the federal district court level, and *t*-statistics are reported in parentheses. *, **, and *** indicate two-tailed significance at the 0.1, 0.05, and 0.01 levels, respectively.

Table 6. SEC Civil Actions and Judicial Vacancies

VARIABLES	(1) *SEC Civil Action*	(2) *SEC Civil Action*	(3) *SEC Civil Action*
Num Vacancy	0.011	0.021	0.044
	(0.565)	(0.844)	(1.657)
Low Num Judges		-0.007	
		(-0.185)	
*Num Vacancy * Low Num Judges*		-0.079**	
		(-2.013)	
High Productivity			-0.009
			(-0.466)
*Num Vacancy * High Productivity*			-0.076*
			(-1.869)
Controls	Y	Y	Y
State FE	Y	Y	Y
2-Digit SIC FE	Y	Y	Y
SEC Office FE	Y	Y	Y
Year FE	Y	Y	Y
Observations	3,570	3,570	3,197
Adjusted R-squared	0.137	0.137	0.108

This table presents the OLS regression results from an examination of whether judicial vacancies affect SEC enforcement likelihood. The dependent variable, *SEC Civil Action*, equals one if the SEC issues a civil enforcement action against the restating firm. The variables of interest are *Num Vacancy* in column (1), *Num Vacancy * Low Num Judges* in column (2), and *Num Vacancy * High Productivity* in column (3). *Num Vacancy* equals the number of judicial vacancies due to death in the current year. *Low Num Judges* equals one if a federal district court has fewer than seven judgeships. *High Productivity* equals one if the number of the outgoing judge's dockets divided by the total number of filings is above the median. Appendix A provides variable definitions. Standard errors are clustered at the federal district court level, and *t*-statistics are reported in parentheses. *, **, and *** indicate two-tailed significance at the 0.1, 0.05, and 0.01 levels, respectively.

Table 7. Financial Reporting Quality and Court Efficiency

			Low Private Enforcement	High Private Enforcement	Less Liberal Courts	More Liberal Courts
	(1)	(2)	(3)	(4)	(5)	(6)
VARIABLES	*AbAcc*	*ICW*	*AbAcc*	*AbAcc*	*AbAcc*	*AbAcc*
	0.006**	0.020**	0.008**	0.005	0.012***	0.001
Avg InefficiencyScore	(2.017)	(2.096)	(2.080)	(1.021)	(2.647)	(0.306)
Controls	Y	Y	Y	Y	Y	Y
2-Digit SIC FE	Y	Y	Y	Y	Y	Y
Year FE	Y	Y	Y	Y	Y	Y
Difference (F-stas)			0.44		3.09*	
Observations	68,532	34,475	34,193	34,339	36,042	32,490
Adjusted R-squared	0.141	0.008	0.143	0.141	0.147	0.136

This table presents the OLS regression results from an examination of whether court efficiency affects abnormal accruals or internal control weakness in columns (1) and (2). The dependent variable in column (1), *AbAcc*, is the unsigned residuals from cross-sectional estimations of the performance-adjusted model in Kothari, Leone, and Wasley (2005). Industry-year regressions are estimated based on the two-digit SIC industry with more than 15 industry peers. The dependent variable in column (2), *ICW*, is a binary variable that equals one for the period in which the firm reports ineffective internal controls in the "SOX 404- Internal Controls" database of Audit Analytics. Columns (3) - (6) present the cross-sectional analysis. Column (3) restricts the sample to firms in federal districts with a below-median proportion of class actions. Column (4) restricts the sample to firms in federal districts with an above-median proportion of class actions. Column (5) restricts the sample to firms in federal circuits with a below-median proportion of judges appointed by Democratic presidents, which are thus considered conservative. Column (6) restricts the sample to firms in federal circuits with an above-median proportion of judges appointed by Democratic presidents, which are thus considered liberal. The dependent variable of interest is *Avg InefficiencyScore*, which is the average of *InefficiencyScore* in the current and previous years. For ease of interpretation, *Avg*

InefficiencyScore is divided by 10 in this table. Appendix A provides variable definitions. Standard errors are clustered at the firm level, and *t*-statistics are reported in parentheses. *, **, and *** indicate two-tailed significance at the 0.1, 0.05, and 0.01 levels, respectively.

Table 8. SEC Civil Actions and Court Efficiency (Late Filings)

VARIABLES	(1) *SEC Civil Action*	(2) *SEC Civil Action*
InefficiencyScore	-0.008*** (-2.920)	-0.007** (-2.104)
Controls	Y	Y
State FE	Y	Y
2-Digit SIC FE	Y	Y
SEC Office FE	Y	-
Year FE	Y	-
SEC Office-Year FE	-	Y
Observations	12,521	12,521
Adjusted R-squared	0.093	0.100

This table presents the OLS regression results from an examination of whether the efficiency of federal district courts affects SEC enforcement likelihood using late filings as trigger events. The sample consists of 12,521 late filings during the 1994-2010 period. The dependent variable, *SEC Civil Action*, equals one if the SEC initiates a civil enforcement action against the late-filing firm. The independent variable of interest is *InefficiencyScore.* Appendix A provides variable definitions. Standard errors are clustered at the federal district court level, and *t*-statistics are reported in parentheses. *, **, and *** indicate two-tailed significance at the 0.1, 0.05, and 0.01 levels, respectively.