Solicitation, Social Exchange, and Auditor-Client Matching: Evidence from Auditor-Provided Awards

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August 12, 2023

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ABSTRACT

This study examines whether and how auditor-initiated social exchange with prospective clients impacts auditor-client matching and future auditor-client outcomes. Social exchange theory posits that when one party takes an action to benefit another, it can induce reciprocity and create synergy, leading to a mutually beneficial and long-lasting relationship (Homans, 1958). Using the Ernst and Young (EY) Entrepreneur of the Year award program in the United States to identify instances where an audit firm initiates social exchange with potential clients, we find that firms that receive an award from EY are more likely to subsequently switch to EY as their external auditor (i.e., more likely to reciprocate in social exchange). This effect is more pronounced among smaller firms, who are more likely to reputationally benefit from award recognition, and prior to the passage of the Sarbanes-Oxley Act, which transferred auditor selection decisions from management to audit committees. Regarding subsequent auditor-client outcomes, we find that award-winning firms that switch to EY have higher auditor-client compatibility, lower discretionary accruals, and are no more likely to restate their financial statements. Thus, contrary to concerns that auditor solicitation distorts audit markets, we find evidence of potential benefits. Overall, our study provides initial empirical evidence on the role of auditor-initiated social exchange in facilitating auditor-client matching.

Keywords: Audit; Social Exchange; Solicitation; Auditor Selection; Auditor-Client Matching.
JEL Classifications: G41, M31, M42.

This paper has benefited from helpful comments and suggestions from Blake Canziani, Jenna El-Khalili, Justin Kim, Robert Knechel, Topcue Lee, Paul Madsen, Kevin Munch, Gabriel Pundrich, Mike Ricci, Philip Wang, Mark Zakota, and workshop participants at the University of Florida and the International Symposium on Audit Research. We gratefully acknowledge financial support from the Fisher School of Accounting and Warrington College of Business at the University of Florida.

I. Introduction

We examine whether and how auditor-initiated social exchange with prospective clients impacts auditor-client matching and future auditor-client outcomes. Social exchange theory posits that when one party takes an action to benefit another, it can create synergies and induce reciprocity, leading to a mutually beneficial and long-lasting relationship (Homans, 1958). Applied to the audit setting, we draw from research on auditor solicitation to study how a distinctive form of auditor-initiated social exchange – Ernst and Young (EY) recognizing potential clients with its Entrepreneur of the Year (EOY) award – impacts auditor-client matching and financial reporting quality. A major impediment to this line of research is the unobservable nature of the solicitation process. Prior literature examines how social exchange arises during audit engagements and through pre-existing social ties (Lennox and Park 2007; Ye et al. 2011; Guan et al. 2016; Christensen et al. 2019); however, we have a limited understanding of social exchange in the context of auditor solicitation. This study seeks to fill this gap by examining an empirical setting in which auditor solicitation is observable *preceding* initial audit engagements.

EY has recognized firms and executives with its EOY award since 1986, giving away more than 10,000 awards to over 15% of firms in Compustat.[1] Through EY's provision of the EOY award to firms (hereafter, "recipients"), EY provides significant indirect financial benefits in the form of increased firm value, lifetime recognition of executives, increased access to equity financing, and reduced cost of equity (Malmendier & Tate, 2009; Jones et al., 2014; Hsu & Zhou, 2020). We hypothesize that the bestowment of this award invites the development of a social exchange relationship between EY and each recipient, which increases the likelihood that

[1] In each year from 1986 to 2022, an average of 0.7% of public companies with relevant data available in Compustat win the EOY award.

recipients will subsequently engage EY for audit services.[2][3] Whether the influence of social exchange on auditor selection enhances or worsens the match between auditors and clients, however, is ex ante uncertain given mixed results in extant literature. While the social exchange may lead to positive auditor-client matching outcomes through enhanced collaboration (Hatfield et al., 2020), it may also create deadweight losses, impair independence, or worsen auditor-client matching by hindering the competitive auditor proposal process (Chaney et al., 1997, 2003).

To empirically test the consequences of auditor-initiated social exchange relationships, we examine the likelihood of new auditor-client matches and the quality of the auditor-client matches that arise between EY and award recipients. Specifically, we examine whether the influence of auditor-initiated social exchanges on the auditor matching process improves or distorts auditor-client compatibility. Using data from 1989 to 2019, we find that the probability of award recipients engaging EY increases relative to non-recipients. Additionally, we find that measures of auditor-client compatibility are higher for recipients that switch to EY relative to recipients that switch to other auditors.[4] This suggests that social exchanges between auditors and potential clients build mutually beneficial relationships that lead to higher quality auditor-client matches.

Next, to examine downstream impacts of the influence of social exchange on auditor selection and matching, we examine the financial reporting consequences of these auditor-client relationships. Using discretionary accruals and financial statement restatements to proxy for audit quality, we find evidence that auditor-client social exchange relationships do not harm financial

[2] De Ruyter and Wetzels (1999) find that companies switching auditors list relationship quality as the most important criterion in auditor selection.

[3] Beyond EY's initiation of social exchange via the EOY award, EY continues to provide valuable exchanges through EOY alumni events, access to advisors and the EY NextGen Academy, and various media spotlight events (Ernst & Young, 2023) that create value for the recipient and perpetuate the auditor-client social exchange relationship over time. EY benefits through client acceptance and retention, and both parties benefit from enhanced communication during audits that can lead to superior financial reporting outcomes (Sanchez et al., 2007).

[4] E.g., Auditor-client compatibility measures from Brown and Knechel (2016) and Shu (2000).

reporting outcomes. Specifically, we find evidence that auditor-client social exchange relationships are associated with lower absolute discretionary accruals, and award recipients are no more likely to restate their financial statements.[5]

Our study makes two primary contributions to the literature. First, it answers calls for empirical research into how auditor-client social exchanges impact audit quality (Dodgson et al., 2020; Knechel et al., 2020). Prior literature primarily focuses on social exchange during the client-auditor relationship (Hatfield et al., 2020). Few studies explore social exchange *preceding* this relationship, and those that do focus on existing social ties outside of the auditors' control, such as common school ties or prior work experience (e.g., Guan et al., 2016; Lennox & Park, 2007; Christensen et al., 2019). Further, many existing studies do not conceptually disentangle between how various types of social ties differentially affect the professionalism of auditor-client interactions.[6] We contribute novel empirical insights on the impact of auditor-initiated social exchange on future auditor-client relationships by identifying observable interactions between auditors and potential clients in the United States.[7]

Second, our study contributes to the literature on auditor-client compatibility and selection by demonstrating how auditor-initiated social exchange leads to enhanced auditor-client compatibility. Our study examines the effects of auditor solicitation on audit quality in the United States in light of mixed perspectives on the externalities of solicitation in extant research.[8] Thus,

[5] Financial reporting quality proxies, such as discretionary accruals and restatements, indirectly proxy for audit quality, as financial reporting quality a function of audit quality and firm characteristics (Defond & Zhang, 2014).

[6] Bruynseels and Cardinaels (2014) examine how different forms of relationships existing between the audit committee and CEO, namely "friendship ties" and "advice networks," impact oversight effectiveness. Though auditor-CEO relationships are not examined, the authors conclude that only friendship ties jeopardize audit quality.

[7] A notable recent publication (Hallman et al., 2022) examines audit market competition and audit quality using a proprietary dataset and a machine learning algorithm to identify auditor bidding activity in the United States. We differ in this study by studying auditor *solicitation*, which encompasses the initial development of auditor-client social exchange relationships preceding any potential bidding process.

[8] Solicitation by auditors may impact audit quality negatively through downward fee pressures and under-auditing (Edenfield v. Fane, 1993) or positively through relationship development and/or reduced information asymmetry

our evidence on these interactions and implications for business development contributes to the broad literature on the benefits of auditor advertisements and gift giving.

Our findings may be of interest to regulators, as they show that social exchange relationships initiated by auditors can lead to beneficial auditor-client matching and financial reporting outcomes. The discretion inherent in the award process combined with the financial benefits realized by recipients may lead to regulatory scrutiny given constraints on conventional forms of auditor gift giving (SEC 2003). While it is important for the accounting profession to understand and deter threats to auditor independence, it is also important to distinguish between detrimental and beneficial forms of auditor-client social ties. In the case of auditor-client social exchange relationships, there appear to be positive financial market externalities. By examining this unique setting of interactions between auditors and potential clients, we highlight the beneficial effects of auditor-initiated social exchanges on future auditor-client matching and financial reporting outcomes.

II. **Literature Review**

The accounting profession has long acknowledged that solicitation by auditors may lead to professional misconduct. Direct solicitation by auditors was against AICPA guidelines until 1979, and many states retained bans on direct solicitation until the US Supreme Court ruled against these bans due to a lack of evidence establishing a causal relationship between solicitation and misconduct (Edenfield v. Fane, 1993). Though auditor marketing efforts remain regulated by standard setting authorities (Qualifications of Accountants, 1972; AICPA, 1992), the nonmonetary EY EOY award may act an unconstrained form of marketing given that application requirements

between auditors and clients (Herda & Lavelle, 2015a, 2015b, 2022; Hatfield et al., 2020). Research in this area is limited and primarily outside of the United States due lack of data availability or new regulations in recent history.

provide EY with requisite information and informal communication channels to initiate a proposal (refer to Appendix A for EOY application guidelines).

Prior research finds mixed evidence on whether auditor solicitation and advertising provide benefits to clients and their auditors. Chaney et al. (1997) examine client-auditor realignment decisions between markets that do and do not allow uninvited direct solicitations from auditors, and this study finds that clients switch audit firms more often when uninvited direct solicitation is permitted to realize the benefit of cost savings revealed through the more competitive proposal process. Further, Jeter and Shaw (1995) find evidence supporting increased audit quality in markets allowing uninvited direct solicitation. Klein and Leffler (1981) describe how investments in advertising positively signal future service quality, and Ciconte (2016) finds that auditor advertising is correlated with lower average audit fees and higher auditor market share. However, Ciconte (2016) further notes that audit quality decreases as advertising increases, lending support to claims of both proponents and critics of auditors' client attraction efforts. Conversely, Hay and Knechel (2010) find that average audit fees in New Zealand increase with advertising and decrease with direct solicitation to clients, implying that the relationship among advertising, solicitation, competition, and quality may be more complex than previously thought and should be researched further. Given conflicting views in the audit literature on the consequences of auditor marketing efforts, financial market impacts of these efforts are uncertain and may be nuanced depending on their origin and nature.

Extant literature shows that affiliations between auditors and management impact auditor selection decisions (Lennox & Park, 2007; Dhaliwal et al., 2012). A firm's choice of auditor involves the matching of a series of like characteristics, such as auditor-client relationship value, auditor location, cost, and expertise (Brown & Knechel, 2016; De Ruyter & Wetzels, 1999). De

Ruyter and Wetzels (1999) find that surveyed companies switching auditors list relationship quality as the single most important auditor selection criterion. Further, Heidi and John (1992) assert that initial interactions between auditors and potential clients establish the social norms of these relationships, and these norms are integral to the development and continuation of efficient economic interactions between independent firms (Heide & John, 1992).[9]. Existing auditor-client relationship literature has typically examined auditor-client affiliations and their consequences arising from common prior education or work experience between management (or the audit committee) and the auditor (Lennox & Park, 2007; Christensen et al., 2019; Guan et al., 2016). Such affiliations involve a lengthy history of rigid auditor-client relationships, that is, relationships that cannot be initiated and developed quickly or at the discretion of the auditor. Thus, auditors stand to benefit from using creative client attraction mechanisms that are unconstrained by regulation, such as relationship marketing, though externalities of these forms of auditor-client relationships should be understood by regulators.

Relationship marketing involves businesses establishing, developing, and maintaining mutually beneficial social (or relational) exchange relationships founded on two key elements: commitment and trust (Morgan & Hunt, 2018; De Ruyter & Wetzels, 1999). Following Scanzioni (1979), Morgan and Hunt (2018) illustrate five stages of social (or relational) exchange between auditors and potential clients: awareness, exploration, expansion, commitment, and ultimately dissolution. Once auditors and potential clients become aware of each other as potential exchange partners, exploration and expansion involves initial and continuing auditor-client social exchange and trust development, and commitment is the peak form of auditor-client relationship in which

[9] Heide and John (1992) define relational norms as "expectations about behavior that are at least partially shared by a group of decision makers," and the authors emphasize that "norms play a very significant role in structuring economically efficient relationships between independent firms."

both parties have established strong mutual trust and are highly satisfied with continuing social exchanges. Once formed, these commitments tend to persist over time and enhance professional service quality (Herda & Lavelle, 2013; Gundlach et al., 1995, Sanchez et al. 2007). Herda and Lavelle (2013) find that increases in client commitment are positively associated with value-added audit services and auditor objectivity. Additionally, they find that higher levels of client commitment lead to higher quality services provided by the auditor that go beyond the basic requirements of the audit itself due to "client citizenship" in which the auditor becomes comfortable providing high quality and objective assessments without fear of retaliation.

Award giving acts as an intersection between relationship marketing, advertising, and solicitation. The existence and renown of the award itself acts as an advertisement for the award provider, and the direct provision of the award acts as a form of relationship marketing that encourages future social exchange and business development between the provider and recipient. Businesses use awards, both monetary and non-monetary, as a tool to improve relationships and motivate future performance with customers, suppliers, and employees. Silverman (2004) finds that nonmonetary recognition awards create a bond between the provider and recipient. Further, "accepting an award establishes a special relationship in which one owes (some measure of) loyalty to the donor" (Frey, 2006, p. 378). Particularly, Frey (2006) finds that nonmonetary awards are more effective than monetary awards at augmenting relationships when the award criteria are vague. Finally, awards given to small businesses lead to positive short-term and long-term financial performance though both enhanced brand identity to external parties and augmented employee morale and drive (Jones et al., 2014). Using vague criteria such as entrepreneurial spirit, purpose, growth, impact, and financial performance, EY exerts substantial subjectivity in

provisioning the EOY award that make this award particularly effective at building relationships with recipients.

Award giving can also be viewed as a form of gift giving that can give rise to a myriad of ethical considerations and agency problems. "[G]ifts and other benefits are often provided in a business-to-business context as one way to develop the relationship between suppliers and their business customers, yet, at the same time, giving and receiving gifts and benefits is cited as one of the most ethically problematic issues in supply management (or purchasing) and sales" (Fisher, 2007, p. 99). Through the EOY award, EY provides significant indirect financial benefits in the form of increased firm value, lifetime recognition of executives, increased access to equity financing, and reduced cost of equity (Malmendier & Tate, 2009; Jones et al., 2014; Hsu & Zhou, 2020). Though gift giving from auditors to existing clients is strictly regulated and generally disallowed, nonmonetary awards are not scrutinized by regulation. Understanding the impacts of nonmonetary awards given by auditors to potential clients is crucial, particularly given that agency problems may create negative market externalities.

These topics can be collectively viewed under the lens of social exchange theory. Social exchange relationships begin with a contribution of value by one that creates a feeling of indebtedness by the receiving party, and reciprocation of these exchanges back and forth develops synergetic social bonds. Social exchange can be characterized in several ways depending on the intent of the initiating party and the response by the counterparty (Rezende Pereira and Strehlau, 2016). Positive Gift Relationships are the most applicable in an auditor-client context and involve those relationships in which one party unselfishly offers to another any form of gift, such as a good, service, experience, or recognition, and subsequently, the recipient reciprocates a gift of similar value, leading to the giver and receiver into a gifted relationship (i.e., social exchange

relationship). In this sense, a gifted relationship contains certain characteristics, namely: "(a) the recipient has full freedom to return the gift or not [i.e., reciprocate]; (b) uncertainty exists about the continuous nature of exchanges; (c) it involves being in an alliance with someone; (d) there is a subjective value of the goods exchanged and (e) there is no way to measure precisely the exchange value among subjects" (Rezende Pereira & Strehlau, 2016). Positive gift relationships enhance social bonds, cooperation, and ultimately service quality in business relationships.

Yu-Chen et al. (2015) finds that in a business-to-business setting, the value of one firm's relationship investment positively and directly influences the reciprocity likelihood by the other firm. Voss et al. (2019) synthesize and test an integrated theory of reciprocity and social exchange that hypothesizes reciprocity breeding both trust and commitment between two parties. While trust and commitment increase quality information exchange, these attributes can allow opportunistic behavior for one party and create an imbalance of commitment to maintaining the business relationship (Gundlach et al., 1995). Consistent with trust and commitment improving the quality of information exchange, Hatfield et al. (2020) find that in the context of employee level auditor-client communication, better customer relationship management exhibited by the auditor promotes reciprocal client behaviors and information exchanges that are associated with higher audit quality. Similarly, Gould-Williams and Davies (2005) find that employee commitment to an organization is substantially improved through social exchange activities by management. Sanchez et al. (2007) experimentally support that reciprocity-based strategies between auditors and management enhance client satisfaction and retention.

Empirical studies on auditor-client relationships yield mixed results on whether relationship benefits outweigh independence threats. On one hand, close relationships may

threaten auditor independence and compromise audit and financial reporting quality.[10] However, excessive efforts to maximize auditor independence may reduce audit quality (Knechel et al., 2020), and many studies fail to find that auditor-client relationships negatively impact audit quality (e.g., Ye et al., 2006; Kachelmeier & Van Landuyt, 2017). These relationships facilitate the development of trust, commitment, and cooperation and, through these channels, improve professional service quality, resulting in augmented audit and financial reporting quality.[11] Further, empirical research finds that certain auditor-client social ties (i.e., those founded in social exchange or advice networks as opposed than social identification or personal friendships) lead to higher audit quality and audit fees, supporting that social exchange relationships lead auditors to perform more objective and value-additive audit services that perpetuate social exchange relationships (Kwon & Yi, 2018; Herda & Lavelle, 2013, Bruynseels & Cardinaels, 2014). Disentangling between different types of auditor-client social ties is critical when examining market externalities of auditor-client relationships.

III. Hypothesis Development

Theories from several disciplines converge to develop this paper's first hypothesis. Any form of recognition, advertising, solicitation, gift, or other type of beneficial social exchange serves to augment the relationship between the two parties. We expect that the development of these relationships will increase the probability that the two parties will engage each other for future business transactions. Applied to an audit setting, we expect that a company receiving a beneficial social exchange from an auditor will be more likely to engage that audit firm over other

[10] E.g., Menon and Williams (2004), Ye et al. (2011), He et al. (2017), Öhman and Svanberg (2015), Bruynseels and Cardinaels (2014), Qualifications of Accountants (1972), Auditor Independence (2003), and AICPA (1992).
[11] E.g., Herda and Lavelle (2013, 2015a, 2015b, 2022), and Knechel et al. (2020), De Ruyter and Wetzels (1999), De Franco et al. (2020), Gundlach et al. (1995).

similar audit firms for external audit services in the future. Similarly, we expect that a company receiving a beneficial social exchange from an auditor with whom the company has already engaged will be less likely to dismiss that audit firm relative to other similar companies. These represent *H1a* and *H1b*, stated in the alternative form below.

> *H1a(b): Auditor-initiated social exchange leads recipients to be more (less) likely than non-recipients to engage (dismiss) that external auditor relative to other similar auditors in the future.*

Next, we consider the research of Brown and Knechel (2016) and De Ruyter and Wetzels (1999) which finds that companies select auditors based on a natural matching of like characteristics, such as relationship value, disclosure similarity, size, and industry specialization. We expect that an auditor may choose to bestow awards upon firms that exhibit similar characteristics to the auditors' existing client portfolio. Likewise, we expect that any influence an auditor may exert on a firm through the award process and continuing social exchange may encourage the recipient to be receptive to adopting similar habits, such as disclosure practices, to those of other clients of the awarding auditor. Therefore, we expect that firms who receive beneficial social exchanges from an external auditor and ultimately engage that external auditor will experience superior auditor-client compatibility compared to both other recipients and non-recipients switching to other similar auditors.

> *H2: Firms reciprocating in social exchange with their auditor experience higher auditor-client compatibility relative to both other recipients and non-recipients engaging similar auditors.*

Next, we consider the potential consequences of an auditor-client social exchange relationship on future audit quality. On one hand, a social exchange relationship may foster enhanced communication between managers and auditors that may subsequently improve audit quality and financial reporting quality (Herda & Lavelle, 2015a, 2015b, 2022; Hatfield et al.,

2020). Conversely, the existence of an extraprofessional relationship between an auditor and client may impair auditor independence and allow opportunistic reporting behavior by the client (Gundlach et al., 1995; Qualifications of Accountants, 1972). Despite these competing incentives that may either harm or improve financial reporting quality (and by proxy, audit quality), we state our third hypothesis below in the alternative form consistent with the expectation of improved quality resulting from collaborative social exchange relationships.

> *H3: Firms reciprocating in social exchange with their auditors exhibit different financial reporting quality relative to both other recipients and non-recipients engaging similar auditors.*

IV. Research Design

To test our first hypothesis, we use a logistic regression model to test auditor switching propensity for award recipient firms following the award date. We regress an indicator variable equal to 1 if the firm switches to EY in the current year (*SwitchToEY*) against an indicator variable equal to 1 if the switching firm received an award in the current or past three years (*AwardWindow*).

$$SwitchToEY_{t+1} = \alpha + \beta_1 AwardWindow_{i,t+1} + \gamma Controls_k + \varphi FE_{ind} + \omega FE_t + \varepsilon_t \quad (1)$$

Following Brown and Knechel (2016) and Landsman et al. (2009), we control for log total assets (*LogAT*), total inventory and receivables scaled by total assets to proxy for inherent firm risk (*iRisk*), absolute value of Kothari cross-sectional performance-matched discretionary accruals (*AbsDACC*), cash and cash equivalents, scaled by total assets (*Cash*), income before extraordinary items, scaled by assets (*ROA*), an indicator equal to 1 *ROA* is negative (*Loss*), change in total assets, scaled by prior year total assets (*Growth_AT*), an indicator equal to 1 if the firm has acquisition costs exceeding 10% of prior year total assets (*Acquis*), the natural log of the number of successive years with the same auditor (*LogAudTenure*), an indicator equal to 1 if the audit

report is nonstandard and contains any additional explanatory language (*ModOpin*), an indicator equal to 1 if cash flows indicate that the client is in the introduction or growth stage of its life cycle following Dickinson (2011) (*CFEarly*), an indicator equal to 1 if cash flows indicate that the client is in the mature stage (*CFMature*), an indicator equal to 1 if the firm is poorly matched with its auditor following Shu (2000), and an indicator equal to 1 if the auditor in the current year is an expert based on having at least 5% more clients than any other auditor in its industry and MSA (*AudExpert*). We also test how this effect differs for small firms (below median assets, *Small*) and following the passage of SOX (*Sox*) by interacting these variables with *AwardWindow*.

Next, we run this same model on auditor dismissals to conversely test whether award recipients become less likely to switch away from EY following receipt of the award. This is performed by changing the dependent variable to *AuditorSwitch*, an indicator variable equal to 1 if the firm switches auditors in the current year, and restricting the sample to firms previously engaged with EY as their auditor. A negative coefficient on *AwardWindow* indicates that award winners are less likely to switch away from EY following receipt of the EOY award.

$$AuditorSwitch_{t+1} = \alpha + \beta_1 AwardWindow_{t+1} + \gamma Controls_k + \varphi FE_{ind} + \omega FE_{yr} + \varepsilon_t \quad (2)$$

In our last auditor switching test, we employ a multinomial logistic regression model with the same control variables to test EOY award recipients' individual auditor selection choice following Brown and Knechel (2016). Each unique auditor choice is regressed on the variable of interest, *AwardWindow*, as well as firm-specific characteristics. This model supports a dependent variable with several categorical outcomes, and these outcomes are limited to the choice of switching to each of the Big 4 auditors to maintain independence of these outcomes, which is a critical assumption of multinomial logit. The application of this model is complicated by the fact that firms switching between Big 4 audit firms can only choose between the three nonincumbent

firms, and therefore, auditor choice is not entirely independent for all outcome variables. To resolve this, we run a separate multinomial logit regression panel for the subset of audit switches away from each of the big 4 firms following Brown and Knechel (2016).

$$NewAuditor_{t+1} = \alpha + \beta_1 AwardWindow_{t+1} + \gamma Controls_k + \varphi FE_{ind} + \omega FE_{yr} + \varepsilon_t \qquad (3)$$

NewAuditor is a nominal categorical variable indicating the identity of the auditor switched to in the subsequent year (taking on a unique value for each of the Big 4 and Arthur Andersen and taking on a single value for any other audit firm). In each model, the coefficient on *AwardWindow* is determined separately for each possible new auditor choice (restricted only to big 4 firms for comparability across our sample period). A negative (positive) coefficient indicates a lower (higher) probability of choosing a given firm relative to the chosen base outcome, which is specified as EY in each model.[12] We expect this coefficient to be negative in all cases, which would indicate that EOY award recipients are less likely to switch to big four auditors relative to EY. Tests include year and industry fixed effects, and robust standard errors are used to mitigate effects of heteroskedasticity.

Taken together, these auditor selection tests intend to show that firms are more (less) likely to switch to (away from) EY after receiving the EOY award, supporting the existence of a social exchange relationship developing following the provision of an award by the auditor.

Next, we test whether distortion in auditor selection resulting from the first hypothesis also distorts auditor-client compatibility for award recipient firms switching to EY for their external auditor within the *AwardWindow*. We expect that auditor-client compatibility will improve for

[12] Multinomial logit regression requires one of the possible dependent variable choice outcomes to be designated as the "base outcome" and thus omitted from the model. The coefficients on each independent variable indicate the incremental log-likelihood of choosing a particular outcome (i.e. auditor) over the "base outcome" for each unit increase in the independent variable. The base outcome is always specified as EY for ease of interpretation.

award recipients choosing EY due to the collaborative social exchange relationship developed following the award process and reciprocation by the recipient.

To test impacts to auditor-client compatibility, we use OLS regression on the panel dataset of EY EOY award recipients and control firms switching to auditors. Our dependent variable, $\Delta BK\_BusDesc_{t+1}$, represents the change from *t* to *t+1* in auditor-client matching score for the business description in the 10-K as used by Brown and Knechel (2016). *AwardWindow is* an indicator variable with a value of 1 if the firm for the four years beginning with the receipt of the EY EOY award, and *SwitchToEY* is an indicator variable equal to 1 if a firm switched auditors to EY in a given year. The interaction of these two terms represents the differential improvement in matching quality between awarded firms who switch to EY versus all other firms, and the expected sign of this variable is positive.[13]

$$\Delta BK_{BusDesc_{t+1}} = \alpha + \beta_1 AwardWindow_{t+1} + \beta_2 SwitchToEY_{t+1} +$$
$$\beta_3 AwardWindow_{t+1} * SwitchToEY_{t+1} + \gamma Controls_k + \varphi FE_{ind} + \omega FE_t + \varepsilon_t \quad (4)$$

Next, an alternative measure of auditor client compatibility—the auditor mismatch indicator variable following Shu (2000)—is used with the same model under logistic regression to further validate robustness of results. The expected sign of this interaction is negative, which would indicate that firms switching to EY following receipt of this award have a lower likelihood of a poor auditor-client match after switching auditors to EY. Control variables mirror those in the Brown and Knechel (2016) similarity model.

$$AudMismatch_t = \alpha + \beta_1 AwardWindow_t + \beta_2 SwitchToEY_t +$$
$$\beta_3 AwardWindow_t * SwitchToEY_t + \gamma Controls_k + \varphi FE_{ind} + \omega FE_{yr} + \varepsilon_t \quad (5)$$

[13] In untabulated results, we additionally control for whether firms switch auditors. Results remain unchanged, and the coefficient on this variable (*AuditorSwitch*) is insignificant across all our auditor-client similarity tests.

Lastly, using the same annual panel data of historical financial information for publicly listed EY EOY recipient firms and control firms, we test whether financial reporting quality (and by proxy, audit quality) is different for EY EOY recipient firms who newly engage EY during the *AwardWindow*.

We employ two measures of financial reporting quality: (a) discretionary accruals and (b) probability of future restatement.[14] Our dependent variables are (a) one-year ahead performance-matched Kothari discretionary accruals ($AbsDACC_{t+1}$) and (b) an indicator equal to 1 if a restatement occurred in the current or future three years ($Restate_t$). These are regressed against *SwitchToEY* interacted with *AwardWindow*, and this interaction is our primary variable. A negative coefficient on the interaction term in each equation below would be consistent with social exchange relationships enhancing audit and financial reporting quality.

$$AbsDACC_{t+1} = \alpha + \beta_1 SwitchToEY_t + \beta_2 AwardWindow_t + \beta_3 AwardWindow_t * SwitchToEY_t + \gamma Controls_k + \varphi FE_{ind} + \omega FE_{yr} + \varepsilon_t \quad (6)$$

$$Restate_t = \alpha + \beta_1 SwitchToEY_t + \beta_2 AwardWindow_t + \beta_3 AwardWindow_t * SwitchToEY_t + \gamma Controls_k + \varphi FE_{ind} + \omega FE_{yr} + \varepsilon_t \quad (7)$$

For the discretionary accrual model, we include control variables following Francis and Wang (2008) and Lamoreaux (2016), and these controls include the log of revenues (*LogSale*), operating cash flows (*CFO*), leverage (*LEV*), sales growth (*Growth_Rev*), lagged loss firm-years ($LOSS_{t-1}$), change in gross property plant and equipment (*dPPE_Gross*), auditor size (*BIG5*) and litigation risk (*HighLitigation*). Additionally, we control for IPO firm-years (*IPO*), as Ball and Shivakumar (2008) find that IPO firms exhibit elevated levels of discretionary accruals that are

[14] We do not employ tests on going concern opinion likelihood to test these hypotheses due to naturally low failure rates and correspondingly low going concern rates for firms receiving the EOY award.

not necessarily indicative of earnings management. This model includes year and Fama French 48 industry fixed effects, and standard errors are clustered by firm.

For the restatement model, we following Johnstone et al. (2014) and control for auditor size (*BIG5*), total accruals (*TAC*), the natural log of total assets (*LogAT*), financial condition and performance metrics including leverage, return on assets, and whether the company incurred a loss (*LEV*, *ROA*, and *Loss*, respectively), company growth metrics including the market-to-book ratio and revenue growth (*MB* and *Growth_Rev*, respectively), litigation risk (*HighLitigation*), probability of bankruptcy score (*Zscore*), and auditor tenure (*AudTenure*). This model includes year and industry fixed effects using Fama French 48 industry classifications, and standard errors are clustered by firm to mitigate within-firm heteroskedasticity of residuals.

V. Data and Sample Selection

We identify EOY award recipients using both the EY EOY recipient database listed on EY's website and BoardEx director achievement data from 1989-2019.[15] We examine the characteristics and auditor choices of sample firms using Compustat and Audit Analytics.[16] And variable definitions are presented in Appendix B. The sample period begins with the year Arthur Young and Ernst and Whinney merged to form EY, and the sample periods ends in 2019 to avoid any confounding effects of the COVID pandemic. Consistent with prior literature, we exclude utilities and financial services firms (SIC codes 4400-4999 and 6000-6999) that have differing

[15] EY publicly lists all previous winners of the EOY award on their website. Matching to Compustat is performed using regex in conjunction with the SPEDIS function in SAS, and all matches are manually reviewed for accuracy. Link: https://eoyhof.ey.com

[16] In obtaining auditor data where conflicting data exists across databases, preference is given to the auditor of record in Audit Analytics. Where Compustat is used to determine the auditor, we follow Utke (2018) in correcting Compustat auditor miscodings during the sample period. Similarly, where Audit Analytics is used, we follow Doogar et al. (2015) to only classify observations as audit switches where the auditor's PCAOB registration number (rather than fkey) changes, as auditor fkeys track firm names rather than the identity of the underlying entity.

characteristics and incentives driven by differing regulatory requirements and incentives. We also exclude group audits and firms not incorporated in the United States to avoid confounding effects of differing countries, laws, and auditor dynamics. Lastly, we exclude observations with total assets below $1 million or with fiscal year lengths not equal to 12 months to improve comparability of firm-year observations. All continuous variables are winsorized by fiscal year at the 1st and 99th percentiles to mitigate the impact of outliers. Tests using the auditor-client similarity measure from Brown and Knechel (2016) leverage their published similarity scores due to calculation complexity, and therefore, sample sizes in these tests are constrained to firms with big four auditors from 1997-2009.[17]

To allow comparisons between decades prior to big 8 auditor merger activity leading to the big 5, we treat audit firm mergers as if they occurred prior to the beginning of our sample period for all models in this paper. We validate that auditor switching proportions to each of these categories are roughly the same during both the pre- and post-big four periods, delineated in 1998 upon the formation of PWC and the beginning of the big 5 era. Auditor switch proportions to each big 5 auditor relative to all auditor switches range from 11.4%–14.7% and 7.3%–10.9% in the pre and post big four periods, respectively, supporting that these groupings are similar and, therefore, comparable over the full sample period.

We additionally test switching rates to each of the big four auditors to validate that results are not simply driven by an overall higher rate of client acquisition by EY. Though EY does have a higher rate of client acquisition during the sample period (of only switches to Big 4 auditors, 29.5% choose EY versus roughly 23.5% for each other big four auditor), this higher attraction rate

[17] Results from Brown and Knechel (2016) are replicated (untabulated) to validate the appropriate use of this measure within this paper. Refer to their paper for additional details regarding sample selection. Results are robust to using the Shu (2000) measure of auditor-client compatibility over the full sample period.

may be driven by auditor switches to EY by award recipients not captured in our hand collected sample and/or switches that occur outside of the defined *AwardWindow*. Even so, EY attraction rates for recipients are markedly higher than those for control firms (42.0% versus 29.3% of all switches to Big 4 auditors, respectively), and this difference in EY selection proportion between award firms and control firms is statistically significant (χ^2=13.38, p<0.001).

Descriptive statistics on the entire sample are shown in in Panel (1) of Table 1. Auditor switching rates are roughly 7.5% (*AuditorSwitch*), which is consistent with prior literature and skewed upwards slightly due to inclusion of smaller firms (Brown and Knechel, 2016). Of all firms switching to any new auditor, roughly 12.8% select EY (mean *SwitchToEY* divided by *AuditorSwitch* in Table 1a), which aligns with average switching rates to each other large audit firms. EOY award recipient firms in the *AwardWindow* switch to EY at a rate of 27% (mean *SwitchToEY* divided by *AuditorSwitch* in Table 1b), providing initial support for an attraction effect of this award.

Table 1a shows descriptive statistics for recipients within the *AwardWindow* versus all other firms in the sample. A total of 1,470 EY EOY award recipients are included in the sample with a total of 4,884 firm-years within the award window.[18] Though similarly sized to other firms in our sample, award recipients have higher net income (*NI*) and return on assets (*ROA*). Similarly, these firms have lower average loss rates (*Loss*), leverage (*LEV*), and going concern opinion rates (*Going_Concern*) rates relative to all other firms, consistent with superior performance.[19] While award recipients experience slightly elevated restatement rates (*Restate*), these elevated

[18] It is possible for a firm to win an EOY award multiple times in different years (i.e. a firm may be a regional winner one year and then national winner in the future). While all award dates are included in tests performed, results in this paper are robust to solely including the first award-year for each firm. Further, when awards are given prior to the IPO of a recipient, financial data may be limited or unavailable within the award window.

[19] Because low rates of going concern for recipient firms are endogenously caused by their high performance, we do not consider this measure for use as an audit quality proxy in this study.

restatements may be due to inherent reporting risks for rapidly growing firms rather than due to intentional accounting manipulation.

VI. Results

a. Auditor Selection: Logistic Regression

Using a logistic regression model of auditor switching propensity, we find that EOY award recipients have a significantly higher rate of switching to EY relative to other big 4 firms within the *AwardWindow* in Table 3. We run these tests on only firms with below median assets in Panel (2), on all firms with an interaction term for the post-SOX period in Panel (3), and on small firms with a SOX interaction in Panel (4). We find that client attraction is higher for smaller firms in all periods, presumably due to the larger relative value of the social exchange initiated by the auditor (i.e., small firms experience relatively greater indirect financial benefits from receiving the EOY award). Further, results show that client attraction from auditor-initiated social exchange persists following the passage of SOX despite the transfer of auditor selection responsibility to the audit committee.[20]

Panel (1) includes all firms and shows a significant attractive effect of the EOY award relative to all sample firms. Panel (2) shows that this effect size more than doubles when looking at the subset of small firms, supporting greater social exchange value received (and propensity to reciprocate) for these firms. These results are unchanged interacted with the post-SOX timeframe in Panels (3) and (4). Lastly, in Panel (5), we observe the probability of dismissing EY declines for existing EY clients receiving the EOY award. Together, results indicate awards given by EY

[20] These results are consistent with prior literature showing that management still has some influence in auditor selection following the passage of SOX when this responsibility officially transferred to the audit committee (Dhaliwal et al., 2013; Almer et al., 2014).

lead to an increased (decreased) propensity for recipients to choose (dismiss) EY as an external auditor, supporting the notion that this action initiates a social exchange relationship between the auditor and recipient.

b. Auditor Selection: Multinomial Logistic Regression

In multinomial logit regressions test auditor switching propensities in Table 4a, results continue to support that recipients are more likely to switch to EY within the award window. The new auditor choice variable in the subsequent period ($NewAuditor_{t+1}$) indicates the identity of the new auditor (DT, EY, PWC, KPMG). Each panel of Table 4 represents a single (*OldAuditor*) to ensure that choices between categories of the dependent variable are independent as discussed in the research design. *OldAuditor* takes on a value between 1 and 6; one value for each of the big 4 auditors plus Arthur Andersen, and an additional category for all other smaller auditors (note that auditor choice upon switching away from EY are not analyzed due to irrelevance to the hypothesis, leading to five total panels in Table 4). We separate Arthur Andersen from all other smaller auditors due to differing characteristics and incentives of firms switching between large auditors versus those newly switching up to a large auditor.

Results are directionally consistent in showing that award recipients are more likely to engage EY, particularly for firms previously engaged with non-Big 5 auditors in Panel (5), though results often lack statistical power due to the infrequency of audit switches between large audit firms combined with the need to run separate regressions for each prior big four auditor. To illustrate, five different multinomial logistic regression models are run (five panels), each on unique subset of 3,524 total audit switches to Big 4 firms (consisting of 226 auditor switches by EOY recipients within the *AwardWindow*). Each tabulated coefficient in Table 4a represents a unique regression (as there are multiple regressions run within a single multinomial logit). Control

variables are not tabulated. Though results in Table 4a weakly support that recipients have a higher probability of choosing EY over other audit firms, we run additional tests in Table 4b to address power issues and related econometric concerns as described below.

To obtain reliable results, Schwab (2002) notes sample size guidelines indicate a minimum of 10 observations per dependent variable category choice (i.e., choice of new auditor). While this assumption is satisfied at its face when viewing all audit switches, there exist limited auditor switches *between* big four firms, and there do not exist at least auditor switches within the *AwardWindow* in each individual model. This may cause inconsistent or unreliable results driven by a small number of treatment observations (i.e., where *AwardWindow*=1). To address this concern, we run an alternative specification in Table 4b expanding the time horizon of *AwardWindow* by three additional years (t to t+6 relative to the award year), which allows for at least 10 treatment observations for each auditor choice in nearly all instances of each model. Our results remain qualitatively unchanged but attain much greater statistical significance for switches between Big 4 auditors, lending further support to hypothesis 1.

Taken together, these auditor selection tests support that awards given by EY lead to an increased (decreased) propensity for recipients to switch to (dismiss) EY as an external auditor, supporting the notion that auditor awards initiate social exchange and induce reciprocity by the recipient through subsequently engaging EY for external audit services. We expect this relationship to persist over time, and in the following sections, we attempt to further this hypothesis by examining how these effects impact auditor-client compatibility and financial reporting quality.

c. Auditor Compatibility

We hypothesize and find that auditor compatibility increases for award recipient firms switching to EY, i.e., for those award recipients that reciprocate the auditor's social exchange.

Using the Brown and Knechel (2020) auditor-client similarity score as a proxy for auditor-client compatibility (we specifically use *BK_BusDesc* to proxy for business similarity), we find that recipients switching to EY within the award window experience greater improvements in auditor-client similarity as shown by the positive coefficient on the interaction term between *AwardWindow* and *SwitchToEY* in all models (significant in three out of four models).

Table 6 shows tests performed under various specifications; coefficients on interaction terms between *AwardWindow* and *SwitchToEY* represent the differential change in similarity scores in the year award recipients switch to EY within the *AwardWindow*. This coefficient is expected to be positive if compatibility increases for award recipients reciprocating a social exchange relationship by engaging EY. Panel (1) includes all firms, Panel (2) includes small firms (with below median total assets), Panel (3) includes an interaction term for SOX, and Panel (4) combines (2) and (3) by including this SOX interaction on the sample of small firms only.

Results are always directionally consistent with hypothesis 2. We observe that similarity improvements are the greatest for small firms in the post-SOX period.

d. Audit and Financial Reporting Quality: Restatements

To test reporting outcomes of auditor-client social exchanges, we first examine restatements occurring in or within three years following a switch to EY for award recipients. Dependent variables include *Restate, Restate_R,* or *Restate_r*, representing whether any restatement, a Big R restatement, or a Little R restatement occurs within three years following the auditor switch date, respectively. Our primary independent variable is the interaction term between *AwardWindow* and *SwitchToEY*, representing the differential odds of restatement for firms switching to EY after receiving the EOY award. Panels 1-3 include all sample firms, and panels 4-6 repeat these tests for small firms (below median total assets). No interaction is included for

SOX, as we begin this test in fiscal year 2002 upon the passage of SOX due to unavailable or sparsely populated restatement data prior to this date.

As shown in Table 7, we find no evidence that restatements occur for treatment firms at a different rate relative to other EOY award firms across Panels 1-6 (insignificant coefficient on AwardWindowEYSwitch). While award recipient firms in general exhibit significantly higher restatement rates relative to non-recipients, this may be caused by inherent risks attributable to rapidly growing entrepreneurial firms rather than intentional accounting manipulation. Regardless of the root cause of these restatements, we do observe any skewed effects resulting from auditor-client social exchange.

Notably, these results differ from the findings of Brown and Knechel (2016) that higher auditor-client similarity is associated with an increased likelihood of restatements, implying that the relationship between auditor-client similarity and restatements may not be fully understood. One potential explanation is that the Brown and Knechel (2016) auditor-client textual similarity score also captures forms of auditor-client bonding that are not founded in social exchange, but rather social identification – i.e., friendship ties that may impair auditor objectivity. Together, these results do not demonstrate that reporting quality is impaired for award recipients switching to EY (i.e., where auditor-client social exchanges exist). Further, these results suggest that social exchange between firms and their auditors may augment auditor-client compatibility without leading to the increased incidence of restatements common to more similar auditor-client pairs as noted by Brown and Knechel (2016).

e. Audit and Financial Reporting Quality: Discretionary Accruals

Lastly, we examine discretionary accruals for award recipient firms following reciprocation of social exchange (i.e., switching to EY). We find that recipients' absolute

discretionary accruals decrease significantly in the year following an auditor switch to EY within the *AwardWindow*.

Like previous tests in this paper, results in Table 8 consist of the sample of all firms, small firms, and the post-SOX period in panels (1), (2), and (3), respectively. Each of these tests show that award recipients switching to EY have smaller absolute discretionary accruals in the following year relative to both non-award and award firms, supporting enhanced reporting quality driven by auditor-client social exchange. These results are consistent with those in Brown and Knechel (2016) that higher auditor-client compatibility leads to lower levels of discretionary accruals, reflecting enhanced audit quality.

Additionally, in Panel (4), we examine discretionary accruals for EY audit clients and exclude any firms that switched to EY only after receiving an EOY award. Consistent with relationship theory, initial interactions are most impactful in developing social exchange relationship norms, and thus we do not expect to find any effects for existing EY clients receiving an award. The null result in this test supports that auditor-client social exchange with potential clients (i.e., auditor-initiated social exchange) drives our previous results, as firms receiving the EOY award who are already engaged with EY do not exhibit observable improvements in financial reporting quality.

VII. Conclusion

We draw from the intersection of several streams of literature to study how a distinctive form of solicitation and social exchange, the awarding of the EOY award by EY, impacts auditor-client matching and subsequent audit quality. A major impediment to research in this area is the unobservable nature of auditors' relationship development with potential clients. This study seeks

to fill this gap by examining an empirical setting in which auditor-initiated social exchange is observable prior to auditor engagement.

We argue and find that recipients of the EOY award are subsequently more likely to select EY as their external auditor (i.e., reciprocate social exchange). This heightened attraction is strongest for small recipients where the auditor's initial social exchange interaction value (i.e., award value) is the highest and most likely to stimulate reciprocation by the recipient. Despite the passage of SOX that limits management's ability to choose the external auditor, we find that this result persists in the post-SOX period. Further, we find that these relationships are associated with more compatible auditor-client matches and either improved or unchanged audit and financial reporting quality, supporting the notion that certain auditor-client social bonds – namely, those founded in social exchange – strengthen professional behaviors of auditors and clients. Collectively, our findings illustrate the benefits of synergetic auditor-client relationships, identify a mechanism how auditors utilize social exchange to build these relationships, and contribute to reconciling the mixed literature on how auditor-client relationships impact financial markets.

There exist several limitations that may inhibit inferences made within this study. First, award recipients that ultimately choose EY may have unique and endogenous characteristics that are also conducive to auditor-client compatibility and high financial reporting quality. EY also may exhibit substantial judgement in the selection of award recipients or may intentionally award either firms with similar characteristics to its existing client base or firms with which social bonds are already established, and this would constrain the interpretation of results herein. Alternatively, EY may base the selection decision for award recipients on firms who are most likely to subsequently engage EY upon award receipt based on economic promises made during the nomination process, and this would negate causal inferences of award provision on auditor

selection. If this were the case, it is also possible that reduced restatements of awarded firms switching to EY are caused by auditor leniency, though this seems unlikely given that reduced restatement incidence persists over many years. Additionally, any strategic behavior in selecting award recipients is at least partially mitigated by the independent panel of judges that determines award winners. Lastly, because sufficient testable award data is only available for EY, results may be driven by EY-specific characteristics that are not generalizable to other auditor-client social exchange relationships.

Despite these limitations, this study shows novel empirical evidence of the impact of auditor solicitation through social exchange on auditor-client matching, answering calls to research in these unobservable areas (Dodgson et al., 2020; Knechel et al., 2020). Existing prior literature primarily focuses on social exchange during the client-auditor relationship (Hatfield et al., 2020), and the few studies explore social exchange preceding this relationship focus on existing social ties not initiated at the discretion of the auditor (e.g., Guan et al., 2016; Lennox & Park, 2007; Christensen et al., 2019). We contribute new insights on the impact of social exchanges initiated at the discretion of the auditor preceding the audit relationship. Our findings – that social exchange relationships initiated by auditors during the solicitation process are associated with improved auditor-client matches and financial reporting quality – highlight the potential benefits of these relationships.

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Table 1a: Descriptive Statistics - All Firms

	N	Mean	SD	p25	Median	p75
AwardWindow	149051	.0328	.178	0	0	0
AuditorSwitch	149051	.075	.263	0	0	0
SwitchToEY	149051	.00906	.0947	0	0	0
LogAT	149051	5.16	2.39	3.41	5.06	6.81
NI	149051	104	563	-4.78	1.6	29.2
ROA	149051	-.113	.596	-.0894	.0217	.0683
Acquis	149051	.0691	.254	0	0	0
LEV	148753	.582	.677	.307	.508	.699
iRisk	147848	.3	.211	.126	.268	.438
LossIB	149051	.399	.49	0	0	1
Growth AT	148883	.294	1.33	-.0545	.0548	.228
AbsDACC	149051	.154	.209	.0359	.0854	.181
BKSim_BusDesc	29136	-.00459	.0692	-.0555	-.0212	.0334
BIG5	149051	.762	.426	1	1	1
Going Concern	71510	.0758	.265	0	0	0
Restate	149051	.0673	.251	0	0	0
IPO	149051	.0413	.199	0	0	0

Table 1b: Descriptive Statistics - EOY Recipients in Award Window

	N	Mean	SD	p25	Median	p75
AuditorSwitch	4884	.0463	.21	0	0	0
SwitchToEY	4884	.0125	.111	0	0	0
LogAT	4884	5.73	1.71	4.51	5.56	6.85
NI	4884	51	367	-8.49	6.28	38.1
ROA	4884	-.0441	.383	-.0466	.0363	.0846
Acquis	4884	.101	.301	0	0	0
LEV	4865	.442	.289	.233	.403	.596
iRisk	4816	.269	.198	.109	.229	.387
LossIB	4884	.335	.472	0	0	1
Growth AT	4878	.4	1.3	.00166	.135	.398
AbsDACC	4884	.147	.189	.0369	.0876	.18
BKSim_BusDesc	1686	.00328	.0734	-.0532	-.0103	.0456
BIG5	4884	.891	.312	1	1	1
Going Concern	2904	.0172	.13	0	0	0
Restate	4884	.0917	.289	0	0	0
IPO	4884	.0565	.231	0	0	0

Table 2: Pairwise Correlations

Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)
(1) AwardWindow	1.00															
(2) AuditorSwitch	-0.01*	1.00														
(3) LogAT	0.04*	-0.12*	1.00													
(4) NI	-0.01*	-0.03*	0.35*	1.00												
(5) ROA	0.02*	-0.07*	0.34*	0.05*	1.00											
(6) Acquis	0.03*	0.01*	0.04*	-0.01*	0.02*	1.00										
(7) LEV	-0.02*	0.05*	-0.26*	-0.02*	-0.77*	-0.02*	1.00									
(8) iRisk	-0.02*	-0.01*	-0.01*	-0.04*	0.10*	-0.05*	-0.03*	1.00								
(9) LossIB	-0.01*	0.10*	-0.41*	-0.20*	-0.25*	-0.02*	0.14*	-0.20*	1.00							
(10) Growth_AT	0.01*	0.03*	-0.07*	-0.03*	0.00	0.10*	-0.03*	-0.10*	0.07*	1.00						
(11) AbsDACC	-0.01*	0.07*	-0.36*	-0.09*	-0.28*	0.00	0.20*	0.01*	0.27*	0.23*	1.00					
(12) BKSim_BusDesc	0.02*	-0.01*	0.24*	0.06*	0.05*	-0.01*	0.03*	-0.17*	-0.05*	-0.03*	-0.08*	1.00				
(13) BIG5	0.06*	-0.12*	0.36*	0.11*	0.18*	0.06*	-0.16*	-0.13*	-0.14*	-0.03*	-0.21*	0.01	1.00			
(14) Going_Concern	-0.05*	0.13*	-0.53*	-0.09*	-0.44*	-0.04*	0.39*	-0.11*	0.38*	0.07*	0.35*	-0.05*	-0.33*	1.00		
(15) Restate	0.03*	0.02*	0.06*	-0.01*	-0.01*	0.02*	0.01*	-0.04*	0.02*	0.02*	0.00	0.04*	0.01*	-0.02*	1.00	
(16) NearIPO	0.05*	-0.03*	-0.10*	-0.07*	0.01*	0.05*	-0.04*	-0.06*	0.09*	0.21*	0.11*	-0.06*	0.07*	-0.03*	-0.02*	1.00

*** $p<0.01$, ** $p<0.05$, * $p<0.1$

Table 3: Auditor Switching Propensity

	(1)	(2)	(3)	(4)
	SwitchToEY_Next	SwitchToEY_Next_Small	SwitchToEY_Next_SOX	SwitchFromEY_Next
AwardWindow (+)	.271**	.545***	.318**	
	(1.94)	(2.424)	(1.836)	
AwardWindow_Sox			-.128	
			(-.445)	
PostAward (-)				-.174**
				(-1.768)
LogAT	.076***	.18***	.076***	-.335***
	(4.648)	(4.237)	(4.65)	(-11.493)
iRisk	.01	.135	.01	-.064
	(.052)	(.489)	(.051)	(-.314)
AbsDACC	.049	.096	.048	-.067
	(.288)	(.432)	(.286)	(-.423)
Cash	.195	.368	.195	-1.045***
	(1.176)	(1.486)	(1.176)	(-5.83)
ROA	.236**	.144	.236**	-.06
	(2.436)	(1.463)	(2.441)	(-.925)
Loss	.25***	.261**	.25***	.423***
	(3.385)	(2.436)	(3.384)	(5.734)
Growth_AT	.013	-.061	.013	-.007
	(.854)	(-1.487)	(.852)	(-.235)
Acquis	-.001	.463***	-.001	-.055
	(-.01)	(2.62)	(-.006)	(-.441)
CFEarly	.018	.082	.018	-.116
	(.216)	(.707)	(.218)	(-1.463)
CFMature	-.097	.005	-.097	-.036
	(-1.041)	(.035)	(-1.039)	(-.387)
LogAudTenure	-.07*	-.082	-.07*	-.014
	(-1.95)	(-1.476)	(-1.945)	(-.389)
ModOpin	.054	-.103	.055	.401***
	(.764)	(-.934)	(.772)	(5.522)
AudMismatch	.142*	.004	.143*	.175*
	(1.704)	(.043)	(1.717)	(1.856)
AudExpert	-.07	.167	-.07	-.426***
	(-.347)	(.455)	(-.344)	(-2.838)
Observations	139129	69994	139129	25457
Pseudo R^2	.049	.049	.049	.092
Industry Fixed Effects	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes

t-values are in parentheses
*** $p<.01$, ** $p<.05$, * $p<.1$

Table 4a: Multinomial Auditor Choice

	(1) DT	(2) PWC	(3) KPMG	(4) Arthur_Andersen	(5) Other
AwardWindow_DT		-.467	-1.889**	-.69	-2.854***
		(-.579)	(-2.325)	(-1.19)	(-2.768)
AwardWindow_PWC	-.436		-1.234*	-.947*	-1.656***
	(-.814)		(-1.535)	(-1.575)	(-2.403)
AwardWindow_KPMG	-.361	-1.944*		.282	-.674
	(-.639)	(-1.459)		(.751)	(-1.078)
Observations	587	488	473	1009	967
Pseudo R^2	.13	.126	.158	.071	.095
Industry Fixed Effects	Yes	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes	Yes

Table 4b: Multinomial Auditor Choice

	(1) DT	(2) PWC	(3) KPMG	(4) Arthur_Andersen	(5) Other
AwardWindow_DT		-.322	-1.241**	-.291	-1.791***
		(-.487)	(-2.033)	(-.702)	(-2.592)
AwardWindow_PWC	-.887**		-.882*	-.937**	-.819**
	(-2.098)		(-1.455)	(-2.055)	(-1.657)
AwardWindow_KPMG	-.811**	-1.423*		.036	-.325
	(-1.798)	(-1.491)		(.115)	(-.661)
Observations	587	488	473	1009	967
Pseudo R^2	.134	.126	.157	.07	.093
Industry Fixed Effects	Yes	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes	Yes

t-values are in parentheses
*** $p<.01$, ** $p<.05$, * $p<.1$

Table 5: Auditor Similarity - Brown and Knechel

	(1) BK_BusDesc	(2) BK_BusDesc lowat	(3) BK_BusDesc _sox	(4) BK_BusDesc lowat_sox
BXEOYPOSTAWARD1_next	.001	0	.001	0
	(1.128)	(-.039)	(1.129)	(.098)
AwardWindowEYSwitch_next	.028***	.016	.009	.003
	(2.629)	(.857)	(.628)	(.191)
AwardWindowEYSwitch_Soxnext			.032*	.074***
			(1.696)	(4.332)
SwitchToEY_Next	.001	.001	.001	.001
	(.328)	(.107)	(.328)	(.104)
AuditorSwitch_Next	-.002	.002	-.002	.002
	(-1.216)	(.896)	(-1.218)	(.898)
LogAT	0***	0	0***	0
	(3.813)	(1.042)	(3.803)	(1.051)
iRisk	.001	.002	.001	.002
	(1.022)	(.987)	(1.036)	(.915)
AbsDACC	0	.001	0	.001
	(-.118)	(.36)	(-.114)	(.378)
Cash	0	.001	0	.001
	(-.363)	(.56)	(-.372)	(.504)
ROA	0	0	0	0
	(-.369)	(-.023)	(-.359)	(-.021)
LossIB	.001	.002***	.001	.002***
	(1.425)	(2.834)	(1.434)	(2.845)
Growth_AT	.001***	0	.001***	0
	(3.411)	(1.179)	(3.399)	(1.144)
Acquis	0	0	0	0
	(-.199)	(.175)	(-.212)	(.051)
LogAudTenure	0	0	0	0
	(-.701)	(.583)	(-.727)	(.584)
ModOpin	0	.001	0	.001
	(1.103)	(.839)	(1.121)	(.868)
CFEarly	-.001**	0	-.001**	0
	(-2.018)	(.008)	(-2.02)	(-.024)
CFMature	-.001	0	-.001	0
	(-1.62)	(-.329)	(-1.617)	(-.351)
AudExpert	0	-.002	0	-.002
	(-.082)	(-1.638)	(-.074)	(-1.625)
Observations	22513	7686	22513	7686
R-squared	.018	.014	.018	.015
Industry Fixed Effects	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes

t-values are in parentheses
*** $p<.01$, ** $p<.05$, * $p<.1$

Table 6: Auditor Similarity - Shu

	(1) All_Switches	(2) Switches_Small	(3) Switches_Sox	(4) Switches_SoxSmall
AwardWindow	-.128	.02	-.322	-.369
	(-.676)	(.074)	(-1.012)	(-.696)
AwardWindowEYSwitch (-)	-1.56***	-1.842***	-1.227**	-1.532**
	(-3.022)	(-3.076)	(-1.886)	(-1.857)
AwardWindowEYSwitch_Sox			-.765	-.093
			(-.667)	(-.074)
SwitchToEY	.013	.391***	-.035	.345***
	(.186)	(4.341)	(-.402)	(3.068)
LogAT	-.414***	-.196***	-.414***	-.197***
	(-23.01)	(-7.891)	(-22.959)	(-7.894)
iRisk	.425***	.403***	.426***	.406***
	(3.049)	(2.74)	(3.052)	(2.757)
AbsDACC	-.303***	-.295***	-.303***	-.295***
	(-2.873)	(-2.72)	(-2.872)	(-2.718)
Cash	.755***	.9***	.753***	.896***
	(5.908)	(6.49)	(5.893)	(6.455)
ROA	.18***	.107***	.18***	.106***
	(4.379)	(2.978)	(4.38)	(2.973)
Loss	.168***	.127**	.168***	.126**
	(2.999)	(2.03)	(3)	(2.02)
Growth_AT	-.029	-.036*	-.029	-.036*
	(-1.608)	(-1.757)	(-1.586)	(-1.726)
Acquis	-.181*	-.16	-.182*	-.159
	(-1.785)	(-1.301)	(-1.789)	(-1.297)
LogAudTenure	-.971***	-.919***	-.968***	-.916***
	(-16.309)	(-15.077)	(-16.248)	(-15.041)
ModOpin	-.199***	-.178***	-.201***	-.181***
	(-3.659)	(-3.02)	(-3.699)	(-3.059)
CFEarly	.066	.066	.065	.065
	(1.105)	(1.037)	(1.096)	(1.022)
CFMature	.067	.082	.067	.082
	(.93)	(1.027)	(.937)	(1.03)
AudExpert	-.074	-.081	-.098	-.107
	(-.258)	(-.222)	(-.337)	(-.288)
Observations	10298	7388	10298	7388
Pseudo R^2	.148	.114	.148	.114
Industry Fixed Effects	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes

t-values are in parentheses
*** p<.01, ** p<.05, * p<.1

Table 7: Restatements

	(1) Restate Future3	(2) BigR Future3	(3) LittleR Future3	(4) Restate Future3Small	(5) BigR Future3Small	(6) LittleR Future3Small
AwardWindow	.228***	.385***	.086	.281**	.329*	.189
	(2.718)	(3.367)	(.79)	(1.998)	(1.778)	(1.005)
AwardWindowEYSwitch	-.295	-.058	-.968	-.13	.63	.
	(-.585)	(-.102)	(-.926)	(-.119)	(.588)	(.)
SwitchToEY	-.094	.159	-.272*	-.172	.052	-.34
	(-.886)	(1.134)	(-1.867)	(-.947)	(.226)	(-1.302)
BIG5	-.109*	-.417***	.14*	-.353***	-.589***	-.081
	(-1.928)	(-5.192)	(1.94)	(-5.319)	(-6.487)	(-.949)
TAC	-.087	-.013	-.113	-.18***	-.127	-.185**
	(-1.549)	(-.166)	(-1.463)	(-3.051)	(-1.591)	(-2.289)
LogAT	.089***	.025	.116***	.227***	.22***	.191***
	(3.833)	(.757)	(4.021)	(6.588)	(4.655)	(4.277)
LEV	-1.2***	-.396	-1.668***	-1.21**	-.922	-1.278*
	(-3.223)	(-.964)	(-3.2)	(-2.57)	(-1.543)	(-1.946)
ROA	.834***	.294	1.135***	.841***	.666*	.861**
	(3.369)	(1.08)	(3.265)	(2.684)	(1.681)	(1.964)
Loss	.047	.109**	-.001	-.007	.014	-.023
	(1.262)	(1.99)	(-.032)	(-.151)	(.213)	(-.363)
BM	.027***	.013	.043***	.024**	.017	.029**
	(3.609)	(1.576)	(3.473)	(2.524)	(1.481)	(2.057)
CFO	.064	.12	.026	-.067	-.046	-.075
	(.926)	(1.283)	(.291)	(-.949)	(-.499)	(-.815)
Zscore	.23***	.081	.314***	.232***	.181	.24**
	(3.352)	(1.073)	(3.271)	(2.67)	(1.645)	(1.978)
LogSale	-.059***	-.044	-.062**	-.063**	-.063*	-.053*
	(-2.726)	(-1.377)	(-2.324)	(-2.492)	(-1.776)	(-1.649)
Growth_Rev	.065***	.075***	.042**	.083***	.087***	.056***
	(5.14)	(4.3)	(2.517)	(5.859)	(4.744)	(3.01)
Constant	.125	-1.304**	-.589	-.46	-2.253**	-1.038
	(.278)	(-2.189)	(-1.012)	(-.676)	(-2.423)	(-1.256)
Observations	69871	69871	69871	34819	34819	34814
Pseudo R^2	.028	.084	.026	.032	.066	.024
Industry Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes

t-values are in parentheses
*** p<.01, ** p<.05, * p<.1

Table 8: Discretionary Accruals

	(1) All_Firms	(2) Small_Firms	(3) Pre/Post_Sox	(4) Existing_EY_Client
AwardWindow	.000	.004	.007	.002
	(-.002)	(.818)	(.406)	(.462)
AwardWindowEYSwitch	-.033**	-.063**	-.054**	
	(-2.359)	(-2.134)	(-2.003)	
AwardWindowEYSwitch_Sox			.033	
			(1.185)	
SwitchToEY	.003	.018*	.011*	
	(.592)	(1.811)	(1.756)	
LogSale	-.016***	-.024***	-.020***	-.012***
	(-42.025)	(-27.197)	(-14.555)	(-12.328)
CFO	-.137***	-.129***	-.143***	-.108***
	(-28.392)	(-23.416)	(-8.731)	(-9.55)
LEV	.034***	.034***	.027***	.031***
	(8.351)	(7.342)	(4.04)	(3.989)
Growth_Rev	.011***	.01***	.012***	.008***
	(11.651)	(8.727)	(4.809)	(3.253)
Loss	.011***	.014***	.016***	.009***
	(7.511)	(6.663)	(3.217)	(2.723)
dPPE_Gross	.000	.000	.000	.000
	(1.381)	(1.151)	(-.192)	(-1.581)
BIG4	-.007***	-.004**	-.016***	
	(-4.781)	(-2.159)	(-3.315)	
HighLitigation	.015***	.015***	.022***	.014***
	(5.703)	(3.718)	(2.6)	(2.645)
Observations	135275	65765	9746	22090
R-squared	.194	.196	.227	.139
Industry Fixed Effects	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes

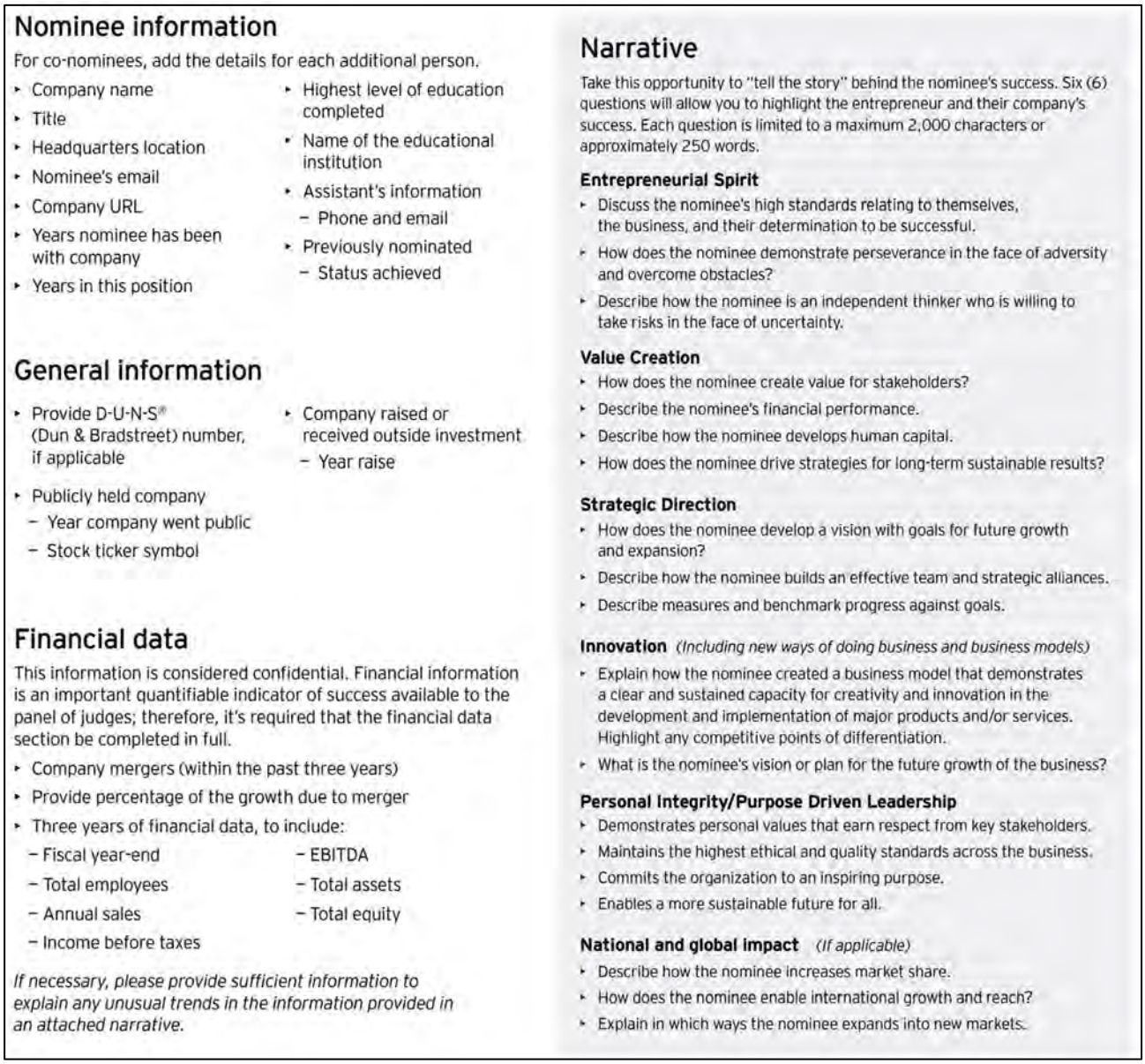
t-values are in parentheses
*** $p<.01$, ** $p<.05$, * $p<.1$

Appendix A

Entrepreneur of the Year Award Selection Criteria

Application guidelines for the EY Entrepreneur of the Year award are shown below. These guidelines remain consistent over time, and application materials primarily entail corporate, financial, and strategic information. The application window lasts until March each year, and awards are granted in June by a panel of independent judges (Ernst & Young, 2021, 2023).

https://assets.ey.com/content/dam/ey-sites/ey-com/en_ca/topics/eoy/2021/ey-eoy-2021-application-guidelines-v2.pdf



Nominee information

For co-nominees, add the details for each additional person.

- Company name
- Title
- Headquarters location
- Nominee's email
- Company URL
- Years nominee has been with company
- Years in this position
- Highest level of education completed
- Name of the educational institution
- Assistant's information
  - Phone and email
- Previously nominated
  - Status achieved

General information

- Provide D-U-N-S® (Dun & Bradstreet) number, if applicable
- Company raised or received outside investment
  - Year raise
- Publicly held company
  - Year company went public
  - Stock ticker symbol

Financial data

This information is considered confidential. Financial information is an important quantifiable indicator of success available to the panel of judges; therefore, it's required that the financial data section be completed in full.

- Company mergers (within the past three years)
- Provide percentage of the growth due to merger
- Three years of financial data, to include:
  - Fiscal year-end
  - Total employees
  - Annual sales
  - Income before taxes
  - EBITDA
  - Total assets
  - Total equity

If necessary, please provide sufficient information to explain any unusual trends in the information provided in an attached narrative.

Narrative

Take this opportunity to "tell the story" behind the nominee's success. Six (6) questions will allow you to highlight the entrepreneur and their company's success. Each question is limited to a maximum 2,000 characters or approximately 250 words.

Entrepreneurial Spirit

- Discuss the nominee's high standards relating to themselves, the business, and their determination to be successful.
- How does the nominee demonstrate perseverance in the face of adversity and overcome obstacles?
- Describe how the nominee is an independent thinker who is willing to take risks in the face of uncertainty.

Value Creation

- How does the nominee create value for stakeholders?
- Describe the nominee's financial performance.
- Describe how the nominee develops human capital.
- How does the nominee drive strategies for long-term sustainable results?

Strategic Direction

- How does the nominee develop a vision with goals for future growth and expansion?
- Describe how the nominee builds an effective team and strategic alliances.
- Describe measures and benchmark progress against goals.

Innovation *(Including new ways of doing business and business models)*

- Explain how the nominee created a business model that demonstrates a clear and sustained capacity for creativity and innovation in the development and implementation of major products and/or services. Highlight any competitive points of differentiation.
- What is the nominee's vision or plan for the future growth of the business?

Personal Integrity/Purpose Driven Leadership

- Demonstrates personal values that earn respect from key stakeholders.
- Maintains the highest ethical and quality standards across the business.
- Commits the organization to an inspiring purpose.
- Enables a more sustainable future for all.

National and global impact *(If applicable)*

- Describe how the nominee increases market share.
- How does the nominee enable international growth and reach?
- Explain in which ways the nominee expands into new markets.

Appendix B: Variable Definitions

Variable Name	Definition
EOYAwardYear	Indicator equal to 1 if company wins EOY award in the current fiscal year
AwardWindow	Indicator variable equal to 1 in and for the three years after a firm wins the EY EOY award (t to t+3 inclusive beginning with the award date)
AuditorSwitch	Indicator variable equal to 1 for firms changing auditors in the current year
SwitchToEY	Indicator equal to 1 if for firms switches their external auditor to EY in the current fiscal year
SwitchFromEY	Indicator equal to 1 if for firms switches their external auditor away from EY in the current fiscal year
NewAuditor (DT, EY, PWC, KPMG)	Categorical variable indicating the identity of the auditor switched to in the current year (with a unique value for each of the big 4)
OldAuditor (DT, EY PWC, KPMG, AA, OTHER)	Categorical variable indicating the identity of the auditor switched away from in the current year (with a unique value for each of the big 4 and Arthur Andersen, and taking on a single value for any other audit firm)
AwardWindowEYSwitch	Indicator equal to 1 if both AwardWindow and SwitchToEY are equal to 1; zero otherwise
PostAward	Indicator equal to 1 for each of the fifteen years following the receipt of an EOY award
Sox	Indicator equal to 1 for years following the passage of the Sarbanes Oxley Act (fiscal years 2002 and beyond)
LogAT	Natural log of total assets
NI	Net income, in millions
MB	Market-to-book ratio of common equity
ROA	Average return on assets using net income before extraordinary items
Acquis	Indicator equal to 1 if the firm has acquisition costs exceeding 10% of prior year total assets
Lev	Total leverage, scaled by total assets
iRisk	Sum of inventories and receivables, scaled by total assets
Cash	Cash and cash equivalents, scaled by total assets
Loss	Loss firm-years (using net income before extraordinary items)
Growth_AT	Growth in total assets, scaled by prior year total assets
AudTenure (LogAudTenure)	Auditor tenure, in years (logged)
ModOpin	Indicator variable equal to 1 if the audit report is nonstandard and contains any additional
CFEarly	Indicator variable equal to 1 for firms in the introduction or growth (CFEarly), mature (CFMature), or declining (CFDecline) life cycle stages based on cash flow identification (Dickinson, 2011)
CFMature	
AbsDACC	Absolute value of Kothari (2005) performance matched discretionary accruals
TAC	Total accruals, computed as net income before extraordinary items (*ib*) less cash flows from operations (*oancf*)
BKSim_BusDesc	These variables represent similarity scores between a firm's 10-k disclosures (namely the business description) compared to its auditor's other clients' disclosures within the same industry-year. Refer to Brown and Knechel (2016) for further detail on variable construction.
AudMismatch	Indicator variable equal to 1 for firms with an auditor mismatch in accordance with Shu (2000)
AudExpert	Indicator variable equal to 1 for firms engaged with an industry expert auditor
Busy	Indicator variable equal to 1 for firms with a fiscal year end during audit busy season
Restate	Indicator variable equal to 1 for firms with a subsequent restatement of the current year financial statements
Restate_r	Indicator variable equal to 1 for firms with a subsequent immaterial restatement of the current year financial statements
Restate_R	Indicator variable equal to 1 for firms with a subsequent material restatement of the current year financial statements
IPO	Indicator variable equal to 1 for firms with an IPO in the current year
LogSale	Natural log of total revenues
CFO	Operating cash flows, scaled by total assets
Growth_Rev	Growth in total revenues, scaled by prior year total revenues
dPPE_Gross	Change in gross PP&E, scaled by prior year gross PP&E
BIG4 (BIG5)	Indicator variable equal to 1 for firms engaged with a big 4 (big 5) auditor in the current year
highlitigation	Indicator variable equal to 1 for firms in a high litigation industry in the current year
Zscore	Altman Z-score
GOING_CONCERN	Indicator variable equal to 1 for firms receiving going concern opinions in the current year

Suffixes of "_1" or "_next" indicate lag or lead variables, respectively.