The Effects of Corporate Social Responsibility Reporting on Audit Quality, Financial Performance, Audit Committee Quality, Auditor Tenure, and Auditor Dismissal

A Dissertation

by Timothy S. Creel

Submitted to
H. Wayne Huizenga College of Business and Entrepreneurship
Nova Southeastern University

in partial fulfillment of the requirements
for the degree of

Doctor of Business Administration

A Dissertation
entitled

The Effects of Corporate Social Responsibility Reporting on Audit Quality, Financial Performance, Audit Committee Quality, Auditor Tenure, and Auditor Dismissal

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We hereby certify that this Dissertation submitted by Timothy S. Creel conforms to acceptable standards, and as such is fully adequate in scope and quality. It is therefore approved as the fulfillment of the Dissertation requirements for the degree of Doctor of Business Administration.

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ABSTRACT

The Effects of Corporate Social Responsibility Reporting on Audit Quality, Financial Performance, Audit Committee Quality, Auditor Tenure, and Auditor Dismissals

by

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Previous CSR studies have examined the financial benefits of corporate social responsibility (CSR) or theories of CSR including stakeholder or legitimacy theory (Cho & Patten, 2007; Woller, 2007). Relative to companies not filing CSR reports, companies filing the reports obtain financial benefits (Lev, Pertrovits, and Radhakrishnan, 2010), experience improved reputation (Toms, 2002), face less financial risk (Orlitzky and Benjamin, 2001), and observe higher earnings (accruals) quality (Kim, Park, & Wier, 2012; Pyo & Lee, 2013). Further, internal control weaknesses, financial restatements, and discretionary accruals have been reported to lead to low audit quality and increased financial risk (Ashbaugh-Skaife, Collins, & Kinney, 2007). Prior studies suggest that audit committee quality and auditor tenure are positively related to audit quality (Geiger and Raghunandan, 2002; Lin and Wang, 2010). In addition, companies may dismiss their auditors to reduce fees (Gul, Fung, & Jaggi, 2009), engage in audit opinion shopping (Lu & Sivaramakrishnan, 2009), or avoid disagreements on accounting principles (Turner, Williams, & Weirich, 2005), reported internal control weaknesses or financial restatements (Ettredge, Li, & Scholz, 2007). These reasons are all considered short-term solutions and are in contrast to the benefits of increased auditor tenure (Geiger & Raghunandan, 2002).

The present study builds on prior research by identifying companies filing and those not filing CSR reports to examine the impact on audit quality, financial performance, audit committee quality, auditor tenure, and auditor dismissal. The findings show that compared to companies not filing CSR reports, those filing the reports have higher auditor quality (i.e., lower discretionary accruals and fewer financial restatements and internal control weaknesses), higher audit committee quality (more financial experts and members on the audit committee), longer auditor tenure, better financial performance (i.e., less net loss and higher return on assets), lower auditor dismissal (i.e., increased likelihood of having only one audit firm during the companies' inception). Companies filing CSR reports have larger total assets and are more likely to have a Big 4 audit firm since their inception than those not filing the reports. Overall, the findings support stakeholder rather than legitimacy theory of CSR reporting. Stakeholder theory is supported by the benefits to stakeholders such as increased audit quality, strong financial performance, high audit committee quality, increased auditor tenure, and decreased auditor dismissal.

Acknowledgements

The pursuit of a doctorate and the completion of a dissertation is more of a journey than a process. It is full of ups and downs and without the help of so many I would not have been able to accomplish this life-long goal. I want to thank my committee consisting of Drs. Siew Chan, Yuliya Yurova, and Qian Song for your many hours of help, advice and support. I also want to say thanks for the support I received from the Doctoral program office as you were always there whenever I needed help with any situation.

I offer special thanks to my family including my wife, Kathy, and sons Heath, Joshua and Franklin. You were always so understanding by allowing me time to work on my dissertation and travel when necessary. Kathy, I could not have completed this without your help during the past two years. I love all of you very much. I thank my first wife, Kelly, for all of her help and understanding while I worked through the classes in Florida. You were not here to see the completion of this journey, but I know you are smiling in heaven. I also want to thank God for your mercy and grace as you have always been there for me and helped me get through the greatest struggles in my life.

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Introduction

Background Problem

Corporate social responsibility (CSR) pertains to a company's actions toward the environment, social causes and communities. Companies may perform CSR acts because they feel it is the right thing to do or to obtain financial benefits from CSR by implementing energy-saving ideas, enhancing their reputation, and improving employee job satisfaction. Many companies voluntarily produce CSR reports that discuss their CSR actions. Some of these voluntarily prepared CSR reports follow the reporting guidelines set forth by the Global Reporting Initiative (GRI) and some of these reports are reviewed by independent third parties.

Voluntary CSR or sustainability reports indicate high transparency (Dhaliwal, Radhakrishnan, Tsang, & Yang, 2012) and high levels of commitment toward socially responsible behavior (Pyo & Lee, 2013). Companies that engage in socially responsible behavior have low cost of capital (Dhaliwal, Li, Tsang, & Yang, 2011), obtain financial benefits (Lev, Petrovits, & Radhakrishnan, 2010), and enjoy enhanced reputation (Toms, 2002).

Socially responsible behavior results in benefits for a company and its stakeholders such as enhanced economic performance (Al-Tuwaijri, Christensen, & Hughes II, 2004; Lev, Petrovits, & Radhakrishnan, 2010), improved community or environmental performance (Besley & Gathak, 2007), and low cost of equity (Dhaliwal, Li, Tsang, & Yang, 2011). Prior research (Woller, 2007; Ballou, Heitger, & Landes, 2006; Cho & Patten, 2007; Handelman & Arnold, 1999) has used stakeholder, legitimacy, firm and resource-based theories to enhance understanding of a company's engagement in socially responsible behavior. Stakeholder theory states that organizations serve different groups of shareholders both inside and outside the companies and emphasizes the importance of keeping stakeholders satisfied as part of future success (Woller, 2007). Many businesses are driven to practice CSR to meet the needs of their stakeholders (Ballou, Heitger, & Landes, 2006).

Legitimacy theory is based on disclosure of CSR information to offset other more negative aspects of company behavior or performance (Cho & Patten, 2007). For example, disclosure of positive CSR activities offsets negative news about a company. This disclosure is proactive because positive socially responsible behavior may be disclosed to offset any future negative concerns about a company. Legitimacy theory is primarily concerned about using socially responsible behavior to improve the reputation of a company (Handelman & Arnold, 1999). CSR researchers have debated on whether a company engages in CSR reporting to obtain high audit quality for the benefit of its stakeholders (stakeholder theory) or to cover its poor financial performance (legitimacy theory).

In addition, a company may realize economic benefits from practicing socially responsible behavior (Lev, Petrovits, & Radhakrishnan 2010) such as reduced future cost of equity (Dhaliwal, Li, Tsang, & Yang, 2011) and decreased analysts' forecast errors (Dhaliwal, Radhakrishnan, Tsang & Yang, 2012). Higher earnings quality (Pyo & Lee, 2013) is observed in companies that file corporate social responsibility reports. Further, disclosure of socially responsible activities is related to strong economic performance (Al-Tuwaijri, Christensen, & Hughes II, 2004).

This study uses financial restatements, internal control weaknesses, and accruals quality as measures of audit quality. Previous research indicates that financial restatements and internal control weaknesses are suggestive of low audit quality (Liu, Raghunandan, & Rama, 2009;

Doyle, Ge, & McVay, 2007). Audit quality has been measured via internal control deficiencies (Doyle, Ge, & McVay, 2007), financial restatements (Stanley & DeZoort, 2007), and accruals quality (Choi, Kim, & Zang, 2010; Wang & Zhou, 2012). Accruals quality is related to use of discretionary (Wang & Zhou, 2012) or abnormal accruals (Choi, Kim, & Zang, 2010) in the financial statements. Audit quality is also positively related to audit firm size (Francis & Yu, 2009), audit committee quality (Krishnan, 2005), and audit firm tenure (Stanley & DeZoort, 2007).

Financial restatements represent a financial reporting failure of a company and an audit failure of an audit firm (Liu, Raghunandan, & Rama, 2009). Restatements may come from internal control weaknesses or earnings management (Linn & Diehl, 2005), and occur in companies with high debt levels (Abdullah, Yusof, & Nor, 2010). Restatements due to fraud or error are considered as audit failures (Stanley & DeZoort, 2007) and can be attributed to low audit effort (Lobo & Zhao, 2013).

Internal control weaknesses are associated with poor reporting quality, high risk, and financial weakness (Ashbaugh-Skaife, Collins, & Kinney, 2007). Weak internal controls are also related to lower accruals quality (Doyle, Ge & McVay, 2007). Failure to correct internal control issues may increase the chances of modified audit opinions (Hammersley, Myers, & Zhou, 2012).

High audit committee quality indicates fewer internal control problems (Krishnan, 2005). The number of internal control weaknesses is high for audit committees consisting of members with less financial and accounting expertise (Zhang, Zhou, & Zhou, 2007). Financial restatements are inversely related to the presence of financial experts on an audit committee (Abbott, Parker, and Peters (2004). Audit committees increase the likelihood of voluntary disclosure among firms (Ho & Wong, 2001). Production of a CSR or sustainability report is a form of voluntary disclosure (Dhaliwal, Li, Tsang, & Yang, 2011).

Auditor tenure refers to the consecutive number of years that a client's financial statements have been audited by the same audit firm (Al-Thuneibat, Al Issa, & Baker, 2011). Although audit failure is high in the first three years of an audit relationship (Stice, 1991), high quality audits are likely to occur in long-term auditor-client relationships because of concerns about increased possibility of issuance of a going-concern report (Geiger & Raghunandan, 2002). Specifically, increased auditor tenure is related to a low probability of financial restatements (Stanley & DeZoort, 2007) and abnormal accruals are likely to be observed in the early years of auditor-client relationships (Chung & Kallapur, 2003). In addition, a company might dismiss its auditor to decrease audit fees (Turner, Williams, & Weirich, 2005), search for a favorable audit opinion (Simon & Francis, 1988), or turn to another audit firm after issuance of an adverse audit opinion (Ettredge, Heintz, Li, & Scholz, 2011).

Low audit quality is related to high risk and adverse financial conditions (Ashbaugh-Skaife, Collins, & Kinney, 2007), modified audit opinions (Hammersley, Myers, & Zhou, 2012), high audit fees (Simunic & Stein, 1996), CFO or CEO turnover (Feldman, Read, & Abdommohammadi, 2009), and abnormal accruals (Choi, Kim, & Zang, 2010) which do not lead to stakeholder satisfaction. Audit quality is positively associated with auditor tenure (Stanley & DeZoort, 2007) and audit committee quality (Krishnan, 2005); this relationship is moderated by CSR reporting, a form of increased voluntary, non-financial disclosure (Dhaliwal, Li, Tsang, & Yang, 2011), and increased emphasis on ethical behavior and stakeholder satisfaction (Kim, Park, & Wier, 2012; Pyo & Lee, 2013).

Previous research has examined socially responsible behavior in relation to earnings quality via discretionary accruals (Kim, Park, & Wier, 2012; Pyo & Lee, 2013). This research extends prior research by investigating characteristics of companies preparing CSR reports in relation to (1) audit quality (2) auditor tenure, and (3) auditor dismissals and (4) audit committee quality and comparing them to companies that do not prepare CSR reports. This study uses standalone CSR reports as a measure of voluntary, non-financial disclosure used in previous studies (Dhaliwal, Radhadrishnan, Tsang, & Yang, 2012). The current study differs from Pyo and Lee (2013) in that it uses U.S. companies (instead of Korean companies) and standalone CSR reports (instead of only standalone CSR reports following the GRI standards). Use of standalone CSR reports allows for a large sample of U.S. companies in a broad range of industries and company sizes than utilization of only CSR reports following the GRI guidelines (Waddock & Graves, 1997; Kolk, 2003) or KLD ratings for socially responsible behavior (Kim, Park, and Wier, 2012). In addition, the present study uses stakeholder and legitimacy theories to promote understanding of the importance of CSR reporting.

CSR reporting suggests possible benefits to a company in terms of enhanced reputation (Toms, 2002) and improvements in financial performance (Al-Tuwaijri, Christensen, & Hughes II, 2004; Lev, Petrovits, & Radhakrishnan, 2010). Hence, companies filing CSR reports may be able to reap the benefits of high audit quality

Strong corporate governance has positive implications for audit quality which benefits stakeholders. A high quality audit committee, increased auditor tenure, and decreased auditor dismissals indicate strong corporate governance (Lary & Taylor, 2012). A high quality audit committee suggests decreased internal control weaknesses (Krishnan, 2005; Zhang, Zhou, & Zhou, 2007). Increased auditor tenure suggests reduced possibility of financial restatements

(Stanley & DeZoort, 2007) while auditor dismissals are associated with increased likelihood of abnormal accruals during the early years of the auditor-client relationships (Chung & Kallapur, 2003). This study postulates that companies may engage in activities that enhance corporate governance and audit quality because of concerns about stakeholder satisfaction. CSR reporting is associated with strong corporate governance due to improved reporting transparency (Dhaliwal, Radhakrishnan, Tsang, & Yang, 2012) and earnings quality (Pyo & Lee, 2013; Kim, Park, & Weir, 2012). Stakeholder theory posits that a company engages in CSR reporting to maintain high audit quality and strong corporate governance which promotes the interests of its stakeholders (Hannifa & Cooke, 2005; Waddock & Graves, 1997).

Research Question

This study identifies companies filing CSR reports and those not filing the reports to examine the impact on audit quality, financial performance, audit committee quality, auditor tenure, and auditor dismissal.

Contributions

Ethical and stakeholder concerns drive a company's decisions to improve its quality of earnings (Kim, Park, & Wier, 2012; Pyo & Lee, 2013). Prior research has investigated the association between CSR and financial performance (Orlitzky, Siegel, & Waldman, 2011; Dhaliwal, Li, Tsang, & Yang, 2011; Lev, Petrovits, & Radhakrishnan, 2010). This study builds on previous research by enhancing understanding of whether CSR reporting increases audit quality, audit committee quality, and auditor tenure, and decreases auditor dismissals.

Voluntary preparation of CSR reports represents enhanced socially responsible behavior (Pyo & Lee, 2013). When stand-alone CSR reports are prepared voluntarily, they signal the transparency of the financial statements. Standalone CSR reports are an indication of financial disclosures and provide increased stakeholder value because of improved forecast accuracy (Dhaliwal, Radhakrishnan, Tsang, & Yang, 2012). Previous research reports that earnings management decreases with increased transparency in comprehensive income reporting (Hunton, Libby & Mazza, 2006). Extending the findings on earnings quality to the context of audit quality, this study accentuates the importance of CSR reporting in enhancing transparency.

Stakeholders have a strong influence on the operating decisions of a company (Dhaliwal, Radhakrishnan, Tsang, & Yang, 2012) and may propel a company to promote high audit quality and enhance auditor-client relationship. Stakeholder theory emphasizes the importance of keeping the internal and external stakeholders of a company satisfied as part of future success (Woller, 2007). Stakeholders are likely to be satisfied by a company's involvement in socially responsible activities (McWilliams & Siegel, 2001). Socially responsible behavior is likely to satisfy internal (e.g., employees) and external (e.g., stockholders, regulatory authorities, suppliers, customers, etc.) stakeholders' desire for high audit quality. Since low audit quality reflects increased financial risk, companies with high audit quality maintain a high level of stakeholder satisfaction via the reduced possibility of financial restatements or internal control weaknesses (Ashbaugh-Skaife, Collins, & Kinney, 2007). Using stakeholder theory, this study posits that companies may signal high audit quality by exhibiting high audit committee quality and improved auditor-client relationship (i.e., increased auditor tenure) and filing CSR reports to indicate their engagement in CSR activities to further strengthen the positive impact on audit quality. Specifically, previous research suggests that earnings manipulation is less likely when audit committee quality is high (Lin & Wang, 2010) and increased auditor tenure is associated with high audit quality (Geiger & Raghunandan, 2002).

In addition, companies may dismiss their auditors due to concerns about low audit quality (Ettredge, Li, & Scholz, 2007; Turner, Williams, & Weirich, 2005). The likelihood of low audit quality is most prevalent during the first three years of an auditor-client relationship (Johnson, Kurana, & Reynolds, 2002). A company dismissing its audit firm is unlikely to reap the benefits of enhanced auditor-client relationship including high audit quality as a result of improved knowledge of the client (Geiger & Raghunandan, 2002). This research adds to the current literature by examining whether companies filing CSR reports are less likely to dismiss their auditors.

In contrast to stakeholder theory, legitimacy theory states that a company may disclose positive information about CSR activities to offset negative aspects of its actual performance (Cho & Patten, 2007). The production of standalone CSR reports supports legitimacy theory if such reports are filed to overcome other negative aspects of a company's performance. This study promotes understanding of whether companies produce standalone CSR reports to highlight a positive aspect of their performance to mitigate negative aspects of their performance and concerns associated with low audit quality.

This study adds contribution to the literature by examining whether the results support stakeholder or legitimacy theory of socially responsible behavior. Audit quality is an effective way to examine this situation as high audit quality with CSR reporting would support stakeholder theory while low audit quality with CSR reporting would support legitimacy theory. The elements of audit quality examined in the research also help answer the question in relation to stakeholder or legitimacy theory. A company producing CSR reports with a high quality audit committee, long-term auditor tenure and a low chance of auditor dismissal would support stakeholder while CSR reporting with a low quality audit committee, short-term auditor tenure, and a higher probability of auditor dismissal would offer support to legitimacy theory. By examining this question, the research may bring greater understanding to the reason why a company practices CSR reporting.

The present study uses financial restatements, internal control deficiencies, and accruals quality as measures for audit quality. Financial restatements have been examined in relation to financial reporting failure and audit failure (Liu, Raghunandan, & Rama, 2009), and internal control deficiencies have been investigated in relation to audit quality such as decreased reporting quality, financial weakness, and increased financial risk (Ashbaugh-Skaife, Collins, & Kinney, 2007). Further, prior research suggests a positive relationship between the filing of CSR reports and earnings quality (Pyo & Lee, 2013) as a result of indications of strong ethical behavior and stakeholder satisfaction.

Organization of the Study

Chapter 2 discusses the theoretical framework that leads to development of the hypotheses. Chapter 3 explains the methodology used for testing the hypotheses. Chapter 4 presents the analysis and results. Chapter 5 discusses the implications of this study, limitations, and suggestions for future research.

Chapter 2

Theoretical Framework

This chapter discusses the corporate social responsibility (CSR) activities of companies via voluntarily produced stand-alone reports. Stakeholder and legitimacy theories provide the theoretical framework for voluntary disclosure of CSR. Further, reasons for a company's choice in filing corporate social responsibility reports and the advantages and disadvantages of these reports are explained. The hypotheses are developed based on the characteristics of companies filing CSR reports and highlight how CSR reporting relates to audit quality, audit committee quality, audit firm tenure, and auditor dismissals.

Corporate Social Responsibility (CSR)

CSR can be defined as voluntary integration of both social concerns and the environment into a company's business practices by making it a part of its overall strategy (Perrini, 2005). Another definition of CSR pertains to a company's actions that support some type of social good over and above what is required under the law or business interests (McWilliams & Siegel, 2001). Corporate social performance (CSP) is a term commonly used to represent CSR and can be defined as voluntary company activities that provide positive social outcomes for external parties (Schuler & Cording, 2006). CSP is also posited to emphasize the results of socially responsible behavior of businesses (Orlitzky & Swanson, 2012). A common feature of these definitions is the voluntary nature of CSR actions which benefit society.

Standalone CSR reports are an indication of the strength of socially responsible behavior (Dhaliwal, Li, Tsang, & Yang, 2011). Prior research (e.g., Neu, Warsame, & Pedwell, 1998; Patten, 2002; Toms, 2002) has examined environmental disclosures in a company's annual report and CSR disclosures obtained from a company's website (Williams & Pei, 1999). Many companies prepare separate corporate social responsibility reports to highlight their activities pertaining to its communities, the environment, and social causes. Some companies prepare sustainability reports to show the details of a company's activities pertaining to the environment. These reports provide verifiable information on social performance, and are becoming a business standard (Perrini, 2005). The growth of voluntary company reporting of socially responsible activities can be seen in the *Fortune* Global 250 where about half of the companies prepare sustainability reports (Kolk, 2003).

CSR reports are prepared by companies of different sizes and across different industries such as retail, healthcare or oil. Kolk (2003) examines the voluntary reports of the *Fortune* Global 250 and finds that a third of these reports are assured by auditors or other independent parties. One study investigates the assurance on sustainability reports for over 2,000 companies from 31 different countries and reports that companies voluntarily assure these reports to improve credibility of the information (Simnett, Vanstraelen, & Chua, 2009).

Many of the voluntarily prepared CSR reports follow the guidelines of the Global Reporting Initiative (GRI). This initiative began in 1997 with the objective of improving the process and providing guidelines for the preparation of sustainability reports. One goal is to improve the transparency of company reports around the world, and this has received support from businesses and organizations (Ballou, Heitger, Landes, & Adams, 2006). The GRI comprises the following six categories: economic, environment, labor, human rights, product responsibility, and society (Simnett, Vanstraelen, & Chua, 2009). An organization can report information on one or all of these categories. The GRI follows 11 different principles: transparency, inclusiveness, auditability, completeness, relevance, sustainability context, accuracy, neutrality, comparability, clarity, and timeliness (Clarkson, Li, Richardson, & Vasvari, 2008). Many large U.S. companies (e.g., Bank of America, Dell, Ford, Exxon-Mobil, McDonald's, Microsoft, Nike, Time Warner, UPS, and Starbucks) follow the GRI guidelines for CSR and sustainability reporting (Ballou, Heitger, Landes, & Adams, 2006).

One study utilizes the GRI guidelines and reports a positive relationship between environmental reporting and the actual performance of U.S. firms (Clarkson, Li, Richardson, & Vasvari, 2008). A more recent study uses the GRI to examine the impact of stand-alone CSR reports on earnings quality and socially responsible behavior, and finds that GRI standards produces high quality and transparent CSR reports (Pyo & Lee, 2013).

Theoretical Framework

The theoretical framework for this study includes stakeholder and legitimacy theories. These theories provide insight into the reasons for a company's engagement in socially responsible behavior. The two major aspects of these theories are improved reputation of a company and the financial gains that a company might derive from engagement in socially responsible activities.

Stakeholder theory indicates that a company should keep the interests of its stakeholders (e.g., regulatory authorities, communities, customers, suppliers, employees, and major stockholders) in mind in its decision-making (McWilliams & Siegel, 2001). Stakeholders are incorporated into the definition of CSR to some extent because the social and environmental actions of a company occur in the context of its interactions with stakeholders (Perrini, 2005).

The needs of stakeholders motivate companies to promote CSR activities (Ballou, Heitger, & Landes, 2006). For example, customers' preference for engagement in business with socially and environmentally friendly companies may motivate the pursuit of CSR as a business strategy. A company practicing CSR may also build goodwill with its customers (Handelman & Arnold, 1999). Further, CSR is an avenue for promotion of a public good such as involvement in a community or reduction of a non-public good such as pollution (Besley & Gathak, 2007). In addition, employees may seek companies that engage in socially responsible actions such as safe working conditions and favorable amenities (McWilliams & Siegel, 2001). Thus, CSR activities increase employee job satisfaction leading to high stock returns in the long-run (Edmans, 2011), improved employee retention rates (Moir, 2001), and enhanced employee work performance (Carmeli, Gilat, & Waldman, 2007).

Stakeholder theory is related to the ethical aspects of CSR. This aspect of socially responsible behavior suggests that companies file CSR reports because they want to do the right thing (Carroll, 1979; Donaldson & Preston, 1995). Companies filing CSR reports have an incentive to be ethical or honest (Jones, 1995) and choose to engage in this action because of the beneficial outcomes (Kim, Park & Wier, 2012). This ethical stance constrains earnings management. This reasoning process can be extended to the audit quality context of this study. Specifically, companies may file CSR reports to signal audit quality due to their ethical stance, consideration of the interests of stakeholders, and desire for maintaining high audit committee quality, increased auditor tenure, and decreased auditor dismissals.

Legitimacy theory states that a company may disclose positive information about CSR activities to offset negative aspects of its actual performance (Cho & Patten, 2007). An examination of the environmental disclosures and the performance of several companies in different industries reveal that organizations use information disclosures as an avenue for legitimizing their performance (Cho & Patten, 2007). One study investigates the leases and environmental disclosures of North American companies and reports that the reactive approach of legitimacy theory is related to environmental press releases; therefore, disclosure of positive CSR actions to offset a negative event may signal a reactive aspect of legitimacy theory (Aerts & Cormier, 2009). A proactive approach of legitimacy theory involves disclosure to prevent future legitimacy concerns (van Staden & Hooks, 2007). Further, independent ratings of companies are positively related to disclosures in the annual reports and standalone CSR and sustainability reports; supporting the proactive aspect of legitimacy theory (van Staden & Hooks, 2007).

Consistent with legitimacy and stakeholder theories, a company may act in a socially responsible manner to improve its reputation. Environmental disclosure and practices can improve the environmental reputation of a company (Toms, 2002) and allows a company to build a goodwill relationship with its customers (Handelman & Arnold, 1999). Previous research reports that about 75 percent of a company's value is related to its reputation (Vallens, 2008). In addition, current CSR actions directed at improving a company's reputation may indicate future financial performance (Orlitzky, Schmidt, & Rynes, 2003). Thus, companies with high financial risk are likely to invest less in socially responsible activities (Orlitzky & Benjamin, 2001).

Firm and resource-based theories provide an economic perspective of a company's motivation for filing a CSR report. Theory of the firm, originally proposed by McWilliams and Siegel (2001), examines the supply and demand of CSR. A cost-benefit approach enables a company to obtain the greatest benefits from its investment in CSR (McWilliams & Siegel, 2001). Thus, companies may improve their CSR performance by making socially responsible activities an essential element of their overall business strategy (Husted & Salazar, 2006). According to the resource-based view of the firm, a company gains a competitive advantage over its competitors via its valuable resources (Barney, 1991). McWilliams and Siegel (2001) use the resource-based view of the firm to build a model to enable companies to maximize benefits from their CSR activities. This cost-benefit model can help a company use its CSR activities as part of a differentiation strategy (Orlitzky, Siegel, & Waldman, 2011). A company may use its CSR activities as an avenue for raising regulatory standards and increasing its political influence (McWilliams, Van Fleet, & Cory, 2002). The resource-based view of the firm also supports the strategic approach toward socially responsible behavior (McWilliams, Van Fleet, & Cory, 2002).

The Impact of CSR on Financial Performance

The greatest potential for future CSR activities resides in the possible financial benefits (Orlitzky, Siegel, & Waldman, 2011). Increased environmental disclosure is positively related to economic performance (Al-Tuwaijri, Christensen, & Hughes II, 2004). Increased CSR disclosures also decrease a company's cost of capital (Dhaliwal, Li, Tsang, & Yang, 2011). Further, increases in charitable donations, an example of CSR activities, lead to future growth in revenues (Lev, Petrovits, & Radhakrishnan, 2010).

Socially responsible investing, a financial feature of CSR, involves factoring in social and environmental factors in investment decisions (Holder-Webb, Cohen, Nath, & Wood, 2009). Funds that invest in socially responsible companies do not invest in companies dealing with tobacco, alcohol, gambling, nuclear energy, and military contracting. Information on social behavior frequently originates from social research such as information in the Kinder, Lyndenberg, Domini (KLD) Research & Analytics (Waddock, 2003). Individuals and stakeholders making socially responsible investments motivate companies to engage in CSR activities. Socially responsible investment funds may also improve investment returns especially when employee satisfaction is factored in as a part of the investment decision (Edmans, 2011).

The Impact of CSR on Audit Quality

Prior research has examined CSR in association with different types of financial results (e.g., Dhaliwal, Li, Tsang, & Yang, 2011; Lev, Petrovits, & Radhakrishnan, 2010; Orlitzky, Siegel, & Waldman. 2011) and earnings quality (Kim, Park, & Wier, 2012; Pyo & Lee, 2013). Kim, Park, and Wier (2012) examine whether socially responsible companies are less likely to engage in earnings management. The authors measure the CSR performance of companies using the KLD survey results with discretionary accruals as a proxy for earnings management. The findings reveal that socially responsible companies are less likely to engage in earnings management, manipulate actual operating activities, or experience an SEC investigation related to adverse financial activities. Pyo and Lee (2013) investigate CSR in relation to earnings quality using the production of standalone CSR reports and the amount of donation expenses as a proxy for socially responsible behavior. The CSR reports examined include companies following the reporting guidelines of the GRI. The results show that socially responsible companies produce high quality earnings and increased company donations, leading to decreased discretionary accruals. This phenomenon is acute with voluntary production of separate CSR reports that follow the GRI guidelines.

Voluntary Disclosure

A company engaging in social disclosure communicates its involvement in the community, environment, employee relations, and contributions of its products or services (Anderson & Frankle, 1980). Companies in industries with increased financing needs tend to produce increased voluntary disclosure (Francis, Khurana, & Pereira, 2005), leading to a lower cost of capital (e.g., Botosan, 1997; Francis, Nanda, & Olsson, 2008) and strong earnings quality (Francis, Nanda, & Olsson, 2008). Further, companies providing informative disclosures have a larger analyst following and higher analyst forecast accuracy than companies not providing such disclosures (Lakhal, 2009; Lang & Lundholm, 1996).

The voluntary disclosure of CSR activities[1] provides valuable information for the capital markets (Anderson & Frankle, 1980), reduces the cost of equity capital in future periods, and enhances performance, resulting in increased analyst coverage and supportive investors (Dhaliwal, Li, Tsang, & Yang, 2011). The voluntary production of stand-alone CSR reports also results in enhanced analyst accuracy and complements a company's required financial disclosures (Dhaliwal, Radhakrishnan, Tsang, & Yang, 2012).

Discretionary Accruals

Accruals quality relates to the effective and accurate use of accruals in a firm's financial statements. Previous research has used discretionary or abnormal accruals as a measure of earnings (Kim, Park & Wier, 2012; Pyo & Lee, 2013) or audit quality (Choi, Kim, & Zang, 2010; Wang & Zhou, 2012). Kim, Park, and Wier (2012) use accruals quality as a representation of earnings quality to examine the relationship between CSR and a company's earnings quality. Pyo and Lee (2013) employ discretionary accruals as a measure of earnings quality to investigate the association between CSR activities and the quality of a company's earnings. Discretionary accruals are also used as a measure of audit quality to examine the relationship between audit quality and abnormal audit fees (Choi, Kim, & Zang, 2010). Further, abnormal accruals are used as a proxy for audit quality in a study that examines the association between audit fees and audit quality after the passage of Auditing Standard 5 which replaces Auditing Standard 2 (Wang & Zhou, 2012). In addition, high accruals quality has been shown to be related to a strong audit

[1] Voluntary disclosure of CSR information usually occurs in a company's annual report, website, press releases, standalone CSR, or sustainability report.

committee (Kang, Kilgore & Wright, 2011) and increased auditor tenure (Johnson, Kurana, & Reynolds, 2002).

Financial Restatements

Financial restatements represent a financial reporting failure of a company and an audit failure of an audit firm (Liu, Raghunandan, & Rama, 2009). Restatements may originate from internal control weaknesses such as employee errors or earnings management (Linn & Diehl, 2005), and may occur in companies with large than small amounts of debt (Abdullah, Yusof, & Nor, 2010). Restatements due to fraud or error are considered as audit failures (Stanley & DeZoort, 2007). Since financial restatements can be attributed to lack of audit effort (Lobo & Zhao, 2013), shareholders attribute at least part of the blame for the restatements to the audit firm (Schmidt, 2012). The market reacts negatively during the time period around the announcement of a restatement (Palmrose, Richardson, & Scholz, 2004), and such announcement results in decreased stock price (Zhu, Kleuskens, & Grebis, 2010). The market also reacts negatively to clients audited by auditors associated with the restatements; this negative reaction is stronger for the Big 4 than non-Big 4 firms (He & Chiang, 2013).

Restatements create a situation where a company may dismiss its audit firm to improve audit quality and its reputation (Mande & Son, 2013). A company that dismisses its audit firm can help improve its stock price because of the market's positive view of a change in the audit firm after the issuance of a restatement. Auditors may resign after restatements involving fraud or turning a profit into a loss, or when the restatement is reported in a press release which signals increased client risk (Huang & Scholz, 2012).

Internal Control Deficiencies

The Sarbanes-Oxley Act (SOX) of 2002 mandates separate audits of the internal control systems (PCAOB, 2004) and Section 404 of SOX holds company management responsible for the company's internal control system (Foster & Shastri, 2013). Companies reporting internal control weaknesses experience low reporting quality, increased financial weakness, and high risk (Ashbaugh-Skaife, Collins, & Kinney, 2007). In addition, internal control weaknesses are positively related to increased auditor changes (Krishnan & Visvanathan, 2007), decreased accruals quality (Ashbaugh-Skaife, Collins, Kinney, & LaFond, 2008; Doyle, Ge & McVay, 2007), and increased financial restatements (Rice & Weber, 2012).

Hammersley, Myers, and Zhou (2012) examine companies reporting internal control weaknesses in two consecutive annual reports and report that these companies have complex operations and pervasive material weaknesses. The authors also find that companies not remediating their material weaknesses are likely to encounter increased audit fees, auditor resignation, and issuance of a modified audit or going-concern opinion. Increased abnormal accruals are also observed for material internal control weaknesses that remain uncorrected for more than two years (Bedard, Hoitash, Hoitash, & Westermann, 2012). On a positive note, companies that remediate material internal control weaknesses exhibit high accruals quality (Ashbaugh-Skaife, Collins, Kinney, & LaFond, 2008). In addition, companies engaging in partial remediation of material internal control weaknesses experience a positive market reaction (Gordon & Wilford, 2012).

Although the cost of debt increases after a company reports a SOX 404 material internal control weakness (Dhaliwal, Hogan, Trezevant, & Wilkins, 2011), failure to remediate these weaknesses can increase the cost of debt due to low credit ratings and increased interest rates

(Hammersley, Myers, & Zhou, 2012). This contention is supported by the higher loan spread, higher interest rates, and lower number of lenders for companies that report relative to those that do not report internal control weaknesses (Kim, Song, & Zhang, 2011).

Audit Committee

The audit committee oversees the quality of financial reporting in a company (U.S. House of Representatives, 2002). The audit committee should control a company's overly aggressive financial reporting and support the auditors in their confrontations with company management on the audit findings (DeZoort, Hermanson, & Houston, 2003). Prior research has examined the benefits of a strong audit committee such as financial expertise, independence, meeting frequency, and audit committee size on a company's performance and audit quality (e.g., Ghafran & O'Sullivan, 2013; Kang, Kilgore & Wright, 2011).

Few internal control problems occur when the quality of an audit committee is high (Krishnan, 2005). Characteristics of the audit committee such as independence and the presence of a financial expert are related to the quality of internal controls (Krishnan, 2005). Companies with audit committees encounter decreased earnings manipulation (Lin & Wang, 2010) and engage in increased voluntary disclose of information (Ho & Wong, 2001). An audit committee acts as an intermediary in the event of disputes between the client management and the audit firm on material issues (Salleh & Stewart, 2012). Prior research indicates that internal control weaknesses are high when the audit committees consist of members with less financial and accounting expertise (Zhang, Zhou & Zhou, 2007). Further, audit committees with increased financial expertise are less likely to allow material misstatements to be waived by company management (Keune & Johnstone, 2012). Thus, a financial restatement is less likely when an audit committee comprises a financial expert (Abbott, Parker, & Peters, 2004).

Audit committee members with accounting expertise are better able to identify financial misreporting than audit committee members with other types of financial expertise (Dhaliwal, Naiker, & Navissi, 2010). The time period between the discovery of a problem and issuance of financial restatements is shorter when an audit committee comprises members with accounting expertise relative to those without such expertise (Schmidt & Wilkins, 2013). In addition, earnings management is lower when the audit committees consist of members with as opposed to those without accounting or auditing expertise (Krishnan, 2005). Earnings management is also low when audit committee characteristics such as financial expertise, independence, and meeting frequency are present (Kang, Kilgore & Wright, 2011). However, increased external auditing effort and assurance of the financial information may be necessary with increased independence, financial expertise, and audit committee size (Ghafran & O'Sullivan, 2013). Lack of independence can make an audit committee less effective; for example, the number of occurrences of financial restatements is high when a CEO is involved in selecting audit committee members and directors (Carcello, Neal, Palmrose, & Scholz, 2011). Companies with small audit committees are also less likely to correct material internal control weaknesses (Hammersley, Myers, & Zhou, 2012).

Auditor Tenure

Auditor tenure is defined as the consecutive number of years a client's financial statements are audited by the same audit firm (Al-Thuneibat, Al Issa, & Baker, 2011). Although an audit failure is likely to occur in the first three years of an audit relationship (Stice, 1991), long-term auditor-client relationships are associated with high quality audits because of concerns about issuance of going-concern reports (Geiger & Raghunandan, 2002).

Stanley and DeZoort (2007) examine auditor tenure from both a short- and long-term perspective and find that auditor tenure is negatively related to the issuance of financial restatements. This finding supports the contention that audit quality is low during the early years of the auditor-client relationship because of lack of knowledge about the client and its business (Stanley & DeZoort, 2007) or reliance by the new auditor on the client's representations (Gul, Jaggi, & Krishnan, 2007). These results support earlier research on increased possibility of unexpected accruals for auditor tenure of less than three years (Johnson, Kurana, & Reynolds, 2002), high probability of abnormal accruals during the early years of the auditor tenure (Chung & Kallapur, 2003), and high perceived earnings quality by investors for companies with increased auditor tenure (Ghosh & Moon, 2005). Further, conservatism in earnings increases over time with the length of the auditor-client relationship (Jenkins & Velury, 2008). Increased auditor tenure also contributes to high constraints on income which leads to low discretionary accruals (Myers, Myers, & Omer, 2003).

However, audit quality may decrease with the length of auditor tenure due to over-familiarity with a client or pressure to maintain a business relationship with the client. The findings of Stanley and DeZoort (2007) contradict some of the assumptions about long-term auditor tenure, leading to the call for mandatory auditor rotation. Mandatory auditor rotation may help some companies, but the benefits are limited and may not be applicable to all clients (Lim & Tan, 2010). Mandatory auditor rotation may improve investment efficiency for some companies but create increased investment inefficiencies for others (Lu & Sivaramakrishnan, 2009). Further, mandatory auditor rotation may reduce audit quality and decrease conservatism in reported earnings (Chung & Kallapur, 2003; Geiger & Raghunandan, 2002; Jenkins & Velury, 2008; Johnson, Kurana, & Reynolds, 2002; Myers, Myers, & Omer, 2003).

Use of an industry specialist can mitigate problems associated with a new auditor's lack of client knowledge; specifically, earnings quality is less likely to be negatively influenced by short auditor tenure when a new auditor specializes in the client's industry (Gul, Fung, & Jaggi, 2009). Indeed, companies audited by specialists with increased auditor tenure have higher audit quality than those audited by non-specialists (Lim & Tan, 2010). Hence, auditor tenure and industry specialization are positively related to audit quality (Almutairi, Dunn, & Skantz, 2009).

Auditor Dismissals

Directly after the implementation of SOX, many organizations dismissed their auditors in an attempt to lower audit fees (Cosgrove & Niederjohn, 2008). Ettredge, Li, and Scholz (2007) examine over 5,000 publicly traded companies in 2004 and report a 40 percent increase in audit fees and nearly doubled number of auditor dismissals. Audit fee reduction was the primary reason for the large increase in companies changing auditors in 2004 (Turner, Williams, & Weirich, 2005). Decreased audit fees after the passage of Auditing Standard 5 in 2007 may slow down the growth of auditor switching to lower audit fees (Wang & Zhou, 2012).

Audit firms may offer new clients low fees during the first year of an engagement to encourage them to switch auditors (i.e., "lowballing"). These low fees offers may increase to normal fee levels over time. However, audit firms lower their initial audit discounts for new clients changing auditors during the post-SOX period. The audit firms report following a more conservative approach to lower their fees to obtain new clients post-SOX (Huang, Raghunandan, & Rama, 2009).

Firms tend to dismiss their auditors the year after receipt of an adverse opinion on their internal controls (Ettredge, Heintz, Li, & Scholz, 2011). Some companies dismiss their auditors to engage in opinion shopping (Lu & Sivaramakrishnan, 2009), but this practice has been shown to be unsuccessful (Chang, Cheng, Reichelt, 2010). Other reasons for auditor dismissal include the presence of financial restatements or disagreements on accounting principles with the auditor (Turner, Williams, & Weirich, 2005). Company size is also reported to be related to auditor dismissals; that is, smaller companies dismiss their auditors more frequently, and auditor dismissals are likely for companies with going-concern reports and material internal control weaknesses (Ettredge, Li & Scholz, 2007).

Hypotheses

Voluntary CSR reporting is related to high earnings quality (Kim, Park, & Wier, 2012; Pyo & Lee, 2013); economic stability and strong financial health (Erhemjamts & Venkateswaran, 2013); and enhanced analyst accuracy (i.e., fewer forecast errors) (Dhaliwal, Radhakrishnan, Tsang, & Yang, 2012). Relative to companies that do not file CSR reports, companies that file CSR reports have higher earnings quality (Pyo & Lee, 2013), stronger financial health and economic stability (Erhemjamts & Venkateswaran, 2013), and decreased cost of equity capital in future periods (Dhaliwal, Li, Tsang, & Yang, 2011). Since companies with high financial risks are less likely to invest in CSR activities, business risk is low for companies filing CSR reports (Orlitzky & Benjamin, 2001). The rapid growth of voluntary CSR reporting is evident from the *Fortune* Global 250 where about half of the companies prepare sustainability reports (Kolk, 2003). Since standalone CSR reports indicate the strength of socially responsible behavior, analyst accuracy is high for companies producing voluntary standalone CSR reports and this complements the companies' required financial disclosures (Dhaliwal, Radhakrishnan, Tsang, & Yang, 2012). Earnings quality is also high for companies engaging in voluntary disclosures (Francis, Nanda, & Olsson, 2008).

Internal control weaknesses are related to impaired financial reporting quality, financial weaknesses, and increased risk (Ashbaugh-Skaife, Collins, & Kinney, 2007); increased likelihood of financial restatements (Rice & Weber, 2012); and low audit quality (Ashbaugh-Skaife, Collins, Kinney, & LaFond, 2008; Doyle, Ge, & McVay, 2007). Although prior research suggests that internal control weaknesses result in low audit quality, this finding contradicts the high earnings quality observed in CSR companies (Kim, Park, & Wier, 2012; Pyo & Lee, 2013). The increased risk associated with internal control weaknesses (Ashbaugh-Skaife, Collins, & Kinney, 2007) also contradicts the previous finding of high risk for companies filing CSR reports (Orlitzky & Benjamin, 2001).

While stakeholder theory posits that companies make decisions based on the satisfaction of their stakeholders (McWilliams & Siegel, 2001), legitimacy theory suggests that a company may engage in CSR reporting to hide negative financial performance (Cho & Patten, 2007). Since the needs of stakeholders is an important aspect of CSR reporting and activities (Ballou, Heitger, & Landes, 2006), a company may report CSR activities for the benefit of stakeholders by maintaining high audit quality and strong financial performance. The negative aspects of poor audit quality for a company and its stakeholders include increased risk, decreased value of the company (Huang & Scholz, 2012), and increased cost of debt (Dhaliwal, Hogan, Trezevant, & Wilkins, 2011). According to stakeholder theory, a company wants to avoid the negative consequences associated with poor audit quality because of the harm caused to stakeholders; therefore, the company may engage in socially responsible behavior for the benefit of stakeholders.

Companies engaging in CSR activities are prudent with their financial reporting because of the need to act in the best interests of their stakeholders (Kim, Park, & Wier, 2012). Socially responsible companies are less likely to engage in earnings management via discretionary accruals, manipulate actual operating activities, or face an SEC investigation on financial activities (Kim, Park, & Wier, 2012). This may be attributed to the ethical nature of CSR which is becoming a part of business operations. Ethics is a core element of stakeholder theory because companies have an incentive to act with integrity and practice philanthropic behavior (Jones, 1995). Further, companies practicing CSR are concerned about developing and maintaining a good reputation (Lev, Petrovits, & Radhakrisnan, 2010). Stakeholder theory of CSR reporting proposes that a company engaging in CSR reporting builds goodwill with its stakeholders (Handelman & Arnold, 1999), increases employee job satisfaction, and improves stock performance in the long-run for investors (Edmans, 2001). Legitimacy theory suggests that a company may engage in CSR reporting to hide negative financial performance (Cho & Patten, 2007). This study posits that companies filing CSR reports are concerned about the interests of stakeholders such as high audit quality (stakeholder theory) instead of masking poor financial performance (legitimacy theory). This leads to the following hypothesis:

H_{1a}: Audit quality is higher for companies filing than those not filing CSR reports.

Companies making social responsibility an important part of their business operations experience a decreased cost of capital (Dhaliwal, Li, Tsang, & Yang, 2011), and receive financial benefits by maintaining a good reputation through CSR reporting and socially responsible activities (Lev, Petrovits, & Radhakrisnan, 2010; Handelman & Arnold, 1999).

Companies filing CSR reports are financially stronger and more stable than those not filing the reports (Erhemjamts & Venkateswaran, 2013). Previous studies report that financially risky companies are less likely to engage in CSR activities (Orlitzky & Benjamin, 2001), In addition, low audit quality has been found to be associated with increased financial risk, decreased value for the company (Ashbaugh-Skaife, Collins, & Kinney, 2007; Zhu, Kleuskens, & Grebis, 2010), and increased cost of capital (Dhaliwal, Hogan, Trezevant, & Wilkins, 2011). Measures of high audit quality, such as high earnings quality and decreased financial restatements and internal control weaknesses, can benefit a company financially as a result of improved reputation and increased value for stakeholders (Roberts & Dowling, 2002). In contrast, legitimacy theory of CSR reporting indicates that this action does not promote to the interests of stakeholders, but cover a financial performance shortcoming. Consistent with stakeholder theory, this study proposes that companies filing CSR reports are concerned about the interests of stakeholders and do not engage in CSR reporting to hide negative financial performance. Hence, companies filing CSR reports are less likely to exhibit negative financial performance. This hypothesis is examined in the next hypothesis:

H_{1b}: Companies filing CSR reports are less likely to exhibit negative financial performance than those not filing the reports.

Companies with high quality audit committees are less likely to encounter earnings manipulation (Lin & Wang, 2010), earnings management (Krishnan, 2005), and financial restatements (Abbot, Parker, & Peters, 2004). Companies with strong audit committees are likely to disclose information voluntarily (Ho & Wong, 2001) and the production of a CSR report is a form of voluntary reporting. Voluntary production of CSR reports indicate high integrity in financial reporting (Pyo & Lee, 2013) and increased disclosure which leads to decreased analyst forecast error (Dhaliwal, Radhadrishnan, Tsang, & Yang, 2012). This study posits that CSR reporting companies will have higher quality audit committees than companies not filing CSR reports. Thus,

H_2: Audit committee quality is higher for companies filing than those not filing CSR reports.

Prior research indicates that auditor tenure is associated with audit quality (Geiger & Raghunandan, 2002; Johnson, Kurana, & Reynolds, 2002; Myers, Myers, & Omer, 2003; Stanley & DeZoort, 2007). Specifically, high quality audits are observed with the increased length of auditor-client relationships (Geiger & Raghunandan, 2002). However, relative to the later period, the earlier period of an auditor-client relationship produces more unexpected accruals (Johnson, Kurana, & Reynolds, 2002). In addition, auditor tenure is negatively related to discretionary accruals (Myers, Myers, & Omer, 2003) and financial restatements (Stanley & DeZoort, 2007), and abnormal accruals are high during the early years of auditor tenure (Chung & Kallapur, 2003).

A company with low audit quality faces a high financial risk (Ashbaugh-Skaife, Collins, & Kinney, 2007) and decreased stock price (Zhu, Kleuskens, & Grebis, 2010) that harms the interests of stakeholders. Companies with financial restatements or internal control weaknesses encounter increased risk (Ashbaugh-Skaife, Collins, & Kinney, 2007) and financial reporting failure (Liu, Raghunandan, & Rama, 2009) which decreases stock price (Zhu, Kleuskens, & Grebis, 2010). These negative events do not add value to stakeholders.

Enhanced auditor-client relationships have been shown to improve audit quality without decreasing stakeholder satisfaction (Geiger & Raghunandan, 2002). Stakeholder expectations are a way for a company to meet its overall strategic business objectives (Ballou, Heitger, Landes, & Adams, 2006). CSR reporting provides performance information to a company's stakeholders (Dhaliwal, Radhakrishnan, Tsang, & Yang, 2012) and is a long-term business objective (Waddock & Graves, 1997). Further, CSR reporting facilitates long-term auditor-client relationships (Ballou, Heitger, & Landes, 2006). This study predicts that CSR reporting companies will have longer auditor tenure than companies that do not prepare CSR reports. The next hypothesis examines this issue:

$H_{3:}$ Auditor tenure is longer for companies filing than those not filing CSR reports.

Companies may dismiss their auditors to decrease audit fees (i.e., low balling) (Gul, Fung, & Jaggi, 2009) or engage in opinion shopping (Lu & Sivaramakrishnan, 2009) as a result of financial restatements, disagreements on accounting principles with their auditors (Turner, Williams, & Weirich, 2005), or reported internal control weaknesses (Ettredge, Li, & Scholz, 2007). These short-term reasons for auditor dismissals are in sharp contrast to the benefits a company can derive from a long-term auditor-client relationship including high audit quality (Geiger & Raghunandan, 2002). Since the market perception of audit quality increases over time (Stanley & DeZoort, 2007), negative market reactions may be elicited toward short-term auditor switching due to increased audit risk (Shu, 2000). Auditor tenure is positively related to audit quality because audit quality issues such as increased financial restatements (Stanley & DeZoort, 2007) and abnormal accruals (Chung & Kallapur, 2003) occur during the first three years of an auditor-client relationship.

Stakeholder theory (Waddock & Graves, 1997) and maintenance of a good reputation (Roberts & Dowling, 2002) are long-term objectives which contrast the short-term nature of auditor dismissals during the early years of the auditor-client relationships. Preparation of CSR reports consistent with stakeholder theory (Dhaliwal, Radhakrishnan, Tsang, & Yang, 2012) which conforms to stakeholder principles assist a company to achieve performance initiatives and business objectives (Donaldson & Preston, 1995). Companies may file CSR reports, an action likely to elicit positive effects on the market's perceptions of audit quality (Shu, 2000), to attenuate negative market reactions when they dismiss their auditors during the early years of the auditor-client relationship. This study predicts that companies filing CSR reports will be less likely to dismiss their auditors than companies not filing CSR reports. This prediction is consistent with the long-term nature of stakeholder theory which accentuates the importance of a company's concerns about its reputation and desire to avoid the risk of low audit quality associated with auditor dismissals during the early years of the auditor-client relationship. These issues are examined in the final hypothesis as follows:

$H_{4:}$ Auditor dismissal is lower for companies filing than those not filing CSR reports.

Chapter 3

Methodology

This chapter describes the data collection procedures and statistical analysis employed to test the hypotheses.

Sample and Data Sources

This study looks at publicly traded U.S. companies because this population includes companies of varying sizes in various industries. Only companies traded on a U.S. stock exchange in 2013 are included in the study. The year 2013 is practical because it is the most recent year with all the necessary information. Since some companies prepare a CSR or sustainability report every other year, this study examines the 2012 and 2013 data on CSR reporting. The CSR reports are available from the companies' websites. Consistent with Dhaliwal, Radhakrishnan, Tsang, and Yang (2012), CSR reporting is measured by the production of voluntary standalone CSR reports. In this study measures, CSR reporting includes companies filing separate CSR or sustainability reports including those following and not filling the GRI. Pyo and Lee (2013), the authors examine only CSR reports following the GRI guidelines

The 2013 data on audit quality, audit committee quality, auditor tenure, and auditor dismissals are obtained from the proxy reports and Audit Analytics. The financial information is obtained from the Compustat database. Companies without all the necessary data are excluded from analysis.

Selection of Variables

This study builds on the research of Pyo and Lee (2013) and Kim, Park and Wier (2012). Modifications to the model are necessary because Pyo and Lee (2013) examine donations and accounting conservatism and these issues are not the focus of this study. In addition, Kim, Park, and Wier (2012) use the KLD score for each company to represent commitment to CSR activities while this study uses the preparation of CSR reports including those following and not following the GRI guidelines, an approach similar to Dhaliwal, Radhakrishnan, Tsang, and Yang (2012). Utilization of standalone CSR reports allows for a larger and more diverse sample than other CSR measures because large companies have KLD scores (Waddock & Graves, 1997) or follow the GRI guidelines for CSR reporting (Kolk, 2003; Pyo and Lee, 2013).

Financial restatements are handled in a similar manner as Huang and Scholz (2012). Internal control weaknesses are measured by the presence or absence of a Sarbanes-Oxley Section 404 internal control weakness (Gordon & Wilford, 2012). This study uses the modified Jones model (Dechow, Sloan and Sweeney, 1995) to compute the absolute value of discretionary accruals (ABSDA1). The discretionary accruals model is as follows:

Modified Jones
$$\frac{TA_{it}}{A_{it-1}} = \alpha_0 + \alpha_1 \frac{1}{A_{it-1}} + \alpha_2 \frac{\Delta REV_{it} - \Delta AR_{it}}{A_{it-1}} + \alpha_3 \frac{PPE_{it}}{A_{it-1}} + \alpha_4 ROA_{it-1} + \varepsilon_{it}$$

Where:

A	Total assets in year $t - 1$
ΔAR	Difference between accounts receivable in year t and in year $t - 1$
PPE	Property, plant, and equipment
ΔREV	Difference between revenues in year t and in year $t - 1$
ROA	Net income/total assets or return on assets in year t - 1
TA	Total Accruals (net income–cash flow from operations) in year t for company i

Audit committee quality (Krishnan, 2005; Braswell, Daniels, Landis & Chang, 2012) is based on the size of the audit committee and the financial expertise of the committee. Financial expertise is measured by the percentage of committee members who are financial experts according to the SEC definition of a financial expert (Krishnan, 2005). Prior research has reported advantages associated with accounting expertise on an audit committee including increased transparency in financial reporting (Schmidt & Wilkins, 2013) and improved assurance and audit coverage by the auditor (Ghafran & O'Sullivan, 2013). The number of members on the audit committee; that is, audit committee size is also examined.

Auditor tenure is based on the length of the auditor-client relationship. Although previous studies have decomposed the length of auditor tenure into the following periods: 0 to 5 years, and 6 years and beyond (Al-Thuneibat, Al Issa, & Baker, 2011), the present study uses a continuous measure of auditor tenure to provide additional insight into the findings.

Pyo and Lee (2013) use SWITCH to represent companies changing auditors which includes voluntary auditor resignations. The current study focuses on companies dismissing their auditors and excludes voluntary auditor resignations. In relation to auditor dismissals, this study examines companies that have only one auditor during their existence. This study posits that companies dismissing their auditors are small in size, have low audit quality, experience low financial growth, and engage a non-Big 4 audit firm. Small companies are likely to dismiss their auditors to reduce audit fees because these fees comprise a large portion of their budgets (Ettredge, Li, & Scholz, 2007). In addition, a financial loss indicates increased risk; risky companies are more likely to dismiss their auditors (DeFond & Subramanyam, 1998) and less likely to engage in CSR activities (Erhemjamts & Venkateswaran, 2013). Companies with less growth are also likely to dismiss their auditors (Ettredge, Li, & Scholz, 2007). Companies are less likely to dismiss the Big 4 audit firms because of their high audit quality (Francis, Maydew, & Sparks, 1999). Although many companies dismiss the Big 4 audit firms after an increase in fees and the passage of the Sarbanes-Oxley Act (Ettredge, Li, & Scholz, 2007), enactment of Auditing Standard 5 has resulted in decreased audit fees; therefore, the dismissal rates of the Big 4 audit firms should decrease (Wang & Zhou, 2012).

Control Variables

The control variables include company size, return on assets, financial performance, and audit firm size. Company size is measured by the logarithm of total assets (Braswell, Daniels, Landis, & Chang, 2012; Kim, Park & Wier, 2012; Pyo & Lee, 2013). Return on assets, an indicator of financial performance, is measured by dividing net income by total assets. Companies with strong financial performance are also likely to engage in CSR activities (Wang, Choi, & Li, 2008). In addition, a high risk company is more likely to report a net loss or receive an audit opinion other than an unqualified opinion (Pyo & Lee, 2012) and less likely to invest in CSR activities (Erhemjamts & Venkateswaran, 2013). Since high audit quality has been observed for the Big 4 audit firms (Francis, Maydew, & Sparks, 1999), audit firm size is also included as a control variable.

Methodology

This study compares companies filing and those not filing CSR in relation to audit quality (FR_and_404 and ABSDA1), financial performance (LOSS and ROA), audit committee quality (Fin_Exp1 and Audit_Comm_Size), auditor tenure (CurrAud_Ten), and auditor dismissal (Ds_Aud_13 and One_Aud). The model includes control variables such as audit firm size (Big 4) and total assets (Log_Tot_Assets).

The Pearson Chi-Square test is used to test the audit quality measures of FR_and_404, LOSS, Ds_Aud_13, LOSS and One_Aud. T-test is utilized to test the audit measure of ABSDA1 for hypothesis 1a and is used to test hypotheses 2, (Audit_Comm_Size and Fin_Exp1), and 3 (CurrAud_Ten). Further, audit firm size (Big 4) is tested using the Pearson Chi-Square Test, and Log_Tot_Assets and ROA are tested using t-test. The descriptive statistics are presented in the next chapter.

Chapter 4

Data Analysis and Results

This chapter describes the time period of the research, the source and selection process of the sample, and data analysis and results.

Time Period of the Study

This research examines the activities of publicly-traded U.S. companies in 2013 and includes information for both 2012 and 2013. This study uses recent data due to the continued growth of CSR and sustainability within the U.S. business environment (Kim, Park, & Wier, 2012). The year 2013 is the most recent year with all the available necessary data, and recent enough to avoid the possibility of irregularities in the data due to the recent recession in the U.S. economy and considering the fact that financial losses and discretionary accruals are included in this study. This approach is consistent with Kim, Park, and Wier (2012) and Pyo and Lee (2013) in which recent data are used in their respective studies of CSR activity. Two years of information is necessary because of the discretionary accruals variable and the fact that some companies produce independent CSR or sustainability reports every other year.

Source of the Sample

The sample consists of all U.S. publicly traded companies. The websites of these companies are examined for commitment to CSR or sustainability reporting based on the preparation of voluntary reports. Financial information of the absolute value of discretionary accruals, total assets and the presence of a financial loss are collected from the Compustat database. Audit Analytics is used to collect information related to the companies' choice of auditors and the current tenure of their present auditors. Information related to the quality of the audit committee and audit committee size is gathered directly from the proxy reports of the companies based on the number of financial experts (using the SEC definition) and the number of members on the audit committee.

Sample Selection

The sample consists of all U.S. publicly-traded organizations except for the financial services industry (SIC code 6000 - 6999) and companies that do not have all the required financial information. The financial services industry is eliminated due to differences in the characteristics of accruals (Kim, Park, & Wier, 2013). A few new companies did not prepare all the necessary financial information or file a proxy report; thus, they are not included in the sample. U.S. publicly-traded companies are selected because they represent the population of organizations of varying sizes in different industries; this sample selection process is similar to the sample selection of Pyo and Lee (2013).

Descriptive Statistics

The sample of 2,716 comprises of 544 companies that prepared the CSR reports and 2,172 that did not voluntarily prepare the CSR reports. The two measures of audit quality are financial restatements or Section 404 internal control weaknesses (FR_and_404), and the absolute value of discretionary accruals (ASBDA), the residual of the modified Jones model (Dechow, Sloan, & Sweeney, 1995). The financial stability of a company is measured by the presence or absence of a net loss (Loss) on the income statement. Current auditor tenure (CurrAud_Ten) is a measure of the number of years a company has been with its current audit firm. The number of self-reported financial experts (Fin_Exp1) on each company's audit committee reported in its proxy reports is used to measure the quality of the audit committee.

The size of the audit committee (Audit_Comm_Size) is also used to measure audit committee quality disclosed in the proxy reports.

A number of control variables related to socially responsible behavior are included in the study. These variables include the use of a Big 4 audit firm (Big4) or use of only one audit firm since the inception of the company (One_Aud). Company size is measured by the logarithm of total assets (Log_Tot_Assets). Table 1 presents the definitions of variables in the model.

Table 1

Term	Definition
ABSDA1	The absolute value of discretionary accruals from the modified-Jones
Audit_Comm_Size	Number of members on the audit committee
Big4	1 if a company was audited by a Big 4 audit firm or 0 otherwise
CSR	1 if standalone CSR report was produced in 2012 or 2013 or 0 otherwise
CurrAud_Ten	Continuous measure of auditor tenure
Ds_Aud_13	1 if auditor was dismissed or 0 otherwise
Fin_Exp1	Percentage of audit committee members considered as financial experts
FR_and_404	1 if a financial restatement or Sarbanes-Oxley 404 internal control weakness existed in 2013 or 0 otherwise
Log_Tot_Assets	The logarithm of total assets
LOSS	1 if company records a net loss or 0 otherwise
One_Aud	1 if company has had only one auditor or 0 otherwise

Results

Hypothesis 1a predicts that audit quality will be higher for companies filing CSR reports than those that do not voluntarily file these reports. Tables 2 and 3 display the descriptive statistics of company's filing and those not filing CSR reports in relation to audit quality. Audit quality is measured by discretionary accruals (ABSDA1) and financial restatements or internal control weaknesses (FR_and_404). The mean ABSDA1 for the 544 companies filing the CSR reports in 2012 or 2013 is lower than the mean ABSDA1 for companies not filing the reports (0.0443 v. 0.1003, p=0.000, Table 3). For FR_and_404, the means for companies filing CSR reports are lower than the means for companies not filing the reports (0.0993 v. 01234, p=0.06, one-tailed, Table 2). The results support hypothesis 1a when audit quality is measured by discretionary accruals and supported at p=0.06 (one-tailed) when audit quality is measured by financial restatements and internal control weaknesses.

Table 2
Difference in Means

	CSR	N	Mean	Difference in means	Significance*
FR_and_404	0	544	0.0993		
	1	2172	0.1234	0.0241	P = 0.120
					P = 0.060**
Ds_Aud_13	0	544	0.0147		
	1	2172	0.0405	0.0258	P = 0.004
One_Aud	0	2172	0.4236		
	1	544	0.6268	0.2032	P= 0.000

* = Pearson Chi-Square Test
** = One-tailed Test

FR_and_404 = Financial restatements and/or Section 404 Internal control report
Ds_Aud_13 = Dismiss audit firm during 2013
One_Aud = Only one auditor during life of company

Table 3
Difference in means – Continuous Measure

	CSR	N	Mean	Std. Deviation	Difference in Means	Significance*	Hypothesis Results
CurrAud_Ten	0	2172	10.5428	13.65177			H3
	1	544	24.5184	24.30484	13.9756	0.000	Supported
Fin_Exp1	0	2172	0.4821	0.26146			H2
	1	544	0.5399	0.28923	0.0578	0.000	Supported
Audit_Comm_Size	0	2172	3.4535	0.77510			H2
	1	544	4.1857	1.04964	0.7322	0.000	Supported
ABSDA1	0	2172	0.1003	0.21483			H1
	1	544	0.0443	0.05315	0.0560	0.000	Supported

* T-test was used for significance. Equal variances were not assumed where appropriate.

CurrAud_Ten = The number of years in the current auditor relationship
Fin_Exp1 = The percentage of financial experts on the audit committee
Audit_Comm_Size = The number of member on the audit committee
ABSDA1 = The absolute value of discretionary accruals

Hypothesis 1b states that companies filing CSR reports are less likely to incur a financial loss on their income statements than those not filing the reports. The mean net loss (Loss) of companies filing CSR reports is lower than the mean net loss of those not filing the reports (0.1305 v. 0.3992, p=0.000, Table 4). The mean ROA of companies filing CSR reports is also higher than those not filing the reports (0.08582 v. 0.05767, p=0.000, Table 5). Thus, hypothesis 1b is supported.

Table 4
Difference in Means – Categorical Variables

	CSR	N	Mean	Difference in means	Significance*
Big4	0	2172	0.6634		
	1	544	0.9632	0.2998	P = 0.000
Loss	0	544	0.1305		
	1	2172	0.3992	0.2687	P = 0.000

* Pearson Chi-Square Test

Big4 = Used a Big 4 audit firm
Loss = Incurred a financial loss in 2013

Hypothesis 2 postulates that companies filing CSR reports have higher audit committee quality than those not filing the reports. Audit committee quality is measured by the percentage of financial experts on the committee (Fin_Exp1) and the size of the audit committee (Audit_Comm_Size). As Table 3 indicates, the mean of Fin_Exp1 for companies filing CSR reports is significantly higher than the mean of companies not filing the reports (0.5399 v. 0.4821, p=0.000). Thus, companies filing CSR reports have a higher percentage of financial experts on their audit committees than those not filing the reports. The mean of Audit_Comm_Size for companies filing CSR reports is significantly higher than the mean of companies not filing the reports (4.1857 v. 3.4535, p=0.000). Hence, companies filing CSR reports have larger audit committees than those not filing the reports. Taken together, the results provide support for hypothesis 2.

Hypothesis 3 posits that auditor tenure is longer for companies filing than those not filing CSR reports. Auditor tenure is related to the length of time of a company's current audit firm (CurrAud_Ten). As shown in Table 3, the mean years of auditor tenure is longer for companies filing than those not filing CSR reports (24.5184 v. 10.5428, p=0.000). Therefore, companies filing CSR reports have longer auditor tenure than those not filing the reports, providing support for hypothesis 3.

Hypothesis 4 proposes that the number of auditor dismissals is lower for companies filing than those not filing CSR reports. The mean rate of auditor dismissals (Ds_Aud_13) for companies filing CSR reports is significantly lower than the mean rate for companies not filing these reports (0.0147 v. 0.0405, Table 2) and is significant based on a Pearson Chi-Square Test (P=0.004, Table 2). Further, this study provides insight into whether companies filing CSR reports are more likely to have only one audit firm since inception (One_Aud) compared to those not filing CSR reports. The mean percentage of companies having one audit firm since inception is significantly higher for companies filing than those not filing CSR reports (0.6268 v. 0.4236, p=0.000, Table 2).

In sum, the results suggest that companies filing CSR reports are less likely to dismiss their auditors compared to those not filing these reports. In addition, companies filing CSR reports are more likely to maintain a relationship with only one audit firm than those not filing these reports. Thus, hypothesis 4 is supported.

<u>Additional Analysis</u>

In addition, the findings indicate that companies filing CSR reports are larger in terms of total assets (Log_Tot_Assets) (3.8030 v. 2.5879, p=0.000, Table 5), and are more likely to use a Big 4 auditor (Big 4) (0.9632 v. 0.6634, P =0.000, Table 4) than those not filing CSR reports.

The results are mixed in the standard deviations of the means. Relative to companies filing CSR reports, companies not filing CSR reports have larger standard deviations for FR_and_404 (0.32896 v. 0.29929; Table 6), Ds_Aud_13 (0.19721 v. 0.12048; Table 6), ABSDA1 (0.21483 v. 0.05315; Table 7), Big4 (0.47264 v. 0.18836; Table 8), Log_Tot_Assets (0.79260 v. 0.69508; Table 9), ROA (0.08582 v. 0.05767; Table 9), and Loss (0.48984 v. 0.33718; Table 8). In contrast to companies not filing CSR reports, those filing the reports have higher standard deviation in relation to One_Aud (0.49424 v. 0.48409; Table 6), CurrAud_Ten (24.30484 v. 13.65175; Table 7, Audit_Comm_Size (1.04964 v. 0.77510; Table 7), and Fin_Exp1 (0.28923 v. 0.26146; Table 7).

In relation to the minimum (Min) and maximum (Max) measures, the maximum is higher for companies filing than those not filing CSR reports in relation to CurrAud_Ten (123 v. 114; Table 7), Aud_Comm_Size (9 v. 8; Table 7), Log_Tot_Assets (5.82 v. 5.05; Table 9). Further, companies not filing CSR reports have a larger maximum for ABSDA1 than those filing the reports (4.46 v. 0.76; Table 7). These results support the findings of the hypotheses with respect to CSR companies having longer auditor tenure (CurrAud_Ten), larger audit committees (Aud_Comm_Size), higher total assets (Log_Tot_Assets) and lower discretionary accruals (ABSDA1) than companies not filing the reports. Relative to companies not filing CSR reports, those filing the reports have a higher minimum for Fin_Exp1 (0.13 v. 0; Table 7) and Log_Tot_Assets (1.62 v. 0.12; Table 9). Companies not filing CSR reports have a higher maximum for ROA than those filing the reports (2.55 v. 0.62; Table 9); this contrasts the higher mean of ROA for the latter. The remaining variables have a minimum of 0 and a maximum of 1 (see Tables 7 to 9).

Table 5
Difference in Means – Continuous Measures – Other Variables

	CSR	N	Mean	Std. Deviation	Difference in Means	Significance*
Log_Tot_Assets	0	2172	2.5879	0.79260		
	1	544	3.8030	0.69508	1.2151	0.000
ROA	0	2172	0.0460	0.08582		
	1	544	0.0630	0.05767	0.017	0.000

* T-test was used for significance. Equal variances were not assumed where appropriate.

Log_Tot_Assets = The logarithm of total assets
ROA = Return on Assets

Table 6
Minimum, Maximum and Standard Deviation

	CCSR	N	Minimum	Maximum	Standard Deviation
FR_and_404	0	544	0	1	0.29929
	1	2172	0	1	0.32896
Ds_Aud_13	0	544	0	1	0.12048
	1	2172	0	1	0.19721
One_Aud	0	2172	0	1	0.48409
	1	544	0	1	0.49424

FR_and_404 = Financial restatements and/or Section 404 Internal control report
Ds_Aud_13 = Dismiss audit firm during 2013
One_Aud = Only one auditor during life of company

Table 7
Minimum, Maximum and Standard Deviation

	CSR	N	Minimum	Maximum	Standard Deviation
CurrAud_Ten	0	2172	0	114	13.65177
	1	544	0	123	24.30484
Fin_Exp1	0	2172	0	1	0.26146
	1	544	.13	1	0.28923
Audit_Comm_Size	0	2172	1	8	0.77510
	1	544	3	9	1.04964
ABSDA1	0	2172	0	4.46	0.21483
	1	544	0	.76	0.05315

CurrAud_Ten = The number of years in the current auditor relationship
Fin_Exp1 = The percentage of financial experts on the audit committee
Audit_Comm_Size = The number of member on the audit committee
ABSDA1 = The absolute value of discretionary accruals

Table 8
Minimum, Maximum and Standard Deviation – Categorical Variables

	CSR	N	Minimum	Maximum	Standard Deviation
Big4	0	2172	0	1	0.47264
	1	544	0	1	0.18836
Loss	0	544	0	1	0.33718
	1	2172	0	1	0.48984

Big4 = Using a Big 4 audit firm
Loss = Incurring a financial loss in 2013

Table 9
Minimum, Maximum and Standard Deviation – Other Variables

	CSR	N	Minimum	Maximum	Standard Deviation
Log_Tot_Assets	0	2172	.12	5.05	0.79260
	1	544	1.62	5.82	0.69508
ROA	0	2172	0	2.55	0.08582
	1	544	0	.62	0.05767

Log_Tot_Assets = The logarithm of total assets
ROA = Return on Assets

Chapter 5

Summary and Conclusion

This chapter discusses the implications of the findings, and explains the contributions, limitations, and suggestions for future research.

Research Problem

A growing number of companies are voluntarily preparing reports that discuss their socially responsible activities toward the environment, social causes, and their communities. The extant literature has examined socially responsible behavior in relation to financial benefits (Lev, Pertrovits, and Radhakrishnan, 2010), improved reputation (Toms, 2002), financial risk (Orlitzky and Benjamin, 2001), and earnings quality (Kim, Park, & Wier, 2012; Pyo & Lee, 2013). This study builds on this research by examining whether engagement in socially responsible behavior via CSR reporting affects audit quality, audit committee quality, auditor tenure, and auditor dismissals.

Audit quality, audit committee quality, auditor tenure and auditor dismissal are important aspects of corporate governance (Francis, 2004; Lary & Taylor, 2012; Braswell, Daniels, Landis, & Chang, 2012; Ghafran & O'Sullivan, 2012). Audit committee size is positively related to audit committee quality and audit committees with more financial experts is associated with decreased possibility of earnings manipulation (Lin & Wang, 2010). Further, increased auditor tenure is negatively related to discretionary accruals (Myers, Myers, & Omer, 2003) and financial restatements (Stanley & DeZoort, 2007). An auditor dismissal is also positively associated with increased possibility of abnormal accruals during the early years of the relationship with a new auditor (Chung & Kallapur, 2003).

CSR reporting can be considered as an element of corporate governance because of increased transparency in voluntary non-financial reporting disclosures (Dhaliwal, Radhakrishnan, Tsang, & Yang, 2012; Haniffa & Cooke, 2005) and decreased cost of capital (Dhaliwal, Li, Tsang, & Yang, 2011). Two theories related to CSR reporting include stakeholder and legitimacy theories. Stakeholder theory states that companies engage in socially responsible behavior to benefit their stakeholders. Legitimacy theory proposes that companies engage in socially responsible behavior to hide poor financial performance or ethical violations. The present study examines these theories to provide insight into the reasons for socially responsible behavior in business. Specifically, this study identifies companies filing versus those not filing CSR reports and examines the impact on audit quality, financial loss, audit committee quality, auditor tenure, and auditor dismissals.

Summary of Findings

The findings reveal that audit quality is higher for companies filing compared to those not filing CSR reports. Specifically, audit quality measured via the absolute value of discretionary accruals is significantly lower for companies filing than those not filing CSR reports. Further, companies filing CSR reports are less likely to have a Section 404 internal control weakness or report a financial restatement. These findings are consistent with prior research findings on lower discretionary accruals for companies with a strong KLD score, suggesting socially responsible behavior (Kim, Park, & Wier, 2012), and lower discretionary accruals for Korean companies filing CSR reports following the GRI guidelines (Pyo & Lee, 2013).

In addition, the findings indicate that relative to companies not filing CSR reports, those filing the reports have higher quality audit committees; that is, higher percentage of financial experts on the audit committees and larger audit committees. Further, the findings indicate that relative to companies not filing CSR reports, those filing the reports have longer auditor tenure, lower tendency to dismiss their audit firms, and are more likely to have only one audit firm.

Implications of Findings

In sum, the findings highlight the financial benefits (Lev, Petrovits, & Radhakrishnan, 2010) and intangible benefits such as enhanced reputation (Toms, 2002) of CSR reporting on audit quality, audit committee quality, auditor tenure, and auditor dismissal. Voluntary filing of CSR reports represents a high level of voluntary disclosure that adds to the financial disclosure of a company. Increased voluntary disclosure facilitates enhanced earnings quality (Francis, Nanda, & Olsson, 2008) and analyst accuracy (Dhaliwal, Radhakrishnan, Tsang, & Yang, 2012), exerting a positive effect on audit quality.

In addition, the findings indicate financial benefits for companies filing CSR reports. Specifically, these companies have a higher return on assets and are less likely to recognize a financial loss. Prior research shows that voluntary filing of CSR reports is associated with decreased cost of capital (Dhaliwal, Li, Tsang, & Yang, 2011), increased environmental reporting is positively related to economic performance (Al-Tuwaijri, Christensen, & Hughes II, 2004), and increased charitable giving is related to future growth in revenues (Lev, Petrovits, & Radhakrishnan, 2010). Additional analysis reveals that companies filing CSR reports are more likely to use Big 4 audit firms and have more total assets than those not filing the reports. These findings are consistent with the findings of previous studies (Pyo & Lee, 2013; Kim, Park, & Wier, 2012).

Consistent with stakeholder theory, the findings of this study suggest that companies filing CSR reports have less financial risk compared to those not filing the reports (Orlitzky & Benjamin, 2001). Low audit quality (i.e., poor earnings quality, financial restatements, Section

404 internal control weaknesses,), auditor dismissals, early years of auditor tenure, financial losses, and poor return on assets indicate increased financial risk for a company. In addition, companies filing CSR reports are less likely to record a net loss on their income statement and have a higher return on assets. Increased financial risk may support legitimacy theory because companies are likely to engage in CSR reporting to hide their poor financial performance. The findings of this study suggest that compared to companies not filing CSR reports, those filing the reports have less financial risk because of higher audit quality, increased auditor tenure, and decreased auditor dismissal. Further, companies filing CSR reports are larger than those not filing the reports. Therefore, the additional analysis corroborates the major findings suggesting decreased financial risk for companies filing CSR reports and providing support for stakeholder theory of socially responsible behavior.

Contributions

The findings of the present study contribute to the extant literature by demonstrating the positive effect of socially responsible behavior (measured via the filing of CSR reports) on audit quality, financial performance, audit committee quality, and auditor tenure, and auditor dismissal. To this study's knowledge, prior research has not examined CSR reporting in relation to audit quality and factors such as financial loss, audit committee quality, auditor tenure, and auditor dismissals.

High audit committee quality, increased auditor tenure, and decreased auditor dismissal enhance audit quality (Zhang, Zhou, & Zhou, 2007; Stanley & DeZoort, 2007; Chung & Kallapur, 2003). Consistent with prior research (Choi, Kim, & Zang, 2010; Lobo & Zhao, 2013; Ashbaugh-Skaife, Collins, & Kinney, 2007), this study uses discretionary accruals, financial restatements, and Section 404 internal control weaknesses as measures of audit quality.

Although previous research has examined accruals quality in relation to CSR reporting (Pyo & Lee, 2013; Kim, Park, & Wier, 2012), the present study uses a different measure of CSR reporting by examining all companies voluntarily preparing a separate CSR report and not just those that prepare a CSR report following GRI standards. The use of companies preparing a CSR report including those who follow GRI guidelines versus only those who prepare CSR reports following GRI standards increases the size and adds diversity (company size and industry) to the sample (Waddock & Graves, 1997; Kolk, 2003). This study also differs from other research by breaking out the results between CSR reporting and non-CSR reporting companies based on audit quality and elements of audit quality. The results indicate that discretionary accruals are a stronger measure of audit quality than financial restatements and Section 404 internal control weaknesses.

Limitations

Like any research, this study has some limitations. Since this study compares companies filing versus those not filing CSR reports; hence, the statistical method used to test the hypotheses does not show the correlations between CSR and the variables shown in a logistic regression model in Pyo and Lee (2013) and Kim, Park, and Weir (2012). For example, correlation analysis can identify the existence of a relationship between CSR and company size. Prior research (Pyo and Lee, 2013; Kim, Park, and Weir, 2012) does not compare directly CSR versus non-CSR reporting companies to examine how this influences audit quality, financial loss, audit committee quality, auditor tenure, and auditor dismissal. The present study contributes to the extant literature by promoting understanding of these issues.

The time period of the sample may also be a limitation. The sample uses the entire population of U.S. companies from 2013, except the financial services companies. However, selection of a current time period such as 2013 avoids use of data during the recent recession. Future research can investigate whether use of data from a longer time period (two or three years) may add credibility to the results of this study and display possible trends in the data.

Filing of standalone CSR reports is a voluntary activity engaged by many companies; however, few companies are audited for verification of any of the activities reported in these reports. CSR reports may indicate a company's socially responsible behavior (Pyo & Lee, 2013), but the accuracy of these self-reported activities depends on the companies preparing the reports; especially if they are not verified by an independent third-party. Hence, the CSR reports may not necessarily reflect socially responsible behavior.

Suggestions for Future Research

Future research can investigate the relationship between CSR reporting and audit quality over an extended period of time to determine whether the findings are different during the recent recession. Further, trends in the data can provide insight into whether the positive effect of CSR reporting on audit quality increases over time or tapers off at a certain point in time.

Future work can decompose the data by industry or SIC code to promote understanding of the relationship between CSR and audit quality. For example, examination of companies in a specific industry such as energy or retail may reveal different relationship between CSR and audit quality. Finally, researchers can identify which industries are more involved in socially responsible behavior and enhance understanding of whether stakeholder or legitimacy theory better explains the CSR activities of companies.

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