EFFECTS OF NEW CLIENTS ON THE

AUDIT QUALITY OF AN AUDIT

PARTNER'S EXISTING PORTFOLIO

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By

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EFFECTS OF NEW CLIENTS ON THE AUDIT QUALITY OF
AN AUDIT PARTNER'S EXISTING PORTFOLIO

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ABSTRACT

Using AP forms filed with the PCAOB between 2017 and 2021, I find that audit partners on new engagements experience attention costs that adversely affect the audit quality of their existing engagements. The existing engagements of a distracted partner have higher discretionary accruals and lower working capital accruals quality. Further analysis reveals that audit firm changes, rather than partner-only changes, drive the negative effects, suggesting that the engagement team's client-specific experience reduces the attention cost an audit partner experiences from a new engagement. In cross-sectional analysis, I find that audit firm tenure, audit firm size, and audit office industry specialization also mitigate the adverse effects of new clients. The attention costs resulting from new clients are distinct from partner busyness measured by the total number of clients. My findings highlight a negative consequence of audit firm rotation and show that new clients impose attention costs on audit partners that adversely affect the audit quality of their existing engagements.

Effects of New Clients on the Audit Quality of an Audit Partner's Existing Portfolio

I. Introduction

Audit partners are important to audit outcomes (Gul, Wu, and Yang 2013). Partner characteristics such as age, gender, education, experience, expertise, ethics, and style have all been shown to impact audit quality (see Lennox and Wu 2018 for a review). However, the differences in inter-partner effects on audit quality are not fully explained by partner demographic information, suggesting that other factors relating to partners influence audit quality (Cameran, Campa, and Francis 2022). My study examines whether the attention cost to a partner resulting from a new client has adverse effects on the audit quality of that partner's existing engagements.

Attention is a finite resource that can be allocated to different activities (Kahneman 1973). "Limited attention" refers to a person's finite capacity of attention or effort. Each task or activity bears a cost on a person's limited attention. These "attention costs" are the amount of limited attention an activity consumes. When an activity does not receive sufficient effort because of the attention costs of other activities, performance falters or fails (Kahneman 1973). The combined attention costs of all activities is a person's "busyness". Regulators are concerned about increased partner busyness contributing to negative audit outcomes (PCAOB 2015a). Prior research looked at a partner's level of busyness, measured as a partner's total number of clients, and found mixed evidence on whether it affects audit quality (Burke, Hoitash, and Hoitash 2019; Goodwin and Wu 2016).

Different activities impose different attention costs (Kahneman 1973). My study looks at a potential source of substantial attention costs on the partner: new clients. Audit

market regulators, including those in the U.S., often require mandatory audit partner rotation, with the reasoning that reduced auditor independence associated with long tenure can decrease audit quality (PCAOB 2011). However, a lack of client-specific experience could impair audit effectiveness and efficiency on new engagements, and the PCAOB recognizes that there is a tradeoff "between preserving the benefit of an audit team's experience with a particular client and adding new auditors who may provide a fresh look at audit issues" (PCAOB 2015a). Gipper, Hail and Leuz (2021) find that new audit engagements consume significant audit partner effort, consistent with the notion that a lack of client-specific experience hurts audit efficiency. Additionally, prior research shows that audit engagements across audit offices and partners are connected (Francis and Michas 2013; Li, Qi, Tian, and Zhang 2017; Christensen, Newton, and Wilkins 2021). The time spent on a new engagement, i.e., the attention costs of the new engagement, could divert the partner's limited attention away from their existing engagements. Therefore, I predict that the assignment of a new client to a partner adversely affects the audit quality of the partner's existing engagements.

To test this prediction, I examine partner changes from 2017 to 2021 using the PCAOB's Form AP data. This data contains information on audit partner identities for U.S. public companies, allowing me to track partner changes and observe the public clients a partner audits. I use new engagements as a source of significant attention costs that could affect the attention expended on the existing clients. I measure the effect of the attention costs of new clients on three audit outcome variables. My first audit outcome measure is the absolute value of discretionary accruals, which captures the financial reporting flexibility management possesses (Kothari, Leone, and Wasley 2005). Next, I examine

working capital accruals quality, proxied by the residual from firm-specific regressions of changes in working capital on past, present, and future operating cash flows (Dechow and Dichev 2002). This residual shows how well the client's accruals map into past, present, and future cash flow realizations. Finally, I look at audit report lag, a measure of timely financial reporting. Not only does audit lag reflect timely financial reporting, it also gives insight into the time constraints a partner experiences.

Consistent with the notion that new clients carry significant attention costs, I find that existing engagements of audit partners with new clients exhibit lower audit quality. Specifically, the existing clients have significantly higher absolute value of discretionary accruals and lower working capital accruals quality. I also find some evidence that existing clients of partners with new clients also have longer audit lags. These findings support the hypothesis that the attention costs of new engagements have negative effects on existing engagements.

To corroborate the inference from the main tests, I conduct a series of analyses that exploit the variation in client-specific knowledge and audit firm resources. Engagements new to the audit firm are different from engagements new to the partner only, as the engagement team will have valuable client-specific experience on the latter but not the former. Prior research has shown that engagement team continuity enhances audit quality and the ability of new partners to connect with prior partners improves post-rotation performance (Christensen, Newton and Wilkins 2021; Pittman, Wang, and Wu 2022). Greater engagement team client-specific knowledge enhances audit efficiency and reduces the attention cost of a new engagement. Consistent with this reasoning, I find audit firm changes bring attention costs that result in negative effects on the partner's existing clients,

but partner-only changes do not. For existing engagements, the client-specific knowledge of the engagement team increases with greater auditor tenure. Tenure helps auditors develop familiarity with the client, and most studies find that tenure improves audit quality (DeFond and Zhang 2014). I find that existing clients with longer audit firm tenure experience less severe negative effects on audit quality when the partner gets a new client.

Audit firm resources and competencies can also mitigate the effects of the attention costs of new clients. Audit firm size promotes economies of scale that make monitoring more efficient and allows for greater investments in human capital (Watts and Zimmerman 1981; Dopuch and Simunic 1982). These resources can support partner transitions and reduce the cost of a new engagement on the audit partner's attention. I find that partners at Big 4 firms experience less severe adverse effects following partner rotation than partners at non-Big 4 firms. In terms of auditor competency, industry specialization can allow auditors to provide more effective and efficient audits (Chin and Chi 2009; Reichelt and Wang 2010; Bills, Jeter, and Stein 2015; Gaver and Utke 2019). I find some evidence that audit office specialization in the existing client's industry helps reduce the effects of new clients on existing engagements.

I also conduct additional tests to help strengthen the conclusion that new engagements bear significant attention costs to audit partners. As prior research has shown the importance of engagement team workload to audit quality (Christensen, Newton, and Wilkins 2021), I consider whether the limited attention stemming from client rotation is truly a partner effect or a wider engagement team effect. While I cannot observe the engagement team composition, I can observe client changes at the partner- and office-level. Engagement team members on the new client are likely to be staffed on other

engagements in the office. When I compare the partner-level effect to the office-level effect (where the office gets a new client), I find that the partner-level effect is still significant.

Prior studies viewed partner busyness as a function of the number of clients a partner has (Goodwin and Wu 2016; Burke, Hoitash, and Hoitash 2019). It is possible that the effect I observe is not coming from more effort on the new engagement, but rather from an increase in the partner's total number of engagements. To test the source of the attention costs, I control for the partner's total number of clients — the measure of partner busyness used by prior studies. My results are robust to including this control, indicating the attention costs from new clients are a distinct strain on the partner's limited attention.

This paper answers the calls in Lennox and Wu (2018) and Hanlon, Yeung, and Zuo (2022) for additional research that explores how individual partner characteristics affect audit and client outcomes. My findings add in two ways to the understanding of how the partner-level characteristic of limited attention affects audit quality. First, I examine how a partner's limited attention is affected by the attention costs that stem from new engagements. Prior literature examined audit partner limited attention by looking at the level of partner busyness, measuring it as a function of the number of clients and provides mixed evidence of its effects on audit quality (Goodwin and Wu 2016; Burke, Hoitash, and Hoitash 2019). Goodwin and Wu (2016) find that limited attention does not adversely affect partners when the partner maintains an optimal equilibrium level of busyness. However, new engagements take significantly more of the partner's time (Gipper, Hail and Leuz 2021), meaning the attention costs from the new clients can disrupt the partner's busyness equilibrium even when the total number of clients does not change. My study shows attention costs resulting from a new engagement have negative effects on the

partner's existing clients, and this effect is distinct from the number of clients the partner has.

Second, my paper provides novel evidence on the negative consequences of the attention costs of new clients and audit partner limited attention on audit quality in the U.S. setting. Currently, the evidence that U.S. audit partners suffer negative effects from limited attention remains sparse, since partner-level engagement data only became available in 2016. Burke, Hoitash, and Hoitash (2019) find a negative relationship between a partner's number of clients and audit fees, but no relationship with audit quality measures such as discretionary accruals or audit delay. Much of prior research examining limited attention in audit partners uses data from non-U.S. settings (Sundgren and Svanstrom 2014; Goodwin and Wu 2016; Gul, Ma, and Lai 2017; Habib, Bhuiyan, and Sun 2019; Lo, Lin, and Wong 2019). However, the U.S. audit market is substantially different from the audit markets of other countries, as institutional factors such as high litigation risk and PCAOB inspections are positively associated with audit quality (Khurana and Raman 2004; DeFond and Lennox 2011; Lamoreaux 2016). Therefore, it is *ex ante* unclear that the international evidence on audit partner limited attention affecting audit quality would generalize to the U.S. setting. My study uses PCAOB data to find evidence that U.S. audit partners suffer consequences because of their limited attention.

This study also adds to the literature documenting the connectedness of engagements. Prior research has found that audit failures, such as restatements, at the office- and partner-level can carry over to other engagements (Francis and Michas 2013; Li, Qi, Tian, and Zhang 2017). This paper complements those studies by highlighting the importance of new engagements on audit partner attention. Rather than looking at how

audit outcomes from one engagement affects related engagements, I show that the existence of a new engagement imposes attention costs that have adverse effects on other engagements in the partner's portfolio.

My results should be of interest to audit firms and regulators concerned about on the attention costs of new clients and audit partner limited attention. Audit firms can factor in the potential decline in audit quality among existing engagements when determining whether to accept new clients. I also highlight the importance of greater audit firm tenure and audit office industry specialization on mitigating the adverse effects from attention costs of a new client. Audit firms can consider these factors in existing clients when assigning new clients to partners in order to reduce the negative consequences of new engagements. Finally, the results of this paper empirically support regulators' concern that audit partners distracted by high attention costs will deliver worse audit outcomes (PCAOB 2015a). My paper identifies audit firm switches — not intra-firm partner changes — as a source of substantial attention costs that adversely affects existing clients. This result provides support for the current U.S. regime of mandatory partner rotation and identifies an additional cost that regulators should be aware of if they consider requiring mandatory audit firm rotation.

II. Background and Hypothesis Development

Limited Attention and Attention Costs in the Accounting Literature

Traditional economic theory assumes decision-makers are perfectly rational and incorporate all available information when making decisions (Simon 1955). Behavioral economics relaxes this assumption through the theories of bounded rationality and limited attention, which accept that decision-makers have cognitive limitations because time and attention are finite resources (Simon 1955; Simon 1990; Kahneman 1973; DellaVigna 2009). In other words, "limited attention" is a person's finite capacity of attention. The "attention cost" of an activity is the amount of limited attention that activity consumes. Any activity that bears an attention cost leaves less attention available for other activities. The overall amount of attention consumed by all activities is a person's "busyness". The finite nature of attention means there is a cost on gathering and processing information, and some useful information might not be incorporated into decisions (Simon 1971). Performance falters or fails when an activity does not receive sufficient effort because of the attention costs of other activities (Kahneman 1973).

It is important to note that while this paper uses the term "attention cost" to refer to the amount of attention consumed by an activity, the term "disclosure processing costs" has been used in the accounting literature to communicate a related idea in the area of disclosures.[1] Both terms operate similarly in the framework of limited attention, and Blankespoor, deHaan, and Marinovic (2020) define disclosure processing costs as "how costs of monitoring for, acquiring, and analyzing firm disclosures … affect investor information choices, trades, and market outcomes" (p. 1). Limited attention has also been

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[1] For a review of the literature on disclosure processing costs, see Blankespoor, deHaan, and Marinovic (2020).

shown to adversely affect the board of directors, investors, sell-side analysts, loan officers, and market makers (Chakrabarty and Moulton 2012; Corwin and Coughenour 2008; DellaVigna and Pollet 2009; Driskill, Kirk, and Tucker 2020; Fich and Shivdasani, 2006; Hirshleifer, Lim, and Teoh 2009; Kempf, Manconi, and Spalt 2017; Liu et al. 2020; Liu 2022; and Peng 2005).

Audit offices are also impacted by attention costs and limited attention. Lopez and Peters (2012) find the concentration of fiscal year-ends in December hurts audit quality, as busy-season clients have larger abnormal accruals and are more likely to meet or beat earnings benchmarks by small amounts. Czerney, Jang, and Omer (2019) show audit quality decreases when audit offices have concentrated client deadlines. Using fieldwork hours data from Korea, Heo, Kwon, and Tan (2021) find busy-season audits are associated with lower audit quality and firms reduce the involvement of senior auditors for these audits.

Audit Partners and Audit Quality

My focus is on the role of attention costs and limited attention in the context of audit partners. Prior research has shown the importance of individual audit partners in affecting audit outcomes. Inter-partner differences are the most important auditor factor in explaining audit quality, when compared to inter-firm or inter-office differences (Cameran, Campa, and Francis 2022). Further, these inter-partner effects are not fully explained by the available partner demographic characteristics. Gul, Wu, and Yang (2013) find significant variation in audit quality between different audit partners in the Chinese audit market. Audit partner differences in industry- or client size-based specialization also affect audit fee premiums (Zerni 2012).

Audit partners have persistent styles which affect audit engagement outcomes (Knechel, Vanstraelen, and Zerni 2015). Audit quality can also vary with auditor IQ or off-the-job behaviors (Kallunki, Kallunki, Neimi, and Nilsson 2019; Pittman, Stein, and Valentine 2021). Audit failures can have a contagion effect on a partner's other engagements (Li, Qi, Tian, and Zhang 2017). Consistent with the findings of these papers on audit partner characteristics, the PCAOB (2015b) believes that providing information about the audit partner can give financial statement users insights into audit quality.

Audit partner rotation is another factor that could impact audit quality. Currently, evidence on partner tenure and rotation is mixed, with some studies finding limited "fresh-look" benefits and others finding no or marginally negative effects of new partners (Carey and Simnett 2006; Gipper, Hail, and Leuz 2021; Kuang, Li, Sherwood, and Whited 2020; Manry, Mock, and Turner 2008; and Laurion, Lawrence, and Ryans 2017). Taking the audit partner literature together, audit partners play a significant role in determining audit outcomes. However, evidence is mixed as to whether partner changes affect audit quality. In their reviews of the literature on audit partners and individual decision makers, Lennox and Wu (2018) and Hanlon, Yeung, and Zuo (2022) call for additional research to explore how individual characteristics of audit partner's affect audit and client outcomes.

Main Hypothesis

Lennox and Wu (2018) recognize that "it is important to determine whether high [audit partner] workloads result in low-quality audits." Regulators are also concerned with the effect of limited attention and attention costs on audit partners. According to the PCAOB (2015a), "Heavy workloads could distract an engagement partner from giving adequate and focused attention to an audit engagement". Researchers have begun to study

the effects of limited attention on audit partners, but they have used variations on one measure of busyness: the total number of engagements per partner. Burke, Hoitash, and Hoitash (2019) examine how U.S. partner busyness, proxied by the number of public clients, affects audit outcomes. They observe no impact of number of clients on discretionary accruals or audit delay, but find audit fees are negatively associated with the partner's number of engagements.

Using data on partners in Swedish audit firms, Sundgren and Svanstrom (2014) find a negative association between the number of engagements and the likelihood of a going-concern opinion before bankruptcy. Gul, Ma, and Lai (2017) find Chinese audit partners with more public clients have lower audit quality, especially for clients with shorter audit tenure. Lo, Lin, and Wong (2019) observe that Chinese CPA firms with more available partners perform higher quality audits. Habib, Bhuiyan, and Sun (2019), observe that the number of clients audited by Australian audit partners affects a client's cost of capital. Goodwin and Wu (2016), using data on audit partners in Australia, do not find that partner workload is linked to audit quality if a partner can maintain an optimal equilibrium busyness.

Overall, the empirical evidence suggests audit partners can be susceptible to negative effects from limited attention in some circumstances. However, the partner busyness literature has focused on busyness as a function of number of clients, which does not account for the varying attention costs that different engagements have. Also, despite some international evidence suggesting limited attention can affect audit partners, there is currently no evidence in the U.S. audit market of such an impact on audit quality beyond audit fees. Several institutional factors set the U.S. audit market apart from the audit

markets of other countries. Auditors of U.S. and U.S-listed clients must undergo PCAOB

inspections, which have been shown to improve audit quality and incentivize low-quality

auditors to exit the market (DeFond and Lennox 2011; Lamoreaux 2016). The U.S. audit

market is also subject to high litigation costs, which create incentives to provide high-

quality audits (Khurana and Raman 2004). It is *ex ante* unclear that the international

evidence on audit partner limited attention affecting audit quality would generalize to the

U.S. setting.

A new engagement could be the source of significant attention costs to the partner.

Gipper, Hail, and Leuz (2021) find evidence that new engagements demand more partner

time than existing engagements. Using proprietary partner-level data, they observe

significant increases in total audit hours and total partner hours following an audit partner

rotation. Christensen, Newton, and Wilkins, (2021) study how audit team staffing

workload affects audit outcomes. They find audit quality on the primary client suffers when

the team members work more hours on other clients concurrently. The significant attention

costs demanded by a new engagement can consume much of the partner's available

attention and distract her from other clients. As a result, I expect existing engagements of

a partner with a new client exhibit lower audit quality, leading to my first hypothesis (stated

in the alternate form):

*Hypothesis 1: The attention costs from a new client result in adverse effects on the audit
quality of the partner's existing engagements, ceteris paribus.*

While this prediction is plausible, there may be no relation between the attention

costs resulting from new clients and audit quality in existing engagements for at least two

reasons. First, an audit engagement is a dual choice by both the partner and client. Goodwin

and Wu (2016) argue that audit partners can choose their optimal busyness when selecting

engagements, making it difficult to empirically observe a causal relation between audit partner busyness and audit quality. Using Australian data, they find evidence that the partner's level of busyness is not reliably linked to audit quality in times of auditor busyness equilibrium. If this view is correct and audit partners could choose their equilibrium busyness, an audit partner would not take on a new client if the attention costs would negatively affect the audit quality of the other engagements, and I will not find evidence of negative effects of attention costs resulting from new clients. Second, to the extent that the audit partner already has experience on the existing clients in their portfolio, client-specific knowledge could allow for an audit to be conducted more effectively (PCAOB 2015a). Therefore, there might not be a drop in audit quality even if a new engagement occupies much of an audit partner's time. Thus, whether I find results consistent with H1 is an empirical question.

The Role of Client-Specific Knowledge

Based on the process of an audit engagement, I do not expect the negative effects of attention costs to be homogeneous across all engagements. The first source of expected variation is whether the partner's new client is already audited by the partner's firm. Engagements new to the audit firm are different from engagements new to just the partner because of the engagement team's experience. Regulators worry about the high learning curve associated with new audits, as auditors lack the client-specific knowledge that make audits more efficient (PCAOB 2011; PCAOB 2015a). In instances of partner-only rotation, much of the existing engagement team will have valuable client-specific knowledge. Their expertise can make the audit more efficient and reduce the attention costs of the new engagement to the partner. The importance of the engagement team's client-specific

experience is shown in Christensen, Newton and Wilkins (2021), which finds increased year-over-year staffing continuity is associated with higher audit quality and efficiency.

Further, the new partner can easily communicate with the prior partner from the same audit firm. Pittman, Wang, and Wu (2022) find evidence that information transfers between old and new audit partners improve audit quality. Also, audit firms engage in transition management to smooth the effects of partner rotation. Dodgson, Agoglia, Bennet, and Cohen (2020) found 75 percent of the interviewees indicated new partners will often shadow on an engagement for six to 12 months before rotation. Additionally, they find office managing partners or even national office leaders can be involved in managing client expectations around the switch, depending on the importance of the client. Gipper, Hail, and Leuz (2021) find evidence of increased audit partner hours in the final year of rotation cycles, which further suggests audit firms prepare for partner rotations.

All the benefits of engagement team client-specific knowledge to new partners for within-firm partner rotation do not exist when the client undergoes an audit firm change. When a client changes audit firms, the incoming partner does not have the benefit of shadowing the engagement before the rotation, communicating with the prior partner during the audit, or relying on an engagement staff with client-specific experience. Therefore, the partner would have to expend more effort to provide a high-quality audit to the new client and have less attention available for the partner's existing clients.

Client-specific knowledge also varies for the existing clients. While longer auditor tenure can reduce independence, it also helps develop familiarity. Consistent with tenure improving client-specific knowledge, most studies on auditor tenure find that long tenure improves audit quality (DeFond and Zhang 2014). Longer tenure on existing clients could

mean more efficient audits, which could mitigate the negative effects brought on by the attention costs of new engagements.

Client-specific knowledge of the engagement team can vary for clients both new and old to the partner. For a partner's new clients, the engagement team has experience with clients already at the firm (intra-firm partner changes), but not for clients new to the firm (inter-firm changes). For existing clients, the auditor's client-specific knowledge increases with tenure. Overall, the benefits of client-specific knowledge leads to my second hypothesis (stated in the alternate form):

Hypothesis 2: Low client-specific knowledge exacerbates the adverse effects of the attention costs from a new client on the audit quality of the partner's existing engagements, ceteris paribus.

The Role of Auditor Resources and Competencies

Not all auditors have the same resources at their disposal. The resources and competencies available to auditors affect how well firms handle transition management. Auditor size promotes economies of scale that make monitoring more efficient and allows for greater investments in human capital (Watts and Zimmerman 1981; Dopuch and Simunic 1982). Large auditors can staff both new and existing engagements with more and better staff. The greater human capital resources of large auditors mean these firms can better assist the partner with the transition management. Therefore, I expect auditor size to help mitigate the negative effects from attention costs of a new engagement.

Auditor industry specialization is an auditor competency relevant to transition management. Industry specialists provide higher quality audits because they have greater relevant knowledge (Dopuch and Simunic 1982). Specialization can also cause economies of scale (Bills, Jeter, and Stein 2015). Industry specialization has been shown to improve

audit quality at both the office- and partner-level (Chin and Chi 2009; Reichelt and Wang 2010). Since auditor specialization allows for more effective and efficient audits, I expect auditors that are industry specialists to be less affected by the attention costs of new engagements. The benefits of auditor size and specialization lead to my third hypothesis (stated in the alternate form):

Hypothesis 3: High auditor resources and competencies mitigate the adverse effects of the attention costs from new clients on the audit quality of the partner's existing engagements, ceteris paribus.

III. Research Design

Measurement of the Attention Costs from New Clients

My measures of attention costs are derived from audit partner changes at the engagement level. Effective for audit reports issued on or after January 31, 2017, the PCAOB requires audit firms to publicly disclose the names of the engagement partners (PCAOB 2015b). This rule change was a major increase in transparency, as the audit engagement partner of U.S. public company audits was unobservable before. The PCAOB publishes a database of Form AP filings on their website. Individual partner data at the engagement level is important to this research question for two reasons. First, identifying individual partners by engagement allows me to see when partner changes happen. Second, the data allows me to identify the partner's public client portfolio. I measure partner changes beginning in fiscal years in 2017, and my sample extends through fiscal years ending on December 31, 2021.

In the instance of partner changes, there is the potential for attention costs from new clients to affect both new and existing clients. As mentioned in Section II, the evidence of the effect of a new partner on audit quality is mixed. Although the focus of this study is on the effect on existing clients, it is still important to observe any effect on the audit quality of the new client. I use a variable *ROTATION* to indicate clients that have changed audit partners from the prior year.

For Hypothesis 2, I look at how a low client-specific knowledge exacerbates the negative effects from attention costs from new clients. One measure of client-specific knowledge is whether the partner's new client was previously audited by a different audit firm. The engagement team on an engagement new to the partner but not the firm would

still possess significant client-specific knowledge that would benefit the partner. To observe the differential effect, I divide *ROTATION* into two separate variables based on whether the change was within audit firms or not. The first is *ROTATION_PARTNER*. This is an indicator variable equal to one if the client was audited by a new partner from the same audit firm as the prior year, and zero otherwise. The next variable for a partner change is *ROTATION_FIRM*, which is an indicator variable equal to one if client firm was audited by both a new audit partner and a new audit firm than the prior year, zero otherwise. In summary, clients with values of one for either *ROTATION_PARTNER* or *ROTATION_FIRM* had a new audit partner, but only clients with a value of one for *ROTATION_FIRM* had a new audit firm.

The other effect potentially present, and the focus of this paper, is the effect the attention costs from new clients have on an audit partner's existing clients. Section II went into detail on how a new client can bear attention costs that negatively impact a partner's limited attention, opening the possibility for lower quality audits of the partner's existing clients. I use the variable *ATTN_COST* to signify existing clients whose audit partner accepted a new engagement in that year. These firms did not change audit partners themselves, but could experience worse audit quality due to the effects of limited attention on their audit partner.

For Hypothesis 2, I divide *ATTN_COST* into two variables. *ATTN_COST_SAME_AUD* is an indicator variable equal to one if the existing client's audit partner had a new client that was audited by the same audit firm as the prior year, and zero otherwise. That is, if another client in the audit partner's portfolio for the year had a value of one for *ROTATION_PARTNER*, then the value of *ATTN_COST_SAME_AUD* would be

one. *ATTN_COST_NEW_AUD* follows the same logic, but for instances when the partner's new client was previously audited by a different audit firm. *ATTN_COST_NEW_AUD* is equal to one if the client's audit partner had a new client that was audited by a different audit firm than from the prior year, and zero otherwise. Both the partner change variables and attention cost variables are mutually exclusive. That is, a firm-year observation can only have a value equal to one for at most one of these four variables (*ROTATION_PARTNER, ROTATION_FIRM, ATTN_COST_SAME_AUD,* and *ATTN_COST_NEW_AUD*). Figure 1 presents a decision tree explaining the outcomes of these four variables for audit client firm-years.

[Insert Figure 1 Here]

Tests of Hypothesis 1

To test Hypothesis 1, which predicts the attention costs of a new client results in adverse effects to the partner's existing engagements, I estimate the following model:

$$Audit\ Outcome_{it} = \beta_0 + \beta_1\ ATTN\_COST + \beta_2\ ROTATION + Controls +$$

$$Year\ FE + Industry\ FE \qquad\qquad (1)$$

Equation 1 includes the variable *ATTN_COST*, which as previously explained is an indicator for existing clients whose partner has a new audit client. As discussed in the next section, larger values of all the audit outcome proxies used indicate lower audit quality. According to Hypothesis 1, I predict a positive coefficient β_1, which would indicate the attention costs of a new client results in lower audit quality for existing clients. *ROTATION* is an indicator for clients that changed audit partner. Hypothesis 1 makes no prediction about the coefficient on *ROTATION*, as it is concerned with the effects of new engagements on existing clients. All regressions include year and industry fixed effects. Industry is

measured at the 2-digit SIC code. Regressions are estimated using ordinary least-squares (OLS), unless otherwise specified. All regressions have heteroskedastic-robust standard errors clustered at the firm-level.

Audit Outcome Measures

The limited timespan of my sample limits the audit quality measures I can use to those measured within a short period after the time of filing. Particularly, I do not have enough years to accurately observe restatements or AAERs. My study focuses on three measures of audit outcomes: absolute discretionary accruals, working capital accruals quality, and audit report lag. While none of these variables capture all aspects of audit quality by themselves, examining all three can give strong evidence of the effect of the attention costs of new clients on audit quality.

My first measure of audit quality is absolute discretionary accruals. Absolute discretionary accruals reflect managerial reporting flexibility, and large values of discretionary accruals could indicate earnings management and lower financial reporting quality. Audit quality is "inextricably intertwined" with financial reporting quality (DeFond and Zhang, 2014). Therefore, I use larger values of absolute discretionary accruals to proxy for lower audit quality. Following Kothari, Leone, and Wasley (2005), I measure discretionary accruals using a performance-matched Jones model (Jones 1991) displayed in Equation 2:

$$TOT\_ACCRUALS_t = \beta_1 \frac{1}{Tot.Assets_{t-1}} + \beta_2 \frac{\Delta\,Sales}{Tot.Ass} \frac{\Delta Rec}{t-1} + \beta_3 \frac{PPE}{Tot.Assets_{t-1}} + \varepsilon \quad (2)$$

$TOT\_ACCRUALS_t$ is measured as the change in non-cash current assets minus the change in current liabilities excluding the current portion of long-term debt, minus depreciation and amortization, scaled by lagged total assets. The first predictor of total accruals is one

divided by lagged total assets. The second predictor is the change in sales minus the change in receivables scaled by lagged total assets. The final predictor is the net PPE in the current year scaled by lagged total assets. This regression is run at the industry-year level, using SIC 2-digit industry classifications. Only industry-years with 10 or more observations are included. *DISC_ACC* is the absolute value of residual from Equation 1. Larger values of *DISC_ACC* represent lower audit quality.

The second audit outcome variable is an accruals quality following Dechow and Dichev (2002), which captures how well a firm's change in working capital maps into past, current, and future cash flow realizations. This variable is measured as the absolute value of the residual from Equation 3.

$$\Delta WC_t = \beta_1 CF_{t-1} + \beta_2 CF_t + \beta_3 CF_{t+1} + \varepsilon \tag{3}$$

Equation 3 is a firm-specific regressions of changes in working capital on past, present, and future operating cash flows. ΔWC is the change in working capital, calculated as the change in accounts receivable, plus the change in inventory, minus the change in accounts payable, minus the change in taxes payable, plus the change in other assets, all scaled by average total assets. *CF* is operating cash flows scaled by average total assets. Dechow and Dichev (2002) use the standard deviation of the residual over time, but since my sample timespan is limited and variables of interest are at the firm-year level, I use the absolute value of the residual by firm-year as the measure of accruals quality, denoted as *AQ_RESID*. I restrict the tests using *AQ_RESID* to firms with at least 5 years of necessary Compustat data. Accruals should be temporary adjustments to resolve timing problems of earnings, and more imprecise estimates, captured by the higher values of the residual,

indicate lower accruals or earnings quality (Dechow and Dichev 2002). Therefore, a larger value of *AQ_RESID* indicates lower audit quality.

The final audit outcome variable used is audit lag. This variable, called *LN_LAG*, is calculated as the natural log of days between the firm's fiscal year end and the release of the audit report. A shorter audit report lag results in more timely financial reporting information for financial statement users. Audit report lag can offer some insight into the effort the auditor exerts (Knechel and Payne 2001). Glover, Hansen, and Seidel (2022) find that while audit lag no longer necessarily indicates the completion of audit fieldwork, it is an appropriate proxy for when the audit is completed, when the auditor attains sufficient appropriate evidence to support the opinion, or "the timeliness of the financial reporting process (of which the audit is an integral part)" (p. 163). This means that audit lag is a useful audit outcome measure when looking at how the attention costs of new clients affect audit partners. Increased audit lag can be indicative of the attention costs facing an audit partner. That is, a partner dealing with an activity, such as a new engagement, that has high attention costs will possibly have to delay audit completion. If the new engagement does bear a high cost on the partner's attention, both the new and existing clients could experience longer audit report lags. Audit lag can help identify both real and direct consequences of a distracted partner. A larger value of *LN_LAG* indicates a less timely audit report.

Control Variables

I include a vector of control variables used in prior research. Becker et al. (1998) find that larger firms are more likely to have higher earnings quality, so I control for *SIZE*, measured as the natural log of total assets. Menon and Williams (2004) show that

SALES_GROWTH is positively associated with a firm's abnormal accruals. I measure *SALES_GROWTH* as the percent change in sales from the prior year. Additionally, cash flow from operations (*CFO*) has been shown to affect discretionary accruals (Dechow, Sloan, and Sweeney 1995). Further, I control for firm market capitalization scaled by the book value of assets (*MTB*), and leverage (*LEVERAGE*). *LOSS*, an indicator variable equal to one if a firm has negative net income, is included. *NEW_FIN* captures if a firm has raised new capital and is equal to one if Compustat footnote SALE_FN equals "AB", the percentage change in long-term debt is greater than or equal to 20 percent, or the percentage change in common shares outstanding (adjusted for stock splits, etc.) is greater or equal to 10 percent. I also control for if the client has a December fiscal year-end (*DEC_YE*), or is in a litigious industry (*LITIGATION*). In addition to the client-related controls, the auditor-related controls of size (*BIG_4)*, tenure with the client (*TENURE)*, office industry specialization (*SPECIALIST)*, and importance of the client to the office (*OFFICE_SHARE)* are also included. To show my measure of a distracted partner is distinct from the prior constructs of partner busyness, I control for the number of clients audited by the partner (*NUM_CLIENTS*). For specifications with either accrual-based measure as the dependent variable (*DISC_ACC* or *AQ_RESID*), I also include the absolute value of lagged current accruals (*LAG_ACCRUALS*) to control for the reversal of discretionary accruals. All variable definitions can be found in Appendix A. I winsorize continuous variables at 1% and 99%.

Tests of Hypotheses 2

Hypothesis 2, which predicts that low client-specific knowledge will exacerbate the negative effects of attention costs from new clients, is tested using Equation 4.

$$Audit\ Outcome_{it} = \beta_0 + \beta_1\ ATTN\_COST\_NEW\_AUD +$$

$$\beta_2 ATTN\_COST\_SAME\_AUD + \beta_3\ ROTATION\_FIRM +$$

$$\beta_4\ ROTATION\_PARTNER + Controls + Year\ FE + Industry\ FE \qquad (4)$$

The difference between Equation 1 and Equation 4 is that the latter distinguishes the attention cost variables based on whether the change client switched audit firms or not. As discussed in Section II, the engagement team's client-specific knowledge varies between audit firm changes and partner-only changes. As client-specific knowledge allows for a more effective audit (PCAOB 2015a), I expect audits new to the firm will require more effort of the partner than audits new to the partner only. A greater effort on these new engagements suggests a greater adverse effect to existing clients. Therefore, Hypothesis 2 predicts a positive coefficient on *ATTN_COST_NEW_AUD*. All regressions include year and industry fixed effects. Industry is measured at the 2-digit SIC code. All regressions are estimated using ordinary least-squares (OLS) and have heteroskedastic-robust standard errors clustered at the firm-level. Controls used are those mentioned in the prior section. As the distinction between audit firm and partner-only changes is significant, I use Equation 4 as the baseline model for the remaining tests of Hypotheses 2 and 3.

Client-specific knowledge also varies for the existing clients. As discussed in Section II, the audit firm's tenure on the client affects the auditor's client-specific knowledge. Longer tenure on existing client could mean more efficient audits these clients, and could mitigate the adverse attention cost effects of a new client. To test the mitigating effect of client-specific knowledge on attention costs, I augment Equation 4 with interaction terms between *TENURE* and the each of the limited attention variables (*ROTATION_PARTNER, ROTATION_FIRM, ATTN_COST_SAME_AUD,* and

ATTN_COST_NEW_AUD). If more client-specific knowledge of the existing client mitigates the adverse effects, I expect the coefficient on the interaction between *TENURE* and *ATTN_COST_NEW_AUD* to be negative.

Tests of Hypothesis 3

Hypothesis 3, which predicts that auditor resources and competencies that help transition management mitigate the negative effects from the attention costs of a new client, is tested using an augmented version of Equation 4. The first auditor characteristic that I examine is auditor size. Auditor size promotes economies of scale and allows for greater investments in human capital (Watts and Zimmerman 1981; Dopuch and Simunic 1982). Audit firms with greater size can better support partners undergoing client changes with staff and other resources. To test the mitigating effect of auditor size on attention costs of new clients, I augment Equation 4 with interaction terms between *BIG_4* and each of the attention cost and rotation variables. Hypothesis 3 predicts a negative coefficient on the interaction term between *BIG_4* and *ATTN_COST_NEW_AUD*.

The next auditor characteristic that could impact partner transition management is auditor specialization. Specialization can cause economies of scale (Bills, Jeter, and Stein 2015), and improves audit quality at both the office- and partner-level (Chin and Chi 2009; Reichelt and Wang 2010). Therefore, I expect audit office or partner industry specialization in the existing client's industry to reduce the negative effects of new clients. To test this, I augment Equation 4 with interaction terms between *SPECIALIST* (*PARTNER_SPEC*) and each of the attention cost and rotation variables. *SPECIALIST* is an indicator variable equal to one if the audit office has the highest of audit fees collected among offices in metropolitan statistical area (MSA) for the client's SIC 2-digit industry. *PARTNER_SPEC*

if an indicator variable equal to one if the partner has the highest of audit fees collected among partners in a MSA for the client's SIC 2-digit industry. Hypothesis 3 predicts a negative coefficient on the interaction term between the relevant auditor specialization variable and *ATTN_COST_NEW_AUD*.

IV. Sample and Data

As mentioned in Section III, I begin with the PCAOB's partner-level information gathered from Form AP which allows for partner changes to be measured beginning in 2017 fiscal years. I exclude all firms whose partner only had one engagement in a given year, as these firms have no chance of being treatment firms (*ATTN_COST = 1* or *ATTN_COST_NEW_AUD* = 1). I combine the data from the PCAOB database with firm-level financial information from Compustat. Compustat allows me to calculate all accruals-related measures as well as accounting control variables. I drop all financial and utility firms (SIC 4400-4999 and 6000-6999), as the financial reporting of these firms can differ from other industries. I include audit fee data from Audit Analytics used to calculate the auditor specialization measure used as a control. For some tests in the Online Appendix, I use quarterly earnings and analyst forecast data from CRSP.

[Insert Table 1 Here]

Table 1 presents the sample reconciliation. My final sample for the discretionary accruals analysis consists of 8,179 firm-year observations from 2017 to 2021. Table 2 breaks down this sample by year (Panel A) and by Fama-French 12 industry (Panel B). The sample is relatively uniform in distribution over time, with no more than 20.9% of the sample coming from any one year. Due to additional data requirements, some additional sample attrition is present for the working capital accruals quality analysis. Specifically, the accruals quality calculation requires a future year, so there are no observations from 2021 in that sample. The working capital accruals quality sample consists of 6,049 firm-year observations.

[Insert Table 2 Here]

Panel A of Table 3 presents the summary statistics of variables in my sample. Panel B of Table 3 presents information about partner-year statistics. I have 1,857 unique audit partners in my sample composing 4,734 partner-years. The mean number of clients per partner-year is 3.5 and the median is 2. The client numbers are based on the public clients reported in the Form AP data, so some clients for each partner-year are not in the final sample due to missing controls.

[Insert Table 3 Here]

V. Empirical Results

Results for Test of Hypothesis 1

Table 4 reports the results for the test of Hypothesis 1. Column (1) displays the results with *DISC_ACC* as the dependent variable. As expected, the coefficient on *ATTN_COST* is positive and significant at the 5% level, indicating that partners suffer from substantial attention costs from a new client, and the audit quality of their existing clients suffers. In terms of economic significance, clients whose partners have a new client experience a 11.0% increase in discretionary accruals when compared to the median firm (0.0076/0.069).

[Insert Table 4 Here]

Column (2) displays the results for the Hypothesis 1 with *AQ_RESID* as the dependent variable. The coefficient on *ATTN_COST* is positive and significant at the 5% level. This suggests clients whose audit partner had a new engagement experience lower accruals quality than firms whose audit partner did not have a new engagement. The effect is also economically meaningful, with treatment leading to a 16.5% (0.0033/0.020) higher value of *AQ_RESID* compared to the median firm.

The results for the test of *LN_LAG* are presented in Column (3). The coefficient on *ATTN_COST* is positive but insignificant, indicating firms whose partner has a new client do not experience significantly longer audit lags. Overall, Table 4 provides evidence supporting Hypothesis 1 with respect to both discretionary accruals and working capital accruals quality. This indicates audit partners have their attention strained by the attention costs of new clients, and the audit quality of their existing clients suffers.

While not of direct interest to Hypothesis 1, it is worth noting the coefficients on *ROTATION* are positive and significant in Columns (1) and (3), indicating firms that change audit partners do have more discretionary accruals and a longer audit report lag. However, the coefficients on *ROTATION* are insignificant in for Column (2), which suggest firms that change audit partners do not have worse working capital accruals quality. The result in Column (3) is particularly relevant to the research question. Audit completion taking longer for new clients indicates the increased attention that these clients demand of the partner, and help validate why I observe the existing clients having lower audit quality.

Consistent with prior research, *SIZE* is positively related to audit quality (has a negative coefficient) in all three specifications. *LAG_ACCRUALS* and *OFFICE_SHARE* are both associated with lower audit quality. *SALES_GROWTH, CFO, LEVERAGE*, *LOSS*, *LITIGATION*, *BIG_4*, *TENURE*, *NEW_FIN*, and *DEC_YE* are significant in the direction consistent with prior research for at least one of the three specifications. *MTB* is significant in the expected direction for Column (1), but insignificant for Columns (2) and (3). The other control variables are not significant at the 10% level.

Also important is the coefficient for *NUM_CLIENTS*, which is not significant in Columns (1) or (2). The result in Column (1) is consistent with Burke, Hoitash, and Hoitash (2019), who find no relation between a partner's number of clients and discretionary accruals. The lack of significance on this coefficient paired with the significantly positive coefficient on *ATTN_COST* in the same columns highlights the difference between the prior literature's proxy for audit partner busyness (*NUM_CLIENTS*) and my proxy for a partner suffering from attention costs from a new client (*ATTN_COST*). It suggests that the attention costs of a new engagement have an effect on the partner separate from the

partner's overall workload. This is consistent with Goodwin and Wu's (2016) theory of audit partners choosing their appropriate number of clients in equilibrium. The one-time attention costs of a new engagement would be separate from the chosen equilibrium, and therefore result in decreased audit quality for other clients in the partner's portfolio. The result in Column (3) suggests that clients of audit partners with more total engagements have a longer audit lag.

Results for Tests of Hypothesis 2

Differential Effects of Audit Firm and Partner-only Client Changes

Table 5 shows the results for the test of Hypothesis 2 relating to the differences in attention costs resulting from audit firm and partner-only client changes. Column (1) displays the results with *DISC_ACC* as the dependent variable. As predicted by Hypothesis 2, the coefficient on *ATTN_COST_NEW_AUD* is positive and significant at the 1% level. This means firms whose audit partner accepted a new engagement on a client previously audited by another audit firm (an audit firm client change) experience higher discretionary accruals. In addition to being statistically significant, the magnitude is also economically significant. Clients whose partner accepted a new client previously audited by a different audit firm experience an increase in discretionary accruals equal to 34.8% (0.024/0.069) of the median level of discretionary accruals. Additionally, the coefficient on *ATTN_COST_SAME_AUD* is statistically insignificant, indicating a partner-only client change does not result in negative attention costs that affect the partner's existing clients. Further, I run a test of differences in the coefficients on *ATTN_COST_NEW_AUD* and *ATTN_COST_SAME_AUD*, and find they are statistically different at the 1% level. Taken

together, the results in Column (1) offer strong support for Hypothesis 2 and suggest low client-specific knowledge exacerbates effects of the attention cost from a new client.

[Insert Table 5 Here]

The regression results with *AQ_RESID* as the dependent variable are displayed in Column (2). The coefficient on *ATTN_COST_NEW_AUD* is significant and positive at the 1% level, indicating clients whose audit partner accepted new engagement on a firm previously audited by a different audit firm experience worse accruals quality. Similar to the result in Column (1), the coefficient on *ATTN_COST_SAME_AUD* is insignificant, and there is a statistically significant difference between the coefficients on *ATTN_COST_NEW_AUD* and *ATTN_COST_SAME_AUD*.

Column (3) presents the results with *LN_LAG* as the dependent variable. The lag time between the audit report can tell us something particularly important for this setting. One way an audit partner experiencing high attention costs might try to compensate is to delay audit completion. This would give the partner more time to review the work done on the engagement before signing off, and can also indicate they are spending more time on other engagements. Therefore, a longer audit lag would help confirm that partners are facing problems of high attention costs when accepting a new client. The coefficient on *ATTN_COST_NEW_AUD* in Column (3) is significant and positive at the 1% level. This indicates a firm whose partner has a new client from a different audit firm experience an audit lag 2.49% longer than firms whose partner didn't have a new client. The median firm in the sample has an audit lag of 60 days, so the increase at this level would be roughly one and a half days. The results show the coefficient on *ATTN_COST_SAME_AUD* is insignificant, and there is a statistically significant difference between the coefficients on

ATTN_COST_NEW_AUD and *ATTN_COST_SAME_AUD*. Overall, Table 5 offers strong support for Hypothesis 2, and suggests client-specific knowledge plays a key role in mitigating the attention costs of a new client.

It is also important to note that the coefficient on *ROTATION_FIRM* is significant at the 10% and 1% level in Columns (2) and (3), respectively. This variable is for clients that had an inter-firm auditor switch, so the results indicate clients that switched audit firms experienced worse accruals quality and a longer audit lag in the first year at the new auditor. The audit lag result is particularly important, as the longer time taken to complete the audit of the new client supports the idea that audit partners suffer high attention costs from the new client and perform worse on their existing clients. The coefficient's magnitude in Column (3) suggests an increase of 8.94% compared to the control group. This equates to over five additional days of audit lag for the median firm. The additional time spent on these new clients helps validate why I observe such significant effects of attention costs from new clients. Overall, Table 5 highlights the importance of distinguishing between inter-firm and intra-firm partner changes when discussing the effects of partner limited attention resulting from new clients. Because of this important distinction, I use Equation 4 as the baseline model for all remaining tests.

Mitigating Effect of Auditor Tenure on Partner Limited Attention

The results of the test of Hypothesis 2 examining the moderating effects of auditor client-specific knowledge of the partner's existing clients, proxied by audit firm tenure, are shown in Table 6. As *TENURE* will be equal to zero for clients new to the audit firm (*ROTATION_FIRM* = 1), they are excluded from this test. For brevity, the coefficients on control variables are not displayed.

[Insert Table 6 Here]

The coefficient on *ATTN_COST_NEW_AUD* is positive and significant at p<0.01 in each column of Table 6, indicating a negative effect on the existing clients audit quality of a partner getting a new client. The interaction term between *ATTN_COST_NEW_AUD* and *TENURE* is also negative and significant at the 1% level in every specification. These coefficients show that tenure also has a mitigating effect on the attention costs resulting from new clients, and provide very strong support for Hypothesis 2.

Results for Tests of Hypothesis 3

Differential Effects of Limited Attention Between Big 4 and Non-Big4 Audit Partners

The results of the test of Hypothesis 3 examining the moderating effects of auditor size, proxied by whether the auditor is a Big 4 firm, on the negative attention costs of new clients are shown in Panel A of Table 7. For brevity, the coefficients on controls variables are not displayed.

[Insert Table 7 Here]

Column (1) shows the results with *DISC_ACC* as the dependent variable. The coefficient on *ATTN_COST_NEW_AUD* is significant at the 1% level, consistent with the results from the main tests and further supporting Hypotheses 1 and 2. The interaction between *ATTN_COST_NEW_AUD* and *BIG_4* is negative and significant at the 1% level, which indicates partners at Big 4 audit firms experience less substantial negative effects from the attention costs from new clients than partners at non-Big 4 firms.

These results are similar when using looking at working capital accruals quality or audit lag. The coefficients on *ATTN_COST_NEW_AUD* are positive and significant at the 1% level in Columns (2) and (3). The interaction on *ATTN_COST_NEW_AUD* and *BIG_4*

is negative and significant at the 1% level in both columns. The magnitude of the coefficients on the interaction term in each column is approximately equal to the magnitude of the coefficient on *ATTN_COST_NEW_AUD* for each column, suggesting the existing clients of audit partners at Big 4 firms do not experience adverse effects on audit quality when the partner gets a new client. Overall, the results in Panel A of Table 7 provide strong support for Hypothesis 3 by indicating auditor resources help mitigate the adverse effects from the attention costs from new clients.

Mitigating Effect of Auditor Industry Specialization on Partner Limited Attention

Panel B of Table 7 presents the results of the test of Hypothesis 3 examining the mitigating effect of audit office industry specialization on the negative effects of attention costs from new clients. Like prior tests, all coefficients on *ATTN_COST_NEW_AUD* are positive and significant. The coefficient on the interaction term between *ATTN_COST_NEW_AUD* and *OFFICE_SPEC* is negative and significant at the 1% and 10% levels in Columns (1) and (2), respectively. The interaction term is negative but insignificant in Column (3). These results offer support for Hypothesis 3 and indicate audit office specialization in the existing client's industry mitigates the adverse effects of attention costs from a new client.

Panel C presents the results related to partner specialization. The coefficient on *ATTN_COST_NEW_AUD* is positive and significant in every specification, consistent with prior tests. The interaction term between *PARTNER_SPEC* and *ATTN_COST_NEW_AUD* is negative but insignificant in all specifications. Overall, Panel C of Table 7 does not indicate the attention costs of new clients are mitigated by partner specialization in the existing client's industry.

Results of Additional Tests

Mitigating Effect of Client Importance and Size

Auditors are highly motivated to avoid audit issues for large, important clients (Reynolds and Francis, 2000). Even when facing high attention costs from a new client, it is likely that reputation concerns will motivate an auditor to provide high-quality audits to their largest and most important clients. Therefore, it is possible the negative effects from the attention costs of new clients are mitigated by client importance and size. To test this, I interact the rotation and attention cost variables with *OFFICE_SHARE* and *PARTNER_SHARE*, which are measures of what proportion of the office's total fees or partner's total fees, respectively, are from that client.

[Insert Table 8 Here]

The results of interacting the attention cost variables with *OFFICE_SHARE* are shown in Panel A of Table 8. The coefficient on the interaction term between *OFFICE_SHARE* and *ATTN_COST_NEW_AUD* is negative and significant at the 10% level in Column (1), which provides some evidence that client importance to the audit office mitigates the effect of the attention costs of new clients on existing client discretionary accruals. I do not find a significant effect for *AQ_RESID* or *LN_LAG*.

Panel B of Table 8 shows the results of interacting the attention cost variables with *PARTNER_SHARE*. The coefficient on the interaction term between *PARTNER_SHARE* and *ATTN_COST_NEW_AUD* is negative and significant at the 5% level in Column (1), indicating that greater client importance to the partner mitigates the effect of the attention costs of new clients on the discretionary accruals of existing clients. I do not find a significant effect for *AQ_RESID* or *LN_LAG*.

[Insert Table 9 Here]

I also test how the existing client's size affects the relationship between the attention costs of new clients and the audit quality of existing clients. Table 9 presents the results of interacting the attention cost variables with *SIZE*. The coefficient on the interaction term between *SIZE* and *ATTN_COST_NEW_AUD* is negative and significant at the 1% level in all three columns, which provides strong evidence that larger existing clients are less affected by the attention costs resulting from new clients.

Effect of the Attention Costs from New Clients on Changes in Audit Quality

While earlier tests showed how the attention costs stemming from a new client affected the levels of audit quality in existing engagements, it is possible they also affect changes in audit quality. To test this, I modify Equation 4. The dependent variables are the change in each of the audit quality measures from year t-1 to year t. For the control variables, I use the changes in the existing controls from year t-2 to t-1, when appropriate. *LITIGATION*, *BIG_4*, *TENURE*, *SPECIALIST_AUD*, and *DEC_YE* are left as previously used, as these variables are either largely static or change at a predictable level year over year. I also include a control for the level of the respective audit quality measure from the year t-1. The results are presented in Table 10.

[Insert Table 10 Here]

The coefficients on *ATTN_COST_NEW_AUD* capture the effects on the change in the audit quality measure from the prior year. In each column, the coefficient on this variable is positive. The coefficient is significant at the 1% level for the Δ *DISC_ACC* and Δ *AQ_RESID* specifications. The coefficient is positive but insignificant for the specification with Δ *LN_LAG* as the dependent variable. Table 10 indicates that attention

costs of a new audit client results in increases in discretionary accruals and decreases in working capital accruals quality for existing clients.

Effect of Partner Limited Attention on Total Accruals

Results thus far consistently show the attention costs from new clients affect the discretionary accruals and working capital accruals quality of a partner's existing clients. However, it is possible the observed results are due to the existing clients of these partners exhibiting fundamentally different total accruals than other firms. To ensure a difference in total accruals is not driving my prior results, I estimate of Equation 4 with the fitted value of the client's total accruals from Equation 2 (*fitted TOT_ACCRUALS*) as the dependent variable.

[Insert Table 11 Here]

The results for this regression are shown in Table 11. The coefficient on *ATTN_COST_NEW_AUD* is insignificant. This suggests the prior results are not due differences in expected total accruals, but rather the substantial attention costs that new clients impose on audit partners.

Partner or Engagement Team Effect

Audit engagement personnel are one of the two main inputs to the audit process (Francis 2011). While the partner is in charge of the engagement and an important decision-maker, the other members of the engagement team certainly have an effect on the quality of the audit. In the results from Christensen, Newton, and Wilkins, (2021), the effects of staffing continuity and workload are driven by audit staff and seniors. An engagement on a new client not only brings a new partner but a whole new engagement team. The additional cost on attention resulting from a new engagement might not only affect the

partner, but the other team members as well. If the partner's other engagements share some team members from the new client, it is possible an effect observed at the partner-level partially includes attention costs experienced by the other personnel on the engagement team.

With the PCAOB data available, I can only track partner changes, not changes in broader engagement team composition. However, I can observe the attention cost effect of a new client at the office-level. That is, I can measure the attention cost effects on audit quality for the office's other engagements when the office gets a new client. The engagement team members on the new client are likely to be staffed on other engagements in the office that the partner is not responsible for. Benefits of measuring the costs at the office-level is that it removes the partner's effect while observing the effects related to the other engagement team members.

I create a variable, called *OFF_ATTN_COST_NEW_AUD*, which equals one if a partner other than that client's partner in the audit office has a new client from another audit firm, zero otherwise. This variable is mutually exclusive to *ATTN_COST_NEW_AUD*. Therefore *ATTN_COST_NEW_AUD* captures the attention cost effects of the partner to his or her other clients, but *OFF_ATTN_COST_NEW_AUD* measures if there is a similar effect to other clients in the office not audited by the partner. I run a regression with both variables to see if the partner or office effect is present, with the results shown in Table 12. I exclude any firms that changed auditors or existing firms whose partner's new client came from the same audit firm (any of *ROTATION_FIRM, ROTATION_PARTNER,* or *ATTN_COST_SAME_AUD* equal to one).

[Insert Table 12 Here]

The coefficients on *ATTN_COST_NEW_AUD* are positive and significant in all three columns of Table 12. This is consistent with the attention costs from new clients affecting the partner's existing clients. The results for *OFF_ATTN_COST_NEW_AUD* are mixed. In Columns (1) and (3) the coefficients for office effects are positive and significant, indicating firms in an office that has a new client exhibit higher discretionary accruals and longer audit lags. However, the loading on *OFF_ATTN_COST_NEW_AUD* is negative and insignificant in Column (2). This is the opposite direction than we would expect if there were negative effects driven by a distracted engagement team. Overall, there is clear and consistent evidence that new clients bear attention costs that negatively affect the partner's existing clients, but inconsistent evidence relating to other clients in the audit office.

Attention Costs from New Engagement or an Increase in Clients

One concern about using accepting a new client as a source of attention costs is that it doesn't take into account when clients leave the partner. Many earlier studies have used the number of clients as a proxy for busyness. My measure is different, as it looks at the new client as a source of high attention costs for the partner. This stems from the different nature of conducting an audit on a new client as opposed to an existing client. A situation can occur where a partner adds a new client, but loses another client. In this instance, the number of engagements is static despite the new client. Other studies would argue that partners in this situation have no change in their attention, but I argue the new partner would experience more demands on their attention due to the substantial attention costs of a new client.

In an attempt to test whether accepting a new client has an effect on partner attention, I partition the sample into subsamples based on whether the partner had an

increase in the total number of engagements. I then run Equation 4 on the two subsamples. It is important to note that these subsamples are each about half of the main sample, so the power for these tests is smaller than for the other tests.

[Insert Table 13 Here]

Panel A of Table 13 presents the results of Equation 4 on the subsample on clients whose partner had an increase in the total number of engagements from the prior year. The coefficients on *ATTN_COST_NEW_AUD* is positive and significant at the 1% level in Columns (1) and (2), and is significant at the 10% level in Column (3). The results in Panel A indicate that the attention costs from a new client negatively affect audit quality on a partner's existing engagements when the partner has an increase in the total number of clients audited.

Panel B of Table 13 presents the results of Equation 4 on the subsample of clients whose partner did not have an increase in the number of engagements. The coefficients on *ATTN_COST_NEW_AUD* are positive and significant at the 10% level in Columns (1) and (3). While the coefficient on *ATTN_COST_NEW_AUD* is positive in Column (2), it is statistically insignificant. However, the coefficient is of a similar magnitude to that of other tests (see Table 5), and the power is smaller due to the decreased sample size. Overall, the results for Panel B of Table 13 provide some support that the attention costs from new clients negatively affect a partner's existing clients even when the partner did not have an increase in their total number of engagements. This table further highlights the difference between the attention costs of a new client and the partner's total number of clients.

Entropy Balancing

As mentioned earlier, the audit engagement is a simultaneous choice between the client and the auditor. This means auditor selection and auditor changes are endogenous by nature. While the endogeneity concerns from this choice are clear in measuring the effect on firms that change auditors, the concern is less for measuring the effect on other clients. It is arguable that a partner accepting a new client is exogenous to the firms already in the partner's portfolio. These firms are unlikely to know of the new client. Even if they did know, it is unlikely they would choose to undergo a change in audit firms or partners in response to their partner's new client.

To mitigate potential endogeneity concerns I conduct a test using entropy balancing. Entropy balancing creates a covariate balance between treatment and control observations. My treatment group consist of firms whose audit partner has a new client that was previously audited by a different audit firm (*ATTN_COST_NEW_AUD* = 1). The control group is firms that did not experience a partner change, nor did their partner accept a new client (all partner change and attention cost variables equal to zero). I balance using all control variables in Equation 4. Results of the regressions using Equation 4 on the balanced samples are displayed in Table 14.

[Insert Table 14 Here]

Columns (1), (2), and (3) show the results when using *DISC_ACC*, *AQ_RESID*, and *LN_LAG* as the dependent variables, respectively. The coefficient on *ATTN_COST_NEW_AUD* is positive and significant at the 1% level in Columns (1) and (2). These results provide evidence that the results observed in the main tests for *DISC_ACC* and *AQ_RESID* are not due to differences between the treatment and control firms. However, the coefficient in Column (3) is positive but insignificant. This suggests

the attention costs from a new client do not lead to a longer audit lag for existing clients

once the sample is balanced.

VI. Conclusion

This study investigates limited attention of U.S. audit partners by examining the effect of attention costs from new clients on the audit quality of a partner's existing clients. In recent years, audit partners have been a focus of both regulators and researchers, and there have been concerns about the potential negative effects of audit partner limited attention (Lennox and Wu 2018; PCAOB 2015a; PCAOB 2015b). Audit partner rotation could adversely affect partner attention, as the lack of client-specific knowledge could result in less efficient audits. Prior research has found partner hours increase on new engagements (Gipper, Hail, and Leuz 2021). The high attention costs demanded by a new engagement can have negative effects on existing clients by diverting the partner's limited attention away from these existing clients.

Using a new client as a source of high attention costs to the partner, I find the partner's existing engagements suffer worse audit quality. Specifically, existing clients have higher absolute discretionary accruals, lower working capital accruals quality, and in some cases longer audit report lags when their partner has a new engagement. The adverse effects are a result of audit firm changes but not partner-only changes, highlighting the importance an engagement team with client-specific knowledge on mitigating attention costs of engagements. The effect is also less severe when the auditor has longer tenure at the existing client. Additionally, I find auditor resources and competencies, proxied by auditor size and industry specialization, mitigate the attention costs. The effect of attention costs from new clients is distinct from an office-wide effect and exists separate from the partner's total number of clients. Audit partners are also less likely to suffer worse audit quality when the existing clients are larger or more important.

Prior research has found mixed results on the effects of audit partner limited attention, and primarily looks at limited attention through the lens the partner's number of clients (Lennox and Wu 2018). My study contributes to the literature on audit partner limited attention by examining a different source of attention costs: new engagements. It also provides evidence in the U.S. setting that attention costs and limited attention in audit partners affects audit quality beyond audit fees. My findings are useful for regulators and audit firms concerned about partner workload and audit firm rotation. The results about audit firm rotation causing negative external effects provide support for the current U.S. regime that does not require mandatory firm rotation. My findings about the moderating effects of client-specific knowledge and auditor competencies can aid audit firms in better planning partner and firm rotations. Overall, the results of this paper provide evidence of limited attention affecting U.S. audit partners and highlight the negative effects of attention costs stemming from new clients.

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Appendix A

Variable Descriptions

Variable	Description
Attention Cost and Change Variables	
ATTN_COST	Indicator variable equal to one if the firm's audit partner had a new client in the current year, zero otherwise. This variable does not distinguish based on whether the new client was previously audited by the same audit firm. Stated another way, equal to one if another firm in the partner's portfolio for the year had a value of one for "*ROTATION*".
ROTATION	Indicator variable equal to one if the firm was audited by a new audit partner, zero otherwise. This variable does not distinguish based on whether the client was previously audited by the same audit firm.
ATTN_COST_NEW_AUD	Indicator variable equal to one if the firm's audit partner had a new client that was audited by a different audit firm from the prior year, zero otherwise. Stated another way, equal to one if another firm in the partner's portfolio for the year had a value of one for "*ROTATION_FIRM*".
ATTN_COST_SAME_AUD	Indicator variable equal to one if the firm's audit partner had a new client that was audited by the same audit firm as the prior year, zero otherwise. Stated another way, equal to one if another firm in the partner's portfolio for the year had a value of one for "*ROTATION_PARTNER*".
ROTATION_FIRM	Indicator variable equal to one if the firm was audited by both a new audit partner and a new audit firm than the prior year, zero otherwise
ROTATION_PARTNER	Indicator variable equal to one if the firm was audited by a new audit partner from the same audit firm as the prior year, zero otherwise
Dependent Variables	
DISC_ACC	Absolute value of the difference between the actual and predicted total accruals. Predicted accruals are calculated using a performance-matched Jones Model (Jones 1991) following Kothari, Leone, and Wasley (2005).
AQ_RESID	The absolute value of the residual from firm-level regressions of changes in working capital accruals on past, present, and future operating cash flows from Dechow and Dichev (2002)

(Continued on next page)

Dependent Variables (Continued)

LN_LAG	Natural log of the number of days between the fiscal year-end and the release of the audit report.
TOT_ACCRUALS	Total accruals, calculated as the change in non-cash current assets minus the change in current liabilities excluding the current portion of long-term debt, minus depreciation and amortization, scaled by lagged total assets
Fitted TOT_ACCRUALS	The predicted value of *TOT_ACCRUALS* from Equation 2.

Control Variables

BIG_4	Indicator variable equal to one if the firm is audited by a Big N auditor; zero otherwise.
CFO	Operating cash flows scaled by lagged total assets.
DEC_YE	Indicator variable equal to one if the firm has a fiscal year-end in December, zero otherwise.
LAG_ACCRUALS	The absolute value of total accruals from the prior period.
LEVERAGE	Total debt divided by total debt and common equity.
LITIGATION	Dummy variable equal to one if the company-year is in a high litigation SIC code: 2833–2836, 3570–3577, 3600–3674, 5200–5961, 7370–7374; zero otherwise.
LOSS	Indicator variable equal to one if net income is less than zero; zero otherwise.
MTB	Market to book ratio
NEW_FIN	Indicator variable indicating new financing. Equal to one if Compustat footnote SALE_FN equals "AB", or the percentage change in long-term debt is greater than or equal to 20 percent, or the percentage change in common shares outstanding (adjusted for stock splits, etc.) is greater or equal to 10 percent; zero otherwise.
NUM_CLIENTS	The total number of clients for the lead audit partner in the fiscal year.
OFFICE_SHARE	Client's audit fees expressed as a percentage of the total audit fees collected by audit office for the year.
SALES_GROWTH	Percent change in sales from prior year
SIZE	Natural log of total assets
SPECIALIST	Indicator variable equal to one if the firm's audit office is in the highest of audit fees collected among partners in metropolitan statistical area for that SIC 2-digit industry, zero otherwise.
TENURE	Audit firm tenure at client in years

Additional Variables

PARTNER_SPEC	Indicator variable equal to one if the firm's audit partner is in the highest of audit fees collected among partners in metropolitan statistical area for that SIC 2-digit industry, zero otherwise.
ATTN_COST_OFFICE	Indicator variable equal to one if the firm's audit office had a new client that was audited by a different audit firm from the prior year, zero otherwise. Variable equals zero if the firm's specific audit partner is the one with the new client (Mutually exclusive with *ATTN_COST_NEW_AUD)*.
INC_CLIENTS	Indicator variable equal to one if the client's audit partner had an increase in number of clients audited compared to the prior year, zero otherwise.
SIGNED_DISC_ACC	Signed value of the difference between the actual and predicted total accruals. Predicted accruals are calculated using a performance-matched Jones Model following Kothari, Leone, and Wasley (2005).
RELATIVE_LAG	Difference in days between the firm's fiscal year end and the release of the audit report, minus the number of days the firm has to file its year-end financial report based on its filing status.
F_SCORE	Predicted likelihood of misstatement, calculated following Dechow, Ge, Larson, and Sloan (2011).
ICMW	Indicator variable equal to one if the auditor issues an adverse opinion relating to a material weakness in the client's internal controls.
MEET_OR_BEAT	Indicator variable equal to one if the client's actual EPS meets or beats by 1 cent the median analyst consensus forecast two months before fiscal year-end.
RESTATEMENT	Indicator variable equal to one if the client has a restatement in year *t*.
PRIOR_RESTATEMENT	Indicator variable equal to one if the client had a restatement in year *t*-1 or *t*-2.
PARTNER_SHARE	Client's audit fees expressed as a percentage of the total audit fees collected by audit partner for the year.

FIGURE 1
Decision Tree for Attention Cost Variables
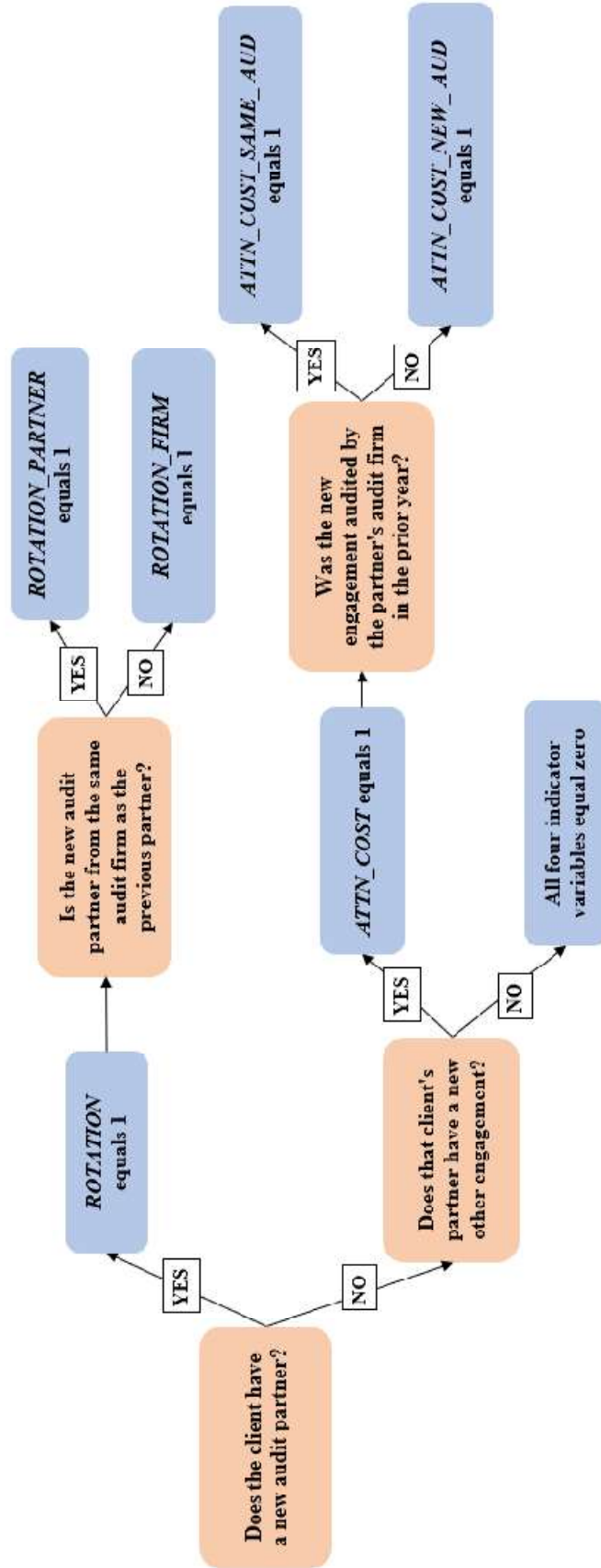
TABLE 1
Sample Reconciliation

	N	%
PCAOB Data (2017-2021)	32,186	100.0
Less: Partners with only one client	(7,118)	
	25,068	77.9
Less: Firm not in Compustat	(4,361)	
	20,707	64.3
Less: Missing necessary controls	(10,671)	
	10,036	31.2
Less: Financial and Utility Firms	(1,159)	
	8,877	27.6
Less: Insufficient observations in industry-year	(739)	
Full discretionary accruals sample	8,179	25.4

Table 1 presents the sample reconciliation from the PCAOB data to the discretionary accruals sample including change firms. Some tests with using discretionary accruals are also run excluding firms that change audit partners, resulting in a sample of 4,400 firm-years in these tests.

TABLE 2
Sample Distribution
Panel A – Temporal Distribution

Year	N	%
2017	1,425	17.4
2018	1,738	21.3
2019	1,655	20.2
2020	1,706	20.9
2021	1,655	20.2
	8,179	100

Panel B – Industry Distribution

Fama-French 12 Industry Code	N	%
Consumer Non-Durables	336	4.1
Consumer Durables	264	3.2
Manufacturing	957	11.7
Oil, Gas, and Coal Extraction and Products	479	5.9
Chemicals and Allied Products	287	3.5
Business Equipment	2,065	25.3
Wholesale, Retail, and Some Services	792	9.7
Healthcare, Medical Equipment, and Drugs	2,201	26.9
Other	798	9.8
Total:	8,179	100

Table 2 presents the sample distribution for the sample. Panel A presents the sample distribution by fiscal year. Panel B presents the sample distribution by Fama-French 12 industry classification.

TABLE 3

Panel A - Summary Statistics

Variable	N	Mean	SD	5th	25th	Median	75th	95th
ATTN_COST	8,179	0.285	0.45	0	0	0	1	1
ROTATION	8,179	0.264	0.44	0	0	0	1	1
ATTN_COST_NEW_AUD	8,179	0.107	0.31	0	0	0	0	1
ATTN_COST_SAME_AUD	8,179	0.177	0.38	0	0	0	0	1
ROTATION_FIRM	8,179	0.063	0.24	0	0	0	0	1
ROTATION_PARTNER	8,179	0.200	0.400	0	0	0	0	1
DISC_ACC	8,179	0.122	0.155	0.006	0.029	0.069	0.145	0.466
AQ_RESID	6,049	0.038	0.056	0.001	0.008	0.020	0.045	0.135
LN_LAG	8,179	4.182	0.281	3.784	4.007	4.094	4.344	4.654
BIG_4	8,179	0.602	0.489	0	0	1	1	1
CFO	8,179	-0.108	0.511	-1.013	-0.142	0.051	0.122	0.272
DEC_YE	8,179	0.776	0.417	0	1	1	1	1
LAG_ACCRUALS	8,179	0.141	0.354	0.006	0.028	0.057	0.113	0.441
LEVERAGE	8,179	0.235	4.02	0	0.056	0.304	0.569	1.197
LITIGATION	8,179	0.474	0.499	0	0	0	1	1
LOSS	8,179	0.53	0.499	0	0	1	1	1
MTB	8,179	4.247	13.165	-4.845	1.132	2.488	5.41	19.377
NEW_FIN	8,179	0.57	0.495	0	0	1	1	1
NUM_CLIENTS	8,179	4.301	7.674	2	2	3	4	12
OFFICE_SHARE	8,179	0.233	0.274	0.016	0.05	0.12	0.291	1
SALES_GROWTH	8,179	0.384	1.693	-0.528	-0.054	0.08	0.273	1.668
SIZE	8,179	5.914	2.397	1.665	4.324	6.171	7.672	9.524
SPECIALIST	8,179	0.274	0.446	0	0	0	1	1
TENURE	8,179	12.254	14.525	0	3	8	16	38
PARTNER_SPEC	8,179	0.154	0.361	0	0	0	0	1
PARTNER_SHARE	8,179	0.556	0.307	0.131	0.297	0.498	0.867	1
ATTN_COST_OFFICE	8,179	0.365	0.481	0	0	0	1	1
TOT_ACCRUALS	8,179	-0.044	0.196	-0.249	-0.082	-0.038	0.002	0.162
INC_CLIENTS	8,179	0.468	0.499	0	0	0	1	1
Panel B - Partner-Year Statistics								
Number of clients	4,734	3.50	4.99	2	2	2	3	8
Sic2 industries covered	4,734	1.73	0.89	1	1	2	2	3

Table 3 presents summary statistics of the sample. It reports the number of observations, mean, standard deviation, 5th percentile, 25th percentile, median, 75th percentile, and 95th percentile. Refer to Appendix A for variable definitions.

TABLE 4
Effects of the Attention Costs from New Clients on a Partner's Existing Clients

	(1) DISC_ACC	(2) AQ_RESID	(3) LN_LAG
ATTN_COST	0.0076**	0.0033**	0.0076
	(2.09)	(2.08)	(1.53)
ROTATION	0.0062*	0.0006	0.0215***
	(1.72)	(0.44)	(4.44)
NUM_CLIENTS	0.0001	0.0004	0.0018***
	(0.37)	(1.40)	(3.43)
SIZE	-0.0125***	-0.0063***	-0.0652***
	(9.99)	(7.54)	(29.22)
LAG_ACCRUALS	0.0459***	0.0454***	
	(5.03)	(5.65)	
SALES_GROWTH	0.0057***	-0.0003	0.0037**
	(3.86)	(0.41)	(2.41)
MTB	0.0003**	-0.0001**	-0.0011***
	(1.99)	(2.17)	(6.13)
CFO	-0.0859***	-0.0002	-0.0034
	(11.20)	(0.06)	(0.44)
LEVERAGE	-0.0001	-0.0003**	-0.0003
	(0.24)	(2.03)	(0.50)
LOSS	-0.0067*	0.0014	0.0489***
	(1.85)	(0.78)	(7.38)
LITIGATION	0.0068	0.0028	-0.0324**
	(1.18)	(0.95)	(2.44)
BIG_4	0.0015	-0.0031	-0.0713***
	(0.32)	(1.31)	(7.35)
TENURE	0.0001	0.0001**	-0.0006**
	(0.61)	(1.98)	(2.50)
SPECIALIST	0.0016	0.0020	-0.0020
	(0.48)	(1.04)	(0.29)
NEW_FIN	0.0115***	-0.0013	0.0087*
	(3.82)	(0.86)	(1.91)
DEC_YE	-0.0026	0.0004	0.0193*
	(0.63)	(0.20)	(2.24)
OFFICE_SHARE	0.0167***	0.0100***	0.0624***
	(2.59)	(2.87)	(5.57)
INTERCEPT	0.1621***	0.0655***	4.5598***
	(18.25)	(12.46)	(274.96)
Industry FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
N	8,179	6,049	8,179
R²	0.252	0.204	0.543
Adjusted R²	0.247	0.194	0.540

Table 4 presents the results of the estimation of Equation 3. Refer to Appendix A for variable definitions. T-statistics are reported in parentheses. Symbols ***, **, and * denote significance at the 1%, 5%, and 10% level respectively.

TABLE 5
Differential Effects the Attention Costs of Intra-firm and Inter-firm Client Changes on a Partner's Existing Clients

	(1) DISC_ACC	(2) AQ_RESID	(3) LN_LAG
ATTN_COST_NEW_AUD	0.0240***	0.0094***	0.0249***
	(3.82)	(2.93)	(3.13)
ATTN_COST_SAME_AUD	-0.0006	0.0007	0.0014
	(0.14)	(0.46)	(0.24)
ROTATION_FIRM	0.0113	0.0069*	0.0894***
	(1.39)	(1.95)	(7.44)
ROTATION_PARTNER	0.0055	-0.0008	0.0027
	(1.46)	(0.55)	(0.55)
NUM_CLIENTS	-0.00001	0.0003	0.0017***
	(0.07)	(1.10)	(3.21)
SIZE	-0.0123***	-0.0062***	-0.0643***
	(9.90)	(7.40)	(28.96)
LAG_ACCRUALS	0.0452***	0.0449***	
	(4.97)	(5.57)	
SALES_GROWTH	0.0058***	-0.0002	0.0036**
	(3.92)	(0.37)	(2.41)
MTB	0.0003**	-0.0001**	-0.0011***
	(2.03)	(2.10)	(6.05)
CFO	-0.0856***	-0.0001	-0.0031
	(11.18)	(0.04)	(0.42)
LEVERAGE	-0.0001	-0.0003**	-0.0004
	(0.33)	(2.17)	(0.63)
LOSS	-0.0067*	0.0014	0.0487***
	(1.86)	(0.75)	(7.38)
LITIGATION	0.0068	0.0027	-0.0318**
	(1.19)	(0.92)	(2.42)
BIG_4	0.0031	-0.0025	-0.0686***
	(0.68)	(1.06)	(7.11)
TENURE	0.0001	0.0001**	-0.0003
	(0.84)	(2.40)	(1.52)
SPECIALIST	0.0016	0.0020	-0.0019
	(0.50)	(1.05)	(0.28)
NEW_FIN	0.0114***	-0.0014	0.0080*
	(3.80)	(0.88)	(1.76)
DEC_YE	-0.0027	0.0003	0.0197**
	(0.66)	(0.16)	(2.31)
OFFICE_SHARE	0.0161**	0.0095***	0.0579***
	(2.50)	(2.75)	(5.21)
INTERCEPT	0.1604***	0.0648***	4.5505***
	(18.04)	(12.30)	(275.28)
Industry FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
N	8,179	6,049	8,179
R^2	0.253	0.206	0.547
Adjusted R^2	0.248	0.196	0.544

Table 5 presents the results of the estimation of Equation 4. Refer to Appendix A for variable definitions. T-statistics are reported in parentheses. Symbols ***, **, and * denote significance at the 1%, 5%, and 10% level respectively.

TABLE 6

Mitigating Effect of Auditor Tenure on the Attention Costs from New Clients

	(1)	(2)	(3)
Dependent Variable:	*DISC_ACC*	*AQ_RESID*	*LN_LAG*
ATTN_COST_NEW_AUD	0.0379***	0.0141***	0.0562***
	(4.44)	(3.24)	(5.09)
TENURE	0.0001	0.0001	-0.0001
	(1.28)	(1.25)	(0.30)
ATTN_COST_NEW_AUD TENURE*	-0.0017***	-0.0005***	-0.0032***
	(3.65)	(2.69)	(4.38)
ATTN_COST_SAME_AUD	-0.0016	-0.0012	0.0080
	(0.28)	(0.53)	(1.00)
ATTN_COST_SAME_AUD TENURE*	0.0001	0.0001	-0.0004
	(0.51)	(1.61)	(1.03)
ROTATION_PARTNER	0.0073	-0.0026	0.0111
	(1.36)	(1.27)	(1.56)
ROTATION_PARTNER TENURE*	-0.0001	0.0001**	-0.0005*
	(0.63)	(2.05)	(1.83)
Controls	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
N	7,660	5,682	7,660
R^2	0.252	0.198	0.539
Adjusted R^2	0.246	0.187	0.535

Table 6 presents the results of the estimation of Equation 4 where the variables of interest are interacted with *TENURE*. Refer to Appendix A for variable definitions. T-statistics are reported in parentheses. Symbols ***, **, and * denote significance at the 1%, 5%, and 10% level respectively.

TABLE 7

Mitigating Effect of Auditor Resources on Attention Costs from New Clients

Panel A – Big 4 vs. Non-Big 4 Auditor

	(1)	(2)	(3)
Dependent Variable:	DISC_ACC	AQ_RESID	LN_LAG
ATTN_COST_NEW_AUD	0.0356***	0.0127***	0.0516***
	(4.06)	(2.77)	(4.43)
BIG_4	0.0075	-0.0030	-0.0469***
	(1.34)	(1.08)	(4.40)
ATTN_COST_NEW_AUD* BIG_4	-0.0328***	-0.0127***	-0.0574***
	(2.76)	(2.21)	(3.79)
ATTN_COST_SAME_AUD	-0.0007	-0.0012	0.0192
	(0.08)	(0.32)	(1.56)
ATTN_COST_SAME_AUD* BIG_4	0.0008	0.0029	-0.0253*
	(0.08)	(0.72)	(1.87)
ROTATION_FIRM	0.0135	0.0085	0.1222***
	(1.31)	(1.65)	(7.80)
ROTATION_FIRM* BIG_4	0.0004	-0.0058	-0.0864***
	(0.02)	(0.93)	(3.76)
ROTATION_PARTNER	0.0111	-0.0045	0.0266***
	(1.38)	(1.41)	(2.58)
ROTATION_PARTNER* BIG_4	-0.0081	0.0058*	-0.0349***
	(0.91)	(1.67)	(2.99)
Controls	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
N	8,179	6,049	8,179
R^2	0.254	0.208	0.549
Adjusted R2	0.249	0.197	0.546

Panel A of Table 7 presents the results of the estimation of Equation 4 where the variables of interest are interacted with *BIG_4*. Refer to Appendix A for variable definitions. T-statistics are reported in parentheses. Symbols ***, **, and * denote significance at the 1%, 5%, and 10% level respectively.

TABLE 7

Mitigating Effect of Auditor Resources on the Attention Costs from New Clients

Panel B – Office Industry Specialization

Dependent Variable:	(1) DISC_ACC	(2) AQ_RESID	(3) LN_LAG
ATTN_COST_NEW_AUD	0.0306***	0.0121***	0.0306***
	(4.17)	(3.34)	(3.29)
OFFICE_SPEC	0.0045	0.0033	0.0031
	(1.09)	(1.53)	(0.39)
ATTN_COST_NEW_AUD* OFFICE_SPEC	-0.0361***	-0.0148*	-0.0285
	(3.07)	(1.89)	(1.57)
ATTN_COST_SAME_AUD	-0.0009	0.0009	0.0053
	(0.19)	(0.44)	(0.78)
ATTN_COST_SAME_AUD* OFFICE_SPEC	0.0017	-0.0002	-0.0126
	(0.21)	(0.05)	(1.04)
ROTATION_FIRM	0.0101	0.0092**	0.0936***
	(1.13)	(2.27)	(7.12)
ROTATION_FIRM* OFFICE_SPEC	0.0142	-0.0139**	-0.0227
	(0.75)	(2.17)	(0.67)
ROTATION_PARTNER	0.0076	-0.0009	0.0027
	(1.58)	(0.49)	(0.44)
ROTATION_PARTNER* OFFICE_SPEC	-0.0065	0.0005	0.0006
	(0.85)	(0.18)	(0.05)
Controls	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
N	8,179	6,049	8,179
R^2	0.254	0.207	0.548
Adjusted R^2	0.429	0.197	0.544

Panel B of Table 7 presents the results of the estimation of Equation 4 where the variables of interest are interacted with *OFFICE_SPEC*. Refer to Appendix A for variable definitions. T-statistics are reported in parentheses. Symbols ***, **, and * denote significance at the 1%, 5%, and 10% level respectively.

TABLE 7

Mitigating Effect of Auditor Resources on the Attention Costs from New Clients

Panel C – Partner Industry Specialization

Dependent Variable:	(1) DISC_ACC	(2) AQ_RESID	(3) LN_LAG
ATTN_COST_NEW_AUD	0.0256***	0.0106***	0.0276***
	(3.73)	(3.06)	(3.21)
PARTNER_SPEC	-0.0015	0.0036	0.0231**
	(0.37)	(1.65)	(2.43)
ATTN_COST_NEW_AUD* PARTNER_SPEC	-0.0195	-0.0115	-0.0287
	(1.44)	(1.25)	(1.18)
ATTN_COST_SAME_AUD	-0.0022	0.0012	0.0023
	(0.50)	(0.65)	(0.39)
ATTN_COST_SAME_AUD* PARTNER_SPEC	0.0108	-0.0025	-0.0050
	(1.12)	(0.57)	(0.32)
ROTATION_FIRM	0.0092	0.0078**	0.0920***
	(1.08)	(2.06)	(7.29)
ROTATION_FIRM* PARTNER_SPEC	0.0220	-0.0101	-0.0315
	(1.07)	(1.13)	(0.71)
ROTATION_PARTNER	0.0041	-0.0009	0.0018
	(0.95)	(0.57)	(0.33)
ROTATION_PARTNER* PARTNER_SPEC	0.0086	0.0013	0.0068
	(1.11)	(0.36)	(0.45)
Controls	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
N	8,179	6,049	8,179
R^2	0.254	0.201	0.548
Adjusted R^2	0.248	0.196	0.545

Panel C of Table 7 presents the results of the estimation of Equation 4 where the variables of interest are interacted with *PARTNER_SPEC*. Refer to Appendix A for variable definitions. T-statistics are reported in parentheses. Symbols ***, **, and * denote significance at the 1%, 5%, and 10% level respectively.

TABLE 8

Mitigating Effect of Client Importance on the Attention Costs from New Clients

Panel A – Office Portfolio Share

	(1)	(2)	(3)
Dependent Variable:	*DISC_ACC*	*AQ_RESID*	*LN_LAG*
ATTN_COST_NEW_AUD	0.0332***	0.0092**	0.0227**
	(3.86)	(2.06)	(2.21)
OFFICE_SHARE	0.0207**	0.0147***	0.0577***
	(2.52)	(3.02)	(4.41)
ATTN_COST_NEW_AUD OFFICE_SHARE*	-0.0379*	0.0009	0.0089
	(1.70)	(0.07)	(0.31)
ATTN_COST_SAME_AUD	0.0005	0.0049**	0.0018
	(0.09)	(2.29)	(0.26)
ATTN_COST_SAME_AUD OFFICE_SHARE*	-0.0040	-0.0192***	-0.0023
	(0.25)	(3.24)	(0.10)
ROTATION_FIRM	0.0166	0.0051	0.0896***
	(1.47)	(1.15)	(5.51)
ROTATION_FIRM OFFICE_SHARE*	-0.0173	0.0045	-0.0006
	(0.66)	(0.39)	(0.02)
ROTATION_PARTNER	0.0034	0.0027	0.0031
	(0.68)	(1.44)	(0.48)
ROTATION_PARTNER OFFICE_SHARE*	0.0099	-0.0145**	-0.0019
	(0.63)	(2.29)	(0.11)
Controls	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
N	8,179	6,049	8,179
R^2	0.254	0.208	0.547
Adjusted R^2	0.248	0.197	0.544

Panel A of Table 8 presents the results of the estimation of Equation 4 where the variables of interest are interacted with *OFFICE_SHARE*. Refer to Appendix A for variable definitions. T-statistics are reported in parentheses. Symbols ***, **, and * denote significance at the 1%, 5%, and 10% level respectively.

TABLE 8

Mitigating Effect of Client Importance on the Attention Costs from New Clients

Panel B – Partner Portfolio Share

	(1)	(2)	(3)
Dependent Variable:	DISC_ACC	AQ_RESID	LN_LAG
ATTN_COST_NEW_AUD	0.0495***	0.0137*	0.0219
	(3.98)	(1.96)	(1.41)
PARTNER_SHARE	0.0236***	0.0060*	0.0430***
	(3.43)	(1.83)	(3.66)
ATTN_COST_NEW_AUD* PARTNER_SHARE	-0.0493**	-0.0083	0.0107
	(2.53)	(0.67)	(0.43)
ATTN_COST_SAME_AUD	0.0077	0.0052	0.0140
	(0.88)	(1.54)	(1.23)
ATTN_COST_SAME_AUD* PARTNER_SHARE	-0.0132	-0.0084	-0.0222
	(0.93)	(1.57)	(1.14)
ROTATION_FIRM	0.0192	0.0038	0.1096***
	(1.22)	(0.55)	(4.54)
ROTATION_FIRM* PARTNER_SHARE	-0.0106	0.0081	-0.0304
	(0.41)	(0.68)	(0.80)
ROTATION_PARTNER	0.0208**	0.0033	0.0118
	(2.16)	(0.86)	(0.97)
ROTATION_PARTNER* PARTNER_SHARE	-0.0262*	-0.0070	-0.0181
	(1.90)	(1.31)	(0.97)
Controls	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
N	8,179	6,049	8,179
R^2	0.254	0.205	0.546
Adjusted R^2	0.248	0.195	0.543

Panel B of Table 8 presents the results of the estimation of Equation 4 where the variables of interest are interacted with *PARTNER_SHARE*. Refer to Appendix A for variable definitions. T-statistics are reported in parentheses. Symbols ***, **, and * denote significance at the 1%, 5%, and 10% level respectively.

TABLE 9

Mitigating Effect of Existing Client Size on the Attention Costs from New Clients

Dependent Variable:	(1) DISC_ACC	(2) AQ_RESID	(3) LN_LAG
ATTN COST NEW AUD	0.0807***	0.0298***	0.0764***
	(4.66)	(3.18)	(3.82)
SIZE	-0.0099***	-0.0056***	-0.0598***
	(6.32)	(5.51)	(24.18)
ATTN_COST_NEW_AUD SIZE*	-0.0117***	-0.0042***	-0.0095***
	(4.20)	(2.78)	(2.89)
ATTN_COST_SAME_AUD	0.0106	0.0057	0.0230
	(0.62)	(0.81)	(1.26)
ATTN_COST_SAME_AUD SIZE*	-0.0016	-0.0007	-0.0032
	(0.68)	(0.76)	(1.23)
ROTATION_FIRM	0.0400	0.0230**	0.1794***
	(1.63)	(2.07)	(6.00)
ROTATION_FIRM SIZE*	-0.0055	-0.0034*	-0.0190***
	(1.23)	(1.82)	(3.49)
ROTATION_PARTNER	0.0177	-0.0046	0.0454***
	(1.08)	(0.68)	(2.72)
ROTATION_PARTNER SIZE*	-0.0018	0.0007	-0.0067***
	(0.81)	(0.71)	(2.82)
Controls	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
N	8,179	6,049	8,179
R^2	0.256	0.210	0.549
Adjusted R^2	0.251	0.200	0.546

Table 9 presents the results of the estimation of Equation 4 where the variables of interest are interacted with *SIZE*. Refer to Appendix A for variable definitions. T-statistics are reported in parentheses. Symbols ***, **, and * denote significance at the 1%, 5%, and 10% level respectively.

TABLE 10
Effect of the Attention Costs from New Clients on Changes in Audit Quality

	(1)	(2)	(3)
Dependent Variable:	Δ DISC ACC	Δ AQ RESID	Δ LN LAG
ATTN COST NEW AUD	0.0412***	0.0084**	1.0243
	(4.49)	(2.07)	(1.42)
ATTN_COST_SAME_AUD	-0.0017	-0.0013	0.3335
	(0.30)	(0.61)	(0.68)
ROTATION_FIRM	0.0301**	0.0041	6.6920***
	(2.44)	(0.88)	(4.18)
ROTATION_PARTNER	0.0096*	-0.0022	0.1794
	(1.89)	(1.25)	(0.40)
PRIOR Dependent Variable	0.0004	0.0005	0.0054
	(0.89)	(1.68)	(0.13)
NUM CLIENTS	-0.8038***	-0.6134***	-0.2076***
	(35.54)	(17.74)	(9.86)
Δ LAG_ACCRUALS	0.0023	-0.0073	
	(0.18)	(1.48)	
Δ SIZE	0.0504***	0.0060	-1.4341*
	(5.35)	(1.56)	(1.93)
Δ SALES_GROWTH	0.0011	-0.0006	0.0599
	(0.69)	(1.00)	(0.69)
Δ MTB	0.00001	0.00001	0.0229*
	(0.02)	(0.04)	(1.72)
Δ CFO	-0.0305**	0.0013	-0.9553
	(2.55)	(0.26)	(1.01)
Δ LEVERAGE	0.0006***	-0.0002	0.0237
	(3.31)	(1.27)	(0.51)
Δ LOSS	0.0310***	0.0067***	2.6621***
	(7.35)	(3.99)	(6.88)
LITIGATION	0.0094	-0.0011	-1.1662**
	(1.26)	(0.40)	(2.12)
BIG_4	-0.0417***	-0.0119***	-4.3010***
	(8.47)	(6.06)	(7.39)
TENURE	-0.0001	-0.00001	0.0182**
	(0.85)	(0.02)	(2.32)
SPECIALIST_AUD	0.0036	-0.0005	-0.6090
	(0.86)	(0.31)	(1.93)
NEW_FIN	0.0090**	0.0012	1.0824***
	(2.01)	(0.72)	(2.98)
DEC_YE	-0.0035	-0.00001	0.0783
	(0.64)	(0.02)	(0.18)
Δ OFFICE_SHARE	0.0025	0.0002	1.8790
	(0.20)	(0.04)	(1.41)
INTERCEPT	0.0837***	0.0226***	14.3643***
	(10.96)	(7.41)	(8.70)
Industry FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
N	4,844	3,599	4,844
R²	0.439	0.352	0.255
Adjusted R²	0.432	0.338	0.247

Table 10 presents the results of the estimation of Equation 4 with control variables measured as the change from t-2 to t-1, where appropriate. Refer to Appendix A for variable definitions. T-statistics are reported in parentheses. Symbols ***, **, and * denote significance at the 1%, 5%, and 10% level respectively.

TABLE 11

Effect of the Attention Costs from New Clients on Total Accruals

	(1) Fitted TOT_ACCRUALS
ATTN_COST_NEW_AUD	-0.0038
	(1.10)
ATTN_COST_SAME_AUD	-0.0009
	(0.46)
ROTATION_FIRM	0.0083**
	(2.06)
ROTATION_PARTNER	-0.0001
	(0.05)
NUM_CLIENTS	-0.0002
	(1.15)
SIZE	0.0029***
	(3.62)
LAG_ACCRUALS	-0.0083
	(1.52)
SALES_GROWTH	-0.0001
	(0.09)
MTB	0.0001*
	(1.90)
CFO	0.0278***
	(5.90)
LEVERAGE	0.0001
	(0.79)
LOSS	0.0048**
	(2.55)
LITIGATION	0.0108***
	(3.85)
BIG_4	-0.0005
	(0.21)
TENURE	-0.0001**
	(2.41)
SPECIALIST	-0.0001
	(0.06)
NEW_FIN	0.0049***
	(3.03)
DEC_YE	0.0018
	(0.91)
OFFICE_SHARE	-0.0020
	(0.52)
INTERCEPT	-0.0654***
	(11.83)
Industry FE	Yes
Year FE	Yes
N	8,179
R^2	0.206
Adjusted R^2	0.201

Table 11 presents the results of the estimation of Equation 4 with the fitted value of *TOT_ACCRUALS* as the dependent variable. Refer to Appendix A for variable definitions. T-statistics are reported in parentheses. Symbols ***, **, and * denote significance at the 1%, 5%, and 10% level respectively.

TABLE 12
Partner-Level and Office-Level Effects of the Attention Costs from New Clients

Dependent Variable:	(1) DISC_ACC	(2) AQ_RESID	(3) LN_LAG
ATTN_COST_NEW_AUD	0.0306***	0.0081**	0.0413***
	(4.49)	(2.28)	(4.37)
ATTN_COST_OFFICE	0.0161***	-0.0013	0.0125*
	(3.70)	(0.63)	(1.84)
NUM_CLIENTS	-0.0002	0.0002	0.0009
	(0.62)	(0.74)	(1.56)
SIZE	-0.0118***	-0.0061***	-0.0633***
	(6.58)	(5.03)	(25.11)
LAG_ACCRUALS	0.0619***	0.0462***	
	(4.91)	(4.53)	
SALES_GROWTH	0.0059***	0.0004	0.0009
	(2.70)	(0.45)	(0.62)
MTB	0.0001	-0.0002	-0.0012***
	(0.44)	(1.87)	(5.03)
CFO	-0.0916***	-0.0040	-0.0031
	(8.25)	(0.69)	(0.34)
LEVERAGE	-0.0010	-0.0008**	-0.0022**
	(0.72)	(2.36)	(2.36)
LOSS	-0.0133***	-0.0021	0.0493***
	(2.63)	(0.87)	(5.98)
LITIGATION	-0.0010	0.0035	-0.0134
	(0.12)	(0.79)	(0.91)
BIG_4	0.0046	-0.0043	-0.0567***
	(0.75)	(1.31)	(5.24)
TENURE	-0.00001	0.00001	-0.0004
	(0.10)	(0.57)	(1.56)
SPECIALIST	0.0010	0.0041	-0.0054
	(0.23)	(1.68)	(0.67)
NEW_FIN	0.0130***	-0.0034	0.0103*
	(3.12)	(1.56)	(1.72)
DEC_YE	-0.0037	-0.00001	0.0188*
	(0.64)	(0.01)	(1.89)
OFFICE_SHARE	0.0217**	0.0153***	0.0707***
	(2.46)	(2.74)	(5.31)
INTERCEPT	0.1543***	0.0679***	4.5227***
	(11.98)	(9.61)	(224.42)
Industry FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
N	4,077	2,992	4,077
R^2	0.297	0.219	0.553
Adjusted R^2	0.287	0.200	0.547

Table 12 presents the results of the estimation of Equation 4 augmented with the additional variable *ATTN_COST_OFFICE* and without *ROTATION_PARTNER*, *ROTATION_FIRM*, or *ATTN_COST_SAME_AUD*. Refer to Appendix A for variable definitions. T-statistics are reported in parentheses. Symbols ***, **, and * denote significance at the 1%, 5%, and 10% level respectively.

TABLE 13

Attention Costs from New Clients or an Increase in the Number of Clients

Panel A – Partners with an increase in total number of clients

	(1)	(2)	(3)
Dependent Variable:	*DISC_ACC*	*AQ_RESID*	*LN_LAG*
ATTN_COST_NEW_AUD	0.0309***	0.0123***	0.0201*
	(3.41)	(2.79)	(1.75)
ATTN_COST_SAME_AUD	0.0114*	0.0039	-0.0006
	(1.65)	(1.29)	(0.06)
ROTATION_FIRM	0.0211**	0.0102**	0.0770***
	(2.05)	(2.25)	(4.85)
ROTATION_PARTNER	0.0140**	0.0006	0.0007
	(2.13)	(0.24)	(0.07)
Controls	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
N	4,348	3,207	4,348
R^2	0.257	0.194	0.538
Adjusted R^2	0.248	0.175	0.533

TABLE 13

Panel B – Partners with no increase in the total number of clients

	(1)	(2)	(3)
Dependent Variable:	*DISC_ACC*	*AQ_RESID*	*LN_LAG*
ATTN_COST_NEW_AUD	0.0205*	0.0073	0.0275*
	(1.71)	(1.29)	(1.87)
ATTN_COST_SAME_AUD	-0.0122*	-0.0013	0.0015
	(1.73)	(0.46)	(0.14)
ROTATION_FIRM	0.0034	0.0041	0.1096***
	(0.21)	(0.52)	(4.58)
ROTATION_PARTNER	0.0026	0.0027	0.0037
	(0.35)	(0.90)	(0.38)
Controls	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
N	3,831	2,836	3,831
R^2	0.256	0.237	0.555
Adjusted R^2	0.245	0.217	0.549

Table 13 presents the results of the estimation of Equation 4 partitioned by whether the partner had an increase in the total number of clients from the prior year. Refer to Appendix A for variable definitions. T-statistics are reported in parentheses. Symbols ***, **, and * denote significance at the 1%, 5%, and 10% level respectively.

TABLE 14

Entropy Balancing Sample

Dependent Variable:	(1) DISC_ACC	(2) AQ_RESID	(3) LN_LAG
ATTN_COST_NEW_AUD	0.0331***	0.0183***	0.0131
	(3.29)	(4.45)	(0.81)
NUM_CLIENTS	-0.0007**	-0.0002	0.0013
	(2.09)	(1.02)	(1.49)
SIZE	-0.0123***	-0.0065***	-0.0602***
	(3.27)	(3.86)	(11.91)
LAG_ACCRUALS	0.0376**	0.0292***	
	(2.22)	(2.89)	
SALES_GROWTH	0.0075**	0.0005	-0.0025
	(2.14)	(0.37)	(0.73)
MTB	-0.0001	-0.0003	-0.0009***
	(0.32)	(1.57)	(2.68)
CFO	-0.0838***	-0.0097	0.0136
	(5.15)	(1.70)	(1.27)
LEVERAGE	-0.0014	-0.0010***	-0.0017
	(0.86)	(5.47)	(1.69)
LOSS	0.0013	0.0056	0.0295
	(0.11)	(1.17)	(1.39)
LITIGATION	-0.0129	0.0195***	-0.0113
	(0.41)	(2.68)	(0.37)
BIG_4	0.0036	-0.0070	-0.0703***
	(0.31)	(1.26)	(3.77)
TENURE	-0.0005	0.0001	-0.0031***
	(1.31)	(0.55)	(4.45)
SPECIALIST	-0.0121	0.0033	-0.0433
	(1.31)	(0.66)	(1.74)
NEW_FIN	0.0183*	-0.0113**	0.0357***
	(1.84)	(2.37)	(2.87)
DEC_YE	-0.0276*	0.0027	-0.0562*
	(1.94)	(0.46)	(1.81)
OFFICE_SHARE	0.0107	0.0202**	0.0308
	(0.62)	(2.42)	(1.48)
INTERCEPT	0.1865***	0.0277**	4.4364***
	(3.63)	(2.02)	(71.84)
Industry FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
N	4,572	3,390	4,572
R^2	0.299	0.240	0.530
Adjusted R^2	0.291	0.224	0.524

Table 14 presents the results of the estimation of Equation 4 without *ROTATION_PARTNER*, *ROTATION_FIRM*, or *ATTN_COST_SAME_AUD*. Refer to Appendix A for variable definitions. T-statistics are reported in parentheses. Symbols ***, **, and * denote significance at the 1%, 5%, and 10% level respectively.

Online Appendix

TABLE 1A
Additional Variable Summary Statistics

Variable	N	Mean	SD	5th	25th	Median	75th	95th
SIGNED_DISC_ACC	8,179	0.0001	0.191	-0.289	-0.069	0.000	0.069	0.288
RELATIVE_LAG	8,179	0.313	26.067	-27	-13	-4	0	70
F_SCORE	8,663	1.108	1.570	0.169	0.447	0.820	1.326	2.271
ICMW	5,375	0.067	0.251	0	0	0	0	1
MEET_OR_BEAT	6,150	0.102	0..303	0	0	0	0	1
RESTATEMENT	4,389	0.021	0.144	0	0	0	0	0
PRIOR_RESTATEMENT	4,389	0.036	0.187	0	0	0	0	0

Table 1A presents summary statistics for additional variables used in the Online Appendix. It reports the number of observations, mean, standard deviation, 5th percentile, 25th percentile, median, 75th percentile, and 95th percentile. Refer to Appendix A for variable definitions

TABLE 2A
Effects of the Attention Costs from New Clients – Alternate Audit Outcomes

	(1) SIGNED_DISC_ACC	(2) RELATIVE_LAG	(3) F_SCORE
ATTN_COST	-0.0029	0.4501	-0.0364
	(0.74)	(0.70)	(0.98)
ROTATION	-0.0018	2.6388***	-0.0409
	(0.48)	(4.09)	(1.18)
NUM_CLIENTS	-0.0002	0.0991*	0.0075
	(0.45)	(1.81)	(1.55)
SIZE	0.0019	-1.6153***	0.0175
	(1.30)	(6.46)	(1.11)
LAG_ACCRUALS	0.0003		0.0520
	(0.02)		(0.48)
SALES_GROWTH	0.0028	0.1851	0.3844***
	(1.38)	(0.97)	(8.45)
MTB	0.0002	-0.0573***	-0.0022
	(1.15)	(2.81)	(0.97)
CFO	-0.0286***	-0.2917	-0.3672***
	(2.65)	(0.30)	(3.65)
LEVERAGE	0.0006	-0.0276	0.0005
	(1.59)	(0.45)	(0.38)
LOSS	-0.0370***	2.8356***	-0.1178***
	(8.71)	(3.56)	(3.17)
LITIGATION	-0.0124**	-0.4945	-0.0295
	(1.97)	(0.37)	(0.46)
BIG_4	-0.0118***	-3.0622***	-0.0211
	(2.68)	(2.66)	(0.39)
TENURE	-0.00001	-0.0819***	0.0007
	(0.69)	(4.18)	(0.85)
SPECIALIST	-0.0001	1.1126	-0.0262
	(0.03)	(1.53)	(0.75)
NEW_FIN	0.0150***	-0.3351	0.0203
	(4.67)	(0.57)	(0.65)
DEC_YE	0.0088**	2.7852***	-0.0154
	(2.22)	(3.21)	(0.36)
OFFICE_SHARE	0.0024	3.2042**	0.2277***
	(0.35)	(2.49)	(3.13)
INTERCEPT	0.0039	7.3208***	0.8505***
	(0.38)	(4.00)	(7.87)
Industry FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
N	8,179	8,179	8,661
R^2	0.020	0.122	0.199
Adjusted R^2	0.013	0.117	0.192

Table 2A presents the results of the estimation of Equation 1 using OLS regression for the dependent variables *SIGNED_DISC_ACC*, *RELATIVE_LAG*, and *F-SCORE*. Refer to Appendix A for variable definitions. T-statistics are reported in parentheses. Symbols ***, **, and * denote significance at the 1%, 5%, and 10% level respectively.

TABLE 3A
Differential Effects of Intra-firm and Inter-firm Client Changes – Alternate Audit Outcomes

	(1) SIGNED_DISC_ACC	(2) RELATIVE_LAG	(3) F_SCORE
ATTN_COST_NEW_AUD	0.0101	2.3009**	0.0168
	(1.10)	(2.11)	(0.24)
ATTN_COST_SAME_AUD	-0.0054	-0.1909	-0.0589
	(0.98)	(0.27)	(1.55)
ROTATION_FIRM	-0.0137	10.4838***	0.0814
	(1.22)	(6.51)	(0.83)
ROTATION_PARTNER	0.0051	0.4691	-0.0733**
	(0.97)	(0.74)	(2.28)
NUM_CLIENTS	-0.0002	0.0830	0.0070
	(0.39)	(1.54)	(1.44)
SIZE	0.0039**	-1.5149***	0.0192
	(2.15)	(6.08)	(1.22)
LAG_ACCRUALS	0.0117		0.0480
	(0.80)		(0.44)
SALES_GROWTH	0.0012	0.1749	0.3844***
	(0.58)	(0.93)	(8.45)
MTB	0.0005**	-0.0545***	-0.0022
	(1.99)	(2.69)	(0.95)
CFO	-0.0475***	-0.2669	-0.3668***
	(4.11)	(0.28)	(3.64)
LEVERAGE	0.0001	-0.0366	0.0004
	(0.15)	(0.58)	(0.25)
LOSS	-0.0169***	2.8112***	-0.1188***
	(3.46)	(3.55)	(3.19)
LITIGATION	-0.0219***	-0.4238	-0.0286
	(2.93)	(0.32)	(0.45)
BIG_4	-0.0158**	-2.7649**	-0.0133
	(2.52)	(2.39)	(0.24)
TENURE	-0.0001	-0.0569***	0.0011
	(0.92)	(2.91)	(1.28)
SPECIALIST	-0.0014	1.1227	-0.0274
	(0.35)	(1.55)	(0.78)
NEW_FIN	0.0193***	-0.4166	0.0193
	(4.73)	(0.71)	(0.62)
DEC_YE	0.0067	2.8382***	-0.0149
	(1.29)	(3.29)	(0.35)
OFFICE_SHARE	0.0064	2.6892**	0.2188***
	(0.73)	(2.11)	(3.06)
INTERCEPT	-0.0187	6.2605***	0.8332***
	(1.48)	(3.42)	(7.70)
Industry FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
N	8,179	6,049	8,179
R^2	0.023	0.129	0.200
Adjusted R^2	0.016	0.123	0.193

Table 3A presents the results of the estimation of Equation 4 using OLS regression for the dependent variables *SIGNED_DISC_ACC*, *RELATIVE_LAG*, and *F-SCORE*. Refer to Appendix A for variable definitions. T-statistics are reported in parentheses. Symbols ***, **, and * denote significance at the 1%, 5%, and 10% level respectively.

TABLE 4A
Effects of the Attention Costs from New Clients – Alternate Audit Outcomes
– Logistic Regression

	(1) ICMW	(2) MEET_OR_BEAT
ATTN_COST	-0.0971	-0.0289
	(0.65)	(0.28)
ROTATION	0.1732	-0.1212
	(1.33)	(1.15)
NUM_CLIENTS	0.0654***	-0.1329***
	(2.63)	(3.16)
SIZE	-0.2900***	-0.0031
	(4.73)	(0.27)
LAG_ACCRUALS	0.4192*	-1.8414***
	(1.70)	(3.32)
SALES_GROWTH	0.0771***	-0.0898**
	(2.68)	(-1.99)
MTB	-0.0026	0.0089***
	(0.60)	(2.85)
CFO	0.0695	0.2762
	(0.27)	(1.53)
LEVERAGE	0.0284	-0.0155
	(0.34)	(-0.87)
LOSS	0.6734***	-0.0596
	(4.58)	(-0.52)
LITIGATION	0.2424	0.2214
	(0.91)	(1.33)
BIG_4	-0.1096	-0.0311
	(0.56)	(-0.22)
TENURE	-0.0216**	0.0081***
	(2.50)	(2.60)
SPECIALIST	0.1353	0.0551
	(0.94)	(0.54)
NEW_FIN	-0.0339	0.1358
	(0.25)	(1.44)
DEC_YE	-0.1574	-0.0580
	(0.86)	(-0.46)
OFFICE_SHARE	0.9716***	0.1240
	(4.16)	(0.65)
INTERCEPT	-1.1229	-1.2744
	(1.43)	(-1.18)
Industry FE	Yes	Yes
Year FE	Yes	Yes
N	5,375	6,150
Pseudo R^2	0.129	0.051

Table 4A presents the results of the estimation of Equation 1 using logistic regression for the dependent variables *ICMW* and *MEET_OR_BEAT*. Refer to Appendix A for variable definitions. T-statistics are reported in parentheses. Symbols ***, **, and * denote significance at the 1%, 5%, and 10% level respectively.

TABLE 5A
Differential Effects of Intra-firm and Inter-firm Client Changes – Alternate
Audit Outcomes – Logistic Regression

	(1) *ICMW*	(2) *MEET_OR_BEAT*
ATTN_COST_NEW_AUD	-0.1607	-0.1516
	(0.68)	(0.86)
ATTN_COST_SAME_AUD	-0.0549	0.0126
	(0.32)	(0.11)
ROTATION_FIRM	0.7506***	-0.4034
	(3.51)	(1.55)
ROTATION_PARTNER	-0.0274	-0.0775
	(0.18)	(0.70)
NUM_CLIENTS	0.0663***	-0.1336***
	(2.64)	(-3.18)
SIZE	-0.2832***	-0.0013
	(4.59)	(0.12)
LAG_ACCRUALS	0.3923	-1.8216***
	(1.56)	(-3.30)
SALES_GROWTH	0.0734**	-0.0898**
	(2.51)	(-2.00)
MTB	-0.0024	0.0087***
	(0.57)	(2.79)
CFO	0.0513	0.2730
	(0.20)	(1.52)
LEVERAGE	0.0262	-0.0147
	(0.31)	(-0.82)
LOSS	0.6825***	-0.0589
	(4.62)	(-0.52)
LITIGATION	0.2473	0.2218
	(0.93)	(1.33)
BIG_4	-0.1158	-0.0440
	(0.59)	(-0.32)
TENURE	-0.0173**	0.0076**
	(2.13)	(2.39)
SPECIALIST	0.1279	0.0539
	(0.88)	(0.53)
NEW_FIN	-0.0498	0.1355
	(0.36)	(1.44)
DEC_YE	-0.1665	-0.0538
	(0.90)	(-0.42)
OFFICE_SHARE	0.9557***	0.1358
	(4.09)	(0.72)
INTERCEPT	-1.2420	-1.2415
	(1.62)	(-1.15)
Industry FE	Yes	Yes
Year FE	Yes	Yes
N	5,375	6,150
Pseudo R^2	0.133	0.052

Table 5A presents the results of the estimation of Equation 4 using logistic
regression for the dependent variables *ICMW* and *MEET_OR_BEAT*. Refer to
Appendix A for variable definitions. T-statistics are reported in parentheses.
Symbols ***, **, and * denote significance at the 1%, 5%, and 10% level
respectively.

TABLE 6A
Effect of the Attention Costs on Changes in Audit Quality

Dependent Variable:	(1) Δ DISC_ACC	(2) Δ AQ_RESID	(3) Δ LN_LAG
ATTN_COST_NEW_AUD	0.0263**	0.0029	-0.6582
	(2.32)	(0.63)	(0.67)
ATTN_COST_SAME_AUD	-0.0056	-0.0014	-0.2084
	(0.70)	(0.50)	(0.38)
ROTATION_FIRM	0.0162	-0.0003	4.5092***
	(1.05)	(0.05)	(2.68)
ROTATION_PARTNER	0.0154**	-0.0022	0.1869
	(2.32)	(0.99)	(0.37)
NUM_CLIENTS	-0.0011***	-0.0002	-0.0596
	(3.32)	(0.97)	(1.52)
Δ LAG_ACCRUALS	-0.0692***	-0.0151**	
	(4.03)	(2.35)	
Δ SIZE	0.0243**	0.0090**	-1.3855
	(2.21)	(2.11)	(1.61)
Δ SALES_GROWTH	0.0031	-0.0002	0.0200
	(1.27)	(0.30)	(0.17)
Δ MTB	0.0001	-0.0001	0.0353**
	(0.32)	(1.36)	(2.13)
Δ CFO	-0.0672***	0.0044	-0.7678
	(3.87)	(0.60)	(0.60)
Δ LEVERAGE	0.0012***	-0.0002	0.0359
	(5.98)	(0.80)	(0.69)
Δ LOSS	-0.0047	0.0019	1.2413***
	(0.97)	(1.00)	(3.07)
LITIGATION	0.0043	-0.0008	-1.0893*
	(0.67)	(0.36)	(1.88)
BIG_4	-0.0018	0.0005	-0.2341
	(0.37)	(0.26)	(0.55)
TENURE	0.0001	0.00001	0.0435***
	(0.73)	(0.56)	(4.96)
SPECIALIST_AUD	0.0068	0.0020	-0.4314
	(1.48)	(1.40)	(1.25)
NEW_FIN	-0.0047	-0.0009	0.4453
	(0.83)	(0.46)	(1.07)
DEC_YE	-0.0064	-0.0002	-0.0530
	(1.35)	(0.10)	(0.12)
Δ OFFICE_SHARE	0.0226	0.0032	3.0040**
	(1.35)	(0.59)	(1.98)
INTERCEPT	0.0020	-0.0025	-1.0227
	(0.28)	(0.94)	(1.54)
Industry FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
N	4,844	3,591	4,873
R^2	0.052	0.019	0.042
Adjusted R^2	0.041	0.0001	0.031

Table 6A presents the results of the estimation of Equation 4 with control variables measured as the change from t-2 to t-1, where appropriate. Refer to Appendix A for variable definitions. The difference between the regressions in Table 10 and the regressions in this table is that Table 9 includes control variables for the value of the respective audit outcome variable for the year t-1. T-statistics are reported in parentheses. Symbols ***, **, and * denote significance at the 1%, 5%, and 10% level respectively.

TABLE 7A

Effects on Clients with December Fiscal Year-Ends

Dependent Variable:	(1) *DISC_ACC*	(2) *AQ_RESID*	(3) *LN_LAG*
ATTN_COST_NEW_AUD	0.0332**	0.0087	0.0478**
	(2.30)	(1.20)	(2.56)
DEC_YE	-0.0028	-0.0008	0.0283***
	(0.56)	(0.36)	(2.74)
ATTN_COST_NEW_AUD DEC_YE*	-0.0117	0.0010	-0.0287
	(0.73)	(0.11)	(1.40)
ATTN_COST_SAME_AUD	0.0013	-0.0017	-0.0035
	(0.16)	(0.65)	(0.30)
ATTN_COST_SAME_AUD DEC_YE*	-0.0024	0.0033	0.0064
	(0.26)	(1.00)	(0.48)
ROTATION_FIRM	-0.0096	0.0056	0.1302***
	(0.63)	(0.84)	(5.21)
ROTATION_FIRM DEC_YE*	0.0274	0.0017	-0.0530*
	(1.55)	(0.21)	(1.87)
ROTATION_PARTNER	0.0062	-0.0019	0.0138
	(0.83)	(0.78)	(1.21)
ROTATION_PARTNER DEC_YE*	-0.0008	0.0015	-0.0142
	(0.09)	(0.51)	(1.12)
Controls	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
N	8,179	6,049	8,179
R^2	0.254	0.206	0.548
Adjusted R^2	0.248	0.196	0.545

Table 7A presents the results of the estimation of Equation 4 where the variables of interest are interacted with *DEC_YE*. Refer to Appendix A for variable definitions. T-statistics are reported in parentheses. Symbols ***, **, and * denote significance at the 1%, 5%, and 10% level respectively.

TABLE 8A
Effect of the Attention Costs from New Clients on Existing Client Restatements
Panel A

	(1) *RESTATEMENT*
ATTN_COST	0.2861
	(0.96)
ROTATION	0.5855**
	(2.15)
NUM_CLIENTS	0.0011
	(0.04)
SIZE	-0.1202*
	(1.80)
LAG_ACCRUALS	-0.2394
	(0.59)
SALES_GROWTH	0.0974
	(1.48)
MTB	0.0100
	(1.36)
CFO	0.1437
	(0.73)
LEVERAGE	0.0259
	(0.31)
LOSS	-0.0032
	(0.01)
LITIGATION	-0.2698
	(0.69)
BIG_4	-0.9430**
	(2.46)
TENURE	-0.0085
	(0.68)
SPECIALIST	0.6461
	(1.60)
NEW_FIN	-0.0842
	(0.35)
DEC_YE	0.5319*
	(1.65)
OFFICE_SHARE	0.4027
	(1.03)
PRIOR_RESTATEMENT	3.4032***
	(12.05)
INTERCEPT	-5.2745***
	(4.73)
Industry FE	Yes
Year FE	Yes
N	4,389
Pseudo R^2	0.275

Panel A of Table 8A presents the results of the estimation of Equation 1 using logistic regression with *RESTATEMENT* as the dependent variable. Refer to Appendix A for variable definitions. T-statistics are reported in parentheses. Symbols ***, **, and * denote significance at the 1%, 5%, and 10% level respectively.

TABLE 8A
Effect of Partner Limited Attention on Restatements
Panel B

	(1) *RESTATEMENT*
ATTN_COST_NEW_AUD	-0.1048
	(0.23)
ATTN_COST_SAME_AUD	0.4579
	(1.42)
ROTATION_FIRM	0.4016
	(0.98)
ROTATION_PARTNER	0.6595**
	(2.20)
NUM_CLIENTS	0.0071
	(0.29)
SIZE	-0.1255*
	(1.88)
LAG_ACCRUALS	-0.2422
	(0.58)
SALES_GROWTH	0.0955
	(1.43)
MTB	0.0097
	(1.29)
CFO	0.1365
	(0.69)
LEVERAGE	0.0263
	(0.33)
LOSS	-0.0008
	(0.00)
LITIGATION	-0.2408
	(0.61)
BIG_4	-0.9580**
	(2.50)
TENURE	-0.0111
	(0.86)
SPECIALIST	0.6398
	(1.61)
NEW_FIN	-0.0767
	(0.32)
DEC_YE	0.5202
	(1.63)
OFFICE_SHARE	0.4246
	(1.09)
PRIOR_RESTATEMENT	3.4100***
	(11.86)
INTERCEPT	-5.2660***
	(4.70)
Industry FE	Yes
Year FE	Yes
N	4,389
Pseudo R^2	0.277

Panel B of Table 8A presents the results of the estimation of Equation 4 using logistic regression with *RESTATEMENT* as the dependent variable. Refer to Appendix A for variable definitions. T-statistics are reported in parentheses. Symbols ***, **, and * denote significance at the 1%, 5%, and 10% level respectively.

VITA

Christopher P. Wertheim was born to Paul and Robyn Wertheim. After graduating from Abilene High School, he earned his bachelor's degree in accounting and master's degree of financial management from Texas A&M University – College Station. Upon graduation, Christopher worked for roughly two years as a staff associate for EY's Structured Finance Advisory Services in Houston, Texas before enrolling at Mizzou in the Accounting PhD program. Christopher is supported by his wife, Alexandra.