When Employees Go to Court: Employee Lawsuits and Talent Acquisition in Audit Offices

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Abstract

I examine whether employee-initiated lawsuits against an audit office adversely affect its ability to attract high-quality talent and deliver quality audits. I posit that employee lawsuits erode prospective employees' perceptions of an office, diminishing their willingness to join. Using a comprehensive dataset of individual auditor profiles, I find a decline in the quality of newly hired auditors following an employee lawsuit. Cross-sectionally, the adverse effect of employee lawsuits on talent acquisition is more pronounced when an office is undergoing higher growth and when a case receives greater media attention. Conversely, this adverse effect is less pronounced when an audit office is larger or offers more competitive wages within the local area. When an audit office is unable to recruit high-quality talent, its audit quality is likely to suffer. Consistent with this, I find a deterioration in audit quality provided by an office following an employee lawsuit. Overall, this study underscores the importance of human capital management and employer reputation for audit offices that operate in competitive labor markets.

1. INTRODUCTION

The audit industry is knowledge-intensive, with quality employees being a key input into audit services (Aobdia, Srivastava, and Wang 2018; CAQ 2018). Recruiting and retaining quality employees is crucial to the performance and success of public accounting firms, especially given the significant talent shortages that characterize the audit labor market in recent years (PCAOB 2015).[1] Despite the importance of cultivating a skilled workforce in the audit industry, we know very little about the factors influencing talent acquisition by audit firms. In this study, I examine whether employee lawsuits filed against an audit office hinder an office's ability to recruit quality employees and provide quality audits.

Employee lawsuits are cases where employees sue their employers for violating employment and labor laws related to issues such as age, gender, or race discrimination, harassment, benefits disputes, wage policy, and wrongful termination. Investigating the labor market outcomes of employee lawsuits in the audit industry is relevant and important for multiple reasons. First, employee lawsuits are prevalent in audit firms. From 2005 to 2018, 25 percent of Big 4 audit offices in the United States (U.S.) experienced such lawsuits.[2] The associated costs, including legal fees, settlements, and reputation loss, are often substantial (Unsal and Rayfield 2019).[3] Second, audit firms have faced a growing supply-demand gap of competent and qualified auditors in recent years (AICPA 2019; Ellis 2022), highlighting the need for a deeper understanding of issues related to talent acquisition. Third, audit professionals are sophisticated individuals who are likely to pay close attention to issues of workplace equity and employee

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[1] A recent article in the Wall Street Journal highlights that high turnover in the audit industry and the dwindling number of college graduates with accounting degrees contribute to a deepening shortage of audit professionals, leading audit firms to hire more temporary workers (Ellis 2022).

[2] I use the Audit Analytics Litigation Database to identify employee lawsuits citing U.S. Big 4 audit firms as defendants.

[3] Among cases with available outcome information in my sample, the largest legal settlement is $11.6 million.

treatment when evaluating potential employers (Glaeser and Saks 2006). Therefore, they are likely to react and respond to employee lawsuits. The audit industry also has unique features that facilitate an examination of employee lawsuits and their economic consequences. Specifically, large audit firms operate in similar organizational structures, which allows me to compare lawsuit effects across different audit offices or position ranks. Furthermore, the audit setting provides observable audit performance indicators, such as restatements and discretionary accruals, which offers an avenue for evaluating the implications of employee lawsuits for audit quality.

An office's involvement in employee lawsuits provides a salient signal of its working conditions and corporate culture, casting it in a bad light in the labor market (Turban and Greening 1997; Benson, Sojourner, and Umyarov 2020). For example, cases related to wage disputes and wrongful termination convey unfavorable information about the extent to which an office supports and cares about the well-being of its employees (Lind, Greenberg, Scott, and Welchans 2000). Similarly, cases of gender bias or race discrimination convey adverse information about an office's practices in managing diversity and equity (e.g., Williams and Bauer 1994; Van Knippenberg, Homan, and Van Ginkel 2013; Dalton, Cohen, Harp, and McMillan 2014). These lawsuits often attract significant media attention, amplifying the detrimental impact on an office's reputation (Grinblatt and Keloharju 2001; Giannetti and Wang 2016; Carnes, Christensen, and Madsen 2020).

Moreover, as litigation could result in substantial payouts in legal fees and settlements (Unsal and Rayfield 2019; Lennox and Li 2020), prospective employees may have concerns about an office's ability to uphold its commitments to its employees and even its long-term viability following an employee lawsuit. The potential litigation liability associated with lawsuits may also raise concerns among prospective employees about an office's future client attraction and retention, which could compress future compensation levels and exacerbate future work pressures.

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Thus, to the extent that competent job applicants value an audit office's work culture and treatment of its employees and can differentiate themselves in the labor market, they may be less inclined to join an audit office after an employee lawsuit.

One major empirical challenge in investigating the labor market outcomes of employee lawsuits is that employment data for individual auditors are not widely available. I overcome this challenge by collecting publicly available professional profiles of all individuals who report any instance of working in an audit position at a U.S. Big 4 accounting firm.[4] I then extract all available information from these profiles and construct measures of individual auditor quality based on an individual's educational background, work experience, and professional certifications (e.g., Call, Campbell, Dhaliwal, and Moon 2017; Gadgil and Sockin 2020; Barrios 2022). After merging this data with audit office data from Audit Analytics and restricting the combined data to the year when an individual joins an office, I obtain an individual auditor-office matched panel dataset for all incoming auditors of Big 4 audit offices from 2005 through 2018, which contains 45,711 individual-year observations.

I next draw a list of lawsuits citing U.S. Big 4 audit firms as defendants from the Audit Analytics Litigation Database. Utilizing a generalized difference-in-differences (GDD) approach, I find that the quality of an audit office's incoming auditors declines following an employee lawsuit, consistent with employee lawsuits adversely affecting an office's ability to attract quality auditors. Cross-sectionally, the adverse lawsuit effect on talent acquisition is more pronounced when an audit office is undergoing higher growth or when a lawsuit receives higher media coverage, and is less pronounced when an office is larger or offers higher wages in the local area.

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[4] Individual profiles are available on professional networking and recruiting websites, with over 775 million profiles available as of 2021. The breadth and granularity of this data allow me to evaluate the composition of the workforce across audit offices. I evaluate the representativeness and precision of this data in Section 3.2.

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When an audit office cannot recruit high-quality talent, its audit quality suffers (Harris 2015; PCAOB 2015; Aobdia, Li, Na, and Wu 2020). Consistent with this view, I find the likelihood of financial restatements among clients served by an audit office increases after the office faces employee lawsuits. This effect is more pronounced when an audit office is smaller or is experiencing higher growth.

To the best of my knowledge, this study is the first to examine employee lawsuits filed against audit offices. The extant auditing literature primarily focuses on accounting lawsuits filed against client firms while naming auditors as codefendants for failing to identify and report client misreporting (Franz, Crawford, and Johnson 1998; Lennox and Li 2014, 2020). While these accounting lawsuits signal poor audit quality to client firms and investors, employee lawsuits signal issues with Human Resource (HR) practices that are particularly relevant to prospective employees. To this end, this study also responds to the call from the labor economics literature for research identifying firm attributes that influence job seekers' knowledge and perceptions of potential employers (e.g., Cable and Graham 2000; Cable and Turban 2001; Highouse and Hoffman 2001).

In a related paper, Turban and Cable (2003) use a sample of business school students from two universities to show that firms with better reputations attract *more* job applicants. My study extends their work by showing that employer reputation also affects the *quality* of talent attracted.[5] Moreover, while Turban and Cable (2003) use firm reputation metrics such as those published by

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[5] While Turban and Cable (2003) also hypothesize a positive association between employer reputation and the quality of applicants, they find limited support for this hypothesis. Specifically, they find firm reputation is weakly related to applicants' grade point averages, but unrelated to their GMAT scores and work experience. One possible explanation of their findings is that their data is limited to a small sample of newly graduated college students who are comparatively less sensitive to employer reputation. By contrast, my study employs a larger sample that includes prospective employees from newly graduated college students to seasoned workers.

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Business Week or *Fortune*, my study utilizes a setting of employee lawsuits.[6] If we take employee lawsuits as a plausible proxy for variation in employer reputation, this study sheds some light on the consequences of employer reputational losses.[7]

This study also contributes to an emerging literature that investigates the role of human capital in audit firms. Research by Beck, Francis, and Gunn (2018) and Lee, Naiker, and Stewart (2022) suggests that audit offices deliver better quality audits when they have access to a higher-quality local talent pool. However, these studies rely on aggregate measures from the general population, such as average educational attainment in a local area, making it challenging to isolate the role of auditors' human capital from that of their client companies. In this study, I utilize employee lawsuits that allege employee mistreatment within specific audit offices and measure human capital quality at the individual auditor level. These lawsuits may introduce variations in employee perceptions that affect the quality of talent attracted to an audit office, but are unlikely to have a similar effect on the quality of talent at client companies. This allows me to examine the implication of human capital management in audit offices without being confounded by factors related to client companies.

2. RELATED LITERATURE AND HYPOTHESIS DEVELOPMENT

2.1 Employer Reputation and Talent Acquisition

Audit firms operate in a highly competitive labor market, where recruiting and retaining the best talent is a top concern (Aobdia et al. 2018; CAQ 2018). However, our current understanding of factors influencing talent acquisition in audit firms is limited. Extant studies in

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[6] The published reputation measures (e.g., *Fortune*'s "100 Best Companies to Work For") or Glassdoor ratings that are used in the literature are only available at the firm level (rather than the office level). To the extent that office-level factors can shape employee perceptions, these measures are less likely to capture variation in employer reputation that determines the desirability of working at a particular audit office.

[7] It is important to note that my study explores variation in an office's reputation induced by employee lawsuits. A comprehensive examination of an office's reputation as an employer is beyond the scope of this study.

the labor economics literature often use law firms to identify individual characteristics that could affect employer-employee matching in human capital-intensive industries. For example, Garicano and Hubbard (2005) show that law partners tend to match with associates from similar quality law schools and vice versa. Oyer and Schaefer (2016) find that offices of large law firms tend to hire from a select group of law schools, and this concentration is mainly driven by geography and professional networks. These findings suggest that employers and employees match on individual reputation and quality, as captured by educational background or social connections. My study extends this literature by investigating the role of employer reputation in shaping employer-employee matching.

Employer reputation represents employee perceptions of a company's intent and ability to fulfill its commitments to its employees relative to a reference group of companies with which they compete for human capital (Fombrun 1996; Turban and Greening 1997). Extensive research documents that employer reputation significantly affects a firm's ability to attract new talent (Cable and Turban 2001; Cable and Turban 2003; Benson et al. 2020). For example, a survey of college students conducted by Gatewood, Gowan, and Lautenschlager (1993) indicates a strong correlation between a firm's recruitment image and a potential applicant's intention to accept a job offered by the firm. Turban and Greening (1997) show that a firm's involvement in socially responsible activities, such as promoting employee relations and supporting women and minorities, favorably influences its image and desirability as an employer among job seekers. However, it is unclear from this literature whether individuals' intentions to join or avoid employers based on their reputations would translate into real actions (Breaugh and Starke 2000).[8]

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[8] Indicating one's intentions to apply for a job is a 'costless' exercise, whereas actually pursuing and accepting a position involves costs in terms of time, emotion, and effort (Rynes 1989).

My study extends this literature by examining the real hiring consequences associated with employer reputation.

2.2 Employee Lawsuits in Audit Offices

Extant research examining audit firm reputation has primarily focused on incidents that allege financial misreporting and audit failures, such as restatements, Accounting and Auditing Enforcement Releases, or securities litigations (e.g., Chaney and Philipich 2002; Krishnamurthy, Zhou, and Zhou 2006; Lennox and Li 2014). These incidents signal poor audit quality and can result in significant reputation loss for auditors. For example, Franz et al. (1998) find that news of litigation against an auditor triggers negative stock returns for their clients. Hennes, Leone, and Miller (2014) document an increase in auditor dismissals following financial statement restatements.

Employee lawsuits are legal actions initiated by employees alleging violations of employment and labor laws. The cause of action includes various issues, such as age, gender, or race discrimination, harassment, benefits disputes, wage policy, and wrongful termination. These lawsuits are distinct from incidents that allege audit failures in several ways. For example, securities and fraud-related litigation cases are filed against client companies with auditors named as codefendants (Lennox and Li 2020).[9] In contrast, employee lawsuits are filed specifically against audit offices, holding them directly responsible for the alleged misconduct. Moreover, while the disclosure of a potential audit failure can affect investors' and clients' perceptions of audit quality provided by an audit office (e.g., Hennes et al. 2014), employee lawsuits are most relevant to current and prospective employees of an audit office because it signals poor HR

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[9] Lennox and Li (2020) find audit firms are sued in only 20.4 percent of accounting-related lawsuits in their sample.

Electronic copy available at: https://ssrn.com/abstract=4141583

practices. Consequently, in this study I focus on the labor market implications stemming from employee lawsuits.

I investigate the impact of employee lawsuits at the audit office level rather than the firm level for three reasons.[10] First, large audit firms operate in a decentralized organizational structure where local offices have considerable autonomy in strategic functions (Reynolds and Francis 2000). As a result, there can be substantial variation in HR practices and associated reputations across different offices within the same firm.[11] Second, audit firms compete for talent at the office level. Offices of different firms in the same area and offices of the same firm in different areas could compete with each other for top talent.[12] Third, news of scandals involving an entity is particularly salient to people living in close geographic proximity to the entity (e.g., Grinblatt and Keloharju 2001; Carnes et al. 2020). Therefore, lawsuits filed against an office are likely to draw more attention from prospective employees in the office's local area.

2.3 Hypothesis Development

Working conditions and corporate culture are important attributes that prospective employees consider when deciding where to work (e.g., Gatewood et al. 1993; Cable and Turban 2003). However, as outsiders of an organization, prospective employees do not possess perfect *ex-ante* information about a future employer and have to rely on available information to form and update their perceptions (Carmichael 1984; Petty and Cacioppo 1986; Ashforth and Mael 1989; Cable and Graham 2000; Turban and Cable 2003).

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[10] Employee lawsuits may adversely affect the reputation of the entire audit firm, since audit offices within the same firm share the same brand name. I investigate this possibility in Online Appendix 3.

[11] This point is further supported by my conversation with practitioners (for more details, see Section 4.5.1 and Online Appendix 8). For example, one interviewee mentioned that he sensed "completely different vibes" while interviewing with two offices in one firm. He went on to say that his perception of the differences in cultures between the offices influenced his decision about which office to join.

[12] For example, if the Boston office of Firm A is viewed as a toxic work environment by an individual auditor, the Boston office of Firm B or the Chicago office of Firm A can both be viable employment alternatives for them.

An office's involvement in an employee lawsuit can affect the perception of prospective employees in at least three ways. First, employee lawsuits serve as a negative signal of an office's working conditions and corporate culture, making the office less appealing as an employer (Turban and Greening 1997; Benson et al. 2020). For example, wage disputes and wrongful termination suits can diminish prospective employees' perceptions of an office's intent and ability to uphold its commitments (Lind et al. 2000). Race and gender discrimination cases could send bad signals about an office's diversity and equity practices, triggering concerns among prospective employees about corporate culture (Williams and Bauer 1994; Van Knippenberg et al. 2013; Dalton et al. 2014). These lawsuits often attract significant media attention, amplifying the detrimental impact on an office's reputation (Grinblatt and Keloharju 2001; Giannetti and Wang 2016; Carnes et al. 2020).

Second, litigation could result in substantial legal fees and settlements (Unsal and Rayfield 2019; Lennox and Li 2020). Consequently, prospective employees may have concerns about the financial viability of an office amid legal proceedings. Moreover, because of the potential liability associated with lawsuits, prospective employees may have concerns about an office's future client attraction and retention, which could consequently affect compensation levels and work pressure for the employees.

Third, prospective employees may hesitate to associate their own professional reputation with an office that has faced damage to its reputation due to employee lawsuits (Turban and Greening 1997). This reluctance could stem from concerns about the impact on their career trajectory and how it might be perceived within their professional network. To the extent competent applicants can differentiate themselves in the labor market and are likely to have

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multiple job opportunities, I predict that an audit office is less likely to be able to recruit high-quality auditors following an employee lawsuit.[13]

Alternatively, employee lawsuits may trigger remedial changes in HR practices or promote reputation-repair actions in an office (e.g., Chakravarthy, DeHaan, and Rajgopal 2014). If office leadership swiftly addresses the issues prompting the lawsuit with effective remedies, I may observe no change or even an improvement in hiring outcomes following employee lawsuits. Following this discussion, I state my first hypothesis in null form:

> **HYPOTHESIS 1**: *The quality of incoming auditors in an audit office does not change following an employee lawsuit.*

When an audit office cannot recruit high-quality talent, its audit quality will likely suffer. Audit work demands significant professional knowledge and judgment (e.g., Libby and Tan 1994; DeFond and Zhang 2014). The competency of individual auditors can affect an office's ability to deliver high-quality audit services (Harris 2015; PCAOB 2015; Aobdia et al. 2020). First, high-quality auditors can provide superior information as inputs into the audit practice. For example, auditors with prior work experience can share knowledge about general auditing practices or a specific industry (Bonner 1990). Second, high-quality auditors are more effective at executing audit procedures and exercising discretion in their judgments, resulting in fewer unintentional errors (McKnight and Wright 2011). Third, high-quality auditors are more likely to identify and uncover intentional misreporting, and they are likely to elevate the issue to the engagement team

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[13] An implicit assumption in this prediction is that prospective employees (or those who influence their job choice decisions) somehow become aware of offices' involvement in employee lawsuits. In my conversation with practitioners, they communicated that news about employee lawsuits could be disseminated through various channels, including news media, social media, and word of mouth (see Section 4.5.1 and Online Appendix 8 for details). In Section 4.2.3, I also perform a cross-sectional analysis based on the level of media coverage of the cases.

and their clients before it escalates into material misstatement (Merchant and Rockness 1994; Glaeser and Saks 2006; O'Fallon and Butterfield 2012).

On the other hand, if an audit office provides effective training programs for new employees and/or maintains an effective quality control system to detect intentional or unintentional misstatements, a decline in incoming auditor quality may not translate into a decline in audit quality. Following this discussion, I state my second hypothesis in null form:

HYPOTHESIS 2: *The audit quality in an audit office does not change following an employee lawsuit.*

3. DATA AND SAMPLE SELECTION

3.1 Employee Lawsuits

To identify the sample of employee lawsuits filed against audit offices, I first retrieve all lawsuits citing U.S. Big 4 audit firms as defendants from the Audit Analytics Litigation Database over the years 2005 through 2018.[14] Using the classification provided by the database and followed with a manual check, I restrict the sample to 138 employment-related cases.[15] I then follow Lennox and Li (2014) and hand-collect audit office information for each case using the lawsuit docket and complaint files obtained from the Audit Analytics and Public Access to Court Electronic Records (PACER). My final sample includes 111 cases with available audit office information.[16]

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[14] I exclusively focus on Big 4 audit firms because their employee composition and client portfolios are more homogenous. In addition, the Big 4 firms have similar organizational structures, technologies, and audit methodologies (e.g., Lawrence, Minutti-Meza, and Zhang 2011).

[15] The Audit Analytics Litigation database does not classify cases based on the party that files the lawsuits. Therefore, I identify lawsuits that are likely to be employment-related using the following classification from Audit Analytics: Americans with Disabilities - Employment (NOS 445), Civil Rights - Jobs (NOS 442), Employment Law, ERISA & Employee Benefits Litigation (NOS 791), Fair Labor Standards Act (NOS 710), Labor - Management Relations (NOS 720), Labor Law. I also consider the following classifications that can include employment-related lawsuits: Civil Rights, Class Action, Collective Action, Disability Law, Multi District Litigation (MDL). Then I manually check each case and remove cases that are not filed by employees.

[16] In Online Appendix 1, I provide four examples of these lawsuits.

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Table 1 presents descriptive statistics for the sample of employee lawsuits. Panel A presents case frequency by audit firms. Deloitte constitutes the highest percentage of lawsuits (29.7 percent), while KPMG constitutes the lowest (16.2 percent). Over the sample period, I identify an average of 230 Big 4 audit offices in a year, among which 57 offices (24.8 percent) were subject to an employee lawsuit. Panel B shows a relatively even distribution of cases over time, with slightly more cases in the earlier years of my sample. Panel C reports the main causes of employee lawsuits, which include age and disability discrimination (21 and 16 cases, respectively), retaliation (24 cases), payment (26 cases), and employee benefit plans (28 cases).[17] Panel D presents the distribution of cases by outcomes. Notably, lawsuit outcomes and settlement information are largely unavailable, as 33 percent of cases are missing outcome information and 42 percent of cases were dismissed and lack settlement details.[18] Panel E shows that the average duration of a lawsuit is 1.73 years, while the average time between the alleged misbehavior and the initiation of a lawsuit (i.e., revelation time) is 3.44 years.

To gain a better understanding of the antecedents of employee lawsuits, I compare characteristics between "treated" offices (i.e., offices subject to an employee lawsuit in year *t*) and "control" offices in the year before a treated office faces a lawsuit.[19] In Panel F, univariate comparisons reveal that large offices (*OFFICE_SIZE*) are more likely to be subject to an employee lawsuit. This is consistent with prior research suggesting that large offices, which can afford larger amounts if cases have unfavorable resolutions, are more likely to be sued (e.g., Gande and Lewis 2009). Offices with lower market share (*MARKET_SHARE*) or higher local market competition

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[17] The sum of the percentage of the sample is greater than 1 because some cases have more than one cause.
[18] Case dismissal does not indicate no settlement, judgment, or compensatory damages, etc. It could be a judgment was entered on behalf of the defendant/plaintiff, the charges were withdrawn with/without settlement, or a non-monetary settlement was reached.
[19] To select control offices, I follow Gormley and Matsa (2011) and match treated offices with all offices that have not been subject to an employee lawsuit in year *t*.

(*MSA_OFFICES*) are more likely to face employee lawsuits. Somewhat surprisingly, the treated offices offer higher wages than control offices in the year before the lawsuits (*OFFICE_WAGE*), suggesting employee issues beyond compensation can trigger lawsuits. Moreover, treated offices exhibit lower employee turnover (*TURNOVER*) relative to control offices before lawsuits.

In Panel G, I perform multivariate analysis to investigate the association between office characteristics and the propensity to be sued. Consistent with the univariate comparison in Panel F, office size (*OFFICE_SIZE*) and local market competition (*MSA_OFFICES*) are important antecedents of employee lawsuits. In both Panels F and G, there is no indication that audit quality (*RESTATE_PERC*) is associated with an office's involvement in an employee lawsuit, highlighting the distinction between the quality of HR practices and audit services within an audit office. Furthermore, I do not observe significant differences in office growth (*OFFICE_GROWTH_NUM* and *OFFICE_GROWTH_FEES*) between treated and control offices in the year before a lawsuit. This finding alleviates concerns that lawsuits coincide with waves of terminations or financial distress in an office, which could also affect hiring practices.

3.2 Incoming Auditors

I gather individual auditor information from publicly available resumés on professional networking and recruiting websites. As of 2021, there are more than 775 million available individual profiles with a wide range of industry and experience levels. Particularly, these websites are widely used by audit professionals, given their high mobility and the demand to establish professional connections with clients (e.g., Krishnan, Krishnan, and Maex 2020).[20] In a survey of accountants conducted by Bramwell (2013), 90 percent of respondents affirmed their use of social networking platforms. Barrios (2022) finds that the count of Certified Public Accountants (CPAs)

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[20] While auditors with higher mobility are more likely to self-select into my sample, this is not expected to distort the relation between employee lawsuits and incoming auditor quality.

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registered on LinkedIn constitutes 60% of the estimated number of accountants according to the Bureau of Labor Statistics (BLS).

I first identify all individuals who report employment as an auditor at a U.S. Big 4 firm at some point in their work histories.[21] I collect all available information from their professional profiles, including details about their job titles, job descriptions, start and end dates of each job, company names and locations, universities attended, degrees obtained, and graduation years.[22] These procedures result in a dataset of individual auditors who worked for Big 4 firms at any time from 2005 to 2018. I then merge this dataset with audit office information from Audit Analytics, wage data from the U.S. Department of Labor, and local area information from the Bureau of Economic Analysis.[23]

The Big 4 firms do not systematically disclose headcount statistics for their audit practices. Therefore, to assess the representativeness of my sample, I first compare it with the employee-related information that the Big 4 firms disclose in their annual audit quality reports. The comparison suggests my sample covers a substantial portion of Big 4 auditors. For example, PwC's 2019 audit quality report indicates 10,415 auditors employed in the U.S. in the year 2018, while my sample includes data for 8,396 of these auditors, constituting 81 percent of the total (PwC 2019). I next examine the correlation between the total number of auditors identified in an office-

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[21] I search job records that include the keywords "audit" or "assurance" in the job title to identify audit personnel. I then exclude job records with job titles belonging to practices other than external audit, such as "internal audit" and "risk assurance".

[22] I provide an example of the raw profile pages and the data generated in Online Appendix 2.

[23] I obtain wage data from the U.S. Department of Labor (DOL) following Hoopes, Merkley, Pacelli, and Schroeder (2018). The DOL provides wage information from H-1B visa applications, which indicates an applicant's job title, employer name, employer location, job code, and starting salary offered. I first identify all applications from the Big 4 audit firms. I then manually examine the job titles listed in the data and retain positions in external audit. Following Hoopes et al. (2018), I also require the data to contain position rank information (i.e., associate, senior, or manager) in an audit office. I then match the wage data with audit office data using the employer location specified in the data, resulting in a dataset of audit personnel salaries for a given job position at an audit office each year. Finally, because offices may not hire foreign employees in all years, I fill in missing wage information in an audit office-year with the average wage the office offered to individuals in a given position.

year and audit office size. I find a positive and significant correlation between auditor headcounts and audit office size, as measured by the number of clients and total audit fees (0.70 and 0.60, p<0.01 untabulated). Furthermore, in my interviews with audit partners and directors (see more details in Section 4.5.1), two interviewees mentioned that their firms encourage employees to actively maintain their profiles on professional networking websites and use the websites as a platform to promote firm events.

The online professional profiles are self-reported, which could raise concerns about the validity of the information. However, considering the extensive usage of professional networking websites for business networking and recruiting, incorrect or imprecise information can be identified by one's employers during background checks. Moreover, while individual tendencies to exaggerate background and work history information could inflate measures of individual auditor quality, this should not distort the relation between employee lawsuits and incoming auditor quality in a systematic way.

3.3 Sample Selection

Table 2, Panel A summarizes the sample selection for the individual-year level analyses. I identify all individual-years where an individual joins an audit office, resulting in 57,806 observations. I then eliminate 10,416 observations with missing individual auditor information and 1,679 observations with missing audit office or local area information. The final sample includes 45,711 individual-years, consisting of 41,916 unique individuals employed across 259 audit offices.

Table 2, Panel B summarizes the sample selection for the client-year level analyses. I begin with 43,409 U.S. client-years audited by U.S. Big 4 firms with matched data on Compustat and Audit Analytics from 2005 to 2018. I eliminate 21,815 observations with missing client

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information and 1,296 observations with missing audit office or local area information. The final sample contains 20,298 client-year observations, consisting of 2,862 unique clients and 251 unique audit offices.

3.4 Descriptive Statistics

Table 3 presents descriptive statistics. Individual auditor characteristics are presented for individual-year observations of incoming auditors. On average, 17 (24) percent of incoming auditors graduated from a top 100 university (top 100 programs in accounting and finance) based on the QS World University Ranking, and 55 percent of them hold a master's degree or higher. The majority of incoming auditors (75 percent) have previously worked for another company, and have an average work experience of 2.86 years. Additionally, 19 percent of these auditors have previous experience in one of the 10 largest audit firms and 46 percent hold a Certified Public Accountant (CPA) certificate. The average age of an auditor when they join an office is 23 years, and 45 percent of incoming auditors are female. Among all incoming auditors, 49.7 percent join the office at the intern level, 38.9 percent join at the associate or senior associate level, and 11.5 percent join at the manager level or higher (untabulated).

Office and local area characteristics are presented at the office-year level. Specifically, 24 percent of office-years are in the post-lawsuit period. On average, an office hires 17 auditors per year. An audit office has an average of 39 clients per year, which accounts for 31 percent of the Big 4 market share in a local area. The mean (median) wage an audit office pays to its audit associates is $51,835 ($49,740). Engagement characteristics are presented at the client-year level. Consistent with prior research that uses restatement propensities as a proxy for audit quality, six percent (two percent) of client-years issue an income-decreasing restatement (an income-decreasing "big R" restatement) over the sample period (e.g., Swanquist and Whited 2015).

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Descriptive statistics for other control variables are consistent with prior literature (e.g., Francis, Michas, and Yu 2013).

4. RESEARCH DESIGN AND RESULTS

4.1 Employee Lawsuits and the Quality of Incoming Auditors (H1)

4.1.1 Research Design (H1)

To investigate the impact of employee lawsuits on the quality of incoming auditors, I adopt a generalized difference-in-differences framework with staggered treatment. The model is specified in the following form:

$NEWHIRE\_QUALITY_{i,j,t} = \alpha_0 + \alpha_1 POSTLAWSUIT_{j,t} + \alpha Controls_{i,j,t-1}$
$$+ \text{Fixed Effects (year, audit office, position rank)} + \varepsilon_{i,j,t}, \qquad (1)$$

where the subscripts i, j, and t correspond to individual auditors, audit offices, and years, respectively. The unit of observation in this analysis is an auditor-year. The dependent variable, *NEWHIRE_QUALITY*, measures the quality of newly hired auditor i in audit office j in year t.[24] The independent variable, *POSTLAWSUIT*, equals one for audit office j in the year after an employee lawsuit filing and all years thereafter, and zero otherwise.[25] Under this framework, offices are part of the control group before lawsuits and then switch into the treatment group after being sued. Offices that are not subject to employee lawsuits throughout my sample period remain in the control group at all times. By including both year and office fixed effects, my research design allows me to evaluate the change in the quality of incoming auditors across pre- and post-periods

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[24] For ease of interpretation, I use OLS across all tests. In untabulated analyses, I confirm that my results are robust to estimating probit specifications when indicator variables are dependent variables. All reported *p*-values are two-tailed throughout the study.

[25] I examine the lawsuit effect from the year of filing, as this is typically when news about the lawsuit becomes public. The indicator is switched on one year after the lawsuit is filed to account for different filing dates within a year and to allow time for the effect to materialize (Cascino, Tamayo, and Vetter 2021). My main findings remain robust when coding the lawsuit indicator to equal one starting from the year a lawsuit is filed or when I omit observations in the year when a lawsuit is filed (untabulated).

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for the sued offices compared to the change over the same time interval for the control offices.[26] The primary coefficient of interest is α_1, which captures the average lawsuit effect on talent acquisition.[27]

The quality of an individual employee is defined as a set of factors, including education, training, motivation, and innate ability, that affect one's productivity and performance at their job (Barrios 2022). Following an extensive literature in labor economics examining employee quality (e.g., Call et al. 2017; Gadgil and Sockin 2020; Baghai, Silva, Thell, and Vig 2021; Barrios 2022), I develop eight measures to capture the quality of individual auditors. Specifically, I construct three measures based on an individual's educational attainment. *TOP_UNIV* (*TOP_ACC*) is an indicator that equals one if an individual graduated from one of the top 100 universities (top 100 programs in accounting and finance) based on QS World University Ranking, and zero otherwise.[28] *MASTERS* is an indicator that equals one if an individual possesses a master's degree or higher, and zero otherwise. I construct three measures based on an individual's previous work experience. *WORK_EXP* is an indicator that equals one if an individual previously worked in any other company before joining the current audit office, and zero otherwise. *AUD_EXP* is an indicator that equals one if an individual worked in one of the top 10 national audit firms before joining the current audit office, and zero otherwise. *WORK_YEARS* is the natural logarithm of an individual's total number of years of previous work experience. I construct a measure based on an individual's professional achievement, *CPA*, which is an indicator that equals one if an individual

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[26] The GDD framework relies on a set of assumptions such as conditional independence, parallel trends, and the stable unit treatment value assumption (SUTVA). I assess these assumptions in Online Appendix 3.

[27] I estimate an average lawsuit effect for all subsequent years after a lawsuit filing. This does not imply the lawsuit persists for all subsequent periods; rather, it allows for the potential persistence of the lawsuit effect in subsequent periods. I adopt this design because there is no theoretical basis to predict when the lawsuit effect begins and how long it lasts. In Figure 1, I use more granular time indicators to investigate how the effect manifests over time.

[28] The QS World University Ranking is published by Quacquarelli Symonds and Times Higher Education magazine. I use the ranking in the year 2011, which is in the middle of my sample period (2005-2018). In untabulated analyses, I confirm that the results are robust when using rankings from the year 2018.

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possesses the CPA designation, and zero otherwise. Finally, based on the seven measures described above, I construct a comprehensive measure, *QUALITY_INDEX*, using principal component analysis. I select the three principal components with eigenvalues greater than 1 and then weigh each component based on the variance explained. In Online Appendix 4, I provide theoretical motivations for each of these measures and perform additional analyses to assess their construct validity.

I control for a set of individual auditor, audit office, and local area characteristics that may be associated with the likelihood of an office's involvement in an employee lawsuit and an office's hiring practice (e.g., Call et al. 2017; Hoopes et al. 2018). Specifically, I control for two individual auditor characteristics, *AGE* and *FEMALE,* that are likely associated with the quality of new hires in an audit office. I control for *OFFICE_SIZE* and *MARKET_SHARE* as they are likely to be associated with both the likelihood of an office's involvement in employee lawsuits (as indicated in Table 1, Panel F and G) and its ability to attract quality talent. Hiring demand in a given year may be correlated with the quality of new hires, so I control for the natural logarithm of the number of incoming auditors in an audit office-year (*HIRENO*).[29] Because compensation is an important factor that prospective auditors consider (Hoopes et al. 2018), I control for the level of compensation offered by an office, *OFFICE_WAGE*, as measured by the natural logarithm of the average salary offered at the associate level in an office-year.[30] An audit office's reputation for providing high-quality audits might be another attribute that prospective auditors consider due to its implications for personal development and career prospects (Aobdia et al. 2018). I thus control for the percentage of restatement announcements in an office-year,

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[29] In Online Appendix 5, I find no significant changes in overall hiring following employee lawsuits.
[30] I measure the level of wages offered by an office at the associate level because the compensation at the entry-level is more standardized and thus comparable across offices. In contrast, wages at the director or partner level vary significantly and may not be representative of the average wages offered in an office.

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RESTATE_PERC, which serves as a public signal of the audit quality provided by an audit office.[31] Finally, I control for local area characteristics that are associated with the supply of talent and the level of labor market competition in the local area (e.g., Call et al. 2017), including *MSA_OFFICES*, *POPULATION*, and *UNEMPLOY_RATE*.[32] I provide detailed variable definitions in Appendix A. All audit office and local area control variables are lagged by one year. All continuous variables are winsorized at the 1 percent and 99 percent levels to mitigate the influence of outliers. Finally, I include audit office and position rank fixed effects to account for unobserved heterogeneity across audit offices or job positions, and year fixed effects to account for broad macroeconomic changes that affect the overall demand or supply of individual auditor quality over time. I cluster standard errors at the audit office level to allow for arbitrary degrees of autocorrelation in shocks within an audit office over time (Petersen 2008).

4.1.2 Main Results (H1)

Table 4 presents the results from estimating equation (1), which examines the impact of employee lawsuits on the quality of incoming auditors. I find a consistent negative coefficient on *POSTLAWSUIT* across various measures of individual auditor quality ($p<0.10$ except columns 3 and 5). This evidence rejects H1 and suggests there is a significant decline in the quality of incoming auditors following an employee lawsuit. The magnitude of the lawsuit effect is economically meaningful. For example, *TOP_UNIV* drops by an average of 0.023 following a lawsuit, representing a 13.5 percent decrease relative to the unconditional mean of the measure (0.17). Importantly, the decline in incoming auditor quality persists for up to five years after the

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[31] This measure captures the number of misstatements that are *revealed* in an office-year (i.e., restatement *announcement*). In contrast, the restatement measures I use to proxy for audit quality in equation (2) in Section 4.3.1 capture the *occurrence* of misstatements that are subsequently restated in future periods.

[32] In Online Appendix 6, I perform robustness tests using specifications with and without these control variables and find that the main findings are robust to alternative specifications.

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filing of a lawsuit, as illustrated in the subsequent time trend analysis (see Figure 1a). This underscores the substantial and lasting impact of employee lawsuits on talent acquisition within an audit office.

An important assumption underlying my identification strategy is that, in the absence of a lawsuit, the distribution of incoming auditor quality in the treated and control offices would have moved in parallel. To validate this assumption and examine how the lawsuit effect unfolds over time, I map out treatment effects in event time. Specifically, I replace the *POSTLAWSUIT* indicator in equation (1) with separate event-time dummies, each denoting a period of time relative to the lawsuit filing year ($t=0$), and plot the estimated treatment effects. I omit the indicator for year *t-1*, which serves as a benchmark period. If changes in incoming auditor quality are associated with employee lawsuits, they should occur in the year of or after a lawsuit is filed, not before.

In Figure 1a, I find no evidence of differential pre-lawsuit trends in incoming auditor quality across treatment and control groups. These results mitigate concerns that my findings are driven by differences in pre-treatment trends. I find a sharp decline in incoming auditor quality in treated offices compared to control offices in the years after an employee lawsuit, and this decline persists over time.[33] This evidence is consistent with prior studies that suggest reputation losses can be long-lived (e.g., Liu and Shankar 2015).

4.2 Cross-sectional Analyses of Lawsuit Effects on Talent Acquisition

Having determined the average impact of employee lawsuits on audit offices' ability to recruit high-quality talent, this section explores cross-sectional variation in this effect based on individual auditor, audit office, and case characteristics. Besides providing interesting insights,

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[33] Figure 1a also suggests there is a delayed impact of lawsuits on talent acquisition in an audit office. This delay may be attributed to the time lag between a lawsuit and an office's hiring season. Notably, when adopting a stacked approach that aligns the relative time of the staggered events in Online Appendix 3, the adverse lawsuit effect on talent acquisition becomes evident in the year after a lawsuit is filed.

exploring cross-sectional variation helps validate my proposition that employee lawsuits hinder audit office hiring by impairing labor market perceptions of the office.

4.2.1 Female Auditors

Because research suggests that female auditors are more susceptible to unfair treatment in the accounting profession (e.g., Anderson-Gough, Grey, and Robson 2005; Dalton et al. 2014), I first investigate whether female auditors respond more strongly to employee lawsuits. To implement this test, I augment equation (1) with an interaction between *FEMALE* and *POSTLAWSUIT*.[34] In the first column of Table 5, Panel A, I find a negative coefficient on *POSTLAWSUIT* ($p<0.01$), consistent with male auditors reacting negatively to employee lawsuits. However, the coefficient on the interaction term is not statistically significant ($p>0.10$), suggesting there is no significant difference in how female and male auditors react to employee lawsuits.

4.2.2 Audit Office Characteristics

Next, I explore characteristics of audit offices that may increase or decrease their susceptibility to the adverse lawsuit effects. First, larger offices could be less affected by employee lawsuits because they may be perceived as having more resources and opportunities for training, professional development, and career advancement. To test this idea, I construct an indicator *LARGE_OFFICE*, which equals one if an audit office's size is greater than the sample median in its local area. I remove *OFFICE_ SIZE* from the set of controls in equation (1) and add *LARGE_OFFICE* and an interaction between *LARGE_OFFICE* and *POSTLAWSUIT* to the model. In the second column of Table 5, Panel A, I find a positive and significant coefficient on the

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[34] I also implement a full interaction model with interactions of the split variable with fixed effects to account for group-specific variation, potential heterogeneity, and other factors that could influence the relationship under investigation. My findings in Table 5, Panel A and Table 7 are robust to this alternative design.

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interaction term ($p<0.10$), consistent with talent acquisition in larger offices being less susceptible to adverse employee lawsuit effects.

Second, I investigate whether the adverse lawsuit effect is more pronounced for offices undergoing higher growth. Rapid growth in an audit office could temporarily stress office resources, including human resources (Bills, Swanquist, and Whited 2016). When an audit office facing an employee lawsuit has a high demand for employees due to its rapid growth, it may be more willing to compromise employee quality during hiring. To test this idea, I construct an indicator, *HIGH_GROWTH*, which equals one if an office's growth in audit fees is greater than the sample median in a year. I then add *HIGH_GROWTH* and an interaction between *HIGH_GROWTH* and *POSTLAWSUIT* to equation (1). In the third column of Table 5, Panel A, I find a negative and significant coefficient on the interaction term ($p<0.05$), consistent with a stronger lawsuit effect for fast-growing offices.

Third, another potential source of variation in the lawsuit effect is the level of wages offered by an audit office. Because compensation is an important factor that job seekers consider when evaluating prospective employers, offices that offer higher wages may be less susceptible to the adverse lawsuit effect. To test this idea, I create an indicator variable, *HIGH_WAGE*, which equals one if the wage offered by an audit office is greater than the sample median in a local area. I then remove *OFFICE_WAGE* from equation (1) and add *HIGH_WAGE* and an interaction between *HIGH_WAGE* and *POSTLAWSUIT* to the model. In the fourth column of Table 5, Panel A, I find a positive and significant coefficient on the interaction term ($p<0.10$), which suggests that the adverse lawsuit effect is partially mitigated when an office offers higher wages in the local labor market.

4.2.3 Lawsuit Characteristics

Finally, I investigate whether the lawsuit effect varies across different case characteristics. First, I analyze cases with varying levels of media coverage. The work environment and culture within public accounting firms consistently draw attention from the media. When an office is involved in an employee lawsuit, the story can be covered by various media channels such as local news (e.g., Los Angeles Times), national news (e.g., Reuters), law websites (e.g., Law360.com), and accounting professional websites (e.g., Accountancy Daily and Goingconcern.com). Examples of media articles covering employee lawsuits are available in Online Appendix 1.[35] Because the publicity surrounding a lawsuit could affect labor market perceptions of the severity of the alleged misbehavior (Hendriks 2016; Carnes et al. 2020), I expect a more pronounced lawsuit effect when a lawsuit receives greater media attention.

To test this expectation, I compile a list of websites known for covering lawsuits in audit firms, including law case websites, news websites, and accounting professional websites (see Online Appendix 7 for the list). While this is not an exhaustive list, it captures prominent news channels and can serve as a proxy for media attention. As presented in Table 1, Panel E, 68 (13, 11) percent of the cases in my sample receive coverage from law case websites (news websites, accounting professional websites). I then split the cases into two subsamples based on whether they receive coverage from at least one of the websites on the list and separately estimate equation (1) for each subset of cases.[36] In Table 5, Panel B, I find a nonsignificant coefficient on

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[35] Media articles typically provide details about the employee(s) who initiated lawsuits, the audit office where they were employed, the alleged misconduct mentioned in the lawsuits, and the claims made by the plaintiffs. In some cases, the articles may include quotes from both the plaintiffs and spokespeople from the firms involved. Some media outlets not only report on the initiation of the lawsuit but also track the ongoing progress of the cases. For instance, goingconcern.com has published several articles covering Case 29594 from the beginning of the lawsuit until a settlement was reached (see Online Appendix 1).

[36] When investigating the impact of lawsuits with low (high) media coverage, I exclude observations that experience lawsuits with high (low) media coverage, rather than coding them as part of the control group. Therefore, each subsample contains the treated offices from one set of lawsuits and the control offices.

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POSTLAWSUIT in column (1) (*p*>0.10) and a significant negative coefficient on *POSTLAWSUIT* in column (2) (*p*<0.01). A comparison of coefficients on *POSTLAWSUIT* in columns (1) and (2) reveals a significant difference between them (*p*<0.05), suggesting there is a stronger effect when a lawsuit receives greater media scrutiny. Importantly, this evidence corroborates the proposition that employee lawsuits affect talent acquisition through their negative impact on the reputation of the office being sued.

Next, I examine cases with different cause of action. I classify the cases into two categories: 1) working environment lawsuits, which involve issues related to working conditions in an office, such as benefits, wage policy, or layoff disputes; and 2) organizational equity lawsuits, which involve issues related to office practices in managing diversity and equity such as age, gender, or race discrimination cases. While all prospective employees are likely to be concerned about issues related to the work environment, whether they care about organizational equity-related issues remains unclear. One could argue that organizational equity-related issues are primarily relevant for individuals expecting to be targets of discrimination. On the other hand, even if a prospective employee does not belong to the group alleged to be discriminated against, they may still care about the cultural values promoted by a prospective employer (Turban and Greening 1997).

To implement the test, I separately estimate equation (1) for the two subsets of cases.[37] In Table 5, Panel B, I find a significant negative coefficient on *POSTLAWSUIT* in both columns (3) and (4) (*p*<0.10) and no significant difference between the coefficients, suggesting that both types of lawsuits can diminish the perceptions of prospective employees.

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[37] Similarly, when investigating the impact of the working environment (organizational equity) lawsuits, I drop the observations that experience organizational equity (working environment) lawsuits, rather than coding them as part of the control group.

4.3 Employee Lawsuits and Audit Quality (H2)

4.3.1 Research Design (H2)

After finding evidence that suggests employee lawsuits hinder talent acquisition in an audit office, I now examine their implication for audit quality (H2). I utilize a generalized difference-in-differences framework in the following form:

$$RESTATE_{l,j,t} = \gamma_0 + \gamma_1 POSTLAWSUIT_{j,t} + \gamma\, Controls_{l,j,t-1}$$
$$+ \text{Fixed Effects (year, audit office, industry)} + \varepsilon_{l,j,t}, \qquad (2)$$

where the subscripts l, j, and t correspond to clients, audit offices, and years, respectively. The unit of observation is a client-year. The dependent variable, *RESTATE*, captures audit quality for client l in audit office j in year t and is measured in two ways following prior literature (e.g., DeFond and Zhang 2014; Aobdia 2019; Choudhary, Merkley, and Schipper 2021).[38] *RESTATE_ALL* equals one if a client-year's financial statements are subsequently restated, either through an Item 4.02 disclosure in a Form 8-K filing (often referred to as a "Big R" restatement) or a revision restatement (often referred to as a "little r" restatement), and zero otherwise.[39] *RESTATE_BIGR* equals one if a client-year's financial statements are subsequently restated through an Item 4.02 disclosure in a Form 8-K filing (i.e., a "Big R" restatement), and zero otherwise. "Big R" restatements suggest that information in the original financial reports can no longer be relied upon, offering "strong evidence of poor audit quality" (DeFond and Zhang 2014, 284). I only consider income-decreasing restatements of audited *annual* financial statements following prior literature

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[38] While Aobdia (2019) suggests that financial restatements serve as a good proxy for audit process quality, in untabulated analysis, I also adopt an alternative audit quality measure, the absolute value of discretionary accruals from the cross-sectional modified Jones model (Dechow, Ge, Larson, and Sloan 2011). My findings are consistent with a decline in audit quality (i.e., higher absolute value of discretionary accruals) following employee lawsuits.

[39] I include revision ("little r") restatements because Choudhary et al. (2021) find they provide a signal of financial reporting unreliability.

(Francis et al. 2013).[40] As previously defined, *POSTLAWSUIT* is an indicator equal to one for audit office *j* in the year after an employee lawsuit filing and all years thereafter.

I control for a set of time-varying client characteristics that are associated with financial reporting quality (e.g., Dechow et al. 2011), including *SIZE_CLIENT*, *CASH_FLOWS*, *LOSS*, *RSST_ACC*, *DEBT*, *CHG_REC*, *CHG_INV*, *CHG_EARN*, *OP_LEASES*, *ISSUE*, and *GC*. I also control for a set of audit office characteristics that have been shown to affect restatement likelihood (e.g., Kedia and Rajgopal 2011), including *TENURE*, *AUDITOR_CHANGE*, *AUDIT_FEES*, *NONAUDIT_FEES*, *NATIONAL_LEADER*, *CITY_LEADER*, *OFFICE_SIZE*, *MARKETSHARE*, and *OFFICE_WAGE*. Finally, I control for *MSA_OFFICES*, *POPULATION*, and *UNEMPLOY_RATE* to account for local market conditions that could affect financial reporting or audit quality (e.g., Francis et al. 2013). I provide detailed variable definitions in Appendix A. All control variables are lagged by one year. I include year fixed effects to control for broad macroeconomic changes over time, client industry fixed effects (based on two-digit SIC codes) and audit office fixed effects to account for unobserved heterogeneity across client industries and audit offices. Standard errors are clustered at the audit office level (Petersen 2008).

4.3.2 Main Results (H2)

Table 6 presents the results from estimating equation (2), which examines the impact of employee lawsuits on audit quality. Using both restatement measures, I find the coefficient on *POSTLAWSUIT* is positive and significant ($p<0.05$), consistent with a deterioration in audit quality in the wake of an employee lawsuit (i.e., H2 is rejected). The effect is economically meaningful. For example, the coefficient in column (1) indicates that a client is 1.6 percentage points more

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[40] The findings of audit quality analyses are robust if I do not make this restriction.

likely to restate when its audit office experiences an employee lawsuit, which is a 27 percent increase relative to the unconditional mean (0.06) of restatements.[41]

To assess the parallel trend assumption and examine how the effect of employee lawsuits on audit quality manifests over time, I replace the *POSTLAWSUIT* indicator in equation (2) with separate event-time dummies and map out treatment effects in event-time. In Figure 1b, I observe a nonsignificant treatment effect prior to a lawsuit, which suggests there are no differential pre-lawsuit trends in restatements across treated and control groups.[42] In contrast, I find a sharp increase in treatment effects in the year following the employee lawsuits. The lawsuit effect on audit quality peaks in the third year after the lawsuit and gradually diminishes in later years. This finding, coupled with the evidence in Figure 1a, indicates that although the negative impact of lawsuits on talent acquisition persists, offices can mitigate the decline in incoming auditor quality and restore audit quality over time. Potential mitigation measures include enhancing internal training, adopting new technologies, and refining existing methodologies/oversight measures.

4.4 Cross-sectional Analyses of Lawsuit Effects on Audit Quality

After finding evidence of an adverse effect of employee lawsuits on audit quality, I next explore how this effect varies across different audit offices. First, I investigate whether the adverse lawsuit effect varies based on office size, considering that larger offices may be more adept at addressing staffing challenges arising from employee lawsuits. To implement the test, I remove *OFFICE_ SIZE* from the set of controls in equation (2) and add *LARGE_OFFICE* and an interaction between *LARGE_OFFICE* and *POSTLAWSUIT* to the model. As previously defined,

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[41] Note that the impact of employee lawsuits on audit quality may occur not only through impairing an office's ability to attract talent, but also through other channels not examined in this study, such as attrition and reduced productivity of its existing workforce.

[42] *RESTATE_ALL* and *RESTATE_BIGR* exhibit similar time trends. For brevity, I only include the time trend for *RESTATE_BIGR*.

LARGE_OFFICE is an indicator that equals one if an audit office's size exceeds the sample median in a local area. In Table 7, I find a negative coefficient on the interaction term in both columns (1) and (2) ($p<0.05$), suggesting that audit quality in larger offices is less sensitive to lawsuit effects relative to smaller offices.

Second, I investigate whether the adverse lawsuit effect on audit quality varies based on office growth. Recall from Table 5, Panel A that the adverse lawsuit effect on talent acquisition is more pronounced when audit offices experience higher growth (e.g., because growth increases staffing needs). If challenges attracting quality talent have negative implications for audit quality, I may see a more pronounced negative effect on audit quality in fast-growing offices. To test this, I add *HIGH_GROWTH* and an interaction between *HIGH_GROWTH* and *POSTLAWSUIT* to equation (2). As previously defined, *HIGH_GROWTH* is an indicator that equals one if an office's growth in audit fees exceeds the sample median in a year. In columns (3) and (4) of Table 7, I find a nonsignificant coefficient on *POSTLAWSUIT* ($p>0.10$) and a positive and significant coefficient on the interaction term ($p<0.10$), indicating the adverse lawsuit effect on audit quality is primarily concentrated in offices experiencing higher growth.

4.5 Additional Analyses

4.5.1 Practitioners' Perspective

To better understand the hiring practice within audit firms, I conducted semi-structured interviews with four practitioners from the Big 4 firms. [43] All interviewees have extensive experience managing large groups of audit employees and actively participate in their firms' recruiting activities. Their previous or current positions at their firms include audit staff, local

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[43] Small-scale interviews are not sufficiently rigorous to draw systematic inferences about lawsuit effects and employing a mixed-methods approach is beyond the scope of this study. However, my conversations with audit practitioners provide valuable anecdotal evidence that helps validate my claims and motivate my analyses.

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office director/partner, national office partner, and talent service area leader.[44] Several interesting insights emerged from the interviews.

The interviewees stated that a firm's reputation for work culture and employee treatment is a key factor in attracting talent. They noted that prospective employees seek more than just income; they also look for firms that prioritize employee well-being and align with their values. Since "the big audit firms (all) appear similar" to job candidates in terms of the job duties and the compensation level, work culture and employee treatment is one way for firms to differentiate themselves in the labor market.[45]

The interviews support the notion that employee lawsuits can adversely affect the perceptions of prospective employees. For example, one interviewee who is actively involved in recruiting every year noted that when an office experiences a scandal, job candidates will often inquire about it during interviews to learn more about its underlying issues and the firm's response. The interviewees identified various channels through which information about employee lawsuits can be disseminated, including national and local news, social media, professional network websites, and word of mouth. They also emphasized the role of the media in amplifying the reach and visibility of incidents that threaten a firm's reputation.

Consistent with the proposition that firms compromise on the quality of new hires when facing staffing challenges, the interviewees indicated that they sometimes broaden their candidate

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[44] The interviewees have 17 years of experience as audit firm employees on average, and interviews lasted an average of 51 minutes. I used a questionnaire that included lead questions about general strategies and challenges associated with talent acquisition, and specific questions about employee lawsuits. I also asked several follow-up questions to better understand the underlying mechanisms of my findings. I provide details about the interviews in Online Appendix 8.

[45] Consequently, firms exert considerable efforts to project a positive employer image. For example, firms proactively discuss their commitment to improve employee well-being and the overall work environment through social media and company websites. Firms also encourage their employees to contribute to the enhancement of firm reputation among prospective hires and clients. For example, two interviewees mentioned that their firms encourage employees to post about firm events such as charity initiatives, team get-togethers, and group projects on professional networking websites.

pool to include students from lower-tier schools or junior colleges to fulfill their hiring needs. To address challenges in talent acquisition, firms may also raise wages and offer referral bonuses.

Finally, the interviewees confirmed that the individual auditor quality measures adopted in this study are frequently used during recruiting. They particularly emphasized the significance of educational attainment in evaluating a prospective employee's aptitude for auditing work. They also emphasized the importance of prior work experience for both rookie and seasoned hires, as it builds knowledge of how businesses operate and develops critical interpersonal skills.

4.5.2 Employee Lawsuits and Office Wages

Earlier in the paper, I find evidence that suggests adverse lawsuit effects can be partially mitigated when an audit office pays higher wages in its local labor market (Table 5, Panel A). To the extent that compensation levels help offices overcome hiring challenges resulting from employee lawsuits, a rational response to such lawsuits is to offer higher wages (subject to available slack in the budget). In Online Appendix 9, I examine whether firms increase wages as a strategy to offset the effects of lawsuits and find evidence suggesting they do.

4.5.3 Employee Lawsuits and Client Perceptions

Prior research indicates that audit offices lose market share when they experience reputational damage induced by audit failure (e.g., Skinner and Srinivasan 2012; Swanquist and Whited 2015). Although an employee lawsuit against an audit office may not directly affect an office's clients, it can affect clients' perceptions of the office's operations and ability to provide quality audits, which can negatively influence clients' auditor selection and retention decisions. Therefore, I examine the market share implications of employee lawsuits in Online Appendix 10. I do not find a significant change in an office's market share following an employee lawsuit.

5. CONCLUSION

In this study, I examine whether employee lawsuits hurt an audit office's ability to recruit quality talent and provide quality audits. Using a comprehensive dataset of individual auditor profiles and employee quality measures motivated by the labor economics literature, I find a decline in the quality of newly hired auditors in an audit office following an employee lawsuit. In cross-sectional analyses, I find the adverse lawsuit effect on talent acquisition is more pronounced when an office experiences faster growth and when a lawsuit receives greater media attention. Conversely, adverse lawsuit effects on hiring are mitigated when an audit office is larger or pays higher wages in its local area. My evidence also suggests an adverse lawsuit effect on audit quality, as restatement propensities increase in the lawsuit's aftermath.

These findings have several practical implications. While audit offices have little control over the local availability of talent, they can manage their reputation as employers by improving HR practices and promoting cultural values. This, in turn, may enhance their ability to attract quality talent. Furthermore, since audit offices involved in employee lawsuits tend to deliver low-quality audits, investors and regulators should exercise caution and scrutinize the quality of audited financial statements when an audit office faces persistent employment-related litigation. The insights drawn from this study may also apply to other professional service firms with organized or highly specialized workforces, such as investment banks and law firms.

This study is subject to several important limitations. First, the online professional profiles from which I collect individual auditor data are self-reported and therefore may contain incorrect or imprecise information. However, the pervasive use of professional networking platforms lends credibility to the data. Second, this study adopts the GDD framework, which relies on assumptions such as conditional independence, parallel trends, and stable unit treatment values. Despite my

careful evaluation of these assumptions, it's important to acknowledge that some may not be directly and perfectly verifiable, or they might not hold in all cases. Therefore, the inferences in the study should be interpreted with this caveat in mind. Third, while my findings suggest that employee lawsuits hurt an office's ability to recruit quality talent and deliver quality audits, I do not claim that talent acquisition challenges are the only channel through which employee lawsuits affect audit quality. I acknowledge that other unexplored channels, such as attrition and reduced productivity among existing employees, could also lead to a decline in audit quality following employee lawsuits. Finally, because employee lawsuits are often settled privately, the data on lawsuit outcomes and settlements are likely incomplete. This data limitation constrains my ability to distinguish between meritorious and non-meritorious lawsuits. Nonetheless, my study suggests that the revelation of an employee lawsuit could adversely affect a prospective employee's perception of an audit office, regardless of case outcomes or motivations. An interesting avenue for future research is to explore audit offices' strategies for mitigating the adverse effects of employee lawsuits on talent acquisition and audit quality.

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Variable Name	Definition
Main variables	
POSTLAWSUIT (indicator)	I set the binary indicator equal to one for an audit office in the year after an employee lawsuit filing and all years thereafter, and zero otherwise. [Audit Analytics]
LAWSUIT (indicator)	I set the binary indicator equal to one if an employee lawsuit is filed against an audit office in a year, and zero otherwise. [Audit Analytics]
TOP_UNIV (indicator)	I set the binary indicator equal to one if an individual graduated from one of the top 100 universities in the world based on the 2011 QS World University Ranking, and zero otherwise. [Online professional profiles; QS World University Ranking]
TOP_ACC (indicator)	I set the binary indicator equal to one if an individual graduated from one of the top 100 accounting and finance programs in the world based on the 2011 QS World University Ranking, and zero otherwise. [Online professional profiles; QS World University Ranking]
MASTERS (indicator)	I set the binary indicator equal to one if an individual holds a master's degree or higher, and zero otherwise. [Online professional profiles]
WORK_EXP (indicator)	I set the binary indicator equal to one if an individual previously worked in another company before joining the current audit office, and zero otherwise. [Online professional profiles]
AUD_EXP (indicator)	I set the binary indicator equal to one if an individual had worked in one of the top 10 national audit firms before joining the current audit office, and zero otherwise. The 10 audit firms are PricewaterhouseCoopers, Ernst & Young, Deloitte & Touche, KPMG, Arthur Andersen, Grant Thornton, BDO Seidman, Crowe Chizek & Company, Plante & Moran, and McGladrey & Pullen. [Online professional profiles]
WORK_YEARS	Natural logarithm of an individual's total number of years of previous work experience in a given year. [Online professional profiles]
CPA (indicator)	I set the binary indicator equal to one if an individual holds the Certified Public Accountant (CPA) designation, and zero otherwise. [Online professional profiles]
QUALITY_INDEX	A comprehensive measure of individual quality derived from the seven measures constructed above. I perform a principal component analysis, wherein I select the three principal components with eigenvalues greater than 1 and then weigh each component based on the variance explained.
RESTATE_ALL (indicator)	I set the binary indicator equal to one if a client-year's financial statements are subsequently restated, either through an Item 4.02 disclosure in a Form 8-K filing or a revision restatement, and zero otherwise [Audit Analytics]
RESTATE_BIGR (indicator)	I set the binary indicator equal to one if a client-year's financial statements are subsequently restated through an Item 4.02 disclosure in a Form 8-K filing, and zero otherwise. [Audit Analytics]
Media Coverage (indicator)	I set the binary indicator equal to one if an employee lawsuit is covered by one of the websites listed in Online Appendix 7, and zero otherwise.
Cause of Action (indicator)	I set the binary indicator equal to one if an employee lawsuit involves issues related to working conditions in an office, such as benefits, wage policy, or layoff disputes; and zero if an employee lawsuit involves issues related to office practices in managing diversity and equity such as age, gender, or race discrimination cases.

Individual Auditor Characteristics

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AGE (years)	is the age of an individual calculated as the current fiscal year less the year the individual started their undergraduate education plus 18 years. [Online professional profiles]
FEMALE (indicator)	I set the binary indicator equal to one if an individual is female, and zero if is male. I impute gender to the resumés using a probabilistic algorithm based on the names of the individuals submitting the resumés. This algorithm is provided by Gender API (https://gender-api.com/). [Online professional profiles]

**Audit Firm and Office Characteristics**

OFFICE_SIZE (number)	Number of audit clients in an audit office in a year. [Audit Analytics]
LARGE_OFFICE (indicator)	I set the binary indicator equal to one if an audit office's size is greater than the sample median in an MSA.
MARKET_SHARE (ratio)	Total number of audit clients in an office in a year to the total number of audit clients for all Big 4 offices in the MSA in a year. [Audit Analytics]
OFFICE_WAGE	is the natural logarithm of the average salary offered at the associate level in an office-year. [U.S. Department of Labor]
HIGH_WAGE (indicator)	I set the binary indicator equal to one if the wage offered by an audit office is greater than the sample median in an MSA.
RESTATE_PERC (ratio)	Number of restatement announcements for clients scaled by the total number of audit clients in an office-year. [Audit Analytics]
MSA_OFFICES (number)	Number of audit offices in an MSA in a year. [Audit Analytics]
OFFICE_GROWTH_NUM (%)	The percentage change in the number of audit clients in an audit office from year *t-1* to year *t*. [Audit Analytics]
OFFICE_GROWTH_FEES (%)	The percentage change in total audit fees in an audit office from year *t-1* to year *t*. [Audit Analytics]
HIGH_GROWTH (indicator)	I set the binary indicator equal to one if an office's growth in audit fees is greater than the sample median in a year.
TURNOVER (ratio)	Number of auditors who departed from an audit office scaled by the number of auditors in an office-year. [Online professional profiles]
HIRENO	Natural logarithm of the number of incoming auditors in an audit office-year. [Online professional profiles]

Client Firm Characteristics

SIZE_CLIENT	Natural logarithm of a client's total assets (in millions of dollars) in a year. [Compustat]
CASH_FLOWS (ratio)	Total client firm cash flows from operations scaled by total assets in a year. [Compustat]
LOSS (indicator)	I set the binary indicator equal to one if net income is negative in a year, and zero otherwise. [Compustat]
RSST_ACC (ratio)	The accruals measure developed by Richardson, Sloan, Soliman, and Tuna (2005) that is the sum of working capital accruals, changes in long-term operating assets, and long-term operating liabilities, scaled by average total assets. [Compustat]
DEBT (ratio)	Total debt scaled by total assets in a year. [Compustat]
CHG_REC (ratio)	The change in accounts receivables from year *t-1* to year *t*, scaled by total assets in year *t*. [Compustat]
CHG_INV (%)	The percentage change in inventories from year *t-1* to year *t*. [Compustat]
CHG_EARN (%)	The percentage change in earnings from year *t-1* to year *t*. [Compustat]
OP_LEASES (%)	The percentage change in the present value of future noncancelable operating lease obligations from year *t-1* to year *t*. [Compustat]
ISSUE (indicator)	I set the binary indicator equal to one if a client issued new debt or equity in a year, and zero otherwise. [Compustat]

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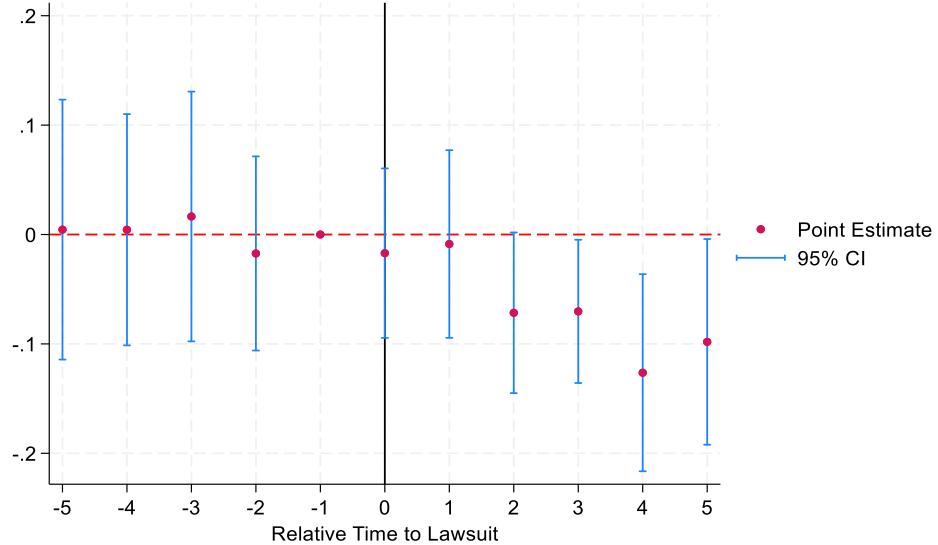
GC (indicator)	I set the binary indicator equal to one if the client received a going concern opinion in a year, and zero otherwise. [Audit Analytics]
TENURE (years)	Number of consecutive years that the same audit firm has issued an opinion on the client's annual financial statements. [Audit Analytics]
AUDITOR_CHANGE (indicator)	I set the binary indicator equal to one if a client changes its audit firm in a year, and zero otherwise. [Audit Analytics]
AUDIT_FEES	Natural logarithm of a client's audit fees in a year. [Audit Analytics]
NONAUDIT_FEES	Natural logarithm of a client's non-audit fees in a year. [Audit Analytics]
NATIONAL_LEADER (indicator)	I set the binary indicator equal to one if an audit firm is the number one in terms of aggregated audit fees in the client's industry in a year, and zero otherwise. [Audit Analytics]
CITY_LEADER (indicator)	I set the binary indicator equal to one if an audit office is the number one audit office in terms of aggregated client audit fees in the client's industry within that city in a year, and zero otherwise. [Audit Analytics]

Local Area Characteristics
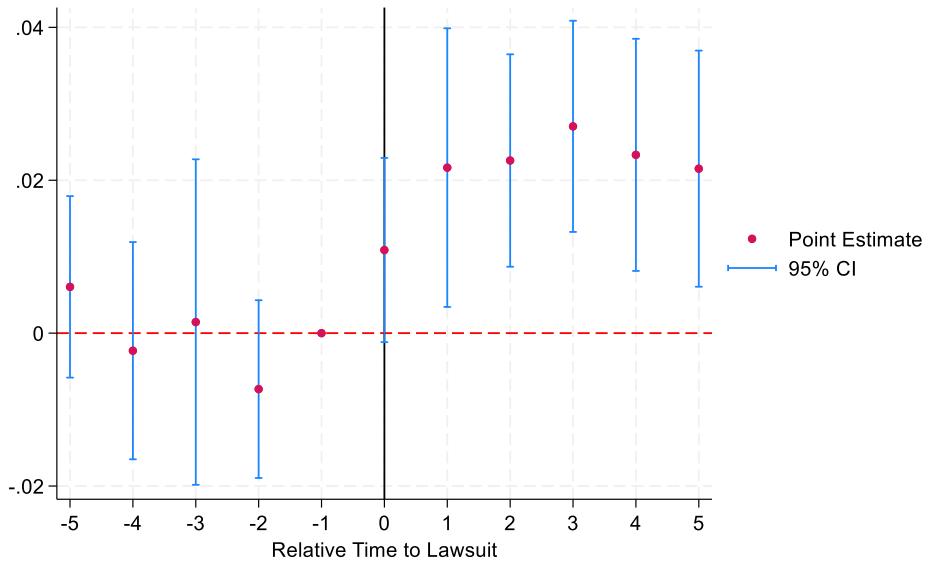
POPULATION	Natural logarithm of the population of the state in which an audit office is located in a year. [U.S. Bureau of Economic Analysis]
UNEMPLOY_RATE (%)	The unemployment rate of the county in which an audit office is located in a year. [U.S. Bureau of Economic Analysis]

Figure 1

a. The Effect of Employee Lawsuit on Talent Acquisition in Event Time

b. The Effect of Employee Lawsuit on Audit Quality in Event Time

Notes: In this figure, I graph the lawsuit effect in event time. Figure 1a graphs the trend of incoming auditor quality over the event time relative to the year of the lawsuit filing. The sample consists of 45,711 individual-years of newly hired auditors in an office. Formally, I estimate $QUALITY\_INDEX_{i,j,t} = \alpha_0 + \sum_{k=2}^{K} \beta\ (LAG\ k)_{j,t} + \sum_{m=1}^{M} \gamma\ (LEAD\ m)_{j,t} + \alpha Controls_{i,j,t-1} + Fixed\ Effects\ (year, audit\ office, position\ rank) + \varepsilon_{i,j,t}$. I omit the indicator for *t-1*, which serves as benchmark period. Figure 1b graphs the trend of audit quality over the event time relative to the year of the lawsuit filing. The sample includes 20,298 client-years. Formally, I estimate $RESTATE_{l,j,t} = \gamma_0 + \sum_{k=2}^{K} \beta\ (LAG\ k)_{j,t} + \sum_{m=1}^{M} \alpha\ (LEAD\ m)_{j,t} + \gamma Controls_{l,j,t-1} + Fixed\ Effects\ (year, audit\ office, industry) + \varepsilon_{l,j,t}$. I omit the indicator for *t-1*, which serves as a benchmark period.

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TABLE 1
TABLE 1

Employee Lawsuits

Panel A: Employee lawsuits by audit firms

Audit firm	Number of lawsuits	% of sample	Offices involved in lawsuits	Total audit offices	% of office involved in lawsuits
PwC	32	28.8%	15	55	27.3%
EY	28	25.2%	15	59	25.4%
Deloitte	33	29.7%	17	54	31.5%
KPMG	18	16.2%	10	62	16.1%
Totals	111	100.0%	57	230	24.8%

Panel B: Employee lawsuits by year (2005–2018)

Year	Number of lawsuits	% of sample
2005	10	9.0%
2006	6	5.4%
2007	11	9.9%
2008	13	11.7%
2009	9	8.1%
2010	6	5.4%
2011	14	12.6%
2012	10	9.0%
2013	7	6.3%
2014	4	3.6%
2015	6	5.4%
2016	5	4.5%
2017	6	5.4%
2018	4	3.6%
Total	111	100.0%

Panel C: Employee lawsuits by cause of action

Cause of Actions	Number of lawsuits	% of sample
Age Discrimination	21	0.19
Religious Discrimination	1	0.01
Disability Discrimination	16	0.14
Retaliation	24	0.22
Payment	26	0.23
Employee Benefit Plan	28	0.25
Others	8	0.07

Panel D: Employee lawsuits by outcome

Lawsuit Outcome	Number of lawsuits	% of sample
Settlement	21	0.19
In favor of Plaintiff	2	0.02
In Favor of Defendant	5	0.05
Dismissed (without settlement info disclosed)	47	0.42
NA	37	0.33

Panel E: Employee lawsuits descriptive statistics

Variable	Mean	Std	10th	Median	90th
Case Length *(years)*	1.73	1.95	0.23	1.07	3.87
Revelation Time *(years)*	3.44	2.98	1.00	3.00	7.00
Law Case Website Coverage *(indicator)*	0.68	0.47	0.00	1.00	1.00
News Website Coverage *(indicator)*	0.13	0.33	0.00	0.00	1.00
Accounting Professional Website Coverage *(indicator)*	0.11	0.31	0.00	0.00	1.00

Panel F: Pre-lawsuit characteristics of treated and control offices

	Control	Treated	Diff	
OFFICE_SIZE (number)	18.64	122.421	-103.781	***
MARKET_SHARE (ratio)	0.335	0.249	0.085	***
OFFICE_WAGE ($)	50285.34	52725.4	-2440.06	**
RESTATE_PERC (ratio)	0.067	0.047	0.02	
MSA_OFFICES (number)	15.066	40.41	-25.345	***
OFFICE_GROWTH_NUM (%)	0.052	0.006	0.045	
OFFICE_GROWTH_FEES (%)	0.235	0.139	0.096	
TURNOVER (ratio)	0.154	0.127	0.027	**

Panel G: Audit office characteristics and employee lawsuits

$$LAWSUIT_{j,t} = \beta_0 + \beta \text{Office Characteristics}_{j,t-1} + \text{Year Fixed Effects} + \varepsilon_{j,t}$$

	(1)
VARIABLES	*LAWSUIT*
OFFICE_SIZE	0.002**
	(3.92)
MARKET_SHARE	-0.017
	(-1.00)
OFFICE_WAGE	-0.007
	(-0.31)
RESTATE_PERC	0.001
	(0.08)
MSA_OFFICES	0.001***
	(16.99)
OFFICE_GROWTH_NUM	-0.011
	(-2.16)
OFFICE_GROWTH_FEES	0.001
	(0.57)
TURNOVER	-0.025
	(-1.75)
Constant	0.070
	(0.28)
Observations	2,652
R-squared	0.20
Year Fixed Effects	Yes

Notes: Table 1 presents descriptive statistics for the employee lawsuits in the sample. Panel A presents the distribution of employee lawsuits across the Big 4 firms. Panel B presents the distribution of employee lawsuits across the sample period (2005-2018). Panel C presents the distribution of employee lawsuits by the cause of action. Panel D presents the distribution of employee lawsuits by lawsuit outcomes. Panel F presents differences in the pre-lawsuit characteristics of treated and control offices. Panel G presents the result of multivariate analysis that investigates the antecedents of employee lawsuits. The sample for panels F and G comprises 2,652 office-years, which consists of 95 treated office-years and 2,557 control office-years. All variables are defined in Appendix A. Standard errors are clustered at the office level. The t-statistics are reported in parentheses. ***, **, * indicate significance at the 0.01, 0.05, and 0.10 levels, respectively, using two-tailed tests. All continuous variables are winsorized at the 1 percent and 99 percent levels.

TABLE 2
Sample Selection

Panel A: Sample of incoming auditors

	Individual-Years
Incoming auditors employed by U.S. Big 4 audit firms from 2005 through 2018	57,806
Less: missing data for individual auditor characteristics	(10,416)
Less: missing data for audit office and local area characteristics	(1,679)
Total individual-year observations	45,711

Panel B: Sample of audit engagements

	Client-Years
Client-year observations of U.S. Big 4 audit offices from 2005 through 2018	43,409
Less: missing data for client firm characteristics	(21,815)
Less: missing data for audit office and local area characteristics	(1,296)
Total client-year observations	20,298

TABLE 3
Descriptive Statistics

Variable	Mean	Std	10th	Median	90th
Individual Auditor Characteristics					
TOP_UNIV	0.17	0.38	0.00	0.00	1.00
TOP_ACC	0.24	0.43	0.00	0.00	1.00
MASTERS	0.55	0.50	0.00	1.00	1.00
WORK_EXP	0.75	0.43	0.00	1.00	1.00
AUD_EXP	0.19	0.39	0.00	0.00	1.00
WORK_YEARS	2.86	3.22	0.00	2.00	7.00
CPA	0.46	0.50	0.00	0.00	1.00
QUALITY_INDEX	0.10	0.76	-0.72	-0.08	1.19
AGE (years)	23.12	2.96	21.00	22.00	27.00
FEMALE	0.45	0.50	0.00	0.00	1.00
Office and Local Area Characteristics					
POSTLAWSUIT	0.24	0.43	0.00	0.00	1.00
HIRENO	17.26	28.32	1.00	8.00	42.00
OFFICE_SIZE	38.53	78.86	3.00	12.00	87.00
MARKET_SHARE	0.31	0.26	0.05	0.23	0.68
OFFICE_WAGE ($)	51,835	9,713	43,000	49,740	62,550
RESTATE_PERC	0.05	0.10	0.00	0.00	0.17
MSA_OFFICES	18.51	22.17	4.00	11.00	44.00
POPULATION	16.11	0.81	15.08	16.11	17.39
UNEMPLOY_RATE (%)	5.82	2.20	3.45	5.20	9.07
Engagement Characteristics					
RESTATE_ALL	0.06	0.23	0.00	0.00	0.00
RESTATE_BIGR	0.02	0.15	0.00	0.00	0.00
SIZE_CLIENT ($ mil.)	8,723	27,324	168	1,502	16,400
CASH_FLOWS	0.07	0.12	-0.02	0.09	0.19
LOSS	0.26	0.44	0.00	0.00	1.00
RSST_ACC	0.02	0.16	-0.12	0.02	0.16
DEBT	0.57	0.27	0.23	0.55	0.89
CHG_REC	0.01	0.04	-0.03	0.00	0.04
CHG_INV	0.12	0.48	-0.23	0.05	0.47
CHG_EARN	-0.18	3.59	-1.76	-0.01	1.34
OP_LEASES	0.15	0.61	-0.24	0.03	0.52
ISSUE	0.93	0.25	1.00	1.00	1.00
GC	0.01	0.12	0.00	0.00	0.00
TENURE (years)	7.85	4.75	2.00	7.00	15.00
AUDITOR_CHANGE	0.03	0.17	0.00	0.00	0.00
AUDIT_FEES	14.46	1.00	13.24	14.37	15.77
NONAUDIT_FEES	11.55	3.59	8.41	12.38	14.49
NATIONAL_LEADER	0.32	0.47	0.00	0.00	1.00
CITY_LEADER	0.68	0.47	0.00	1.00	1.00

Notes: Table 3 presents the descriptive statistics of my sample. Individual auditor characteristics are presented for individual-year observations of incoming auditors in Big 4 audit firms from 2005 through 2018 (n = 45,711). Office

and local area characteristics are presented for office-year observations of Big 4 audit firms from 2005 through 2018 (n = 3,217). Engagement characteristics are presented for client-year observations of Big 4 audit firms from 2005 through 2018 (n = 20,298). *WORK_YEARS*, *HIRENO*, *OFFICE_WAGE*, and *SIZE_CLIENT* are presented before taking the log for ease of interpretation. All variables are defined in Appendix A. All continuous variables are winsorized at the 1 percent and 99 percent levels.

TABLE 4
TABLE 4
Employee Lawsuits and the Quality of Incoming Auditors

Panel A: Main analyses

$NEWHIRE\_QUALITY_{i,j,t} = \alpha_0 + \alpha_1 POSTLAWSUIT_{j,t} + \alpha Controls_{i,j,t-1} + \text{Fixed Effects (year, audit office, position rank)} + \varepsilon_{i,j,t}$

VARIABLES	(1) TOP_UNIV	(2) TOP_ACC	(3) MASTERS	(4) WORK_EXP	(5) AUD_EXP	(6) WORK_YEARS	(7) CPA	(8) QUALITY_INDEX
POSTLAWSUIT	-0.023**	-0.026**	0.006	-0.017**	-0.005	-0.036**	-0.034*	-0.059***
	(-2.00)	(-2.00)	(0.44)	(-2.08)	(-0.35)	(-2.59)	(-1.91)	(-2.77)
AGE	0.006***	0.004***	0.032***	0.027***	0.026***	0.112***	-0.003*	0.060***
	(6.00)	(3.01)	(15.27)	(30.10)	(18.53)	(65.16)	(-1.74)	(22.56)
FEMALE	0.008*	0.006	-0.012***	0.007**	0.027***	0.013**	-0.050***	-0.000
	(1.92)	(1.09)	(-2.60)	(2.06)	(6.95)	(2.13)	(-10.32)	(-0.04)
HIRENO	-0.001	-0.000	0.002	-0.001	0.000	-0.002	0.002	0.001
	(-0.62)	(-0.05)	(1.46)	(-1.03)	(0.26)	(-1.55)	(1.06)	(0.53)
OFFICE_SIZE	-0.000	-0.000	-0.000***	0.000	-0.000	0.000	-0.000	-0.000**
	(-0.70)	(-0.29)	(-2.84)	(0.40)	(-1.60)	(0.57)	(-1.07)	(-2.03)
MARKET_SHARE	-0.031	-0.010	0.007	-0.026	-0.027	-0.023	0.021	-0.043
	(-1.12)	(-0.31)	(0.15)	(-0.86)	(-0.82)	(-0.42)	(0.49)	(-0.65)
OFFICE_WAGE	-0.034	-0.022	-0.003	0.015	-0.022	-0.005	0.010	-0.043
	(-1.40)	(-0.70)	(-0.10)	(0.54)	(-0.92)	(-0.11)	(0.32)	(-0.86)
RESTATE_PERC	-0.009	-0.026	0.023	-0.034	-0.009	-0.036	0.025	-0.023
	(-0.36)	(-0.83)	(0.60)	(-1.03)	(-0.26)	(-0.72)	(0.50)	(-0.38)
MSA_OFFICES	-0.000	-0.000	-0.002***	0.001	-0.001	0.001*	-0.000	-0.001
	(-0.90)	(-0.24)	(-3.88)	(1.30)	(-1.55)	(1.79)	(-0.14)	(-1.65)
POPULATION	-0.084	-0.104	0.353**	-0.251*	-0.016	-0.562***	0.202	-0.034
	(-0.72)	(-0.85)	(2.33)	(-1.95)	(-0.12)	(-2.83)	(1.47)	(-0.13)
UNEMPLOY_RATE	-0.000	0.003	0.003	0.001	-0.005*	-0.002	-0.004	-0.000
	(-0.04)	(0.86)	(0.72)	(0.26)	(-1.67)	(-0.39)	(-0.86)	(-0.08)
Constant	1.813	2.111	-5.902**	4.068*	0.138	7.756**	-2.848	-0.159
	(0.90)	(1.02)	(-2.32)	(1.95)	(0.06)	(2.37)	(-1.25)	(-0.04)
N	45,704	45,704	45,704	45,704	45,704	45,704	45,704	45,704
R-squared	0.09	0.13	0.14	0.19	0.23	0.32	0.04	0.13
Year Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

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Audit Office Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Position Rank Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Notes: Table 4 presents the results of estimations of equation (1), which explores the change of incoming auditor quality in sued offices pre- and post-employee lawsuits compared to control offices. The sample consists of 45,704 individual-years (7 singleton observations are dropped from the main sample). All variables are defined in Appendix A. Standard errors are clustered at the office level. The t-statistics are reported in parentheses. ***, **, * indicate significance at the 0.01, 0.05, and 0.10 levels, respectively, using two-tailed tests. All continuous variables are winsorized at the 1 percent and 99 percent levels.

TABLE 5
Cross-Sectional Analyses of Lawsuit Effects on Talent Acquisition
Panel A: Individual Auditor and Audit Office Characteristics

$$QUALITY\_INDEX_{i,j,t} = \alpha_0 + \alpha_1 POSTLAWSUIT_{j,t} + \alpha_2 X_{j,t-1} + \alpha_3 POSTLAWSUIT_{j,t} * X_{j,t-1}$$
$$+ \alpha Controls_{i,j,t-1} + \text{Fixed Effects (year, audit office, position rank)} + \varepsilon_{i,j,t}$$

	(1) QUALITY_ INDEX	(2) QUALITY_ INDEX	(3) QUALITY_ INDEX	(4) QUALITY_ INDEX
X=	FEMALE	LARGE_OFFICE	HIGH_GROWTH	HIGH_WAGE
POSTLAWSUIT	-0.070***	-0.107***	-0.045**	-0.095***
	(-3.04)	(-2.70)	(-2.09)	(-2.96)
X	-0.014	-0.024	0.015	-0.019
	(-1.36)	(-1.44)	(1.41)	(-1.38)
POSTLAWSUIT*X	**0.023**	**0.037***	**-0.028****	**0.032***
	(1.48)	**(1.72)**	**(-2.02)**	**(1.73)**
Constant	-0.126	0.363	-0.118	0.475
	(-0.03)	(0.08)	(-0.03)	(0.11)
Controls	Yes	Yes	Yes	Yes
N	45,704	45,704	45,704	45,704
R-squared	0.13	0.13	0.13	0.13
Year Fixed Effects	Yes	Yes	Yes	Yes
Audit Office Fixed Effects	Yes	Yes	Yes	Yes
Position Rank Fixed Effects	Yes	Yes	Yes	Yes

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Panel B: Lawsuit characteristics

$$QUALITY\_INDEX_{i,j,t} = \alpha_0 + \alpha_1 POSTLAWSUIT_{j,t} + \alpha Controls_{i,j,t-1} + \text{Fixed Effects (year, audit office, position rank)} + \varepsilon_{i,j,t}$$

CASE TYPE= VARIABLES	Media Coverage		Cause of Action	
	(1) Low Media Coverage QUALITY_INDEX	(2) High Media Coverage QUALITY_INDEX	(3) Work Environment QUALITY_INDEX	(4) Organizational Equity QUALITY_INDEX
POSTLAWSUIT	-0.004	-0.048***	-0.077***	-0.056*
	(-0.17)	(-2.60)	(-2.74)	(-1.77)
Chi2		4.50**		0.28
Prob > chi2		(0.034)		(0.596)
Controls	Yes	Yes	Yes	Yes
N	38,326	41,199	40,639	36,085
R-squared	0.13	0.13	0.13	0.14
Year Fixed Effects	Yes	Yes	Yes	Yes
Audit Office Fixed Effects	Yes	Yes	Yes	Yes
Position Rank Fixed Effects	Yes	Yes	Yes	Yes

Notes: Table 5 presents the results of cross-sectional analyses that investigate heterogeneity in the lawsuit effect on talent acquisition across different dimensions. Panel A presents results of analyses that test for variation in lawsuit effects across *FEMALE*, *LARGE_OFFICE*, *HIGH_GROWTH*, and *HIGH_WAGE*. The sample for Panel A consists of 45,704 individual-years. Panel B presents results of analyses that test for variation in lawsuit effects across two lawsuit characteristics, media coverage and cause of action. When investigating the impact of cases with lower (higher) media coverage in column (1) ([2]), I drop observations that experience lawsuits with higher (lower) media coverage so that each subsample contains observations treated by one class of lawsuits and observations in control group. This results in 38,326 (41,199) individual-years in column (1) ([2]). Similarly, when investigating the impact of the working environment (organizational equity) lawsuits in column (3) ([4]), I drop observations with organizational equity (working environment) lawsuits, resulting in 40,639 (36,085) individual-years. All variables are defined in Appendix A. Standard errors are clustered at the office level. The t-statistics are reported in parentheses. ***, **, * indicate significance at the 0.01, 0.05, and 0.10 levels, respectively, using two-tailed tests. All continuous variables are winsorized at the 1 percent and 99 percent levels.

TABLE 6
Employee Lawsuits and Audit Quality

$RESTATE_{l,j,t} = \gamma_0 + \gamma_1 POSTLAWSUIT_{j,t} + \gamma\,Controls_{l,j,t-1} + \text{Fixed Effects (year, audit office, industry)} + \varepsilon_{l,j,t}$

VARIABLES	(1) *RESTATE_ALL*	(2) *RESTATE_BIGR*
POSTLAWSUIT	0.016**	0.015***
	(2.09)	(3.82)
SIZE_CLIENT	-0.003	-0.004***
	(-1.11)	(-2.64)
CASH_FLOWS	-0.062***	-0.041***
	(-4.13)	(-3.57)
LOSS	-0.004	-0.002
	(-0.89)	(-0.66)
RSST_ACC	-0.008	-0.002
	(-0.86)	(-0.20)
DEBT	0.004	0.008*
	(0.54)	(1.70)
CHG_REC	-0.032	-0.025
	(-0.63)	(-0.70)
CHG_INV	0.010***	0.007**
	(2.62)	(2.35)
CHG_EARN	-0.001	-0.000
	(-1.08)	(-1.59)
OP_LEASES	-0.006**	-0.001
	(-2.22)	(-0.72)
ISSUE	-0.004	0.003
	(-0.64)	(0.71)
GC	-0.026*	-0.018*
	(-1.79)	(-1.94)
TENURE	-0.001*	0.000
	(-1.73)	(0.76)
AUDITOR_CHANGE	0.000	0.005
	(0.02)	(0.63)
AUDIT_FEES	0.010**	0.006**
	(2.48)	(2.02)
NONAUDIT_FEES	0.000	-0.000
	(0.71)	(-0.25)
NATIONAL_LEADER	-0.000	-0.002
	(-0.13)	(-0.67)
CITY_LEADER	0.001	-0.002
	(0.36)	(-0.56)
OFFICE_SIZE	0.000	0.000
	(0.86)	(0.62)
MARKET_SHARE	0.043*	0.046***
	(1.94)	(3.72)
OFFICE_WAGE	-0.040***	0.009
	(-2.62)	(0.95)
MSA_OFFICES	0.000	0.000

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	(0.01)	(0.40)
POPULATION	-0.201***	-0.144***
	(-2.71)	(-2.83)
UNEMPLOY_RATE	-0.002	-0.003**
	(-1.15)	(-2.17)
Constant	3.643***	2.222***
	(3.00)	(2.68)
N	20,295	20,295
R-squared	0.08	0.07
Year Fixed Effects	Yes	Yes
Audit Office Fixed Effects	Yes	Yes
Industry Fixed Effects	Yes	Yes

Notes: Table 6 presents the results of estimations of equation (2), which explores changes of audit quality in sued offices pre- and post-employee lawsuits compared to control offices. The sample includes 20,295 client-years (3 singleton observations are dropped from the main sample). All variables are defined in Appendix A. Standard errors are clustered at the office level. The t-statistics are reported in parentheses. ***, **, * indicate significance at the 0.01, 0.05, and 0.10 levels, respectively, using two-tailed tests. All continuous variables are winsorized at the 1 percent and 99 percent levels.

TABLE 7
Cross-Sectional Analyses of Lawsuit Effects on Audit Quality

$RESTATE_{l,j,t} = \gamma_0 + \gamma_1 POSTLAWSUIT_{j,t} + \gamma_2 X_{j,t-1} + \gamma_3 POSTLAWSUIT_{j,t} * X_{j,t-1}$
$+ \gamma Controls_{l,j,t-1} + $ Fixed Effects (year, audit office, industry) $+ \varepsilon_{l,j,t}$

	(1) RESTATE_ALL LARGE_OFFICE	(2) RESTATE_BIGR LARGE_OFFICE	(3) RESTATE_ALL HIGH_GROWTH	(4) RESTATE_BIGR HIGH_GROWTH
X=				
POSTLAWSUIT	0.079***	0.044***	0.007	0.010
	(3.68)	(3.38)	(0.48)	(1.60)
X	0.047***	0.021***	-0.008*	-0.003
	(4.29)	(3.12)	(-1.83)	(-1.09)
POSTLAWSUIT*X	**-0.036***	**-0.016**	**0.011**	**0.006*
	(-3.14)	**(-2.37)**	**(2.05)**	**(1.65)**
Constant	3.547***	2.198***	0.366	-0.129
	(2.91)	(2.67)	(1.63)	(-1.02)
Controls	Yes	Yes	Yes	Yes
N	20,295	20,295	20,295	20,295
R-squared	0.08	0.07	0.08	0.06
Year Fixed Effects	Yes	Yes	Yes	Yes
Audit Office Fixed Effects	Yes	Yes	Yes	Yes
Industry Fixed Effects	Yes	Yes	Yes	Yes

Notes: Table 7 presents the results of cross-sectional analyses that explore heterogeneity in the lawsuit effect on audit quality across two audit office characteristics, *LARGE_OFFICE* and *HIGH_GROWTH*. The sample includes 20,295 client-years. All variables are defined in Appendix A. Standard errors are clustered at the office level. The t-statistics are reported in parentheses. ***, **, * indicate significance at the 0.01, 0.05, and 0.10 levels, respectively, using two-tailed tests. All continuous variables are winsorized at the 1 percent and 99 percent levels.

Online Appendix:

When Employees Go to Court: Employee Lawsuits and Talent Acquisition in Audit Offices

This online appendix provides additional descriptions and analyses referenced but not tabulated in the main paper.

Contents

1. Examples of Employee Lawsuits

Case_ID	17732	24267	23167	29594
Title	David B Greenberg v. KPMG LLP	Rai v. Ernst & Young LLP	German v. Deloitte LLP et al	Rabin v. PricewaterhouseCoopers LLP
Docket	2:09-cv-05273-SJO-RC	2:09-cv-13194-VAR-MJH	1:12-cv-02470-RWS	4:16-cv-02276-JST
Audit firm	KPMG LLP	Ernst & Young LLP	Deloitte & Touche LLP	PricewaterhouseCoopers LLP
Audit Office City	Los Angeles	Detroit	New York	San Jose
Audit Office State	CA	MI	NY	CA
Alleged Misconduct Began	2003	2008	1997	2016
Employee termination date	2003	2009	2012	NA
Case Began	7/20/2009	8/13/2009	4/2/2012	4/27/2016
Case Ended	1/14/2013	9/8/2010	4/14/2014	12/24/2020
Summary	Plaintiffs allege that the defendants are guilty of **Breach of implied contract for indemnity, Breach of the covenant of good faith and fair dealing, Breach of fiduciary duty, Malicious prosecution, Defamation, Intentional infliction of emotional distress, and Fraud.**	Plaintiff is a male of Indian national origin who was employed by Defendant throughout the period giving rise to his Complaint. The plaintiff alleges that the Defendants **discriminated against him based on his ethnicity**, terminated his employment based on his ethnicity, and retaliated against him when he reported abuses. The Plaintiff seeks all lost wages, past and future, reasonable attorney's fees, and any other relief the court deems just and proper.	Plaintiff Michelle German, an IT Support Technician and trainer for Defendant Deloitte & Touche LLP, located in the New York office, brought the action to **recover unpaid overtime wages.** The Plaintiff and the Collective Action Members were all subjected to Defendants' illegal policies of failing to pay overtime and inappropriately classifying IT Technicians as "exempt" from overtime pay.	A class and collective action alleges **violations of the Age Discrimination** in Employment Act of 1967 and the California Fair Employment and Housing Act. The complaint describes PricewaterhouseCoopers LLP hiring policies and states the number of older workers in entry-level and lower- to mid-level positions is low. Plaintiff claims intentional discrimination, disparate impact discrimination and seeks certification of the class, declaratory judgment, an order that PwC carries out policies that provide equal employment opportunities, an order appointing a monitor, front and back pay benefits, monetary damages, liquidated damages, punitive damages, costs, pre and post judgment interest.
Case Outcome	Dismissed with prejudice.	The Court ruled in favor of the Defendant.	The case was settled for $1.5 million and dismissed with prejudice.	PwC settled this case for $11.625 million. The settlement also provides an improvement in PwC's recruiting and hiring process for older workers. The settlement was preliminarily approved on August 19, 2020.
Examples of Media Coverage	"Former KPMG partner files suit" by Los Angeles Times	"RAI v. ERNST YOUNG, LLP" by casetext.com	"Deloitte, Technicians Reach $1.5M Deal to End OT Suit" by LAW360.com	"PwC's US firm faces age discrimination claim" by Accountancy Daily "Lawsuit accuses PwC of discriminating against older job applicants" by Reuters "The Olds vs. PwC: Age Discrimination Case Can Proceed as a Collective Action" and "The Olds vs. PwC: $11.625 Million Settlement Reached In Age Discrimination Case" by goingconcern.com

2. Example of Individual Auditor Profile and Data Processing

In this Online Appendix, I provide an example of the raw profile pages for an individual auditor and the data generated. I parse out information from the Education and Experience section and generate two datasets as presented in the tables below.

Processed (Machine Readable) Data:

Edu ID	Degree	School Name	Started	Ended
1	Bachelor of Science, Accountancy	University of Illinois at Urbana-Champaign	2011	2015
2	Master of Accounting Science, Accounting	University of Illinois at Urbana-Champaign	2015	2016

JobID	Company Name	Title	City	State	Started	Ended
1	PwC	Assurance Associate	Chicago	Illinois	2016	2018
2	PwC	Senior Assurance Associate	Chicago	Illinois	2019	2021
3	PwC	Assurance Manager	Chicago	Illinois	2021	present

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3. Assessment of GDD Analysis and Assumptions

In this Online Appendix, I provide an assessment of several key assumptions underlying the GDD framework and the robustness of the main findings in this study.

1) Conditional Independence

The conditional independence assumption posits that, in the absence of the treatment (i.e., employee lawsuit), the potential outcomes of the treatment and control groups should be conditionally independent of the treatment status.

To assess this assumption, I first compare the characteristics of the treated and control groups during the pre-treatment period, as presented in Table 1, Panels F and G of the paper. I observe differences between treated and control offices in office size and local market competition, suggesting that the occurrence of employee lawsuits is not entirely random. Consequently, I include a set of office characteristics as controls in my main specification to address potential confounding factors in the relationship between the treatment and the outcomes.

Next, I map out differences between treatment and control units around the event time (i.e., the filing of an employee lawsuit). If changes in incoming auditor quality and audit quality are associated with the announcement of employee lawsuits, they should occur in the year of, or the year after a lawsuit is filed, not before. Consistent with this, I find no evidence of differential pre-lawsuit trends in incoming auditor quality and audit quality across treatment and control groups in Figure 1 of the paper.

2) Contemporaneous Events and Omitted Variables

The contemporaneous events assumption assumes that there are no shocks coinciding with employee lawsuits that differentially affect incoming auditor quality within treated and control offices.

One potential shock is termination waves or financial distress in an office, which could both trigger lawsuits and affect the hiring practice in an office. To evaluate this possibility, I use two factors, client losses and decreases in audit fees, as potential indicators of large restructuring efforts in an office and evaluate whether these two factors may trigger employee lawsuits. In Table 1, Panel F and G of the paper, I find no significant differences in these two variables (i.e., *OFFICE_GROWTH_NUM* and *OFFICE_GROWTH_FEES*) between the treated and control groups in the year preceding the lawsuits. Additionally, I rerun my main analyses by excluding offices that experienced the highest 10% decline in client number or audit fees in the sample. I continue to observe a decline in the quality of incoming auditors after dropping the office-years that are most likely to be affected by these concurrent events (untabulated).

I also review the lawsuit files and gather information regarding the timing of employee termination. I find that only 10 cases within the sample were initiated by employees who had been terminated within a year. In reviewing the case files, I did not come across indications of large restructuring efforts and termination waves within the audit offices. Instead, the plaintiffs in these cases alleged that their employment terminations were primarily attributed to their specific individual characteristics such as ethnicity, disability, or age.

Despite my effort to assess this assumption, I may not be able to measure and account for all underlying factors and events, especially given the complex and unobservable nature of some factors. Therefore, the inferences in the study should be interpreted with this caveat in mind.

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3)   Staggered Design Diagnostics and Robustness

Baker, Larcker, and Wang (2022) note possible biased coefficients in a Difference-in-Differences design with staggered treatments. Therefore, I follow their suggestion to adopt a "stacked regression" approach as a robustness check. Specifically, following Gormley and Matsa (2011), I create a cohort of treatment and control offices for each event year t. The treatment offices are offices that have not been sued by year $t-1$ and are sued in year t, while the control offices are offices that have not been sued by year t. I then include all office-year observations for both treatment and control offices from five years before to five years after the event year (i.e., $t-5$ to $t+5$). If a control office was affected by a different event within the time window (i.e., during $t+1$ to $t+5$), I remove the post-event observations. I then stack the data across all the cohorts into one dataset and estimate the average treatment effect, i.e., I run the same estimates as in the main analyses (i.e., equations [1] and [2]) but include interactions of cohort identifier with all of the fixed effects and clusters.

I present the results of this analysis in Table OA3.1. For ease of comparison, I first reproduce the estimates from the main analyses in column (1) of Panel A and columns (1) and (2) of Panel B. I then report the results from the stacked approach in column (2) of Panel A and columns (3) and (4) of Panel B. I continue to find a decline in incoming auditor quality (audit quality) following employee lawsuits. In Figure OA3.1 a and b, I map out treatment effects in event-time using the stacked sample. I find no evidence of differential pre-lawsuit trends in incoming auditor quality and audit quality across treatment and control groups. In contrast, I find a sharp decline in incoming auditor quality and audit quality in treated offices compared to control offices in the year after the employee lawsuits, and this decline persists over time.

The stacked approach has the same intuition as the one adopted in the main analyses, but it can help to isolate a specific window of interest around each event. Moreover, it aligns events based on event time rather than calendar time, mitigating issues of negative weighting of some events in staggered design (Baker et al. 2022). Furthermore, while the approach adopted in the main analyses compares all pre- versus post-treatment observations against each other, the stacked approach provides flexibility by allowing the use of different control groups.

4)   Stable Unit Treatment Value Assumption (SUTVA)

SUTVA assumes that the treatment assigned to one unit does not affect the outcomes of other units. In the setting of this study, it is possible that employee lawsuits in one office adversely affect the reputation and talent acquisition of other offices within the same firm, or other audit offices operating in the same area. In this case, the control offices may be indirectly treated (i.e., a potential violation of SUTVA). In this section, I conduct additional analyses to 1) evaluate the robustness of my main findings with various alternative control groups, and 2) explore potential interference between the treatment and control groups.

I first assess the possibility that lawsuits in one office may affect all offices in the same firm (i.e., if there is a firm-level effect). To implement this analysis, I construct a variable *FIRM_LAWSUIT*, which equals one if an employee lawsuit occurs in an audit firm in a year, and zero otherwise. Because of the pervasiveness of employee lawsuits in the Big 4 firms, the mean of *FIRM_LAWSUIT* is 0.895 (untabulated). I then regress the incoming auditor quality measures on *FIRM_LAWSUIT*, together with a set of controls and year, audit firm, and position rank fixed effects. In Table OA3.2, I find a negative and significant coefficient on *FIRM_LAWSUIT* across various incoming auditor quality measures ($p<0.1$ except columns 3 and 7), suggesting that employee lawsuits have a negative impact on talent acquisition at the audit firm level.

<div align="center">5</div>

The observed firm-level effect suggests possible spillover effects on control offices within the same firm. In addition, spillover may also exist through competition or interactions among audit offices operating in the same area. As pointed out by Berg, Reisinger, and Streitz (2021), these spillovers could lead to biases in estimating treatment effects. To mitigate the concern that the estimated treatment effect is driven by interference or spillover effects from one office to another, I conduct a series of additional analyses utilizing various alternative control groups. Specifically, I examine the impact of lawsuits on incoming auditor quality and audit quality by 1) excluding never-treated offices, 2) restricting the control group to offices within the same MSA as the treated offices, 3) restricting the control group to offices in different MSAs from the treated offices, 4) restricting the control sample to offices in different firms from the treated offices, and 5) retaining only the control sample.

The results of these analyses are presented in Table OA 3.1. As discussed above, I reproduce the baseline panel estimates in column (1) of Panel A (columns [1] and [2] of Panel B), which captures an average lawsuit effect on talent acquisition (audit quality). In column (2) of Panel A (columns [3] and [4] of Panel B), I present the results for the stacked approach. Given that the stacked approach facilitates matching between treatment and control offices, I continue to leverage this design to construct various control samples. In column (3) of Panel A (columns [5] and [6] of Panel B), I excluded never-treated offices when identifying control offices to address potential benchmarking issues arising from units that were never treated. I consistently observed a decline in incoming auditor quality and audit quality following employee lawsuits.

In column (4) of Panel A (columns [7] and [8] of Panel B), I restrict the control group to offices located within the same MSA as the treated offices. Subsequently, in column (5) of Panel A (columns [9] and [10] of Panel B), I restrict the control group to offices located in different MSAs from the treated offices. I observe a stronger lawsuit effect on talent acquisition in the different MSA sample compared to the same MSA sample (i.e., comparing column [5] to column [4] in Panel A), suggesting that lawsuits may have an adverse spillover effect on the offices in the same local area as the sued offices.
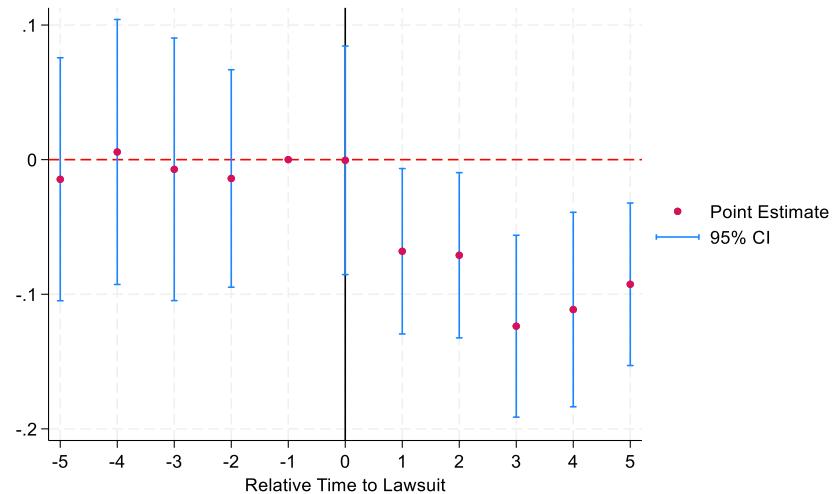
In column (6) of Panel A (columns [11] and [12] of Panel B), I limit the control group to offices in different firms from the treated offices. To the extent that spillover effect within the same firm may bias the results, this analysis allows for the identification of a "cleaner" control group. I continue to observe a decrease in incoming auditor quality and audit quality following employee lawsuits.

Finally, in column (7) of Panel A (columns [11] and [12] of Panel B), I drop the treated office and only retain the control group after identifying the control offices within each cohort. I then evaluate if employee lawsuits had any impact on these control offices. In this analysis, *POSTLAWSUIT* has no variation within cohort*year, so I replace cohort*year fixed effects with year fixed effects. I find no indication of lawsuit effects on incoming auditor quality and audit quality in control offices.
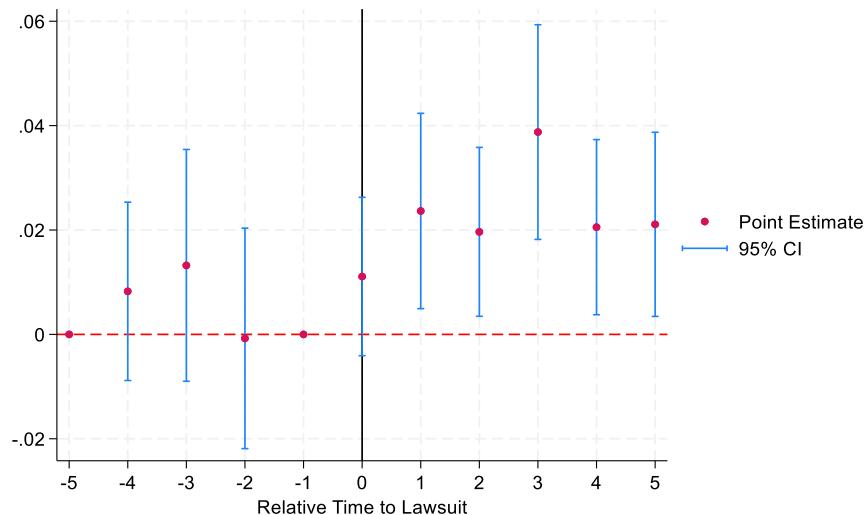
To conclude, despite potential spillover effects to control offices, the main findings of the study remain consistent when comparing the treated offices with various control groups. These findings reinforce the robustness of the adverse lawsuit effects on the sued offices.

Figure OA3.1

a. The Effect of Employee Lawsuit on Talent Acquisition in Event Time Using Stacked Approach

b. The Effect of Employee Lawsuit on Audit Quality in Event Time Using Stacked Approach

Notes: In this figure, I graph the lawsuit effect in event time using the stacked approach. Figure OA3.1a graphs the trend of incoming auditor quality over the event time relative to the lawsuit. The sample consists of 191,893 individual-years of newly hired auditors in an office. Formally, I estimate $QUALITY\_INDEX_{i,j,t} = \alpha_0 + \sum_{k=2}^{K} \beta (LAG\ k)_{j,t} + \sum_{m=1}^{M} \gamma (LEAD\ m)_{j,t} + \alpha Controls_{i,j,t-1} + Fixed\ Effects\ (cohort * year, cohort * audit\ office, cohort * position) + \varepsilon_{i,j,t}$. I omit the indicator for *t-1*, which serves as a benchmark period. Figure OA3.1b graphs the trend of audit quality over the event time relative to the lawsuit. The sample includes 106,856 client-years. Formally, I estimate $RESTATE_{l,j,t} = \gamma_0 + \sum_{k=2}^{K} \beta (LAG\ k)_{j,t} + \sum_{m=1}^{M} \alpha (LEAD\ m)_{j,t} + \gamma Controls_{l,j,t-1} + Fixed\ Effects\ (cohort * year, cohort * audit\ office, cohort * industry) + \varepsilon_{l,j,t}$. I omit the indicator for *t-1*, which serves as a benchmark period.

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TABLE OA3.1
Alternative Control Groups

Panel A: Employee Lawsuit and Incoming Auditor Quality

VARIABLES	(1) Baseline *QUALITY_* *INDEX*	(2) Stack Approach *QUALITY_* *INDEX*	(3) *Drop Never* *Treated Offices* *QUALITY_* *INDEX*	(4) *Same MSA* *QUALITY_* *INDEX*	(5) *Diff MSA* *QUALITY_* *INDEX*	(6) *Diff Firms* *QUALITY_* *INDEX*	(7) *Control Groups* *Only* *QUALITY_* *INDEX*
POSTLAWSUIT	-0.059***	-0.064***	-0.063***	-0.038*	-0.064***	-0.064***	0.003
	(-2.77)	(-3.15)	(-2.87)	(-1.75)	(-3.24)	(-2.99)	(0.40)
N	45,704	191,893	43,076	52,773	175,580	56,737	155,433
R-squared	0.13	0.15	0.10	0.12	0.15	0.12	0.16
Fixed Effects	Year Audit Office Position Rank	Cohort*Year Cohort*Audit Office Cohort*Position Rank	Cohort*Year Cohort*Audit Office Cohort*Position Rank	Cohort*Year Cohort*Audit Office Cohort*Position Rank	Cohort*Year Cohort*Audit Office Cohort*Position Rank	Cohort*Year Cohort*Audit Office Cohort*Position Rank	Year Cohort*Audit Office Cohort*Position Rank

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Panel B: Audit Quality Test

VARIABLES	(1) Baseline RESTATE_ALL	(2) Baseline RESTATE_BIGR	(3) Stack Approach RESTATE_ALL	(4) Stack Approach RESTATE_BIGR	(5) Drop Never Treated Offices RESTATE_ALL	(6) Drop Never Treated Offices RESTATE_BIGR	(7) Same MSA RESTATE_ALL	(8) Same MSA RESTATE_BIGR
POSTLAWSUIT	0.016**	0.015***	0.033***	0.021***	0.050***	0.020***	0.042***	0.025***
	(2.09)	(3.82)	(4.10)	(4.18)	(5.11)	(2.68)	(4.99)	(3.82)
N	20,295	20,295	106,856	106,856	19,530	19,530	24,455	24,455
R-squared	0.08	0.07	0.12	0.10	0.12	0.13	0.14	0.13
Fixed Effects	Year; Audit Office; Industry	Year; Audit Office; Industry	Cohort*Year; Cohort*Audit Office; Cohort*Industry	Cohort*Year; Cohort*Audit Office; Cohort*Industry	Cohort*Year; Cohort*Audit Office; Cohort*Industry	Cohort*Year; Cohort*Audit Office; Cohort*Industry	Cohort*Year; Cohort*Audit Office; Cohort*Industry	Cohort*Year; Cohort*Audit Office; Cohort*Industry

VARIABLES	(9) Diff MSA RESTATE_ALL	(10) Diff MSA RESTATE_BIGR	(11) Diff Firms RESTATE_ALL	(12) Diff Firms RESTATE_BIGR	(13) Control Groups Only RESTATE_ALL	(14) Control Groups Only RESTATE_BIGR
POSTLAWSUIT	0.031***	0.019***	0.052***	0.019***	-0.000	-0.000
	(3.84)	(3.73)	(6.10)	(3.36)	(-0.09)	(-0.16)
N	95,258	95,258	22,176	22,176	93,974	93,974
R-squared	0.13	0.11	0.17	0.16	0.13	0.11
Fixed Effects	Cohort*Year; Cohort*Audit Office; Cohort*Industry	Cohort*Year; Cohort*Audit Office; Cohort*Industry	Cohort*Year; Cohort*Audit Office; Cohort*Industry	Cohort*Year; Cohort*Audit Office; Cohort*Industry	Year; Cohort*Audit Office; Cohort*Industry	Year; Cohort*Audit Office; Cohort*Industry

Notes: Panel A (Panel B) of this table presents the results of analyses that investigate the change of incoming auditor quality (audit quality) following employee lawsuits by defining different control offices. In column (1) of Panel A (columns [1] and [2] of Panel B), I reproduce the baseline estimates presented in the main paper, which captures an average lawsuit effect on talent acquisition (audit quality). In column (2) of Panel A (columns [3] and [4] of Panel B), I present the results using the stacked approach. In column (3) of Panel A (columns [5] and [6] of Panel B), I excluded never-treated offices when identifying control offices. In column (4) of Panel A (columns [7] and [8] of Panel B), I restrict the control group to offices located within the same MSA as the treated offices. In column (5) of Panel A (columns [9] and [10] of Panel B), I restrict the control group to offices located in different MSAs from the treated offices. In column (6) of Panel A (columns [11] and [12] of Panel B), I restrict the control group to offices in different firms from the treated offices. In column (7) of Panel A (columns [11] and [12] of Panel B), I drop the treated office and only retain the control group after identifying the control offices within each cohort. All variables are defined in Appendix A. The t-statistics are reported in parentheses. ***, **, * indicate significance at the 0.01, 0.05, and 0.10 levels, respectively, using two-tailed tests. All continuous variables are winsorized at the 1 percent and 99 percent levels.

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Firm-level Effect

$NEWHIRE\_QUALITY_{i,f,t} = \alpha_0 + \alpha_1 FIRM\_LAWSUIT_{f,t} + \alpha Controls_{i,f,t-1} + \text{Fixed Effects (year, audit firm, position rank)} + \varepsilon_{i,f,t}$

VARIABLES	(1) TOP_UNIV	(2) TOP_ACC	(3) MASTERS	(4) WORK_EXP	(5) AUD_EXP	(6) WORK_YEARS	(7) CPA	(8) QUALITY_INDEX
FIRM_LAWSUIT	-0.046***	-0.035***	0.009	-0.026***	-0.018*	-0.051***	0.006	-0.076***
	(-3.98)	(-2.96)	(0.59)	(-3.28)	(-1.92)	(-3.53)	(0.48)	(-3.62)
AGE	0.006***	0.003**	0.039***	0.027***	0.026***	0.111***	-0.003	0.063***
	(4.78)	(2.22)	(18.10)	(30.57)	(18.18)	(67.66)	(-1.58)	(20.41)
FEMALE	0.010**	0.007	-0.011**	0.007**	0.028***	0.012**	-0.050***	0.003
	(2.49)	(1.27)	(-2.16)	(2.00)	(7.18)	(1.98)	(-10.52)	(0.35)
HIRENO	0.002	0.002	0.006***	-0.000	0.002**	-0.003***	0.000	0.007*
	(1.23)	(0.91)	(3.24)	(-0.77)	(2.20)	(-2.63)	(0.05)	(1.94)
OFFICE_SIZE	0.000	0.000	-0.000**	0.000	-0.000	0.000*	-0.000	0.000
	(1.33)	(0.83)	(-2.41)	(0.79)	(-0.12)	(1.74)	(-0.80)	(0.35)
MARKET_SHARE	-0.076*	-0.083	0.048	-0.001	-0.048**	-0.032	0.021	-0.106
	(-1.95)	(-1.50)	(0.75)	(-0.04)	(-2.26)	(-0.95)	(1.12)	(-1.38)
OFFICE_WAGE	0.151***	0.037	-0.228***	0.060**	0.028	0.102**	-0.033	0.054
	(3.28)	(0.56)	(-3.14)	(2.19)	(1.32)	(2.28)	(-1.06)	(0.56)
RESTATE_PERC	-0.082*	-0.154**	0.169*	-0.034	-0.009	-0.053	0.063	-0.073
	(-1.71)	(-2.23)	(1.93)	(-0.96)	(-0.27)	(-0.89)	(1.23)	(-0.79)
MSA_OFFICES	-0.001***	-0.001***	-0.001	0.000	0.000	0.000	-0.000	-0.002***
	(-3.36)	(-3.65)	(-1.21)	(0.51)	(1.32)	(0.47)	(-0.60)	(-3.17)
POPULATION	0.057***	0.097***	-0.034	-0.009	0.006	-0.020*	-0.003	0.085***
	(6.26)	(7.41)	(-1.46)	(-1.45)	(1.27)	(-1.80)	(-0.52)	(4.44)
UNEMPLOY_RATE	0.011*	0.030***	0.004	0.002	0.002	0.002	-0.001	0.032**
	(1.70)	(3.33)	(0.43)	(0.71)	(0.59)	(0.51)	(-0.21)	(2.55)
Constant	-2.529***	-1.939***	2.632***	-0.372	-0.836***	-2.249***	0.943***	-3.422***
	(-5.48)	(-2.83)	(3.12)	(-1.26)	(-3.49)	(-4.46)	(2.83)	(-3.48)
N	45,711	45,711	45,711	45,711	45,711	45,711	45,711	45,711
R-squared	0.03	0.04	0.04	0.18	0.22	0.31	0.03	0.08
Year Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Audit Firm Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Position Rank Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

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Notes: This table presents the results of analyses that investigate the change of incoming auditor quality in sued firms pre- and post-employee lawsuits compared to control firms. The sample consists of 45,711 individual-years. *FIRM_LAWSUIT* is an indicator that equals one if an employee lawsuit occurs in an audit firm in a year, and zero otherwise. I control for *AGE*, *FEMALE*, *HIRENO*, *OFFICE_SIZE*, *MARKET_SHARE*, *OFFICE_WAGE*, *RESTATE_PERC*, *MSA_OFFICES*, *POPULATION*, and *UNEMPLOY_RATE*, as well as the year, audit firm, and position rank fixed effects. Standard errors are clustered at the office level. The t-statistics are reported in parentheses. ***, **, * indicate significance at the 0.01, 0.05, and 0.10 levels, respectively, using two-tailed tests. All continuous variables are winsorized at the 1 percent and 99 percent levels.

4. Individual Auditor Quality

In this Online Appendix, I provide theoretical motivations for individual auditor quality measures adopted in this study and perform additional analyses to validate these metrics.

The quality of an individual employee is defined as the set of factors that affect one's productivity and performance at their job (Barrios 2022). These factors include education, training, motivation, and innate ability. High-quality auditors can provide superior information as inputs in the auditing process, and can identify and uncover both intentional and unintentional financial misreporting. Motivated by the extensive literature in labor economics examining employee quality (e.g., Turban and Cable 2003; Call, Campbell, Dhaliwal, and Moon Jr 2017; Gadgil and Sockin 2020; Baghai, Silva, Thell, and Vig 2021; Chen, Cheng, Chow, and Liu 2021), I introduce eight measures to capture the quality of newly hired auditors based on different dimensions.

I first construct three measures based on an individual's educational attainment, *TOP_UNIV*, *TOP_ACC*, and *MASTERS*. Studies examine cross-sectional differences in individuals' education suggest that education is likely to shape individuals' values, cognitive ability, style of conformity and rationality, and ethics, which in turn can affect their reporting outcomes (e.g., Hambrick and Mason 1984; Ghoshal 2005; Call et al. 2017; Beck, Francis, and Gunn 2018). Individuals who graduated from top universities or obtained advanced degrees likely experienced rigorous entry screening and received high-quality training. In the context of auditing, the nature of audit work demands extensive specialized knowledge and significant professional judgment (DeFond and Zhang 2014). Individual auditors who graduated from top universities or obtained advanced degrees can contribute higher-quality inputs in the audit process and are more likely to identify fraudulent behavior, therefore proving higher-quality audits (Merchant and Rockness 1994; Glaeser and Saks 2006; O'Fallon and Butterfield 2012; Beck et al. 2018).

I next construct three measures based on an individual's previous work experience. *WORK_EXP* and *WORK_YEARS* capture an individual's skills and competencies accumulated through previous jobs. Specifically, auditors with previous working experience are more likely to recognize abnormal transactions and possibly fraudulence during the auditing process, elevating that information to management before it becomes a more serious misstatement. Here I do not restrict prior work experience to audit firm experience, as knowledge (e.g., industry-specific knowledge) and skills (e.g., communication skills and critical thinking) from outside the accounting function could translate into better work performance in auditing work. *AUD_EXP* captures audit-specific working experience. Prior audit literature suggests that big firm employees are of higher quality because big firms have greater reputation concerns while performing audit engagements and have more resources for employee training (e.g., Akerlof 1978; Leland 1979; Francis, Maydew, and Sparks 1999; Lennox and Pittman 2011). Accordingly, big firm experience is used as a proxy for accounting and financial expertise (Goh 2009; Chen et al. 2021).

I further construct a measure based on an individual's professional accomplishments, *CPA*, which is an indicator variable that equals one if an individual auditor possesses the Certified Public Accountant (CPA) designation, and zero otherwise. CPA licensure is an occupational licensing requirement for public accounting practice and is intended to enhance the competency of public accountants (DeFond and Zhang 2014). The licensure process includes mandatory training (from required education hours in college and continuing professional education), examinations, and related work experience (supervised by an active CPA). It captures the extent to which an individual invests in accounting-specific human capital and has been used as a proxy for financial expertise

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and accounting human capital in previous accounting research (Abbott, Parker, and Peters 2004; Gore, Matsunaga, and Yeung 2011; Chen et al. 2021).

Finally, I construct a comprehensive measure, *QUALITY_INDEX*, using principal component analysis (PCA). To assess the suitability of using PCA, I first assess the correlation among the input measures within an audit office in Table OA 4.1. Here I include all identified audit personnel within an audit office, not just incoming auditors. *WORK_YEARS* is standardized. The individual auditor quality measures exhibit significant correlations. It's worth noting that certain measures, such as *TOP_UNIV* and *EXPERIENCED*, exhibit inverse correlations with each other, suggesting that these measures capture distinct dimensions of individual quality. I next calculate the Kaiser-Meyer-Olkin (KMO) measure of sampling adequacy and find the overall KMO value of 0.5438 (untabulated), indicating that PCA is appropriate for the analysis. After performing PCA, I retained three components with Eigenvalues exceeding 1, in accordance with Kaiser's rule. Subsequently, I construct the *QUALITY_INDEX* by assigning weights to each component based on the variance explained.

To evaluate the construct validity of the individual auditor quality measures, I follow Barrios (2022) to assess whether the individual quality of existing auditors in an audit office is associated with audit quality. To the extent that these individual quality measures capture the quality of existing auditors, they should be positively correlated with audit quality, as higher quality of audit personnel should translate into better audits. To perform this analysis, I first calculate the average individual auditor quality for each position rank within an office-year and subsequently calculate an average at the audit office-year level. This approach mitigates the concern that the office-level average is affected by the number of auditors at different positions in an office. Audit quality at the office-year level is measured by the number of restatements that occurred in a year scaled by office size and the average abnormal accruals in an office-year. As presented in Table OA4.2, Panel A, the majority of the individual quality measures exhibit inverse correlations with restatement occurrence and the level of abnormal accruals (except *MASTERS* and *CPA*), suggesting a positive correlation between the quality of individual auditors within an office and audit quality.

Further, I perform multivariate analyses by regressing audit quality measures on each of the individual auditor quality measures. I include office controls that have been included in my office-level tests, including *OFFICE_SIZE*, *MARKET_SHARE*, *OFFICE_WAGE*, *MSA_OFFICES*, *POPULATION*, and *UNEMPLOY_RATE*, as well as office fixed effects and year fixed effects. In Table OA4.2, Panel B, I find a positive association between the quality of existing auditors in an office and audit quality (i.e., a negative coefficient on individual auditor quality measures except columns [5] and [11]), suggesting that the metrics capture some attributes of individual auditor quality. The coefficient on *QUALITY_INDEX*, the comprehensive measure of input quality, is negative and significant across both audit quality measures.

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TABLE OA4.1
Correlations Between Individual Auditor Quality Measures

	TOP_UNIV	TOP_ACC	MASTERS	WORK_EXP	AUD_EXP	WORK_YEARS	CPA
TOP_UNIV	1						
TOP_ACC	0.798***	1					
MASTERS	0.122***	0.127***	1				
WORK_EXP	-0.026***	-0.031***	0.068***	1			
AUD_EXP	0.013***	0.015***	0.026***	0.403***	1		
WORK_YEARS	-0.027***	-0.031***	-0.036***	0.378***	0.250***	1	
CPA	0.014***	0.021***	0.087***	0.023***	0.036***	-0.009***	1

Notes: This table presents the correlation matrix for the seven individual auditor measures constructed in the sample. The sample consists of 626,850 individual-years for all auditors identified in an audit office. *WORK_YEARS* is standardized.

TABLE OA4.2
Individual Auditor Quality and Audit Quality

Panel A: Correlations

	Restatement	Abnormal_Accruals
TOP_UNIV	-0.030*	-0.002
TOP_ACC	-0.030*	-0.005
MASTERS	0.032*	-0.008
WORK_EXP	-0.078***	-0.078***
AUD_EXP	-0.071***	-0.062***
WORK_YEARS	-0.060***	-0.079***
CPA	0.003	0
QUALITY_INDEX	-0.056***	-0.053***

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Panel B: Multivariate Analysis

$$AUDIT\_QUALITY_{j,t} = \gamma_0 + \gamma_1 INDIVIDUAL\_QUALITY_{j,t} + \gamma\, Controls_{l,j,t-1} + \text{Fixed Effects (year, audit office)} + \varepsilon_{l,j,t}$$

VARIABLES	(1) Restatement	(2) Restatement	(3) Restatement	(4) Restatement	(5) Restatement	(6) Restatement	(7) Restatement	(8) Restatement
TOP_UNIV	-0.098**							
	(-2.00)							
TOP_ACC		-0.078*						
		(-1.86)						
MASTERS			-0.020					
			(-0.71)					
WORK_EXP				-0.076***				
				(-2.70)				
AUD_EXP					0.013			
					(0.32)			
WORK_YEARS						-0.006		
						(-0.37)		
CPA							-0.046*	
							(-1.77)	
QUALITY_INDEX								-0.057***
								(-2.79)
Constant	3.333	3.234	3.103	3.973	3.222	3.307	3.282	3.312
	(1.12)	(1.09)	(1.04)	(1.33)	(1.08)	(1.11)	(1.10)	(1.12)
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	3,251	3,251	3,251	3,251	3,251	3,251	3,251	3,251
R-squared	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35
Year Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Audit Office Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

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VARIABLES	(9) Abnormal_ Accruals	(10) Abnormal_ Accruals	(11) Abnormal_ Accruals	(12) Abnormal_ Accruals	(13) Abnormal_ Accruals	(14) Abnormal_ Accruals	(15) Abnormal_ Accruals	(16) Abnormal_ Accruals
TOP_UNIV	-0.026*							
	(-1.81)							
TOP_ACC		-0.024*						
		(-1.93)						
MASTERS			0.007					
			(0.92)					
WORK_EXP				-0.016*				
				(-1.90)				
AUD_EXP					-0.027**			
					(-2.28)			
WORK_YEARS						-0.008*		
						(-1.76)		
CPA							-0.013*	
							(-1.71)	
QUALITY_INDEX								-0.017***
								(-2.90)
Constant	0.984	0.963	1.022	1.105	1.051	1.011	0.980	0.986
	(1.14)	(1.11)	(1.18)	(1.27)	(1.21)	(1.17)	(1.13)	(1.14)
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	3,175	3,175	3,175	3,175	3,175	3,175	3,175	3,175
R-squared	0.12	0.12	0.12	0.12	0.13	0.12	0.12	0.13
Year Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Audit Office Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Notes: This table presents the results of analyses that investigate the association between the individual quality of existing auditors in an audit office and audit quality. Panel A presents the correlation between the average individual auditor quality in an office-year and the audit quality measured by the number of restatements that occurred in a year scaled by office size and the average abnormal accruals in an office-year. Panel B presents the multivariate analyses by regressing the audit quality measures on individual auditor quality. I control for *OFFICE_SIZE*, *MARKET_SHARE*, *OFFICE_WAGE*, *MSA_OFFICES*, *POPULATION*, and *UNEMPLOY_RATE*, as well as office and year fixed effects. The sample consists of 3,175 office-years. Standard errors are clustered at the office level. The t-statistics are reported in parentheses. ***, **, * indicate significance at the 0.01, 0.05, and 0.10 levels, respectively, using two-tailed tests. All continuous variables are winsorized at the 1 percent and 99 percent levels.

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5. Employee Lawsuits and Overall Hiring

One natural question that arises when investigating the quality of incoming auditors is whether the overall hiring changes following a lawsuit. If there is a significant increase in the number of new hires in an office, the decline of incoming auditor quality may stem from this change, not the reputation loss following the lawsuits. In this Online Appendix, I evaluate this possibility by regressing the number of new hires in an audit office-year on *POSTLAWSUIT*, together with a set of audit office and local area characteristic controls that are likely associated with hiring in an office. I find that the coefficient on *POSTLAWSUIT* is nonsignificant ($p>0.10$), suggesting there is no significant changes in overall hiring in the wake of employee lawsuits.

TABLE OA5.1

Employee Lawsuits and Overall Hiring

$HIRENO_{j,t} = \beta_0 + \beta_1 POSTLAWSUIT_{j,t} + \beta Controls_{j,t-1} + \text{Fixed Effects (year, audit office)} + \varepsilon_{j,t}$

VARIABLES	(1) *HIRENO*
POSTLAWSUIT	-0.003
	(-0.07)
OFFICE_SIZE	0.000
	(0.37)
MARKET_SHARE	-0.034
	(-0.26)
OFFICE_WAGE	0.157**
	(1.99)
RESTATE_PERC	0.060
	(0.62)
MSA_OFFICES	0.001
	(0.47)
POPULATION	1.817***
	(4.11)
UNEMPLOY_RATE	0.007
	(0.61)
Constant	-28.706***
	(-3.98)
N	3,196
R-squared	0.90
Year Fixed Effects	Yes
Audit Office Fixed Effects	Yes

Note: This table presents the results of an analysis that investigates the change of overall hiring in sued offices pre- and post-employee lawsuits compared to control offices. The sample consists of 3,196 office-years. I control for *OFFICE_SIZE*, *MARKET_SHARE*, *OFFICE_WAGE*, *RESTATE_PERC*, *MSA_OFFICES*, *POPULATION*, and *UNEMPLOY_RATE*, as well as office and year fixed effects. Standard errors are clustered at the office level. The t-statistics are reported in parentheses. ***, **, * indicate significance at the 0.01, 0.05, and 0.10 levels, respectively, using two-tailed tests. All continuous variables are winsorized at the 1 percent and 99 percent levels.

6. Employee Lawsuits and Quality of Incoming Auditors: Different Controls

As discussed in the research design section, the controls included in the main analyses are associated with the likelihood of an office's involvement in employee lawsuits and its hiring practice and therefore are important to include. However, some variables can also be influenced by the lawsuits. For example, employee lawsuits may affect the level of wages an office offers in the following years. Similarly, client companies may react to lawsuits and therefore affect an audit office's size and market share in the following years. As suggested by Angrist and Pischke (2009) and Whited, Swanquist, Shipman, and Moon Jr (2022), these variables may contain aspects of both "good" and "bad" controls. To address concerns about potential bias in estimating the treatment effect due to the inclusion of these variables, I rerun the analyses of equation (1) with and without these controls in this Online Appendix. In Table OA6.1, I find the treatment effect is robust across different specifications.

Table OA6.1
Employee Lawsuit and Quality of Incoming Auditors: Different Controls

$QUALITY\_INDEX_{i,j,t} = \alpha_0 + \alpha_1 POSTLAWSUIT_{j,t} + \alpha Controls_{i,j,t-1} +$ Fixed Effects (year, audit office, position rank) $+ \varepsilon_{i,j,t}$

VARIABLES	(1) Baseline QUALITY_ INDEX	(2) Add Turnover QUALITY_ INDEX	(3) No Controls QUALITY_ INDEX	(4) Individual Controls QUALITY_ INDEX	(5) Office Controls QUALITY_ INDEX	(6) MSA Controls QUALITY_ INDEX	(7) Exclude "bad" Controls QUALITY_ INDEX
POSTLAWSUIT	**-0.059***	**-0.059***	**-0.062***	**-0.065***	**-0.056**	**-0.061***	**-0.062***
	(-2.77)	**(-2.77)**	**(-2.67)**	**(-2.95)**	**(-2.50)**	**(-2.66)**	**(-2.80)**
AGE	0.060***	0.060***		0.060***			0.060***
	(22.56)	(22.56)		(22.65)			(22.62)
FEMALE	-0.000	-0.000		-0.000			-0.000
	(-0.04)	(-0.04)		(-0.03)			(-0.02)
HIRENO	0.001	0.001			0.000		
	(0.53)	(0.54)			(0.03)		
OFFICE_SIZE	-0.000**	-0.000**			-0.000		
	(-2.03)	(-2.03)			(-1.63)		
MARKET_SHARE	-0.043	-0.044			-0.056		
	(-0.65)	(-0.66)			(-0.85)		
OFFICE_WAGE	-0.043	-0.042			-0.051		
	(-0.86)	(-0.85)			(-1.03)		
RESTATE_PERC	-0.023	-0.022			-0.044		
	(-0.38)	(-0.38)			(-0.74)		
MSA_OFFICES	-0.001	-0.001*			-0.002**		-0.001**
	(-1.65)	(-1.66)			(-2.46)		(-2.10)

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	(1)	(2)	(3)	(4)	(5)	(6)	(7)
POPULATION	-0.034	-0.033				-0.100	-0.000
	(-0.13)	(-0.12)				(-0.37)	(-0.00)
UNEMPLOY_RATE	-0.000	-0.000				0.000	-0.001
	(-0.08)	(-0.08)				(0.01)	(-0.18)
TURNOVER		-0.021					
		(-0.31)					
Constant	-0.159	-0.179	0.135***	-1.245***	0.783	1.779	-1.191
	(-0.04)	(-0.04)	(9.94)	(-19.12)	(1.45)	(0.40)	(-0.27)
N	45,704	45,698	45,704	45,704	45,704	45,704	45,704
R-squared	0.13	0.13	0.10	0.13	0.10	0.10	0.13
Year Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Audit Office Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Position Rank Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Notes: This table presents the results of analyses estimating equation (1) that investigate the change of incoming auditor quality in sued offices pre- and post-employee lawsuits compared to control offices by including different control variables. In column (1), I reproduce the result in the main analysis (Table 4, column 8). In column (2), I include *TURNOVER*, which is calculated as the number of auditors who departed from an audit office scaled by the number of auditors in the office in a year. In columns (3)-(6), I include individual characteristic controls, office characteristic controls, and local area characteristic controls respectively. In column (7), I exclude the controls that are likely to be affected by the lawsuits, i.e., the "bad" controls. The sample consists of 45,704 individual-years (7 singleton observations are dropped from the main sample). Standard errors are clustered at the office level. The t-statistics are reported in parentheses. ***, **, * indicate significance at the 0.01, 0.05, and 0.10 levels, respectively, using two-tailed tests. All continuous variables are winsorized at the 1 percent and 99 percent levels.

7. Media Coverage

In this Online Appendix, I list the main websites that cover employee lawsuits in audit firms.

Law case websites:

https://casetext.com/

https://law.justia.com/

https://www.findlaw.com/

https://www.law360.com/

https://www.courtlistener.com/

https://www.govinfo.gov/

https://www.pacermonitor.com/

https://www.casemine.com/

https://www.plainsite.org/

https://www.leagle.com/

https://www.lexology.com/

https://unicourt.com/

https://www.supremecourt.gov

https://www.anylaw.com

https://case-law.vlex.com/

https://www.lexisnexis.com/

https://thecomplexlitigator.com/

http://www.paed.uscourts.gov

https://www.hivlawandpolicy.org/

https://www.paed.uscourts.gov

https://www.dol.gov

https://clearinghouse.net/

News websites:

https://www.forbes.com/

https://www.reuters.com/

https://www.yahoo.com/

https://www.latimes.com/

https://news.bloomberglaw.com/

https://www.lexislegalnews.com/

https://economictimes.indiatimes.com/

https://www.goingconcern.com/

https://pennrecord.com/

https://www.courthousenews.com/

https://www.nytimes.com/

https://www.bizjournals.com/

https://www.prnewswire.com/

https://today.westlaw.com/

https://hrdailyadvisor.blr.com/

https://www.benefitnews.com/

https://whistleblowersblog.org/

Accounting professional websites:

https://www.accountancydaily.co/

https://www.sec.gov/

goingconcern.com/

https://www.accountingtoday.com/

https://www.taxnotes.com/

https://www.pwcagecase.com/news

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8. Practitioners' Perspective

Method

To better understand talent acquisition practices in audit firms and practitioners' perspectives on the topic, I conduct semi-structured interviews with four practitioners from the Big 4 firms. I identified these interviewees by asking contacts at the four firms to solicit audit partners who had recruiting experience and were willing to share their insights. Given that I do not intend to use the survey responses to conduct statistical analysis, I keep the survey scale relatively small and manageable.[1] The average experience span, as an audit firm employee, of the interviewees was 17 years. All interviewees have extensive experience managing large groups of audit employees and actively participate in their firms' recruiting activities. Their previous or current positions at their firms include audit staff, local office director/partner, national office partner, and talent service area leader. Table OA8.1 provides details about individual interviewees' experiences.

I conducted the interviews on Zoom. The interviews lasted for an average of 51 minutes. I used a questionnaire that included lead questions about general HR practices and talent acquisition strategies in a firm, as well as specific questions about employee lawsuits. I also asked several follow-up questions to better understand the underlying mechanisms of my archival findings.

Interview Questions

1. Could you please provide information about your firm, title, and years of experience? Have you previously been involved in recruiting activities within your firm?

2. What practices does your firm adopt to attract and retain talent? In your opinion, what factors are crucial in attracting and retaining talent?

3. How do employees typically learn about your firm? What practices does your firm adopt to establish and maintain its reputation as an employer?

4. What, in your opinion, could potentially trigger internal employee issues, including complaints and lawsuits?

5. How does your firm handle employee complaints and lawsuits? Are there established standard policies and procedures? Are these issues typically addressed by firm or office personnel? Are there adjustments made to the internal hiring practices in response to employee complaints and lawsuits?

6. In my research, I assess individual auditor quality based on educational attainment, work experience, and professional certifications. Do you believe these measures effectively identify desirable characteristics when recruiting new talent?

7. In your perspective, how does the quality of individual employees influence the overall audit quality?

8. Are there any final thoughts or impressions that you would like to share?

Summary of Findings

All interviewees stated that acquiring and retaining talent has been a top concern for CPA firms

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[1] I do not purport that the small-scale interview is sufficiently rigorous to justify drawing systematic inferences. Rather, I intend to obtain important anecdotal evidence from the responses that add face validity to my claims.

over the years. With declining enrollment in accounting majors in universities and competition from other industries, firms have been struggling to obtain competent talent. In response, firms adopt various strategies during recruitment to gain a competitive advantage in the local labor market, such as organizing events to showcase firm culture and providing opportunities for prospective employees to connect with current employees.

When asked about factors they believe could affect a firm's ability to attract and retain talent, all interviewees stressed that a firm's reputation is a key factor (two interviewees rank this aspect as "the No.1 driver" in hiring practices). They noted that prospective employees seek more than just income; they also look for firms that prioritize employee well-being and align with their values. Since "the big audit firms (all) appear similar" to job candidates in terms of the job duties and the compensation, work culture and employee treatment is one way for firms to differentiate themselves in the labor market. Consequently, firms exert considerable efforts to project a positive employer image. For example, firms proactively discuss their commitment to improve employee well-being and the overall work environment through social media and company websites. Firms also encourage their employees to contribute to the enhancement of firm reputation among prospective hires and clients. For example, two interviewees mentioned that their firms encourage employees to post about firm events such as charity initiatives, team get-togethers, and group projects on professional networking websites.

One interviewee discussed their experience interviewing with two offices of the same firm while in college and emphasized experiencing a "completely different vibe" between the two offices. This affected their decision on which office to join. This conversation offers anecdotal evidence reinforcing the notion that office culture and reputation may vary significantly across offices, highlighting the importance of examining employer reputation and talent acquisition at the audit office level.

The interviews support the notion that employee lawsuits can have adverse effects on an office's reputation as an employer. One interviewee, with 16 years of experience in recruiting events, mentioned that when a scandal occurs in an office, many job candidates ask about it during recruitment interviews:

> *Especially in the big 4, there are always so many articles going on about the latest scandals…A lot of these are public and we spend a lot of time talking to kids [prospective employees] who see this stuff and break their interests following that…How we see this play out is if a firm's reputation is hurt, then there is a knock-on effect on not being able to hire the best talent.*

While the interviewees I talked with do not have direct experience in handling employee lawsuits, they offered insights into some issues that may prompt employees to pursue legal action against the firms. For instance, employees may resort to lawsuits when they feel their concerns or disputes have not been adequately addressed by the firm. The lack of transparent communication regarding decisions, changes, or company policies can also contribute to misunderstandings and, ultimately, legal disputes. The interviewees also mentioned that as the leaders in their offices, they actively participate in training sessions focused on handling personnel issues, conflict resolution, and understanding employment laws. They acknowledged that mismanagement of situations can elevate the risk of lawsuits.

The interviewees noted various channels through which information about employee lawsuits can

be disseminated, including national and local news, social media, company websites, professional network websites, and word of mouth. For example, one interviewee mentioned that after the U.S. chair of the firm openly addressed systemic racism in the aftermath of George Floyd's death, multiple candidates indicated that they came across this information on social media. They expressed that this initiative motivated them to apply for the job. Another interviewee noted that media can amplify the reach and visibility of a reputational incident:

> *Obviously bad press, I think tends to be a problem. If there's some scandal*
> *that's going on, I think that is a disadvantage to that firm as (job) candidates*
> *are paying attention to that.*

In discussing how the firms handle an allegation of employee issues internally, all interviewees indicated that specialized personnel are responsible for handling internal investigations or matters related to lawsuits. This team includes the local HR department, relationship leaders, the legal team, the talent relations team, and the general council (maintained by the national office) in the firm. The focal employee may not be immediately sidelined from their current role unless there is direct evidence indicating threats to safety. In this case, lawsuits may not cause significant disruptions to the regular operation of an office.

The interviewees confirm that the individual auditor measures adopted in the study are frequently used in their recruiting practice. Specifically, they highlighted the importance of educational attainment when assessing whether a prospective candidate has acquired the essential skills for auditing work. One interviewee noted:

> *A lot of the time our best people usually did go to some of the more reputable*
> *schools. I think (this is) because the students are well-prepared from the*
> *professors. They have developed important skills like critical thinking from*
> *school.*

The interviewees also highlighted the importance of previous working experience for both college student hires and experienced hires. For example, one interviewee stated:

> *We look at career experience, not necessarily (focusing on whether) they have*
> *worked at one of our competitors. But we want to understand their ability to*
> *meet work commitments and do they have interpersonal skills to work in teams*
> *and build relationships. These qualities often translate well into work.*

Another interviewee noted:

> *People could get experience about how business work, or how to interact with*
> *people or talk with customers. Even sometimes people are still in college, their*
> *experience from a second job can help them perform better at work.*

To address challenges in talent acquisition, firms may employ diverse strategies, such as raising wages and offering referral bonuses. Consistent with the notion that firms may compromise the quality of new hires when facing staffing challenges, the interviewees acknowledged expanding their search to include students from lower-tier schools or junior colleges to broaden the pool of potential employees.

Finally, all the interviewees share the belief that quality talent is a key input to audit quality. One audit partner noted:

> *If you have a team member who isn't performing up to expectation, it can have severe effects. I think a unique part of this is we moved 30% of our hours overseas, so our expectations of someone now are much more different than it was previously. If you don't have the ability to manage multiple tasks, that quickly becomes a bigger issue.*

Overall, these findings, although anecdotal in nature, provide some evidence that helps validate the claims in the paper and motivates some analyses.

TABLE OA8.1

Individual Interviewee Details

ID	Rank	Years of Experience	Big 4 Firms?	Level of involvement with talent acquisition
1	Partner	16	Yes	Local, Regional
2	Partner	20	Yes	Local, Regional
3	Partner	15	Yes	Local
4	Managing Director	17	Yes	Local, National

Notes: This table presents detailed information for the four individual interviewees.

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9. Employee Lawsuits and Office Wages

In this Online Appendix, I evaluate whether the wages offered by an audit office change following employee lawsuits. To evaluate this question, I regress *OFFICE_WAGE* on *POSTLAWSUIT* and a set of audit office and local area characteristic controls that are likely associated with the wages offered by an office. I find the coefficient on *POSTLAWSUIT* is positive and significant ($p<0.05$), indicating that audit offices offer a higher wage after lawsuits.

TABLE OA9.1

Employee Lawsuits and Office Wages

$$OFFICE\_WAGE_{j,t} = \beta_0 + \beta_1 POSTLAWSUIT_{j,t} + \beta Controls_{j,t-1} + \text{Fixed Effects (year, audit office)} + \varepsilon_{j,t}$$

VARIABLES	(1) OFFICE_WAGE
POSTLAWSUIT	0.030**
	(2.35)
OFFICE_SIZE	0.000***
	(3.17)
MARKET_SHARE	-0.025
	(-1.16)
RESTATE_PERC	-0.010
	(-0.56)
MSA_OFFICES	-0.002***
	(-2.72)
POPULATION	0.088
	(0.85)
UNEMPLOY_RATE	-0.005
	(-1.36)
Constant	9.465***
	(5.70)
N	3,196
R-squared	0.67
Year Fixed Effects	Yes
Audit Office Fixed Effects	Yes

Note: This table presents the results of an analysis that investigates the change of wages offered in sued offices pre- and post-employee lawsuits compared to control offices. The sample consists of 3,196 office-years. I control for *OFFICE_SIZE*, *MARKET_SHARE*, *RESTATE_PERC*, *MSA_OFFICES*, *POPULATION*, and *UNEMPLOY_RATE*, as well as office and year fixed effects. Standard errors are clustered at the office level. The t-statistics are reported in parentheses. ***, **, * indicate significance at the 0.01, 0.05, and 0.10 levels, respectively, using two-tailed tests. All continuous variables are winsorized at the 1 percent and 99 percent levels.

10. Employee Lawsuits and Market Share

In this Online Appendix, I evaluate whether the market share of an audit office changes following employee lawsuits. To examine this question, I regress *MARKETSHARE* on *POSTLAWSUIT*. I control for audit office and local area characteristics that are likely associated with its ability to attract and retain clients, including *OFFICE_SIZE*, *OFFICE_WAGE*, *RESTATE_PERC*, *MSA_OFFICES*, *POPULATION*, and *UNEMPLOY_RATE*. I find that the coefficient on *POSTLAWSUIT* is nonsignificant ($p>0.10$), suggesting no significant changes in clients' perceptions in the wake of employee lawsuits.

TABLE OA10.1

Employee Lawsuits and Market Share

$$MARKET\_SHARE_{j,t} = \beta_0 + \beta_1 POSTLAWSUIT_{j,t-1} + \beta Controls_{j,t-1} + \text{Fixed Effects (year, audit office)} + \varepsilon_{j,t}$$

VARIABLES	(1) *MARKET_SHARE*
POSTLAWSUIT	-0.014
	(-0.94)
OFFICE_SIZE	0.001***
	(4.74)
OFFICE_WAGE	-0.037*
	(-1.94)
RESTATE_PERC	0.002
	(0.08)
MSA_OFFICES	0.000
	(0.03)
POPULATION	0.077
	(0.44)
UNEMPLOY_RATE	-0.002
	(-0.41)
Constant	-0.548
	(-0.19)
N	3,196
R-squared	0.90
Year Fixed Effects	Yes
Audit Office Fixed Effects	Yes

Note: This table presents the results of an analysis that investigates the change of market share in sued offices pre- and post-employee lawsuits compared to control offices. The sample consists of 3,196 office-years. I control for *OFFICE_SIZE*, *OFFICE_WAGE*, *RESTATE_PERC*, *MSA_OFFICES*, *POPULATION*, and *UNEMPLOY_RATE*, as well as office and year fixed effects. Standard errors are clustered at the office level. The t-statistics are reported in parentheses. ***, **, * indicate significance at the 0.01, 0.05, and 0.10 levels, respectively, using two-tailed tests. All continuous variables are winsorized at the 1 percent and 99 percent levels.

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