

The scope of audit committee oversight and financial reporting reliability: Are audit committees overloaded?

Abstract

Audit committee (AC) responsibilities have been increasing over time, prompting concerns that overloading ACs may impair their effectiveness. Using new measures to capture AC responsibilities based on AC charters, we find that greater AC responsibilities are associated with improved financial statement reliability. Contrary to overload concerns, this association is strongest when ACs have very high levels of responsibilities. Cross-sectional analyses indicate greater AC responsibilities improve financial statement reliability at complex firms, following significant governance lapses, when AC members are capable and experienced, and when ACs also meet often to carry out their oversight duties. Further analysis suggests that our AC responsibility results are driven by duties related to financial reporting while, in stark contrast, allocating responsibilities unrelated to financial reporting to the AC (e.g., risk management) detracts from monitoring effectiveness by decreasing financial statement reliability. The latter is consistent with an overload effect driven by responsibilities that distract the AC from its core financial reporting oversight mandate. Our results inform recent regulatory changes at some exchanges to expand AC oversight.

Keywords: Corporate governance; Audit committees; Restatements; Monitoring; Financial reporting quality

JEL Classification: G30; G34; G38; M41

I. INTRODUCTION

In this study, we examine the relation between the scope of audit committee (AC) oversight and financial reporting reliability. AC responsibilities have consistently increased over time and practitioners have raised concerns that ACs may be overloaded with too many duties. For example, forty percent of AC members polled by KPMG (2015) report that it is increasingly difficult to adequately fulfill all of the AC's responsibilities. These concerns are in sharp contrast to the belief held by regulators that assigning ACs more oversight responsibilities enhances financial reporting (e.g., Beasley, Oxley, and Sarbanes 2012). Despite these diverging perspectives and the importance of this question, extant research is limited due to empirical challenges, particularly the inability to effectively measure the duties performed by ACs. We fill this gap by using AC charters, which delineate AC responsibilities, to analyze whether assigning the AC high levels of oversight responsibility enhances or impairs financial reporting reliability.

ACs play an important role in corporate governance. Effective ACs promote the credibility of financial statements by monitoring accounting and reporting processes, overseeing financial statement attestation, and promoting a firm's internal controls and regulatory compliance (Deloitte 2013; PWC 2018). This financial reporting oversight is the core duty of ACs (Blue Ribbon Committee on Audit Committee Effectiveness 1999; SEC 1999a). Empowering ACs with greater responsibility related to this core mandate may enhance AC authority over management and the committee members' familiarity with the accounting processes that inform financial statements, thus enabling the AC to more effectively promote financial reporting reliability. However, if responsibilities increase to the point of overload where ACs cannot fulfill them all, then adding more responsibilities may not improve reporting reliability, even if the responsibilities are related to financial reporting. If this is true, assigning the AC more duties may not necessarily harm

financial reporting but could be detrimental to corporate governance by providing the board (and investors) with a “false sense of security” with regards to oversight provided by the AC.

While having too many responsibilities may stress the AC’s ability to complete them all, AC overload that *impairs* reporting reliability is more likely driven by responsibilities that distract the AC from its core mandate to oversee financial reporting. Some AC responsibilities are indeed unrelated to financial reporting per se, and ACs that try to do too many different things may not do any one thing very well (Ernst & Young 2014; KPMG 2014). For example, AC oversight over financial risk management (including hedging programs and asset management) has increased significantly over time, prompting Deloitte to caution that “boards should take care not to overburden the audit committee with risk oversight responsibilities” (Deloitte 2014, 2018, pg. 1). Many AC members surveyed by KPMG (2015) reported that risk-related responsibilities make it difficult for them to carry out their core responsibilities related to financial reporting. To the extent that oversight responsibilities unrelated to financial reporting detract from AC members’ ability to carry out their core financial reporting oversight, we predict a negative association between such extraneous oversight duties and financial reporting reliability.

To study whether ACs may be overloaded, we measure AC responsibilities using AC charters. AC charters describe the responsibilities ACs perform, must be reviewed annually by the AC, and are disclosed publicly (PWC and IARF 2011; SEC 1999b; SEC 1999c; SEC 1999d).¹ We hand-collect a sample of AC charters from 2000 to 2006 and proxy for the overall scope of AC oversight using the length of an AC’s charter in a given year (i.e., the number of words in a charter). During this time period, the SEC required that public companies include a copy of their

¹ It is the AC’s responsibility to adopt a charter and to reassess its adequacy on an annual basis. The charter and any changes thereto must be approved by the board. (SEC rulemaking file nos. SR-AMEX-99-38, SR-NYSE-99-39, and SR-NASD-99-48).

AC charter as an appendix to their proxy statement at least once every three years (SEC 2000).² According to AC directors who collectively chair or serve on ten ACs and with whom we held semi-structured interviews, ACs closely abide by their respective charters and perform every duty listed therein.³ As such, we posit that the length of the AC charter is an appropriate proxy for the depth of responsibilities performed by an AC.

We begin our analysis by providing descriptive evidence to explain variation in AC responsibilities. We observe a general increase in AC charter length over time and a significant lengthening immediately following SOX. To investigate the uniqueness of our measure, we examine AC charter length as a function of variables commonly used in prior literature to proxy for AC and board characteristics. We find that the number of AC meetings is positively associated with AC charter length, which we expect since both variables capture the scope of AC activity to some degree.⁴ AC composition variables, including members' expertise, also vary positively with AC charter length. After controlling for AC meetings, composition, and other AC and board characteristics, only 40 percent of the variation in AC charters is explained, indicating substantial unique variation in our measure relative to proxies used in prior literature.

We then use our charter-based proxy to study the relation between the level of AC responsibilities and the reliability of financial reporting. We examine financial restatements as a salient measure of reporting reliability, finding that AC charter length is negatively associated with

² This rule was modified in November 2006; now, firms can maintain a current version of the AC charter on their company website and simply refer to the website in the proxy statements. We end our sample in 2006 because it is difficult to reliably obtain a large historical sample of AC charters for November 2006 onwards as companies maintain current, rather than historical, versions of AC charters on their website after the rule change.

³ AC members have a fiduciary duty to shareholders and are subject to potential civil and/or criminal liability if they fail to perform the functions listed in the AC charter (e.g., Lipman 2015). For example, fraud charges have been brought against individuals for "failure to carry out their responsibilities as ... Audit Committee members" (SEC v. Krantz). An AC may perform responsibilities above and beyond those listed in its charter. While empirically this noise should not bias towards findings, we recognize this as a limitation of our measure.

⁴ Prior research on AC meetings finds largely mixed results on impacting financial reporting quality, in part because of measurement and reverse causality issues; we discuss this in section 2.1.

the likelihood of restating, consistent with more AC responsibilities improving financial reporting reliability on average. This result is robust to entropy balancing, which helps to reduce potential bias in estimates that results from non-random treatment assignment.⁵ Further, we observe that the negative association between charter length and restatements is strongest in firms with the longest charters, reinforcing the notion that AC effectiveness is not impaired at high levels of oversight. In cross-sectional tests, we find results consistent with the intuition that greater AC oversight matters more at complex firms and following significant governance lapses. We also find that greater AC oversight improves reporting reliability most when AC members are highly capable and when ACs meet more often to carry out their oversight duties.

Since financial reporting oversight is the AC's overarching duty (the vast majority of AC responsibilities are related to financial reporting oversight, as evident in Appendix B), the total length of the AC charter likely proxies for the scope of AC *financial reporting* oversight. Accordingly, we find no evidence of overload using this proxy: while increasing financial reporting-related responsibilities may stress the AC's ability to complete them all, it is unlikely to *harm or detract from* reporting reliability. Instead, as argued above, financial reporting reliability is more likely to suffer when AC overload arises from extraneous, 'non-core' responsibilities that distract from the AC's core responsibility to monitor financial reporting.

To examine this assertion, we construct content-specific measures that capture (1) the extent of the AC's oversight of internal controls, which is part of the AC's core oversight function, and (2) the extent of AC's oversight of financial risk management, which is non-core oversight and could serve as a distraction. We focus on financial risk management in particular because of

⁵ Entropy balancing improves covariate balance between the treatment and controls groups by reweighting observations, which reduces model dependence when estimating a treatment effect. Entropy balancing does not mitigate bias resulting from self-selection. Selection is less of a threat in our setting because all public firms must disclose their AC charter.

its prevalence as an AC duty (e.g., in 2004, the New York Stock Exchange implemented a requirement that ACs review financial risk management) and because of practitioner concerns that such risk-related responsibility can detract from the committee's ability to fulfill their main financial reporting oversight responsibility (e.g., Deloitte 2014). We find that the likelihood of restatements decreases as more of the AC's responsibilities focus on internal control oversight, in both main and entropy-balanced samples, consistent with our charter length results largely measuring financial reporting duties. In stark contrast, we find that greater financial risk management oversight is associated with a *greater* likelihood of restatements in both main and entropy-balanced samples, indicating that non-core responsibilities distract the AC from its core oversight. The latter results are consistent with practitioner concerns that assigning extraneous oversight duties to the AC can harm financial reporting reliability, highlighting a potential unintended consequence of the regulatory effort to broaden the AC agenda (including the NYSE requirement that ACs review financial risk management).

We conduct several additional analyses. First, we examine whether AC oversight acts as a compliment to or a substitute for external audit effort. We find that audit fees vary positively (negatively) with charter length and internal control-related duties (financial risk management oversight), consistent with the notion that ACs more focused on financial reporting demand greater monitoring provided by the external auditor. Second, we examine the robustness of our main results to using an alternate measure of financial reporting responsibilities based on a count of a broad list of accounting terms contained in the Oxford Dictionary of Accounting. We find consistent results using this alternate content-based measure. Third, to ensure that our charter-based measures are not driven by a firm's disclosure tendency, we include the length of the 10-K as a control and find consistent results.

We contribute to the literature in two ways. First, we provide empirical evidence regarding the implications of assigning ACs a greater role in corporate governance. To our knowledge, we are the first to investigate whether assigning the AC greater responsibilities makes the AC more effective in promoting financial reporting reliability. Our results support the belief of regulators that ACs with more responsibilities are more effective in promoting financial reporting reliability but only when those duties are related to financial reporting.⁶ At the same time, our findings lend credence to the concerns of practitioners that AC “scope creep” can impair the oversight of financial reporting when additional oversight responsibilities are unrelated to financial reporting. This is a particularly important insight given the overall trend to assign ACs more non-core duties, such as the 2004 regulatory change at the NYSE that increased the scope of AC oversight to include financial risk management oversight. Second, we develop new and unique measures that capture the extent and type of AC oversight. Our measures complement, but are distinct from, existing measures and should be considered in future research studying AC effectiveness or corporate governance.

II. BACKGROUND AND HYPOTHESIS DEVELOPMENT

2.1 Audit Committee Research

Studies of audit committees date back at least to Greene and Falk (1979), who suggest that a good audit committee is an integral part of the board at-large. Since that time, and especially in recent years, the AC has increased in importance and responsibility. The academic literature over this time has examined characteristics associated with AC effectiveness, commonly discussing the

⁶ For example, in an interview on July 30, 2012, Paul Sarbanes discusses how SOX strengthens AC oversight of the external auditors, saying that the increased AC responsibility is “making an important difference” in promoting honest record keeping and meaningful financial statements (Beasley, Oxley, and Sarbanes 2012).

AC in terms of three key dimensions: (1) composition, (2) resources, and (3) authority (DeZoort et al. 2002; Bedard and Gendron 2010; Cohen et al. 2014).

AC composition studies are the most common, especially those examining committee members' independence and financial expertise (DeZoort et al. 2002; Carcello, Neal, Palmrose, and Scholz 2011). Numerous studies document an association between AC independence or financial expertise and better monitoring, measured using restatements, SEC sanctions for misreporting, earnings management proxies, disclosure metrics, accounting conservatism, audit fees, auditor selection, audit quality, and internal control weaknesses (Abbott and Parker 2000; Abbott, Park, and Parker 2000; Carcello and Neal 2000; Klein 2002; Abbott, Parker, Peters, and Raghunandan 2003; Xie, Wallace, and DaDalt 2003; Abbott et al. 2004; Bedard, Chtourou, and Courteau 2004; Mangena and Pike, 2005; Krishnan 2005; Krishnan and Visvanathan 2008; Badolato et al. 2014).^{7,8}

The effectiveness of ACs also depends on their access to resources they need to do their job (e.g., Jaggi 2019). Such resources include having enough committee members as well as access to information from relevant entities, including management, auditors, legal counsel, and the full board (DeZoort et al. 2002). For lack of a better proxy, studies in this literature focus mainly on the size of the AC as a measure of resources; however, evidence linking AC size to AC effectiveness is weak. For example, while Bedard et al. (2004) report some evidence that AC size is associated with less aggressive earnings management, Xie et al. (2003) and Abbott et al. (2004) report that AC size is not significantly associated with accruals and restatements, respectively.

⁷ Beginning in 1999, the stock exchanges require listed firms to have fully independent ACs and this requirement is also legally mandated by the Sarbanes Oxley Act of 2002 (Klein 2002; SEC 2003).

⁸ SOX Section 407 requires that issuers disclose whether they have at least one financial expert on the AC, the name of the expert, and whether the expert is independent. An "audit committee financial expert" has (1) an understanding of GAAP and financial statements, (2) direct experience preparing or evaluating financial statements or experience supervising individuals engaged in these activities, (3) an understanding of internal controls and financial reporting procedures, and (4) an understanding of AC functions.

Finally, AC authority is a function of the AC's *influence* and *responsibilities* (DeZoort et al. 2002). Badolato et al. (2014) examine the *influence* of the AC using a measure of the status of AC members relative to management, finding that relative status is important in determining AC effectiveness in promoting financial reporting quality. In terms of *responsibilities*, Bratten, Causholi, and Sulcaj (2019) find that financial reporting quality improves when ACs take a more active role in overseeing the external audit. Numerous studies rely on AC meetings frequency as a measure of the diligence of the AC in carrying out their responsibilities, or put another way, the quantity of AC oversight (Raghunandan and Rama 2007; Bedard and Gendron 2010). Extant evidence on the association between AC meetings and monitoring effectiveness is mixed. Some studies find that the number of AC meetings is associated with improved monitoring, as observed by fewer restatements (Abbott et al. 2004), less aggressive earnings management (Bedard et al. 2004), auditor selection and audit quality (Abbott and Parker 2000; Abbott and Parker 2002), and fewer fraud indictments (Farber 2005). Other studies find that the number of meetings is associated with *more* restatements (Sharma and Iselin 2012) and *more* internal control weaknesses (Krishnan and Visvanathan 2007). Some studies also report insignificant results, including Lin, Li, and Yang (2006), Krishnan (2005), and Abbott et al. (2003). Overall, there is no consensus in the literature regarding the association between AC meetings and AC effectiveness.⁹

The mixed evidence in the AC meetings literature largely stems from measurement issues. For example, there are significant reverse causality concerns with AC meetings: more meetings may be associated with higher financial reporting quality if ACs are proactively overseeing financial reporting but more meetings may also be a response by the AC to address financial

⁹ Building on the review of Bedard and Gendron (2010), we identify 57 studies that test the relation between AC meetings and various measures of outcomes of AC effectiveness. Fifty-eight percent of these studies find no relationship, 37 percent find a positive relationship, and 5 percent find a negative relationship.

reporting or internal control problems that arise during the year. Additionally, the meetings measure does not capture the amount of time spent in meetings or the effort expended by AC members outside of meetings, which can be significant. For example, four two-hour meetings may cover the same scope as eight one-hour meetings, though the AC meetings proxy implies an AC with eight meetings is more diligent.¹⁰ Relative to the AC meetings measure, our charter-based measure is less prone to these measurement issues and better captures the construct of the scope of AC oversight. In particular, our charter-based measure does not suffer from the reverse causality issue because AC charters are determined in advance and are unlikely to change *during* the year in response to financial reporting or internal control problems.

In summary, extant literature finds that AC composition (specifically, independence and financial expertise) is associated with monitoring effectiveness, but studies on AC resources and responsibilities are inconclusive. We help to fill this gap in the literature by developing new measures of AC responsibilities using AC charters and studying their association with financial reporting reliability.

2.2 Hypotheses

Capital market participants depend on financial statement reliability to mitigate agency costs of information asymmetry that arise due to the separation of ownership and management (Healy and Palepu 2001). The central role of the AC is to enhance or maintain investor confidence in financial reports and thereby encourage the efficient functioning of financial markets (PWC and IIAIRF 2011). Practically, ACs do this by providing oversight over the financial reporting process, thus promoting the reliability of financial reports and disclosures that are disseminated to the

¹⁰ There are other limitations of the AC meetings proxy as well. For example, companies diverge in their assessment of what constitutes an AC meeting that they must report. In some cases, reported meetings include only those that occur in person, while others include all occasions during which the committee acted unanimously, whether in person, via teleconference, or in emails.

market (Bedard and Gendron 2010). Anecdotally, AC members we interviewed asserted that they perceive and take this responsibility seriously, emphasizing the processes and procedures they follow to exercise oversight over financial reporting, including selecting and evaluating the auditor, monitoring internal controls, and reviewing disclosures among other duties.

Given the importance of the AC in monitoring financial reporting, increasing the oversight responsibilities of the AC may improve financial reporting reliability. Extensive oversight responsibility gives the AC a holistic and deeper understanding of a firm, its management, its financial reporting process, and the control environment. A better overall understanding of a firm's financial reporting process enables the AC to ask pointed questions of management and hold management accountable for financial reporting. It also allows the AC to play a more active role in addressing concerns raised by external and internal constituents. Furthermore, empowering ACs with greater oversight responsibility enhances the AC's authority over management. This is particularly important because, in the end, it is up to management to implement changes recommended by the AC. These arguments suggest that increasing the scope of AC oversight should increase the committee's monitoring effectiveness and the overall reliability of financial reporting.

Alternatively, it is possible that increasing the scope of oversight does not increase monitoring effectiveness because the AC becomes overburdened. In our semi-structured interviews with AC directors, one AC chairperson warned of "audit committee overload" when discussing their view on AC responsibilities. We define overload as the accumulation of responsibilities to the point where one cannot reasonably accomplish them all effectively. Concerns about AC overload began to proliferate as expectations of ACs increased with the corporate governance reform in the late 1990s and early 2000s, (e.g., Blue Ribbon Committee,

Sarbanes-Oxley, etc.). At that time, governance professionals cited ‘critical concern’ that ACs faced an onslaught of new rules and roles, rising workloads and heavy agendas, and unrealistic expectations (e.g., Hunt and Carey 2001; Zaman 2001; Bill and Matthews 2007). Such concerns have persisted in the time since. For example, Ernst & Young (2014) notes that the role of an AC member has become more demanding, in part because regulators and investors ask the AC to take on increasing responsibilities. In a survey conducted by KPMG (2015), 74 percent of AC members reported a significant or moderate increase in the amount of time required to carry out their responsibilities, and 40 percent of respondents reported that it is increasingly difficult to meet all of the AC’s responsibilities. If oversight responsibilities increase to the point where ACs cannot fulfill them all, then adding more responsibilities may not improve reporting reliability, even if the additional responsibilities relate directly to financial reporting. Thus, while an increase in oversight responsibilities may improve financial reporting reliability, the alternative *overload hypothesis* suggests that it may have no benefit. We state our first hypothesis as follows:

H1: *The scope of audit committee responsibilities is positively associated with financial reporting reliability.*

When creating an oversight agenda, the board and AC generally allocate responsibilities to the AC that keep with the committee’s core mandate to monitor financial reporting.¹¹ However, this is not always the case. In an article aptly titled “Audit Committee Workload – Keeping an Eye on the Ball”, KPMG (2014) highlights the concern that many ACs are being asked to take on oversight responsibilities that are unrelated to financial reporting and that such non-core duties can detract from the AC’s ability to effectively monitor the processes that ultimately inform financial reporting. AC chairs interviewed by KPMG (2014) note that oversight of financial reporting is a

¹¹ See Appendix B for a listing of common AC responsibilities based on our manual analysis of AC charters.

significant undertaking on its own and that agendas laden with additional responsibilities (especially risk oversight) make the role of the AC the most demanding in governance. Indeed, when asked to do too much, ACs must allot their time and effort across more tasks — some that ultimately inform financial reporting and others that do not. Thus, overload of AC members may be especially problematic when driven not only by an excessive quantity of responsibilities in general as in H1, but by the inclusion of extraneous responsibilities that distract AC members from their core responsibility. This *distraction hypothesis* suggests that the more non-financial-reporting (i.e., non-core) oversight responsibility the AC amasses, the more likely it is that the AC devotes inadequate time and effort to financial reporting oversight activities. Accordingly, we state our second hypothesis in the alternative form:

H2: *The scope of non-core audit committee responsibilities is negatively associated with financial reporting reliability.*

III. RESEARCH DESIGN

3.1 Data

Beginning in December 2000, the SEC required all public companies to include a copy of their AC charter as an appendix to their proxy statement at least once every three years (SEC 2000). However, this rule was relaxed in November 2006 such that public companies are now required to maintain a *current* version of the AC charter on their company website and simply refer to the website in the proxy statements (SEC 2006). The historical requirement to disclose the AC charter in proxy statements (which every public company is subject to) allows us to manually gather a time series of AC charters from 2000 to 2006.

Consequently, as summarized in Table 1, we begin our sample with 18,753 firm-year observations between 2000 and 2006 that are on Compustat and can be matched to AC data on

BoardEx. We then identify 21,114 DEF-14A proxy filings on SEC EDGAR filed by these firms between December 15, 2000 (the start of SEC regulation requiring proxy filings to include AC charters every third year) and November 7, 2006 (the end of the SEC requirement to include AC charters in proxy filings every third year). Using a textual search, we eliminate 2,461 proxy filings that do *not* mention the words “audit committee charter” or “charter of the audit committee” in the DEF-14A at least once. We then enlist research assistants to help us manually analyze the content of the 18,653 remaining proxy filings and manually extract the AC charter and the number of AC meetings from these filings.^{12,13} This results in 10,070 firm-year observations that include an AC charter. We eliminate 44 observations that are not on a major US stock exchange (i.e., NASDAQ, NYSE, and AMEX), resulting in a base sample of 10,026 Compustat firm-year observations at the intersection of our hand collected AC charter data and AC data available on BoardEx.¹⁴

In addition to Compustat and BoardEx, we merge our AC charter data with Thomson Reuters and Audit Analytics to calculate variables as necessary. For our restatements analyses, this results in 5,629 firm-year observations. The samples used in additional tests vary based on the availability of data to compute variables specific to each analysis. For example, in our determinants tests reported in Table 4, the sample consists of 6,924 firm-year observations because the model is more parsimonious than our restatements model, which we discuss in the next section.

3.2 Model

We test our hypotheses by estimating an OLS model as follows:

$$RESTATE_{it} = \beta_0 + \beta_1 Charter\ Variable + \beta_2 AC_MEETINGS_{it} + \sum \beta_n Governance\ Controls \quad (1)$$

¹² More specifically, we had research assistants manually examine each proxy statement, locate the AC charter if the proxy statement has one, and copy and paste the whole AC charter into a separate text file. We use the text file for each AC charter for all subsequent analyses.

¹³ Firms are required to disclose the number of AC meetings in their proxy statement (see 17 CFR 229.407(b)).

¹⁴ To verify integrity of the charter-gathering process (i.e., to ascertain that AC charters were properly identified and accurately extracted), we randomly selected proxy filings every time a research assistant finished the assigned task. This resulted in a manual analysis by at least one co-author of 600 proxy filings. In so doing, we observed a type one and type two error rate of less than 1 percent.

$$+ \sum \beta_m \text{Other Controls} + \sum \beta_i \text{Stock Exchange FE} + \sum \beta_j \text{Industry FE} + \sum \beta_k \text{Year FE} + \varepsilon_{it}$$

where the dependent variable, *RESTATE*, is an indicator variable equal to one if firm *i* restates year *t*'s 10-K subsequent to original issuance, and zero otherwise.¹⁵ *RESTATE* encompasses both “Big R” (which require 8-K Item 4.02 disclosure) and “little r” restatements, obtained from Audit Analytics.¹⁶ We focus on *RESTATE* because financial misstatements are a salient indicator of poor financial reporting reliability commonly used in the literature (e.g., Dechow, Ge, and Schrand 2010). The coefficient of interest is β_1 , which captures the effect of AC oversight using one of three *Charter Variables*: *CHARTER_LENGTH*, *IC_COUNT*, and *FINRISK_COUNT*.

To test our overload hypothesis (H1), we create a measure of the scope of AC oversight using the length of the AC charter, *CHARTER_LENGTH*, calculated as the natural log of the number of words in the AC charter of firm *i* in year *t*.¹⁷ A negative coefficient on *CHARTER_LENGTH* would be consistent with greater AC responsibilities making an AC more effective in overseeing the financial reporting process. Alternatively, as we argue in our hypothesis development, greater duties may overburden the AC and thus may have no impact on financial reporting reliability.

We believe the length of the AC charter is an appropriate proxy for the amount of AC responsibilities because the AC charter lists the responsibilities that ACs must perform throughout the year. Consistent with this notion, the charter's purpose and importance have been stressed by both regulators and academics. For example, the SEC notes that “audit committees that have their

¹⁵ Our main dependent variable (*RESTATE*) is binary. To avoid the incidental parameters problem (Greene 2004), we report results of employing a linear probability model instead of a logistic model. To ensure our results are not driven by this design choice, we rerun our main analyses with logistic regression (untabulated) and find consistent results.

¹⁶ To use only Item 4.02 restatements is to drastically limit our sample, since these only exist from 2004 on.

¹⁷ In untabulated analysis, we calculate two alternate definitions of *CHARTER_LENGTH*. We observe similar results when using the natural log of the number of *unique* words in the AC charter and when scaling *CHARTER_LENGTH* by the number of audit committee members.

responsibilities set forth in a written charter are more likely to play an effective role in overseeing the company's financial reports” and that firms should tailor the charters to their specific circumstances (SEC 2000). Per regulatory requirements, the charter must specify the scope of the AC’s responsibilities and how the AC carries out those responsibilities, including structure, processes, and membership requirements (SEC 1999b; SEC 1999c; SEC 1999d). In light of the AC’s fiduciary responsibility to shareholders, the AC charter also informs committee members of the matters for which they can be held personally liable (Lipman 2015).

Further, Kalbers and Fogarty (1993) speak of the charter as an instrument for establishing the authority and mandate of the AC and DeZoort et al. (2002) state that “the audit committee charter has become an increasingly important document for helping audit committee members focus on their specific responsibilities and for helping stakeholders assess the role and responsibilities of the audit committee” (p.44). Bohm, et al. (2016) and Abbott, Parker, Peters, and Rama (2007) also argue that the AC charter is informative for understanding the role of the AC.¹⁸ These papers, along with Carcello et al. (2002), provide evidence of meaningful variation in the content and scope of audit committee charters and dispel the possibility that the charters are entirely boilerplate. Taken together, the findings of academics and perspectives of regulators help confirm what AC members reported to us in interviews: that the AC charter is a useful public signal of actual AC responsibilities.

To better understand the content of AC charters, we closely examine 100 randomly-selected charters from our sample period. In Appendix B, we provide a listing of topics that appear

¹⁸ Bohm et al. (2016) manually analyze the content of AC charters from a sample of 202 firms in 2010 in the US, Europe and Australia, creating a count of distinct AC responsibilities in each charter. They show that this charter-based scope of oversight differs significantly from one firm to another and document a positive and significant association between AC charter scope and the number of AC meetings. In a sample of 219 firms, Abbott, Parker, Peters, and Rama (2007) use an indicator for firms in 2000 whose charters stipulate that the AC reviews internal audit plans and results; they find that ACs who perform this review are negatively correlated with outsourcing routine internal audit tasks.

in these charters, along with the related regulations, if applicable. We find that, while many topics in the charters are tied to AC responsibilities stipulated by the SEC and/or stock exchanges (e.g., AC responsibility for auditor selection is required by stock exchanges and codified by SOX), many are not (e.g., AC review of IT controls, taxes, investments, etc.). We observe numerous charter topics relating to financial reporting, internal control, and external audit. We also note other common topic areas, including internal audit, regulatory compliance, and financial risk management. This detailed analysis supports the notion that AC charters are far from boilerplate.

Our second hypothesis – the distraction hypothesis – addresses the notion that duties that distract the AC from overseeing financial reporting may impair the overall reliability of a firm’s financial reports. To test this hypothesis, we develop two content-specific measures based on AC charters – *IC_COUNT* and *FINRISK_COUNT*. The first measure, *IC_COUNT*, is the total number of internal control-related terms in the AC charter of firm *i* in year *t*, scaled by the total word length of the same charter and multiplied by 100 for expositional convenience.¹⁹ This measure captures AC duties that are clearly related to financial reporting. As such, we do not expect distraction by these duties. Rather, given how critical internal controls are to financial reporting (e.g., DeFond and Zhang 2014), we expect an improvement in financial reporting reliability as the AC focuses more on overseeing internal controls, which should manifest as a negative coefficient on *IC_COUNT*, or no effect.

For the second measure, our goal is to capture the extent of “extraneous” oversight responsibility undertaken by the AC – or duties clearly *unrelated* to financial reporting. In constructing such a measure, we rely on anecdotal evidence that highlights risk oversight as the

¹⁹ We create a list of internal control-related words by reading 50 random AC charters and manually identifying words that relate to oversight of internal controls. The words we count are *internal control*, *material weakness*, *significant deficiency*, *control deficiency*, and *control weakness*, and their plural equivalents.

major area of AC responsibilities that is not related to the AC's core mandate. This evidence suggests that extensive risk oversight responsibility may impair the committee's monitoring of financial reporting (KPMG 2014, 2015). Since ACs are more likely to oversee financial risk as opposed to operational and other types of risk (e.g., Bill and Matthews 2007; KPMG 2015), we examine the association between the extent of financial risk oversight and financial reporting reliability. To create a measure of financial risk oversight we first read 50 random AC charters and manually identify words that relate to financial risk.²⁰ We calculate *FINRISK_COUNT* as the total number of financial risk-related terms in the AC charter of firm *i* in year *t*, scaled by the length of the same charter in words and multiplied by 100 for expositional convenience. If non-core duties overburden an AC and prevent the AC from effectively overseeing financial reporting, then the coefficient on *FINRISK_COUNT* should be positive.

We include in Equation (1) a number of control variables. First, because prior literature uses AC meetings to measure the AC's oversight responsibilities, we include *AC_MEETINGS* as a control in all multivariate analyses. By controlling for *AC_MEETINGS*, we identify the incremental effect of *CHARTER_LENGTH*. We define *AC_MEETINGS* as the number of meetings firm the AC of firm *i* holds during year *t*. Second, we include control variables that prior literature has shown to impact the quality of a firm's corporate governance or financial reporting: *ACCT_EXPERTISE*, *LEGAL_EXPERTISE*, *AC_BUSY*, *AC_SIZE*, *AC_TENURE*, *BOARD_SIZE*, *BOARD_INDEP*, and *CEO_CHAIRMAN* (e.g., Brickley, Coles, and Jarrell 1997; Core, Holthausen, and Larcker 1999; Carcello and Neal 2000; Xie, Davidson, and DaDalt 2003;

²⁰ The NYSE states that "the audit committee should discuss the listed company's major financial risk exposures and the steps management has taken to monitor and control such exposures" (NYSE Listed Company Manual §303A.07[b][iii][D]). The words we count include: 'financial risk', 'financial exposure', 'hedg*', 'derivativ*', 'swaps', 'forward contracts', 'commodity', 'commodities', 'interest rate', 'foreign exchange', 'exchange rate', 'currency', 'currencies', 'futures', 'trading', 'stock options', 'put options', 'call options', 'treasury', 'asset management', 'investments', 'investing', 'capital structure', 'debt', and 'equity'.

Krishnan and Visvanathan 2008; Krishnan, Wen, and Zhao 2011). We include these variables to illustrate that our charter-based measures are distinct from other measures that may capture governance quality. Third, we control for factors commonly included in restatements models by prior literature. These variables are *SIZE*, *MTB*, *LEVERAGE*, *ISSUANCE*, *ROA*, and *INST_OWN* (Badolato, Donelson, and Ege 2014). All these control variables are defined in Appendix A.

IV. RESULTS

4.1 Descriptive Statistics and Pearson Correlations

We begin our analysis with descriptive evidence regarding AC charters. As noted in Figure 1, AC charters increase in length over our sample period, particularly in response to SOX: the average charter length increases from 1,022 words before SOX (i.e., before 2002) to 1,974 words after SOX (i.e., after 2002). Given the increase of AC oversight mandated by SOX, this provides initial univariate evidence that AC charters *do* reflect the level of AC responsibilities. The prevalence of internal control-related and financial risk-related words in AC charters also rises monotonically from year to year.

Table 2 presents descriptive statistics for our main restatements sample. The average length of AC charters in our sample is 1,836 words with an interquartile range of 884 words, suggesting economically significant variation across ACs and that AC charters are not boilerplate. Similarly, the average AC charter discusses internal control-related duties 4.74 times and financial risk-related duties 1.03 times with interquartile ranges of five and one, respectively. Further, ACs meet seven times per year and have four members on average. Finally, the average firm in our sample has a market capitalization of \$742 million, return on assets of one percent, and market-to-book of 3.10. In general, the descriptive statistics of our variables are comparable to prior studies (e.g., Carcello and Neal 2003; Krishnan, Wen and Zhao 2011; Badolato et al. 2014).

In Table 3 we present Pearson correlations among *CHARTER_LENGTH*, *IC_COUNT*, *FINRISK_COUNT*, *RESTATE*, and the control variables included in Equation (1). *CHARTER_LENGTH* is positively correlated with *IC_COUNT* ($\rho = 0.17$; p -value < 0.01) and negatively correlated with *FINRISK_COUNT* ($\rho = -0.04$; p -value < 0.10). This suggests that financial reporting-related duties drive increases in overall AC oversight rather than unrelated duties. Further, the strongest correlation for *CHARTER_LENGTH* is with *AC_MEETINGS* ($\rho = 0.19$; p -value < 0.01). This is expected as both measures capture, to some degree, the extent of AC oversight responsibilities. This univariate analysis also indicates a significantly negative relation between *CHARTER_LENGTH* and *RESTATE* ($\rho = -0.04$; p -value < 0.01), suggesting that greater AC responsibility is associated with better monitoring and improved financial reporting reliability. We explore these relations in more detail in subsequent multivariate analyses.

4.2 Determinants of Charter Length

Next, we provide insights on how AC charter length relates to variables used in prior literature to capture corporate governance, including AC and board characteristics. In particular, we are interested in AC meetings as a common measure of AC monitoring activity (e.g., Larcker, Richardson and Tuna 2007) and AC expertise variables that capture competence (e.g., Carcello and Neal 2003; Krishnan, Wen and Zhao 2011; Badolato et al. 2014). Table 4 presents results from an OLS regression modeling *CHARTER_LENGTH* as a function of all these variables.

We find AC meetings, AC accounting expertise, AC legal expertise, and AC busyness are all significantly positively associated with AC charter length (p -values < 0.05 or lower), consistent with the notion that ACs are assigned more duties (i.e., longer charters) in firms with stronger ACs. We also find that AC director tenure is negatively associated with AC charter length (p -value < 0.01). This is potentially because greater AC duties may create burnout for AC directors – or the

inability to serve on the AC for longer time periods due to excessive work demands. As a whole, these variables explain forty percent of the variation in AC charter length, which is evidence that AC charter length is related to but distinct from existing firm, board, and governance measures.

4.3 AC Oversight and Financial Reporting Reliability

Main Analyses of Overload Hypothesis (H1)

Our first hypothesis addresses the relation between the scope of AC oversight and financial reporting reliability. To test this hypothesis, we examine the association between AC charter length and financial restatements. If greater responsibility makes ACs more effective, *CHARTER_LENGTH* should be negatively associated with *RESTATE*. If greater AC responsibility overburdens ACs to the point where they are unable to complete all the duties, *CHARTER_LENGTH* may have no association with *RESTATE*. Results of this analysis are presented in Table 5. The coefficient on *CHARTER_LENGTH* is significantly negative in column 1 (p -value < 0.05), suggesting that greater overall AC responsibilities make ACs more effective in monitoring the financial reporting process. A one standard deviation increase in *CHARTER_LENGTH* is associated with a 1.4 percentage point decrease in the likelihood of experiencing a restatement, which is an 8 percent decrease relative to overall incidence rate of restatements in our sample.²¹

We use entropy balancing to mitigate potential bias in estimates that results from non-random treatment assignment. This procedure balances covariates between treatment and control groups and brings the treatment variable closer to being independent of other characteristics. In this way, entropy balancing reduces model dependence when estimating a treatment effect

²¹ The coefficient on *AC_MEETINGS* is positive but insignificant, consistent with the measurement issues associated with *AC_MEETINGS*, including its inability to capture fully the time spent in monitoring and the reverse causality concern.

(Hainmueller 2012). Since entropy balancing requires a binary treatment, we sort firms into quintiles based on *CHARTER_LENGTH*. We assign observations in the top quintile to *TOP_CHARTERLENGTH* = 1, those in the bottom quintile to *TOP_CHARTERLENGTH* = 0, and drop observations in the remaining three quintiles. We then entropy balance the first and second moments of each covariate, ensuring that the mean and variance of each covariate is not statistically different between the treatment (*TOP_CHARTERLENGTH* = 1) and control groups (*TOP_CHARTERLENGTH* = 0). We re-estimate Equation (1) on this balanced sample and present results in column 2 of Table 5 which are consistent with our main results in column 1. Overall, the results in Table 5 are consistent with the notion that ACs with more responsibilities are more effective in monitoring the financial reporting process.

As discussed previously, a relevant concern is that ACs can be overburdened if assigned too many responsibilities, which could negatively influence their ability to monitor financial reporting. Our main analyses suggest ACs with greater responsibilities are more effective in monitoring financial reporting. However, overburdening may manifest only at the highest levels of ACs oversight and may not be captured by the on-average effect. Thus, as a further test of the overload hypothesis, we assign each observation in our sample to a quintile of *CHARTER_LENGTH*, where higher quintiles represent charters with greater length. We then re-estimate Equation (1) after replacing *CHARTER_LENGTH* with indicator variables for each quintile. Because we omit the *QUINTILE 1* indicator from the model, the coefficients on the other quintiles in this model capture the effect of each quintile relative to *QUINTILE 1*.

As reported in Table 6, the coefficients on all quintile dummy variables are negative, and mostly decreasing across quintiles indicating larger effects with more responsibilities. The coefficient on *QUINTILE 4* is significant at traditional levels (p -value < 0.05), and the coefficient

on *QUINTILE 5* is marginally significant (p -value = 0.12).²² Contrary to the AC overload hypothesis, these results suggest that the association between AC responsibilities and restatements is strongest at the highest levels of responsibility. These results are further evidence that assigning the AC higher levels of responsibility does not appear to impair their oversight over financial reporting.

Additional Analyses for H1: Cross-sectional Tests

We conduct several cross-sectional tests to reinforce our main findings. First, we predict that AC oversight is more likely to improve financial reporting reliability when there is a greater need for monitoring. For example, at firms recovering from lapses in governance, we expect higher levels of AC oversight to improve reporting reliability more. We test this expectation by introducing the variable *AAER* and its interaction with *CHARTER_LENGTH* into Equation (1). We include *AAER* as our proxy for lapse in governance and measure it as an indicator variable equal to one if an AAER against firm i is announced during year t (zero otherwise). This variable captures firms that are subject to a financial reporting-related enforcement action from the SEC, and we expect that firms seek to ‘clean up their act’ after being sanctioned – which is a scenario in which greater AC oversight should be more beneficial.

We also expect AC monitoring of financial reporting to be more impactful at firms with relatively more complex reporting. It logically follows that complex firms are at a greater inherent risk of misstating their financials, and that greater AC oversight should help mitigate this risk. We test this expectation by including the variable *FOREIGN* as well as its interaction with *CHARTER_LENGTH* in Equation (1), where *FOREIGN* is a proxy for firm complexity (which equals one if firm i reports non-zero pre-tax foreign income in year t , and zero otherwise).

²² Using F-tests, we note that the coefficient on *QUINTILE 5* is not significantly different from the coefficients on *QUINTILES 2, 3, or 4*.

Results for both preceding cross-sectional analyses are presented in Table 7. In the AAER cross-section in column 1, the coefficient on the interaction term (β_3) is negative and marginally significant (p -value = 0.106). In the complexity cross-section in column 2, the coefficient on the interaction term is significantly negative (p -value < 0.05). We interpret these results as evidence that AC monitoring impacts financial reporting reliability (i.e., the likelihood of a restatement) more when the need for such monitoring is greater – in times of lapses in overall governance and at complex firms.

Next, we explore whether the impact of AC oversight varies with the “busyness” of the AC members. Ex ante, it is unclear whether the busyness of AC members should have an interactive effect with the amount of responsibilities assigned to the AC. On one hand, asking AC members who are already busy with multiple other board appointments to undertake high levels of oversight may result in overburdening and no improvement to monitoring quality. On the other hand, AC members with multiple board appointments may be in demand as a director because of their monitoring abilities, and assigning additional oversight to highly capable monitors is likely to improve governance. We analyze this question with an interaction of *CHARTER_LENGTH* and *AC_BUSY* in Equation (1), where *AC_BUSY* is as defined previously. Results of this analysis are presented in column 1 of Table 8. The interaction term (β_3) is negative and significant (p -value < 0.05), suggesting that highly capable directors carry out high levels of oversight effectively, which results in fewer restatements.

Finally, we explore whether the impact of AC oversight varies with the number of meetings held by the AC. Assigning oversight responsibility to the AC can only improve financial reporting reliability if the committee spends the time and effort to accomplish the duties. We test this expectation by introducing into Equation (1) the interaction between *CHARTER_LENGTH* and

AC_MEETINGS. We measure *AC_MEETINGS* as described previously. Results of this test are presented in column 2 of Table 8. The interaction term is negative and significant (p -value < 0.10), suggesting that assigning high levels of oversight to the AC (long charters) is more effective in reducing restatements when the committee is also diligent in carrying out the duties (more meetings).

Main Analysis of Distraction Hypothesis (H2)

Our second hypothesis predicts a decrease in financial reporting reliability as the AC takes on more duties that are unrelated to financial reporting. As noted previously, we test this hypothesis using content-specific charter-based measures, including *FINRISK_COUNT* and, for comparison, *IC_COUNT*. The former captures the percentage of AC duties that is devoted to financial risk management (i.e., *unrelated* to financial reporting) while the latter measures the percentage of AC duties that is devoted to internal controls (i.e., *related* to financial reporting). Our analysis of Hypothesis 1 suggests that greater oversight does not overburden ACs and does not impair financial reporting oversight, likely because the majority of AC duties *are* related to financial reporting. Negative consequences of AC overload are more likely to manifest when ACs focus on duties that *are not* related to financial reporting. Consequently, we expect *IC_COUNT* to be negatively associated with restatements, since internal controls are integral to financial reporting, and *FINRISK_COUNT* be *positively* associated with *RESTATE*, since financial risk management is not directly related to financial reporting.

Results of this analysis are presented in Table 9. In column 1, the coefficient on *IC_COUNT* is negative and significant (p -value < 0.10). This result corroborates our earlier findings and suggests that it is the oversight related to reporting and control that drives the *CHARTER_LENGTH* results. In column 3, the coefficient on *FINRISK_COUNT* is positive and

significant (p -value < 0.05). This suggests that assigning ACs duties that distract the committee from performing its oversight over financial reporting impairs the overall reliability of financial reports. As reported in columns 2 and 4 of Table 9, we run these analyses using an entropy-balanced sample following the methodology described previously and find consistent results. In summary, our evidence is consistent with the AC distraction hypothesis in that financial reporting reliability is higher for firms with ACs that have significant internal control oversight, but lower for firms with ACs that have significant financial risk management oversight responsibilities.

4.4 Additional Analyses

Audit Effort

Given that the AC is responsible for the appointment, compensation, retention, and oversight of the external auditor (see Exchange Act 10A-3), we next examine whether the scope of the AC's oversight impacts the AC's demand for (or the auditor's supply of) audit effort. It is possible that ACs which undertake greater monitoring themselves demand less monitoring from the independent auditor, suggesting a substitution effect (Simunic 1980; Anderson, Francis, and Stokes, 1993; Craswell, Francis, and Taylor 1995). In a similar substitution effect, independent auditors that perceive stronger internal monitoring in the form of active ACs may estimate lower engagement risk and reduce costly effort accordingly. On the other hand, ACs with greater scope of oversight may demand more audit evidence and procedures in carrying out this oversight and to protect their reputation and promote shareholder interests (Carcello, Hermanson, and Neal 2002). Similarly, ACs with duties that are unrelated to financial reporting may demand less external audit effort because the AC is less focused on ensuring the reliability of financial reports.

To test this question, we regress the log of audit fees on our three charter-based measures. Results are presented in Table 10. In column 1, *CHARTER_LENGTH* is significantly positively

associated with *AUDIT_FEES* (p -value < 0.05), indicating that ACs with more responsibilities also require the auditor to do more work. This effect appears to be driven by ACs that have more financial reporting-related duties, as evidenced by a significantly positive coefficient on *IC_COUNT* in column 2 (p -value < 0.01). In column 3, *FINRISK_COUNT* is significantly *negatively* associated with *AUDIT_FEES* (p -value < 0.01), indicating that audit fees are lower on average when ACs have more oversight duties *unrelated* to financial reporting reliability. In summary, the results in Table 10 suggest that ACs demand more assurance from the independent auditor when the AC has greater oversight responsibilities related to financial reporting but less when that oversight is unrelated to financial reporting.

Alternate Measures of AC Responsibilities

We conduct numerous un-tabulated additional procedures to examine the robustness of our results to alternate measures of the scope of AC oversight. First, we calculate *CHARTERLENGTH_UNIQUE* as the natural log of *unique* words in the charter (meaning each word is counted only once, regardless of how many times it is used). Using this adjusted measure, which is less likely to be affected by the wordiness of the charter, we find consistent results. Second, we calculate *CHARTERLENGTH_SCALED* as the total number of words in the charter scaled by the number of AC members. This variable may be considered a somewhat more specific proxy for the scope of AC oversight, as it measures the extent of duties *per AC member*. We find consistent results using this measure. Third, as we have noted previously, our *CHARTER_LENGTH* measure likely picks up duties that are generally related to financial reporting oversight since that is the primary function of an AC. To provide greater assurance over this assertion, we create another content-specific measure which we name *OXFORD_COUNT*, calculated as the natural log of one plus the number of times that terms contained in the Oxford

Dictionary of Accounting appear in the AC charter. We find consistent results when estimating Equation (1) with *OXFORD_COUNT* in the place of *CHARTER_LENGTH*.

Disclosure Tendency of the Firm

It is possible that *CHARTER_LENGTH* captures a firm's disclosure tendencies (i.e., firms that tend to disclose more may be well-governed firms, which could explain why we find an on-average reduction in restatements). To address this concern, as our final analysis we rerun our main analysis while controlling for *10K_LENGTH* (the natural log of the number of words in a firm's 10-K in a given year), where *10K_LENGTH* is a proxy for a firm's disclosure style. Un-tabulated results are consistent with our main analysis, indicating that the effect of *CHARTER_LENGTH* is *not* due to a correlated omitted factor related to disclosure styles.

V. CONCLUSION

Audit committee (AC) responsibilities have increased significantly over the past two decades. To the extent that expanding AC responsibilities leads to higher quality monitoring, this expansion benefits investors. On the other hand, practitioners suggest increasing AC responsibilities may represent harmful “scope creep” that impairs the effectiveness of monitoring. In this study, we investigate the relation between the scope of AC oversight and the reliability of financial reporting.

Using new measures of AC oversight that we develop based on hand-collected AC charters (which are a required disclosure that delineates the responsibilities of ACs), we provide evidence of two important insights. First, our results suggest that greater AC oversight actually improves financial reporting reliability on average as evidenced by a reduction in the likelihood of restating financial statements. We find that this association is strongest at very high levels of AC responsibility. The result is also stronger in times of significant governance lapses, at complex

firms, when AC members are capable and experienced, and when ACs also meet often to carry out the oversight duties. Second, we provide evidence that the improvement in financial reporting reliability is due to AC responsibilities that are related to financial reporting. In sharp contrast, we find that financial reporting reliability actually *decreases* when ACs perform duties that are *unrelated* to financial reporting, consistent with our distraction hypothesis. These insights are similar when we analyze audit fees rather than restatements.

As a whole, our results suggest that ACs with greater oversight are more effective monitors of financial reporting and that increasing AC responsibilities improves financial reporting reliability. However, consistent with practitioner concerns, our evidence also suggests that assigning extraneous oversight duties to the AC (like financial risk management oversight) can distract the AC to the detriment of financial reporting reliability. These are particularly important insights given the apparently divergent perspectives of regulators and practitioners, where regulators lean towards assigning greater oversight responsibilities to the AC and practitioners raise concerns that greater duties may make ACs less effective in monitoring financial reporting, especially when the duties are unrelated to financial reporting.

Our results should be interpreted with caveats. First, due to the evolution of disclosure requirements and availability of AC charters, our sample is restricted to the years 2000 through 2006. We argue that this is an appropriate setting to test our research question because corporate governance and AC duties were in flux during this time period due to regulations imposed by stock exchanges and the SEC, and this enables a rich setting to test our research question. However, restricting the analysis to this period limits our ability to speak to current AC oversight trends. Second, while our results are robust to entropy balancing, we make no causal inference due to the inherent endogenous nature of governance, AC charters, and reporting quality. Third, while our

charter-based measures are conceptually superior to measures used in prior literature to capture AC oversight, we acknowledge limitations of our measures. For example, activities carried out by the AC likely extend beyond those explicitly listed in the charter. Further, many charters are carefully vetted by legal counsel to limit disclosures that could increase potential liability for the firm or AC members. Such effects may reduce the informativeness of the charters.

Overall, our findings provide clarity to the AC and governance literature. We inform the debate regarding whether ACs should be assigned greater oversight responsibilities and the effect that enhanced responsibility has on the ability of the AC to perform its oversight function. This should be of interest to academics, regulators, and practitioners who are interested in improving corporate governance.

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Appendix A

Variable definitions

Variable	Definition	Source
<u>Test Variables</u>		
<i>CHARTER_LENGTH</i>	= the natural log of the length of AC charter in words for firm <i>i</i> in year <i>t</i>	AC Charters (hand collected)
<i>FINRISK_COUNT</i>	= the total number of times any of the following words (including both singular and plural forms if applicable) appears in the AC charter of firm <i>i</i> in year <i>t</i> (scaled by <i>CHARTER_LENGTH</i>): 'hedg*', 'derivativ*', 'swaps', 'forward contracts', 'financial risk', 'financial exposure', 'commodity', 'commodities', 'interest rate', 'foreign exchange', 'exchange rates', 'currency', 'currencies', 'futures', 'trading', 'stock options', 'put options', 'call options', 'treasury', 'asset management', 'investments', 'investing', 'capital structure', 'debt', and 'equity'. We multiply this number by 100 for expositional convenience.	AC Charters
<i>IC_COUNT</i>	= The total number of times any of the following words (including both singular and plural form if applicable) appears in the AC charter of firm <i>i</i> in year <i>t</i> (scaled by <i>CHARTER_LENGTH</i>): 'internal control', 'material weakness', 'significant deficiency', 'control deficiency', and 'control weakness'. We multiply this number by 100 for expositional convenience.	
<i>TOP_CHARTERLENGTH</i>	= one (zero) if the AC charter is in the top (bottom) quintile of <i>CHARTER_LENGTH</i> . This variable is used in entropy balancing where the middle three quintiles are discarded.	AC Charters
<i>TOP_FINRISKCOUNT</i>	= one (zero) if the AC charter is in the top (bottom) quintile of <i>FINRISK_COUNT</i> . This variable is used in entropy balancing where the middle three quintiles are discarded.	AC Charters
<i>TOP_ICCOUNT</i>	= one (zero) if the AC charter is in the top (bottom) quintile of <i>IC_COUNT</i> . This variable is used in entropy balancing where the middle three quintiles are discarded.	AC Charters
<u>Dependent Variables</u>		
<i>AUDIT_FEES</i>	= the natural log of audit fees charged to firm <i>i</i> in year <i>t</i>	Audit Analytics
<i>RESTATE</i>	= one if firm <i>i</i> restated the 10-K for year <i>t</i> (zero otherwise)	Audit Analytics
<u>Governance Control Variables</u>		
<i>AC_BUSY</i>	= the average number of boards the AC directors of firm <i>i</i> concurrently serve on in year <i>t</i>	BoardEx
<i>AC_MEETINGS</i>	= the number of times the AC of firm <i>i</i> held formal meetings in year <i>t</i>	AC Charters
<i>AC_SIZE</i>	= the number of directors on the audit committee for firm <i>i</i> in year <i>t</i>	BoardEx
<i>AC_TENURE</i>	= the average number of years the AC directors of firm <i>i</i> have served on the AC as of year <i>t</i>	BoardEx
<i>ACCT_EXPERTISE</i>	= one if firm <i>i</i> had an accounting financial expert on the AC in year <i>t</i> (zero otherwise); accounting financial expert is defined as someone who has prior experience working as a(n): Auditor, CFO, Accounting Officer, Chief Accountant, Controller, Certified Public Accountant, Chartered Accountant, Head of Accounting, Vice President of Accounting, Accounting Director, VP of Finance, or Treasurer	BoardEx
<i>BOARD_INDEP</i>	= total independent board members scaled by total board members for firm <i>i</i> in year <i>t</i>	BoardEx

Appendix A, cont.
Variable Definitions

Variable	Definition	Source
<i>BOARD_SIZE</i>	= the number of directors on the board for firm <i>i</i> in year <i>t</i>	BoardEx
<i>CEO_CHAIR</i>	= one if the CEO is the Chairman of the Board for firm <i>i</i> in year <i>t</i> (zero otherwise)	BoardEx
<i>LEGAL_EXPERTISE</i>	= one if firm <i>i</i> had a legal expert in year <i>t</i> on the audit committee (zero otherwise); legal expert is defined as someone who has prior experience as an attorney, lawyer, or general counsel or has a Juris Doctor or Doctor of Jurisprudence degree (following Krishnan, Wen, and Zhao 2011)	BoardEx
Other Variables		
<i>AAER</i>	= one if an AAER against firm <i>i</i> is announced during year <i>t</i> (zero otherwise)	SEC
<i>CURRENT_ASSETS</i>	= current assets scaled by total assets for firm <i>i</i> in year <i>t</i>	Compustat
<i>DECEMBER</i>	= one if the fiscal year for firm <i>i</i> in year <i>t</i> ends in December (zero otherwise)	Compustat
<i>FOREIGN</i>	= one if firm <i>i</i> reports non-zero pre-tax foreign income in year <i>t</i> (zero otherwise)	Compustat
<i>GOING_CONCERN</i>	= one if the auditor issued a going concern opinion for firm <i>i</i> in year <i>t</i> (zero otherwise)	Audit Analytics
<i>INST_OWN</i>	= the percent of firm <i>i</i> owned by institutional owners in year <i>t</i>	Thomson Reuters
<i>ISSUANCE</i>	= one if firm <i>i</i> issued equity or debt equal in year <i>t</i> equal to than 10% of total assets in year <i>t</i>	Compustat
<i>LEVERAGE</i>	= long term debt scaled by total assets for firm <i>i</i> in year <i>t</i>	Compustat
<i>LOSS</i>	= one if firm <i>i</i> reports net income less than zero in year <i>t</i> (zero otherwise)	Compustat
<i>MTB</i>	= market value of equity scaled by book value of equity for firm <i>i</i> in year <i>t</i>	Compustat
<i>QUICK_RATIO</i>	= current assets minus inventory, all scaled by current liabilities for firm <i>i</i> in year <i>t</i>	Compustat
<i>ROA</i>	= net income scaled by total assets for firm <i>i</i> in year <i>t</i>	Compustat
<i>SEGMENTS</i>	= the number of geographic and business segments for firm <i>i</i> in year <i>t</i>	Compustat
<i>SIZE</i>	= natural log of market value of equity for firm <i>i</i> in year <i>t</i>	Compustat
<i>SIZE_ASSETS</i>	= natural log of total assets for firm <i>i</i> in year <i>t</i>	Compustat

Appendix B

Topics in Audit Committee Charters

Based on manual analysis of 100 AC charters
and mapped to related regulation

Required by (as of year):

	SEC*	Auditing Standards*	NYSE*	NASD*	AMEX*
Organization / membership					
Independence of members	(B) 2003-04		(I) 2001	(G) 2001	(K) 2001
Independence exception			(I) 2001	(G) 2001	(K) 2001
Financial literacy of members			(I) 2001	(G) 2001	(K) 2001
Financial expertise of members			(I) 2001	(G) 2001	(K) 2001
Review and update charter annually			(I) 2001	(G) 2001	(K) 2001
Prepare audit committee report	(A) 2000				
Authority to engage advisors	(B) 2003-04				
Report to the board			(J) 2004		
Maintain minutes					
Review of audit committee performance			(J) 2004		
Member compensation					
Serve on limited # of other boards					
Minimum number of meetings					(L) 2004
Number of members			(I) 2001	(G) 2001	(K) 2001
Request other committees to also monitor					
Financial reporting and disclosure					
Discuss accounting/reporting matters and policies		(D) 1989 (F) 2000	(J) 2004		
Judgment, estimates	(A) 2000	(D) 1989 (F) 2000			
Alternative GAAP			(J) 2004		
Interim statements review by auditor		(E) 1992			
MDA			(J) 2004		
Press releases / guidance			(J) 2004		
Off-balance sheet			(J) 2004		
Review SEC filings			(J) 2004		
Internal Controls					
Review/evaluate internal control		(C) 1988	(J) 2004		
Review internal control findings of independent auditor			(J) 2004		
Review information system controls					

* Legend (relevant regulation)

A - Release No. 34-42266	E - SAS 71	I - SR-NYSE-99-39
B - SOX	F - SAS 90	J - SR-NYSE-2002-33
C - SAS 60	G - SR-NASD-99-48	K - SR-AMEX-99-38
D - SAS 61	H - Release No 34-48745	L - SR-AMEX-2003-65

Appendix B, cont.

Topics in Audit Committee Charters

Required by (as of year):

	SEC	Auditing Standards	NYSE	NASD	AMEX
Independent Auditor					
Auditor selection	(B) 2003-04		(I) 2001	(G) 2001	(K) 2001
Audit fee approval	(B) 2003-04				
Non-audit services approval	(B) 2003-04				
Independence: general			(I) 2001	(G) 2001	(K) 2001
Independence: partner rotation			(J) 2004		
Independence: firm rotation			(J) 2004		
Independence: former employees			(J) 2004		
Independence: written auditor statement			(I) 2001	(G) 2001	(K) 2001
Audit scope		(D) 1989			
Meet separately with auditor			(J) 2004		
Disagreements and difficulties	(B) 2003-04	(D) 1989	(J) 2004		
Auditor communications		(D) 1989			
Auditor's quality control			(J) 2004		
Evaluation of auditor			(J) 2004		
Audit adjustments		(D) 1989			
Employing other audit firms					
Auditor consultation with national office			(J) 2004		
Internal auditor					
Scope			(J) 2004		
Meet separately			(J) 2004		
Other					
Fraud					
Procedure to receive complaints	(B) 2003-04				
Fraud					
Regulatory/Accounting compliance					
General legal, regulatory compliance			(J) 2004		
Meet with general counsel					
Code of ethics / code of conduct					
Illegal acts					
Foreign corrupt practices					

Legend (relevant regulation)

A - Release No. 34-42266	E - SAS 71	I - SR-NYSE-99-39
B - SOX	F - SAS 90	J - SR-NYSE-2002-33
C - SAS 60	G - SR-NASD-99-48	K - SR-AMEX-99-38
D - SAS 61	H - Release No 34-48745	L - SR-AMEX-2003-65

Appendix B, cont.

Topics in Audit Committee Charters

Required by (as of year):

	<u>SEC</u>	<u>Auditing Standards</u>	<u>NYSE</u>	<u>NASD</u>	<u>AMEX</u>
Other					
Risk management			(J) 2004		
Related parties				(H) 2004	

Also: accounting personnel, executive officer expense account review, tax, asset management, investments, employee benefit plans, pensions, review clarity of disclosure, review auditor assessment of materiality, insurance, budget, capital structure, SEC comment letters, dividends, operational efficiency, environmental

Disclaimers

Not the responsibility of the AC to plan/conduct audits

Not the responsibility of the AC to determine that financials are complete/accurate

Not the duty of the AC to assure compliance with laws, regulations, code of ethics and conduct

Not the duty of the AC to conduct investigations or resolve disagreements between management and auditors

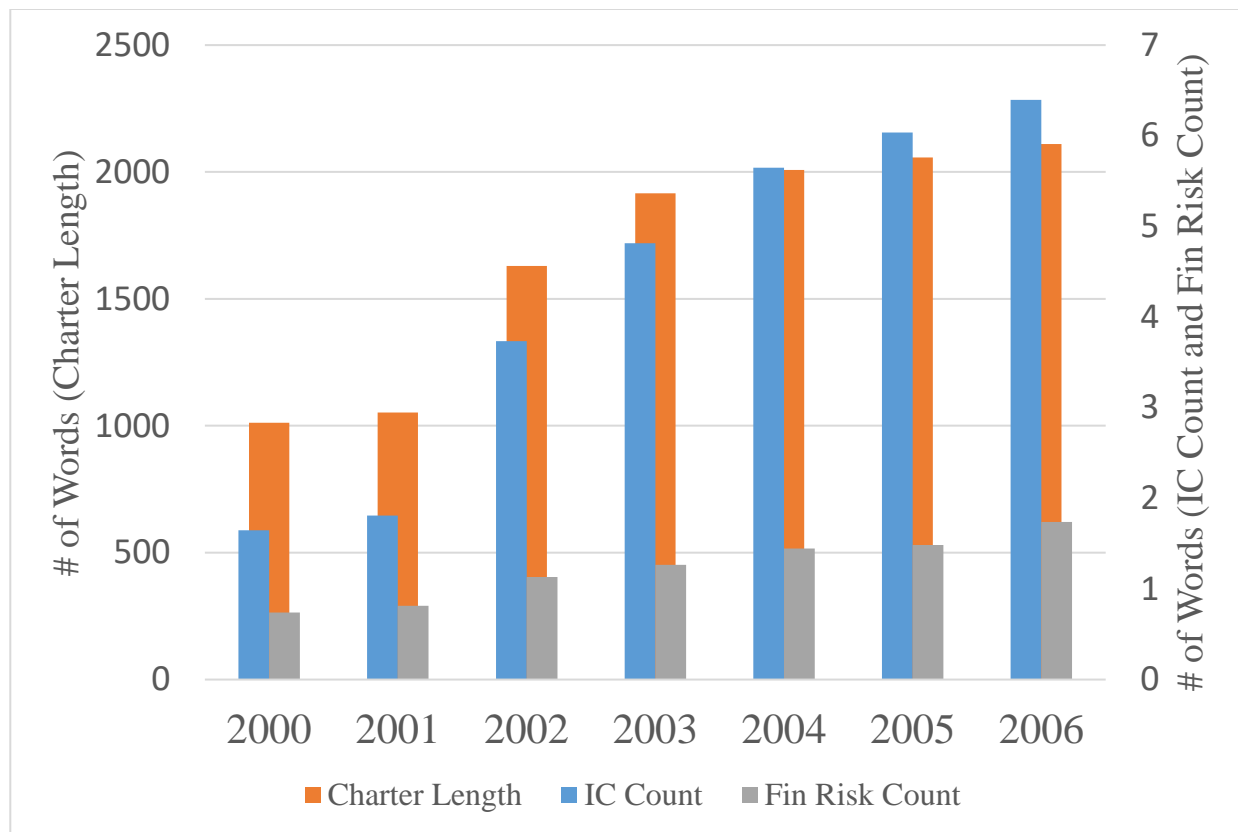
Reliance on information from management

Legend (relevant regulation)

A - Release No. 34-42266	E - SAS 71	I - SR-NYSE-99-39
B - SOX	F - SAS 90	J - SR-NYSE-2002-33
C - SAS 60	G - SR-NASD-99-48	K - SR-AMEX-99-38
D - SAS 61	H - Release No 34-48745	L - SR-AMEX-2003-65

Figure 1

Time trend of charter length, internal control-related words, and financial risk-related words



This figure depicts the time trend in the average number of words in AC charters (left axis) and the average number of internal control-related and financial risk-related words (right axis) over our sample period.

Table 1
Sample selection

Firm-year observations at the intersection of Compustat and BoardEx (2000-2006)	18,753
DEF 14A filings on SEC EDGAR for sample firms	21,114
Charters obtained from DEF 14A filings	10,070
Less: Charters for firms not on NYSE, NASD, or AMEX	(44)
Base sample of firm-year observations with charters	<hr/> 10,026
Less: Observations missing data to compute necessary variables	<hr/> (4,397)
Final sample of firm-year observations used in restatements analysis	<hr/> <hr/> 5,629

Table 2

Descriptive statistics for restatements sample (n = 5,629)

Variable	Mean	Std.	25%	Median	75%
<i>Test Variable</i>					
<i>CHARTER_LENGTH (in words)</i>	1,836.36	661.99	1,359.00	1,765.00	2,243.00
<i>IC_COUNT (in words)</i>	4.74	3.56	2.00	4.00	7.00
<i>FINRISK_COUNT (in words)</i>	1.03	1.20	0.00	1.00	1.00
<i>Dependent Variable</i>					
<i>RESTATE (binary)</i>	0.17	0.37	0.00	0.00	0.00
<i>Governance Control Variables</i>					
<i>AC_MEETINGS</i>	7.17	3.35	5.00	7.00	9.00
<i>ACCT_EXPERTISE (binary)</i>	0.61	0.49	0.00	1.00	1.00
<i>LEGAL_EXPERTISE (binary)</i>	0.38	0.49	0.00	0.00	1.00
<i>AC_BUSY</i>	3.30	1.69	2.00	3.00	4.00
<i>AC_SIZE</i>	4.01	1.21	3.00	4.00	5.00
<i>AC_TENURE</i>	6.65	4.16	3.68	5.82	8.85
<i>BOARD_SIZE</i>	11.16	3.61	8.00	11.00	14.00
<i>BOARD_INDEP</i>	0.55	0.16	0.45	0.56	0.67
<i>CEO_CHAIR (binary)</i>	0.59	0.49	0.00	1.00	1.00
<i>Other Control Variables</i>					
<i>SIZE</i>	6.61	1.80	5.43	6.53	7.76
<i>MTB</i>	3.10	3.55	1.52	2.22	3.61
<i>LEVERAGE</i>	0.17	0.19	0.00	0.11	0.27
<i>ISSUANCE (binary)</i>	0.33	0.47	0.00	0.00	1.00
<i>ROA</i>	0.01	0.15	0.00	0.03	0.07
<i>INST_OWN</i>	0.55	0.29	0.31	0.57	0.78

This table reports descriptive statistics. The sample period is from 2000 through 2006. *CHARTER_LENGTH* is the length of the audit committee charter for firm *i* in year *t*. In this table, we present this variable as the raw number of words. In subsequent multivariate analysis, we log this variable. All other variable definitions are provided in Appendix A.

Table 3

Pearson correlations (n = 5,629)

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)		
1 <i>CHARTER_LENGTH</i>																		
2 <i>IC_COUNT</i>	0.17																	
3 <i>FINRISK_COUNT</i>	-0.03	-0.08																
4 <i>RESTATE</i>	-0.04	-0.03	0.03															
5 <i>AC_MEETINGS</i>	0.19	0.12	-0.01	0.01														
6 <i>ACCT_EXPERTISE</i>	0.10	0.05	-0.01	-0.01	0.12													
7 <i>LEGAL_EXPERTISE</i>	0.05	0.02	-0.04	-0.01	0.02	-0.02												
8 <i>AC_BUSY</i>	0.01	0.00	0.00	0.00	0.02	0.02	0.02											
9 <i>AC_SIZE</i>	0.03	0.08	0.02	-0.04	0.16	0.19	0.17	0.01										
10 <i>AC_TENURE</i>	-0.08	-0.02	-0.01	0.00	-0.01	-0.14	0.06	-0.12	0.03									
11 <i>BOARD_SIZE</i>	0.01	0.10	0.00	0.00	0.25	0.08	0.14	0.11	0.54	0.11								
12 <i>BOARD_INDEP</i>	0.09	0.07	0.00	-0.09	0.04	0.11	-0.03	-0.06	0.19	-0.02	-0.08							
13 <i>CEO_CHAIR</i>	-0.03	0.02	0.02	0.01	-0.03	-0.02	0.02	0.00	0.04	0.04	0.07	0.10						
14 <i>SIZE</i>	0.03	0.09	0.01	0.01	0.26	0.06	0.10	0.23	0.31	0.05	0.65	-0.15	0.16					
15 <i>MTB</i>	-0.02	-0.02	-0.01	-0.03	-0.04	0.02	-0.02	0.07	-0.04	-0.04	-0.04	0.00	0.00	0.15				
16 <i>LEVERAGE</i>	0.06	0.02	0.00	0.03	0.05	0.02	0.06	0.08	0.06	-0.05	0.13	-0.13	0.06	0.14	-0.06			
17 <i>ISSUANCE</i>	0.06	-0.02	-0.01	0.00	-0.07	0.02	-0.02	0.06	-0.14	-0.15	-0.13	-0.05	-0.02	-0.05	0.08	0.33		
18 <i>ROA</i>	0.02	0.02	-0.01	-0.01	0.02	0.01	0.02	-0.11	0.08	0.13	0.11	-0.01	0.09	0.25	0.03	0.00	-0.11	
19 <i>INST_OWN</i>	0.05	0.07	0.00	0.07	0.24	0.09	0.01	0.13	0.11	0.02	0.29	-0.11	0.09	0.50	0.03	0.12	0.02	0.20

This table provides Pearson correlations for primary variables. The sample period is from 2000 through 2006. *CHARTER_LENGTH* is the natural log of the number of words in the audit committee charter for firm *i* in year *t*. All other variable definitions are provided in Appendix A. Correlations in **boldface** are significant at the 10 percent level or lower.

Table 4The association between *CHARTER_LENGTH* and governance characteristics

$$CHARTER_LENGTH_{it} = \beta_0 + \beta_1 AC_MEETINGS_{it} + \sum \beta_n Governance$$

$$Characteristics + \sum \beta_k Fixed Effects + e_{it}$$

	Coeff.	t-Stat	
<i>AC_MEETINGS</i>	0.0087	5.44	***
<i>ACCT_EXPERTISE</i>	0.0262	2.38	**
<i>LEGAL_EXPERTISE</i>	0.0368	3.24	***
<i>AC_BUSY</i>	0.0107	3.51	***
<i>AC_SIZE</i>	-0.0092	-1.76	*
<i>AC_TENURE</i>	-0.0063	-4.93	***
<i>BOARD_SIZE</i>	0.0026	1.20	
<i>BOARD_INDEP</i>	-0.0099	-0.29	
<i>CEO_CHAIR</i>	-0.0144	-1.32	
<i>SIZE</i>	-0.0031	-0.66	
Industry Fixed Effects		Y	
Year Fixed Effects		Y	
Stock Exchange Fixed Effects		Y	
Adjusted R ²	0.409		
Observations	6,924		

This table reports results from an OLS regression relating audit committee charter length to governance variables for NYSE/NASDAQ/AMEX firms from 2000-2006. The dependent variable is *CHARTER_LENGTH*, which is equal to the natural log of the number of words in the audit committee charter for firm *i* in year *t*. All other variables are as defined in Appendix A. Industry is defined at the 2-digit SIC level. Continuous variables are winsorized at 1 and 99. T-statistics are based on robust standard errors clustered at the firm level. *, **, and *** denote two-tailed significance at the 10%, 5%, and 1% level, respectively.

Table 5

The association between charter variables and restatements

$$RESTATE_{it} = \beta_0 + \beta_1 Charter_Variables_{it} + \sum \beta_n Controls + e_{it}$$

		Dep. Var. =	(1)		(2)	
		(pred)	RESTATE		RESTATE	
			Coeff.	t-Stat	Coeff.	t-Stat
<i>Charter variables</i>	<i>CHARTER_LENGTH</i>	(-)	-0.0363	-2.10 **		
	<i>TOP_CHARTERLENGTH</i>	(-)			-0.0622	-1.82 *
<i>Governance controls</i>	<i>AC_MEETINGS</i>		0.0013	0.71	0.0010	0.26
	<i>ACCT_EXPERTISE</i>		0.0014	0.12	0.0064	0.24
	<i>LEGAL_EXPERTISE</i>		-0.0034	-0.27	0.0526	2.02 **
	<i>AC_BUSY</i>		-0.0017	-0.41	-0.0121	-1.53
	<i>AC_SIZE</i>		-0.0018	-0.31	-0.0118	-1.08
	<i>AC_TENURE</i>		0.0010	0.65	0.0002	0.07
	<i>BOARD_SIZE</i>		-0.0015	-0.59	0.0054	1.14
	<i>BOARD_INDEP</i>		-0.1571	-3.52 ***	-0.1888	-2.13 **
	<i>CEO_CHAIR</i>		0.0125	1.01	0.0345	1.38
<i>Firm controls</i>	<i>SIZE</i>		0.0024	0.41	-0.0038	-0.34
	<i>MTB</i>		-0.0032	-2.05 **	-0.0057	-1.93 *
	<i>LEVERAGE</i>		0.0846	1.96 **	-0.0206	-0.29
	<i>ISSUANCE</i>		0.0047	0.37	-0.0448	-1.88 *
	<i>ROA</i>		-0.0825	-2.09 **	0.0124	0.16
	<i>INST_OWN</i>		0.0815	2.85 ***	0.1453	2.86 ***
	Industry Fixed Effects		Y		Y	
	Year Fixed Effects		Y		Y	
	Stock Exchange Fixed Effects		Y		Y	
	Entropy Balanced Sample		N		Y	
	Adjusted R ²		0.056		0.160	
	Observations		5,629		1,940	

This table reports results from OLS regressions relating financial reporting reliability to the scope of AC oversight for NYSE/NASDAQ/AMEX firms from 2000-2006. The dependent variable is *RESTATE*, which equals one if the firm restated the 10-K for year *t*. In column 1, the sample consists of all observations with requisite data and the independent variable of interest is *CHARTER_LENGTH*, which is the natural log of the number of words in the audit committee charter for firm *i* in year *t*. For column 2, we sort observations into quintiles based on *CHARTER_LENGTH*. We assign observations in the top quintile to *TOP_CHARTERLENGTH* = 1 and the bottom quintile to *TOP_CHARTERLENGTH* = 0; the remaining quintiles are discarded. We entropy balance the first and second moments of each covariate. All other variables are as defined in Appendix A. Industry is defined at the 2-digit SIC level. Continuous variables are winsorized at 1 and 99. T-statistics are based on robust standard errors clustered at the firm level. *, **, and *** denote two-tailed significance at the 10%, 5%, and 1% level, respectively.

Table 6
Quintile regression

$$RESTATE_{it} = \beta_0 + \sum \beta_n Charter_Length\ Quintils_{it} + \sum \beta_m Controls + e_{it}$$

		(1)			
		Dep. Var. =	<i>RESTATE</i>		
		(pred)	Coeff.	t-Stat	
<i>Charter variables</i>	<i>QUINTILE 2</i>	$[\beta_2]$	(?)	-0.0250	-0.96
	<i>QUINTILE 3</i>	$[\beta_3]$	(?)	-0.0320	-1.17
	<i>QUINTILE 4</i>	$[\beta_4]$	(?)	-0.0542	-1.98 **
	<i>QUINTILE 5</i>	$[\beta_5]$	(?)	-0.0440	-1.56 #
<i>Tests of differences in coefficients</i>					F-stat
		$\beta_5 = \beta_2$			0.97
		$\beta_5 = \beta_3$			0.58
		$\beta_5 = \beta_4$			0.51
		Governance and Firm Controls		Y	
		Industry Fixed Effects		Y	
		Year Fixed Effects		Y	
		Stock Exchange Fixed Effects		Y	
		Adjusted R ²		0.056	
		Observations		5,629	

This table reports results from OLS regressions relating financial reporting reliability to the scope of AC oversight for NYSE/NASDAQ/AMEX firms from 2000-2006. We sort firms into quintiles based on *CHARTER_LENGTH*, assigning observations with the lowest (highest) values to *QUINTILE 1* (*QUINTILE 5*). The dependent variable is *RESTATE*, which equals one if the firm restated the 10-K for year *t*. All other variables are as defined in Appendix A. Industry is defined at the 2-digit SIC level. Continuous variables are winsorized at 1 and 99. T-statistics are based on robust standard errors clustered at the firm level. #, *, **, and *** denote two-tailed significance at the 15%, 10%, 5%, and 1% level, respectively.

Table 7

The moderating effects of governance lapses and firm complexity

$$RESTATE_{it} = \beta_0 + \beta_1 Charter_Length_{it} + \beta_2 Partition_{it} + \beta_3 Charter_Length_{it} * Partition_{it} + \sum \beta_n Controls + e_{it}$$

			(1)		(2)	
		Dep. Var. =	<i>RESTATE</i>		<i>RESTATE</i>	
		<i>PARTITION</i> =	<i>AAER</i>		<i>FOREIGN</i>	
		(pred)	Coeff.	t-Stat	Coeff.	t-Stat
<i>CHARTER_LENGTH</i>	$[\beta_1]$		-0.0354	-2.05 **	-0.0145	-0.77
<i>PARTITION</i>	$[\beta_2]$		2.3121	1.65 *	0.5745	2.30 **
<i>CHARTER_LENGTH * PARTITION</i>	$[\beta_3]$	(-)	-0.2919	-1.62 #	-0.0735	-2.21 **
<i>Total Effect of CHARTER_LENGTH when PARTITION = 1 [F-stat]</i>						
	$\beta_1 + \beta_3$	(-)	-0.3274	[3.28] *	-0.0880	[8.28] ***
Governance and Firm Controls			Y		Y	
Industry Fixed Effects			Y		Y	
Year Fixed Effects			Y		Y	
Stock Exchange Fixed Effects			Y		Y	
Adjusted R ²			0.057		0.058	
Observations			5,629		5,629	

This table reports results from OLS regressions relating financial reporting reliability to the scope of AC oversight for NYSE/NASDAQ/AMEX firms from 2000-2006. The dependent variable is *RESTATE*, which equals one if the firm restated the 10-K for year *t*. *AAER* is equal to one if an AAER against firm *i* is announced during year *t* (zero otherwise). *FOREIGN* is equal to one if firm *i* has pre-tax foreign income in year *t* (and zero otherwise). Control variables, while included in the regression, are repressed. All variables are as defined in Appendix A. Industry is defined at the 2-digit SIC level. Continuous variables are winsorized at 1 and 99. T-statistics are based on robust standard errors clustered at the firm level. #, *, **, and *** denote two-tailed significance at the 15%, 10%, 5%, and 1% level, respectively.

Table 8

The moderating effects of director busyness and AC diligence

$$RESTATE_{it} = \beta_0 + \beta_1 Charter_Length_{it} + \beta_2 Partition_{it} + \beta_3 Charter_Length_{it} * Partition_{it} + \sum \beta_n Controls + e_{it}$$

			(1)		(2)	
		Dep. Var. =	<i>RESTATE</i>		<i>RESTATE</i>	
		PARTITION =	<i>AC_BUSY</i>		<i>AC_MEETINGS</i>	
		(pred)	Coeff.	t-Stat	Coeff.	t-Stat
<i>CHARTER_LENGTH</i>	$[\beta_1]$		0.0338	1.01	0.0166	0.50
<i>PARTITION</i>	$[\beta_2]$		0.1612	2.28 **	0.0613	1.83 *
<i>PARTITION * CHARTER_LENGTH</i>	$[\beta_3]$	(?)	-0.0220	-2.36 **	-0.0080	-1.81 *
<i>Total Effect of CHARTER_LENGTH at the mean of AC_BUSY [F-stat]</i>						
	$\beta_1 + (3.30 * \beta_3)$	(?)	-0.0388	[5.00] **		
<i>Total Effect of CHARTER_LENGTH at the mean of AC_MEETINGS [F-stat]</i>						
	$\beta_1 + (7.17 * \beta_3)$	(?)			-0.0407	[5.35] **
Governance and Firm Controls			Y		Y	
Industry Fixed Effects			Y		Y	
Year Fixed Effects			Y		Y	
Stock Exchange Fixed Effects			Y		Y	
Adjusted R ²			0.058		0.057	
Observations			5,629		5,629	

This table reports results from OLS regressions relating financial reporting reliability to the scope of AC oversight for NYSE/NASDAQ/AMEX firms from 2000-2006. The dependent variable is *RESTATE*, which equals one if the firm restated the 10-K for year *t*. *AC_BUSY* is the average number of board positions held by the firm's AC members in year *t*. *AC_MEETINGS* is the number of AC meetings held in year *t*. Control variables, while included in the regression, are repressed. All variables are as defined in Appendix A. Industry is defined at the 2-digit SIC level. Continuous variables are winsorized at 1 and 99. T-statistics are based on robust standard errors clustered at the firm level. #, *, **, and *** denote two-tailed significance at the 20%, 10%, 5%, and 1% level, respectively.

Table 9The association between financial risk oversight duties in AC charters and *RESTATE*

$$RESTATE_{it} = \beta_0 + \beta_1 Charter_Variables_{it} + \sum \beta_n Controls + e_{it}$$

		(1)		(2)		(3)		(4)	
	Dep. Var. =	<i>RESTATE</i>		<i>RESTATE</i>		<i>RESTATE</i>		<i>RESTATE</i>	
	(pred)	Coeff.	t-Stat	Coeff.	t-Stat	Coeff.	t-Stat	Coeff.	t-stat
<i>IC_COUNT</i>	(-)	-0.0627	-1.69 *						
<i>TOP_ICCOUNT</i>	(-)			-0.0348	-1.68 *				
<i>FINRISK_COUNT</i>	(+)					0.2302	2.26 **		
<i>TOP_FINRISKCOUNT</i>	(+)							0.0340	1.70 *
Governance and firm controls		Y		Y		Y		Y	
Industry FE		Y		Y		Y		Y	
Year Fixed Effects		Y		Y		Y		Y	
Stock Exchange FE		Y		Y		Y		Y	
Entropy Balanced Sample		N		Y		N		Y	
Adjusted R ²		0.056		0.072		0.057		0.084	
Observations		5,629		2,231		5,629		2,674	

This table reports results from OLS regressions relating financial reporting reliability to the scope of AC oversight for NYSE/NASDAQ/AMEX firms from 2000-2006. The dependent variable is *RESTATE*, which equals one if the firm restated the 10-K for year *t*. In column 1 (column 3), *IC_COUNT* (*FINRISK_COUNT*) is the number of times the AC charter mentions the words related to internal control (financial risk) oversight described in Appendix A, scaled by *CHARTER_LENGTH*. In column 2 (column 4), we sort observations into quintiles based on *IC_COUNT* (*FINRISK_COUNT*). We assign observations in the top quintile to *TOP_ICCOUNT* (*TOP_FINRISKCOUNT*) = 1 and the bottom quintile to *TOP_ICCOUNT* (*TOP_FINRISKCOUNT*) = 0; the remaining quintiles are discarded. We entropy balance the first and second moments of each covariate. All other variables are as defined in Appendix A. Control variables, while included in each regression, are repressed. Industry is defined at the 2-digit SIC level. Continuous variables are winsorized at 1 and 99. T-statistics are based on robust standard errors clustered at the firm level. *, **, and *** denote two-tailed significance at the 10%, 5%, and 1% level, respectively.

Table 10The association between AC charter measures and *AUDIT_FEES*

$$AUDIT_FEES_{it} = \beta_0 + \beta_1 Charter_Variables_{it} + \sum \beta_n Controls + \epsilon_{it}$$

			(1)		(2)		(2)	
		Dep. Var. =	<i>AUDIT_FEES</i>		<i>AUDIT_FEES</i>		<i>AUDIT_FEES</i>	
		(pred)	Coeff.	t-Stat	Coeff.	t-Stat	Coeff.	t-Stat
<i>Charter variables</i>	<i>CHARTER_LENGTH</i>	(?)	0.0745	2.57 **				
	<i>IC_COUNT</i>	(?)			0.1640	2.74 ***		
	<i>FINRISK_COUNT</i>	(?)					-0.4043	-2.82 ***
<i>Governance controls</i>	<i>AC_MEETINGS</i>		0.0256	7.43 ***	0.0261	7.59 ***	0.0263	7.63 ***
	<i>ACCT_EXPERTISE</i>		-0.0017	-0.08	-0.0002	-0.01	-0.0005	-0.02
	<i>LEGAL_EXPERTISE</i>		0.0080	0.37	0.0106	0.49	0.0088	0.41
	<i>AC_BUSY</i>		0.0120	1.85 *	0.0123	1.91 *	0.0121	1.87 *
	<i>AC_SIZE</i>		0.0098	0.99	0.0091	0.92	0.0099	0.99
	<i>AC_TENURE</i>		-0.0143	-5.68 ***	-0.0147	-5.81 ***	-0.0150	-5.94 ***
	<i>BOARD_SIZE</i>		0.0083	1.75 *	0.0079	1.67 *	0.0082	1.74 *
	<i>BOARD_INDEP</i>		0.2822	4.09 ***	0.2279	4.03 ***	0.2793	4.05 ***
<i>CEO_CHAIR</i>		0.0363	1.74 *	0.0352	1.68 *	0.0369	1.77 *	
<i>Firm controls</i>	<i>SIZE_ASSETS</i>		0.4759	42.06 ***	0.4747	42.07 ***	0.4761	42.14 ***
	<i>LEVERAGE</i>		0.1589	2.16 **	0.1642	2.25 **	0.1622	2.23 **
	<i>LOSS</i>		0.1118	4.09 ***	0.1157	4.24 ***	0.1149	4.21 ***
	<i>ROA</i>		-0.4097	-5.59 ***	-0.4022	-5.50 ***	-0.4072	-5.55 ***
	<i>CURRENT_ASSETS</i>		0.4836	6.28 ***	0.4823	6.25 ***	0.4854	6.29 ***
	<i>QUICK_RATIO</i>		-0.0270	-6.58 ***	-0.0269	-6.56 ***	-0.0268	-6.56 ***
	<i>FOREIGN</i>		0.2813	10.65 ***	0.2833	10.71 ***	0.2828	10.73 ***
	<i>SEGMENTS</i>		0.0504	10.66 ***	0.0500	10.54 ***	0.0501	10.63 ***
	<i>DECEMBER</i>		0.1672	6.84 ***	0.1709	7.01 ***	0.1686	6.91 ***
	<i>GOING_CONCERN</i>		0.3044	2.66 ***	0.3109	2.68 ***	0.2981	2.57 **
Industry Fixed Effects			Y		Y		Y	
Year Fixed Effects			Y		Y		Y	
Stock Exchange Fixed Effects			Y		Y		Y	
Adjusted R ²			0.784		0.784		0.784	
Observations			5,938		5,938		5,938	

This table reports results from OLS regressions relating audit fees to the scope of AC oversight for NYSE/NASDAQ/AMEX firms from 2000-2006. The dependent variable is *AUDIT_FEES*, which is the natural log of a firm's audit fees in year *t*. *CHARTER_LENGTH* is the natural log of the number of words in the AC charter for firm *i* in year *t*. *FINRISK_COUNT* is the number of times the AC charter mentions the words related to financial risk oversight described in Appendix A, scaled by *CHARTER_LENGTH*. All other variables are as defined in Appendix A. Industry is defined at the 2-digit SIC level. Continuous variables are winsorized at 1 and 99. T-statistics are based on robust standard errors clustered at the firm level. *, **, and *** denote two-tailed significance at the 10%, 5%, and 1% level, respectively.