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The effects of Section 404 of Sarbanes-Oxley Act of 2002 on the audit fees of foreign firms listed on US exchanges

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Abstract

Purpose – The purpose of this study is to examine the change in audit fees for US-listed foreign firms in their first year of providing Section 404 auditor attestation reports for fiscal years ending between July 15, 2006 and July 14, 2007.

Design/methodology/approach – During the sampling time period, foreign large accelerated filers had to provide both auditor and management Section 404 reports while the foreign accelerated filers only had to provide management Section 404 reports without the auditor attestation reports. Foreign non-accelerated filers did not have to provide any Section 404 report. This research design and sample allows the authors to control for the general market-wide increases in audit fees. The paper examines the annual change in audit fees from the preceding year to the first year of Section 404 compliance.

Findings – It is found that foreign large accelerated filers have an average increase of 74 percent in audit fees in this first year of Section 404 compliance, while the foreign accelerated filers and non-accelerated filers only have increases in audit fees of 33 percent and 42 percent, respectively. Since this research design and sample allow the authors to control for the general market-wide increases in audit fees, the authors are able to conclude that foreign large accelerated filers incurred, on average, a 30 percent increase in audit fees just to comply with Section 404. It is also found that the increase in audit fees among foreign large accelerated filers is negatively associated with the strength of their home countries' legal environment.

Originality/value – Arguably, Section 404 is perhaps the most controversial aspect of Sarbanes-Oxley Act due to its high audit fees. The results of this study would provide interesting findings to regulators and researchers.

Keywords Audit fees, Sarbanes-Oxley, Foreign firms, Section 404, Auditing, Exchange, United States of America

Paper type Research paper

I. Introduction

The US Congress passed the Sarbanes-Oxley Act of 2002 to improve the accuracy and reliability of corporate disclosures (The Senate and House of Representatives of the United States of America (US Congress), 2002). Under Section 404 of the

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Sarbanes-Oxley Act, both management and auditor are required to report on the effectiveness of a firm's of internal control over financial reporting. Section 404 is considered by many as the most important aspect of the Sarbanes-Oxley Act[1]. Initially, the Securities and Exchange Commission (SEC) required all US public companies that are considered as accelerated filers to report on the effectiveness of their internal control over financial reporting for fiscal years ending on or after November 15, 2004. Accelerated filers are generally defined as companies with at least $75 million in public equity float. Foreign issuers and non-accelerated filers were supposed to comply with Section 404 for fiscal years ending on or after July 15, 2005 (SEC, 2003).

Responding to numerous complaints about the high compliance cost of Section 404, the SEC modified Section 404 rules for foreign registrants and smaller US firms several times. One key change in 2005 was the postponement of Section 404 compliance date for foreign registrants and non-accelerated filers to fiscal years ending on or after July 15, 2006 (SEC, 2005). In 2006, the SEC further re-classified the accelerated filers into large accelerated filers with public equity float of at least $700 million and accelerated filers with public equity float of at least $75 million but less than $700 million (SEC, 2006a, b). The revised rule also requires foreign large accelerated filers to provide both management and auditor Section 404 reports for fiscal years ending on or after July 15, 2006. Foreign accelerated filers need only provide management Section 404 reports on effectiveness of their internal control over financial reporting, without the corresponding auditor attestation report. Starting the following fiscal year, foreign accelerated filers would have to provide both management and auditor Section 404 reports. All non-accelerated filers do not have to provide any Section 404 report for fiscal years ending before December 15, 2007. Appendix A summarizes the revised Section 404 requirements[2].

Arguably, Section 404 is perhaps the most controversial aspect of Sarbanes-Oxley Act due to its high audit fees. For example, Eldridge and Kealey (2005) find an average increase of 100 percent in audit fees among banks. Likewise, Raghunandan and Rama (2006) report an average 86 percent increase in audit fees among industrial firms in 2004[3]. Consistent with increases in audit fees, Ettredge *et al.* (2006) find significant audit delays due to Section 404 reviews. The main objective of this study is to examine the initial effects of Section 404 on the audit fees of foreign registrants. This study would provide interesting findings to regulators and researchers for several reasons.

First, the high Section 404 compliance cost is often cited as the main reason for the decline in listings of foreign firms on US exchanges (*Wall Street Journal*, 2005). John Thain (CEO of the NYSE), Bob Greifeld (CEO of Nasdaq), and US Treasury Secretary Hank Paulson have all publicly expressed concern that foreign firms are avoiding US exchanges because of Sarbanes-Oxley (Thain, 2004; Greifeld, 2006; Paulson, 2006). This study provides early evidence on the change in audit fees in the first year of Section 404 compliance among foreign registrants[4].

Second, this initial compliance year represents a unique environment in that there are three different compliance levels:

(1) foreign large accelerated filers have to submit both management and auditor Section 404 reports;

(2) foreign accelerated filers have to submit only their management Section 404 reports; and

(3) foreign non-accelerated filers are not required to submit any Section 404 report.

These differential requirements allow us to examine the incremental effects of Section 404 on audit fees while controlling for the general market-wide increase in audit fees due to the overall changes in regulatory environment since the passage of SOX in 2002[5].

Third, Simunic (1980) suggests that the amount of audit fees is affected by the amount of audit effort and the extent of auditor's legal liability exposure. Prior studies have found increase in audit fees for foreign firms after they have cross-listed in the US or in other countries that have stronger legal environments than their home countries (Seetharaman *et al.*, 2002; Choi *et al.*, 2009). The expanded scope of the audit under Section 404 obviously requires substantial increase in audit effort. It is worth noting, however, that Section 404 also increases the auditor's legal liability exposure in the event that an auditor fails to identify a client's material internal control weaknesses[6]. William McDonough, the then chairman of the Public Company Accounting Oversight Board, surmised, "in a litigious society, there is no question that some auditors may be protecting themselves by doing work that all of us might think objectively is excessive" (*Business Week*, 2005). Similarly, Wallison (2007) suggests that firms and their auditors are concerned with litigation risk from audit failure related to Section 404 reviews. Clearly, if auditors and management fail to identify material internal control weaknesses, such weaknesses when discovered can lead to accounting restatements. This, in turn, may lead to lawsuits against management and their auditors. For foreign firms, the increase in audit fees from auditor's Section 404 review may be affected by the strength of the legal environments in their home countries. Given the incremental audit work to comply with Section 404, additional increase in auditor's legal liability should be less for firms that have strong legal environment in their home countries. In other words, the increase in auditor's legal liability due to Section 404 reviews for foreign firms from countries with stronger legal environment should be less than those domiciled in countries with weaker legal environment. Consequently, we predict a smaller (larger) amount of increase in audit fees for firms from countries with stronger (weaker) legal environment. Indeed, the initial Section 404 compliance of foreign firms provides an interesting setting to examine the effects of legal environment on audit fees.

The rest of this study is organized as follows. Section 2 discusses the related literature and research objectives. Section 3 describes the research design. Section 4 summarizes the empirical findings and Section 5 presents concluding comments.

II. Related literature and research hypotheses

The Sarbanes-Oxley Act of 2002 is generally considered as the most important legislation since the 1930s (Cutler, 2004). Recent studies examine the expected value of the Sarbanes-Oxley Act to firms by investigating stock price reactions to the passage of this Act. The results are mixed, however. While Rezaee and Jain (2006) find positive stock price reactions to events associated with the passage of this legislation, Zhang (2007) reports negative stock price reactions to the related legislation events.

Several studies examine the effect of Section 404 on the audit fees of US firms. Raghunandan and Rama (2006) examine the audit fees of 660 manufacturing firms. These accelerated filers have to comply with Section 404 starting in 2004. They find that the average (median) audit fees of their sample firms have increased by 86 (128) percent in 2004 as compared to 2003. Raghunandan and Rama (2006) also find that firms reporting ineffective internal controls experienced larger increases in audit fees

than firms with effective internal controls. Eldridge and Kealey (2005), on the other hand, examine a sample of 245 commercial banks that have complied with Section 404 starting in 2004. The authors report an average of 100 percent increase in audit fees among the commercial banks in 2004. Consistent with an increase in audit effort, Ettredge *et al.* (2006) find that Section 404 has caused an average audit delay of 34 days among accelerated filers in 2004. Their research also report that the average audit delay among firms with ineffective internal controls is about 16 days longer than firms with effective internal controls. Benoit (2006) summarizes an interesting research study by Lord and Benoit LLC on the effects of Section 404 on real estate firms. As expected, the study shows that the average audit fees of a sample of real estate firms, all accelerated filers, increased by 85 percent from 2003 to 2004. Moreover, their study also finds an average increase of 36 percent in audit fees among real estate firms with market capitalizations of $1-$75 million. As non-accelerated filers, these smaller real estate firms are not subject to Section 404 reviews. Therefore, one interpretation of the substantial increase in audit fees among these non-accelerated filers is that audits are generally more extensive for all firms given the stricter regulatory environment after SOX. This also suggests that the increase in audit fees among accelerated filers in 2004 can be attributed to the auditor attestation on internal controls as well as the more extensive audit efforts common to all firms.

Given the substantial increase in audit fees due to Section 404 compliance, there is a current unresolved debate on the role of Sarbanes-Oxley, in general, and Section 404, in particular, on the decisions of foreign firms to list their securities on US exchanges or elsewhere. On one hand, several studies document a relationship between the passage of Sarbanes-Oxley and the declining number of foreign firms listed on US exchanges (Marosi and Massoud, 2006; Li, 2007; Piotroski and Srinivasan, 2008). On the other hand, other studies suggest that the US market has not lost its attractiveness and the declining number of foreign firm listings is attributable to other firm and market factors (Hansen *et al.*, 2007; Doidge *et al.*, 2007a, b). Salman and Carson (2009) also find that Australian firms cross-listed on US stock exchanges have significant higher audit fees compared to other domestic Australian firms in 2001-2005 due to the general effects of SOX. However, the sampling period in Salman and Carson (2009) is before the compliance date of Section 404. Thus, the effects of Section 404 on foreign firms, including Australian firms, have not been documented in the literature.

Section 404 is often cited as one of the main factors influencing the decisions of foreign firms to list on US exchanges. The main objective of this study is to provide an empirical analysis on the effects of Section 404 on foreign firms' audit fees. For fiscal years ending on or after July 15, 2006, foreign large accelerated filers have to provide both management and auditor Section 404 reports. With a substantial increase in audit effort, one would expect a commensurate increase in audit fees among foreign large accelerated filers. Benoit (2006) documents that even non-accelerated filers experience substantial increase in audit fees. To obtain comparable data, we also examine the changes in audit fees among foreign accelerated filers and foreign non-accelerated filers. Foreign accelerated filers provide only management Section 404 report and non-accelerated filers are not required to provide any Section 404 report. Thus, the changes in audit fees for the foreign accelerated filers and non-accelerated filers should represent the general market-wide changes in audit fees and be less than those of foreign large accelerated filers. Since our analysis of foreign accelerated and

non-accelerated filers allows us to control for the general changes in audit fees, we can estimate the incremental effects of Section 404's auditor report on audit fees.

Simunic (1980) posits that the amount of audit fees is positively related to the amount of audit effort and the extent of the auditor's potential legal liability. Seetharaman *et al.* (2002) find that UK auditors increase their fees when clients list shares on US exchanges. This audit fee increase is associated with the more litigious legal environment in the US security markets. This is consistent with the suggestions from Coffee (1999) and Stulz (1999) that US-listed foreign firms offer more protection to minority shareholders by bonding themselves to the stronger US securities laws. However, more recent studies find that the legal bonding mechanism is ineffective for foreign firms. For example, Siegel (2005) reviews US court cases related to US-listed Mexican firms and finds little evidence of US strong legal enforcement on Mexican firms. Lang *et al.* (2006) examine the earnings management practices of US-listing foreign firms. They find evidence of significant earnings management on their "earnings reconciled to US-GAAP," and the extent of the earnings management is negatively related to the strength of legal environment of the firms' home countries. Recently, Berkman and Nguyen (2010) compare the changes in stock liquidity of foreign firms in their domestic markets before and after their US stock listings. These authors suggest that legal bonding can increase stock liquidity of foreign firms in their domestic markets since US-listing, with enhanced disclosure rules and more stringent securities laws, can reduce information asymmetry among investors. However, the authors do not find any significant increase in domestic stock liquidity after the US-listing of foreign firms as compared to a matched sample of control firms.

Choi *et al.* (2009) examine the effect of international cross-listings on audit fees using a large sample of firms from 14 countries. The authors find that firms cross-listing in foreign exchanges with stronger legal regimes relative to their home countries, experience significant increases in audit fees. The expanded scope of the audit under Section 404 will increase the auditor's potential legal liability, particularly in the event of an audit failure occasioned by the auditor overlooking material internal control weaknesses[7]. Given the ineffective legal bonding of US-listing, a foreign firm with strong legal environment at home should see a smaller increase in auditor legal liability from the additional Section 404 review. As a result, foreign firms from countries with stronger (weaker) legal environments should have less (more) increases in legal liability from the additional Section 404 compliance. Therefore, the increase in audit fees should be negatively related to the strength of the foreign firms' home countries' legal environment. While Choi *et al.* (2009) have shown that audit fees are associated with differences in legal environments across countries, this current study will provide evidence if changes in regulation differently affect cross-listed firms from different countries on US exchanges. Taken together, we propose the following two research hypotheses:

H1. Foreign large accelerated filers have bigger increases in audit fees in the first year of Section 404 compliance than that of foreign accelerated and non-accelerated filers.

H2. The increases in audit fees among foreign large accelerated filers are negatively related to the strength of the legal environments of the foreign firms' home countries.

III. Research design

The objective of this study is to examine the effects of Section 404 on the audit fees of US-listed foreign firms. An initial sample of US-listed foreign firms is collected from the Audit Analytics database in mid-January of 2008. Foreign firms can file their Form 20F within six months after their fiscal year-end. To be included in the final sample, a firm must:

- be located in a foreign country;
- have filed a Form 20F for fiscal year ending between July 15, 2006 and July 14, 2007;
- be listed on the New York Stock Exchange, American Stock Exchange, or Nasdaq;
- not be a subsidiary of another parent firm;
- not be from common tax havens of Bahamas, Bermuda, Panama, Papua New Guinea, or Virgin Islands; and
- have sufficient financial data as defined in the models below.

We excluded 12 firms with voluntary auditor Section 404 reports prior to July 15, 2006. Thus, our final sample consists of 345 initial filings of Section 404 compliance by foreign registrants with fiscal years ending between July 15, 2006 and July 14, 2007.

We examine the annual change in audit fees from the preceding year to the first year of Section 404 compliance. Our empirical model is as follows:

$$\Delta\text{Audit\_fees}_i = a_0 + a_1\Delta\text{TA}_i + a_2\text{Auditor404}_i + a_3\text{Mgt404}_i + a_4\text{Big4}_i + a_5\text{Ineffective}_i + a_6\text{Going\_Concern}_i + e_i \quad (1)$$

where:

ΔTA	= (total assets in year (t)/total assets in year (t − 1)) − 1 for firm i;
Auditor404	= 1 if firm i reported both management and auditor Section 404 reports; = 0 otherwise;
Mgt404	= if firm i reported only management Section 404 report; = 0 otherwise;
Big4	= 1 if firm i's external auditor is one of the Big4 firms; = 0 otherwise;
Ineffective	= 1 if firm i reported ineffective disclosure/internal controls in year t and did not report such ineffective controls in year t − 1; = 0 otherwise; and
Going_Concern	= 1 if firm i reported a going concern opinion in year t and did not report such going concern opinion in year t − 1; = 0 otherwise.

Our research design uses each firm as its own control of firm characteristics in the analysis of changes in audit fees similar to Ghosh and Lustgarten (2006). This has the advantage that the analysis is less likely to be affected by potential omitted company factors. In addition, a change model rather than a level model is used in the audit fee analysis since our research objective is on the changes in audit fees caused by the changes in regulation over time. ΔAudit_fees is the percentage change in audit fees

from the preceding year to the fiscal year ending on or after July 15, 2006. ΔTA is the percentage change in total assets. We included change in total assets since Hay *et al.* (2006) find that firm size can explain more than 70 percent of the variation in audit fees across firms, and it is the most dominant variable in explaining audit fees in the literature. Auditor404 equals 1 for foreign firms reporting both management and auditor Section 404 reports. Mgt404 equals 1 for foreign firms reporting only management Section 404 report without the corresponding auditor Section 404 report. For foreign firms without any Section 404 report, their corresponding Auditor404 and Mgt404 values are set to 0. Thus, Auditor404 measures the incremental increase in audit fees for firms with both management and auditor Section 404 reports. Mgt404 measures the incremental increase in audit fees for firms with only management Section 404 reports. This design also allows us to control for the general market change in audit fees for our entire sample of foreign firms. The Ineffective variable measures the disclosure effect of initial ineffective internal controls on audit fees. The Going_Concern variable estimates the effect of having initial going concern opinion on audit fees. Firms with initial going concern opinions should present significant increase in financial risk. In essence, firms that previously reported going concern opinion or ineffective disclosure/internal controls should already have elevated audit fees due to the ineffective controls and bankruptcy risk before 2006. Big4 measures the audit fee premium for Big4 auditors since prior studies have found such a premium in foreign markets (Firth, 1985; Francis and Stokes, 1986; DeFond *et al.*, 2000). We do not compare the increases in audit fees resulting from SOX 404 audits between the foreign and US firms since the initial compliance date for the US firms are over two years earlier than that of the foreign firms. As such, the increases in audit fees of the foreign firms are affected by the additional SOX 404 audit guidelines from the SEC and PCAOB.

To control for differences in audit fees across countries, we include country indicator variables, C_i, for each country with at least ten firms in the sample:

$$\Delta\text{Audit\_fees}_i = a_0 + a_1\Delta\text{TA}_i + a_2\text{Auditor404}_i + a_3\text{Mgt404}_i + a_4\text{Big4}_i + a_5\text{Ineffective}_i + a_6\text{Going\_Concern}_i + a_7\sum_{c=1}^{n} C_i + e_i \quad (2)$$

where:

C = 1 if a firm is from the respective country; = 0 otherwise; and

n = number of countries with at least ten firms in the sample.

We also examine the effect of the strength of the foreign firms' home country legal environment on the changes in audit fees due to Section 404 compliance using the following model:

$$\Delta\text{Audit\_fees}_i = a_0 + a_1\Delta\text{TA}_i + a_2\text{Auditor404}_i + a_3\text{Mgt404}_i + a_4\text{Big4}_i + a_5\text{Ineffective}_i + a_6\text{Going\_Concern}_i + a_7\text{Legal}_i + e_i \quad (3)$$

where:

Legal = Anti-director right rating*law and order rating.

Durnev and Kim (2005) suggest that the strength of a country's legal environment is based on both *de jure* and *de facto* aspects of regulation. The *de jure* aspect of investor protection is based on the anti-director right index defined in LaPorta *et al.* (1998). The

strength of *de facto* regulation is measured using the rule-of-law index from the *International Country Risk Guide*. Durnev and Kim define the strength of a country environment, Legal, as the product between the anti-director index and the rule-of-law index. Doidge *et al.* (2007a, b) find that firm characteristics explain only a very small fraction of the variation in corporate governance and disclosure practices among foreign firms, whereas country level dummy variables and Legal explain much more of the variation. Thus, country level dummy variables and Legal also capture variations in corporate governance among firms. We obtained the anti-director index from LaPorta *et al.* (1998). We also collected the anti-director index from Durnev and Kim (2005) for countries that are not listed in LaPorta *et al.* (1998). The law and order index, a new data series, is collected from *International Country Risk Guide* based on its July 2007 data[8]. Large values of the anti-director index and law and order index are indicative of strong legal environment in a country. Country indicator variables are not included with Legal since they are highly correlated. Empirical results are reported in the following section.

IV. Empirical findings

Table I presents the sample firms by countries. There are 345 firms in our sample from 39 countries with China, Israel, and the UK having the highest number of firms. The anti-director index, law and order index, and Legal are also reported in Table I. The anti-director index for the sample ranges from 0 to 5. The law and order index ranges from 1.5 to 6. Legal is the overall measure of the strength of a country's legal environment.

The filing status and types of Section 404 reports provided by sample firms are summarized in Table II. The firm's filing status and the Section 404 report information are collected from Form 20F. There are 190 firms reporting both management and auditor Section 404 reports. While 176 of these firms are foreign large accelerated filers, there are nine accelerated filers and two non-accelerated filers that provided auditor attestation reports for the effectiveness of their internal control over financial reporting. The filing status of three firms is not available in their Form 20F reports. An additional 85 firms reported only management Section 404 reports with 84 of them being accelerated filers. All 70 firms without any Section 404 reports are classified as non-accelerated filers[9].

Summary statistics for variables used in the analysis are presented in Table III. All continuous variables are winsorized for the top and bottom 1 percent of the sample distributions. For the overall sample, the average (median) change in audit fees is about 57 percent (33 percent). Similar to the US firms, about 93 percent of the foreign firms have Big4 auditors[10]. Only about 5 percent of the sample firms reported initial ineffective internal controls and about 1 percent of the sample firms received initial going concern opinions from their external auditors. For firms reporting management and auditor Section 404 reports, the change in audit fees is about 73 percent with average audit fees of about $10 million. Five of these firms reported ineffective internal controls that did not report any ineffective internal controls in the previous year. Three of these five firms have one material internal control weakness and the other two have two material internal control weaknesses[11]. On the other hand, the changes in audit fees are 33 and 42 percent for firms filing only management Section 404 reports and firms filing no Section 404 report, respectively. These two groups of firms also have

Country	No. of firms	Anti-director right[a]	Law and order[b]	Legal[c]
Argentina	10	4	2.5	10.0
Australia	9	4	5.5	22.0
Belgium	1	0	5.0	0.0
Brazil	21	2	2.0	6.0
Chile	13	5	5.0	25.0
China	37	1	4.5	4.5
Colombia	1	3	1.5	4.5
Denmark	1	2	6.0	12.0
Finland	1	3	6.0	18.0
France	13	3	5.0	15.0
Germany	7	1	5.0	5.0
Greece	9	2	4.5	9.0
Hong Kong	13	5	5.0	25.0
Hungary	1	3	4.0	12.0
India	10	5	4.0	20.0
Indonesia	1	2	3.0	6.0
Ireland	9	4	6.0	24.0
Israel	56	3	5.0	15.0
Italy	5	1	4.0	4.0
Japan	17	4	5.0	20.0
South Korea	10	2	5.0	10.0
Luxembourg	3	–	6.0	–
Mexico	14	1	3.0	3.0
The Netherlands	14	2	6.0	12.0
The Netherlands Antilles	1	–	–	–
New Zealand	2	4	5.5	22.0
Peru	2	3	3.0	9.0
Philippines	2	3	2.5	7.5
Portugal	1	3	5.0	15.0
Russia	5	5	4.0	20.0
Singapore	1	4	5.0	20.0
South Africa	6	5	2.5	12.5
Spain	4	4	5.0	20.0
Sweden	2	3	6.0	18.0
Switzerland	4	2	5.0	10.0
Taiwan	11	3	5.0	15.0
Turkey	1	2	4.5	9.0
UK	26	5	5.5	27.5
Venezuela	1	1	2.0	2.0

Table I.
Sample distribution by country

Notes: [a]Anti-director ratings from LaPorta *et al.* (1998) and Durnev and Kim (2005); [b]law and order rating from *International Country Risk Guide*; [3]legal = anti-director right rating*law and order rating

lower total assets, smaller audit fees, and used fewer Big4 auditors than the firms reporting both management and auditor Section 404 reports[12]. Even though these two groups of firms are not required to have auditor attestation of their internal control opinions, their audit fees increased by about 37 percent. We interpret this result as indicative of a general increase in the intensity of external audit efforts resulting from the initial compliance with Section 404 by foreign registrants and their auditors.

	Auditor and management Section 404 reports	Only management Section 404 report	No Section 404 report
Large accelerated filers	176	0	0
Accelerated filers	9	84	0
Non-accelerated filers	2	0	70
No filing status reported	3	1	0
Total	190	85	70

Table II.
Filing status and Section 404 reports

The results of the regression analysis are reported in Table IV. In the first model, the coefficient on ΔTA is positive as expected and is statistically significant. The coefficient on Auditor404 is 0.3178 and is also significant. This suggests that firms reporting management and auditor Section 404 reports have an average of 32 percent increase in audit fees compared to firms without the auditor Section 404 opinion. This finding supports our *H1*. On the other hand, the coefficient on Mgt404 is −0.0727 but is insignificant. Since management Section 404 reports do not have to be reviewed by external auditors, the audit fee increases of the accelerated filers are not expected to be significantly different from those of the non-accelerated filers without any Section 404 opinion. The coefficients on the other control variables are insignificant. The insignificant results for Going_Concern and Ineffective variables are probably due to the small number of firms with initial going concern opinions or initial ineffective disclosure/internal control disclosures[13].

The second model in Table IV includes country indicator variables for countries with at least ten firms. The results, in general, are similar to those of the first model. The coefficient on Auditor404 is again significant and suggests a 33 percent average increase in audit fees due to both management and auditor Section 404 compliance. After controlling for country differences, the coefficient on Big4 is positive and significant. This suggests that there is a premium for Big4 auditors. Among the country indicator variables, the coefficients on Brazil, China, Hong Kong, India, and Mexico are all positive and significant. This implies that firms from these countries experience larger increase in audit fees in the first year of Section 404 compliance after controlling for other factors.

Our research design uses each firm as its own control in examining the annual changes in audit fees and key firm characteristics. To examine the sensitivity of our results to our models, we also add several financial statement variables, which have been used in prior audit fee studies. These variables include the changes in the sum of receivables and inventory, current ratio, and total liabilities. Based on the prior literature, the expected signs of the coefficients for the changes in the sum of receivables and inventory and total liability are positive. The expected sign of the coefficient for change in current ratio is negative. The data for these additional variables are collected from Zacks and 20-F reports. The additional results are reported in models 4-6 in Table IV. These results show that the findings in models 1-3 are robust to the model structure.

The results of the analysis for the effects of legal environment on the increase in audit fees from Section 404 compliance are reported in the last model in Table IV.

	Mean	Median	Min.	Max.
*Overall sample (*n = *345)*				
Total assets (in millions)	73,713	2,570	14	1,706,928
ΔTotal Assets	0.2757	0.1527	−0.4097	3.1380
Audit fees	6,109,670	1,235,480	55,000	62,000,000
ΔAudit fees	0.5741	0.3386	−0.5136	4.9534
Ineffective	0.0463	0	0	1
Going Concern	0.0115	0	0	1
Big4	0.9304	1	0	1
ΔRec. & Inv.	0.0441534	0.0217116	0.2395080	0.4972427
ΔCurrent Ratio	0.1037870	0.0051333	−0.8726799	2.6944868
ΔTotal Liab.	0.1013850	0.0443407	−0.3157803	1.3444237
*Firms reporting both management and auditor Section 404 reports (*n = *190)*				
Total assets (in millions)	130,164	12,601	186	1,706,928
ΔTotal Assets	0.2428	0.1565	−0.4097	3.1380
Audit fees	10,599,491	4,648,930	64,266	62,000,000
ΔAudit fees	0.7356	0.5198	−0.5136	4.9534
Ineffective	0.0263	0	0	1
Going Concern	0	0	0	0
Big4	0.9789	1	0	1
ΔRec. & Inv.	0.0414629	0.0202710	−0.2395080	0.4972427
ΔCurrent Ratio	0.0707266	−0.0072141	−0.8726799	2.6944868
ΔTotal Liab.	0.0983996	0.0565047	−0.3157803	1.2816199
*Firms reporting only management Section 404 report (*n = *85)*				
Total assets (in millions)	864	280	39	9,656
ΔTotal Assets	0.2604	0.1753	−0.4097	3.1380
Audit fees	672,695	486,000	55,000	4,982,090
ΔAudit fees	0.3323	0.1486	−0.5136	4.9534
Ineffective	0.1058	0	0	1
Going Concern	0.0235	0	0	1
Big4	0.8823	1	0	1
ΔRec. & Inv.	0.0339432	0.0269600	−0.2395080	0.3419381
ΔCurrent Ratio	0.0993641	0.0270211	−0.7846196	2.6944868
ΔTotal Liab.	0.0956723	0.0336326	0.2676347	1.3444237
*Firms without any Section 404 report (*n = *70)*				
Total assets (in millions)	8,947	54	14	568,707
ΔTotal Assets	0.3835	0.0975	−0.4097	3.1380
Audit fees	525,055	189,911	55,000	10,732,000
ΔAudit fees	0.4294	0.1015	−0.4615	4.9534
Ineffective	0.0285	0	0	1
Going Concern	0.0285	0	0	1
Big4	0.8571	1	0	1
ΔRec. & Inv.	0.0638540	0.0268533	−0.1794250	0.4972427
ΔCurrent Ratio	0.1988933	0.0149371	−0.8726799	2.6944868
ΔTotal Liab.	0.1164249	0.0317705	−0.3157803	1.3444237

Notes: Total assets – the amount of total assets at the end of the fiscal year; ΔTotal Assets – (total assets in year (t)/total assets in year (t − 1)) − 1; Audit fees = amount of audit fees paid to external auditor; ΔAudit fees – (audit fees in year (t)/audit fees in year (t − 1)) − 1; Ineffective – 1 if a firm reported ineffective disclosure/internal controls in year t and did not report such ineffective controls in year t − 1; equals 0 otherwise; Going concern – 1 if a firm reported a going concern opinion in year t and did not report such going concern opinion in year t − 1; equals 0 otherwise; Big4 – 1 if a firm's external auditor is one of the Big4 firms; equals 0 otherwise; ΔRec. & Inv. – [(receivable in year (t) + inventory in year (t)) − (receivable in year (t − 1) + inventory in year (t − 1))]/total assets in year (t − 1); ΔCurrent Ratio – (current ratio in year (t) − current ratio in year (t − 1))/current ratio in year (t − 1); ΔTotal Liab. – (total liabilities in year (t) − total liabilities in year (t − 1))/total assets in year (t − 1)

Table III.
Sample descriptive statistics

Model	(1)	(2)	(3)	(4)	(5)	(6)
Intercept	0.12	−0.26	0.36	0.10	−0.24	0.33
ΔTotal Assets	0.33***	0.30***	0.32***	0.20*	0.25**	0.21*
Auditor404	0.32**	0.33**	0.30**	0.32**	0.33**	0.30**
Mgt404	−0.07	−0.07	−0.09	−0.06	−0.07	−0.07
Big4	0.21	0.34*	0.20	0.20	0.32	0.19
Ineffective	0.11	0.02	0.13	0.10	0.01	0.12
Going_Concern	−0.30	−0.27	−0.36	−0.25	−0.26	−0.32
Legal			−0.01**			−0.01**
ΔRec. & Inv.				0.93	0.70	0.91
ΔCurrent Ratio				−0.04	−0.02	−0.03
ΔTotal Liab.				0.27	0.02	0.22
Argentina		0.20			0.21	
Brazil		0.97***			0.94***	
Chile		0.38			0.38	
China		0.50***			0.49***	
France		−0.03			−0.03	
Hong Kong		0.77***			0.73***	
India		0.90***			0.85***	
Israel		0.27			0.23	
Japan		0.32			0.31	
South Korea		0.32			0.29	
Mexico		0.62**			0.59***	
The Netherlands		−0.18			−0.19	
Taiwan		0.31			0.32	
UK		−0.17			−0.17	
Adjusted R^2	0.0638	0.1545	0.0755	0.0959	0.1517	0.081
F-statistics	4.91***	4.14***	4.97***	3.95***	3.67***	4.00***
Sample size	345	345	341	345	345	341

Notes: Significance at: *10, **5, and ***1 percent, respectively, of two-tail p-values; dependent variable is change in audit fees; ΔTotal Assets – (total assets in year (t)/total assets in year (t − 1)) − 1; Auditor404 – 1 if a firm reported both management and auditor Section 404 reports; equals 0 otherwise; Mgt404 – if a firm reported only management Section 404 report; equals 0 otherwise; Big4 – 1 if a firm's external auditor is one of the Big4 firms; equals 0 otherwise; Ineffective – 1 if a firm reported ineffective disclosure/internal controls in year t and did not report such ineffective controls in year t − 1; equals 0 otherwise; Going_concern – 1 if a firm reported a going concern opinion in year t and did not report such going concern opinion in year t − 1; equals 0 otherwise; Legal – anti-director right rating*law and order rating; Argentina, Brazil, Chile, China, France, Hong Kong, India, Israel, Israel, Japan, South Korea, Mexico, The Netherlands, Taiwan, and the UK are dummy variables with each equals 1 if a firm is from the respective country; equals 0 otherwise; ΔRec. & Inv. – [(receivable in year (t) + inventory in year (t)) − (receivable in year (t − 1) + inventory in year (t − 1))]/total assets in year (t − 1); ΔCurrent Ratio – (current ratio in year (t) − current ratio in year (t − 1))/current ratio in year (t − 1); ΔTotal Liab. – (total liabilities in year (t) − total liabilities in year (t − 1))/total assets in year (t − 1)

Table IV.
Regression results

Similar to the results in the first two models, the coefficients on ΔTA and Auditor404 are both positive and statistically significant. The coefficient on Legal is −0.0145 and is statistically significant. This suggests that the increase in audit fees is negatively related to the strength of legal environment of a firm's home country. This finding is consistent with *H2* that if the legal environment of a firm's home country is weak

(strong), there would be a larger (smaller) increase in potential legal liability from the expanded scope of audit for Section 404. Thus, the weaker (stronger) the legal environment of a firm's home country is, the bigger (smaller) the increase in audit fees. As a sensitivity test, we also estimate a level form of the last model using data in year t. The results are qualitatively similar to those reported in Table IV for the change model. Specifically, firms with Section 404 auditor reviews have significantly higher audit fees. The audit fees are also negatively associated with the strength of the legal environment of the firms' home countries, after controlling for the other firm characteristics. But as discussed above, the change model is likely to have less bias from potential omitted factor and it is more suitable for examining the audit fee changes caused by regulation changes over time.

Since we find that only firms reporting both management and auditor Section 404 reports have significant increase in audit fees, we further analyze the effect of the strength of legal environment on change in audit fees among firms with auditors' Section 404 attestation reports. The results of the additional analysis are reported in Table V. The model is the same as model 1 except that the two indicator variables, Auditor404 and Mgt404, are omitted since the regressions are estimated for each subgroup of firms. The variable, Going_Concern is not in the model for firms reporting both management and auditor Section 404 reports since none of the firms in this subgroup has initial going concern opinion. Comparing the results of the three

	Auditor and management Section 404 report (1)	Only management Section 404 report (2)	No Section 404 report (3)	Auditor and management Section 404 report (4)	Only management Section 404 report (5)	No Section 404 report (6)
Intercept	1.00**	−0.10	0.49	0.97**	−0.11	0.50
ΔTA	0.28*	0.11	0.43**	−0.11	−0.09	0.39
Big4	−0.02	0.29	0.13	−0.06	0.40	0.12
Ineffective	0.37	0.03	−0.02	0.38	−0.02	−0.06
Going_Concern		−0.19	−0.54		−0.13	−0.50
Legal	−0.02***	0.01	−0.02	−0.02**	0.00	−0.02
ΔRec. & Inv.				0.43	2.48**	0.26
ΔCurrent Ratio				−0.19	0.19	0.02
ΔTotal Liab.				1.04**	0.06	0.11
Adjusted R^2	0.0513	−0.0218	0.0568	0.0791	0.0008	0.0110
F-statistics	3.54***	0.65	1.81	3.31***	1.01	1.09
Sample size	189	84	68	189	84	68

Notes: Significance at: *10, **5, and ***1 percent, respectively, of two-tail *p*-values; dependent variable is change in audit fees; ΔTA – (total assets in year (t)/total assets in year (t − 1)) − 1; Big4 – 1 if a firm's external auditor is one of the Big4 firms; equals 0 otherwise; Ineffective – 1 if a firm reported ineffective disclosure/internal controls in year t and did not report such ineffective controls in year t − 1; equals 0 otherwise; Going_Concern – 1 if a firm reported a going concern opinion in year t and did not report such going concern opinion in year t − 1; equals 0 otherwise; Legal – anti-director right rating*law and order rating; ΔRec. & Inv. – [(receivable in year (t) + inventory in year (t)) − (receivable in year (t − 1) + inventory in year (t − 1))]/total assets in year (t − 1); ΔCurrent Ratio – (current ratio in year (t) − current ratio in year (t − 1))/current ratio in year (t − 1); ΔTotal Liab. – (total liabilities in year (t) − total liabilities in year (t − 1))/total assets in year (t − 1)

Table V.
Regression results by Section 404 reporting types

regressions in Table V, the coefficient for Legal is negative and only significant in the subgroup of firms reporting management and auditor Section 404 reports. This supports the notion that firms from countries with stronger legal environment would experience less of an increase in potential legal liability for auditors from the additional auditor attestation for Section 404. This, in turn, leads to smaller increases in audit fees. This is also consistent with the fact that the other two subgroups without auditor attestation reports did not have significant changes in audit fees. The fact that the two regressions for these two subgroups are also not significant suggests that audit fee changes for these two subgroups reflect market-wide intensification in audit efforts. As in Table IV, we also include additional variables in our models to examine the sensitivity of our findings. Additional results for models 4-6 are reported in Table V. They show that the results for models 1-3 are not sensitive to the inclusion of additional variables in the models.

Since our sample reflects different number of firms for each country, the results can be biased toward countries with more sample firms. Therefore, as an additional sensitivity test, we also conduct cross-sectional, country-level rank regressions for models 1 and 4 in Table V[14]. A firm with the median change in audit fees was selected in each of the 37 countries. As reported in Table I, data on legal environment is not available for two of the 39 countries. Regression analysis was performed based on the ranks of the variable values. Results are reported in Table VI and the findings support the negative relationship between change in audit fees and the strength of legal environment.

	(1)		(2)	
	Coefficients	*t*-value	Coefficients	*t*-value
Intercept	0.45	1.23	−0.19	−0.33
ΔTA	−0.16	−0.59	−0.26	−0.83
Big4	0.06	0.18	0.68	1.21
Ineffective	0.12	0.70	0.07	0.38
Legal	−0.01*	−1.93	−0.01*	−1.82
ΔRec. & Inv.			−0.10	−0.12
ΔCurrent Ratio			0.20	1.37
ΔTotal Liab.			0.39	1.49
Adjusted R^2	0.03		0.05	
F-statistics	1.28		1.27	
Sample size	37		37	

Notes: Significance at: *10 percent, respectively, of two-tail *p*-values; dependent variable is change in audit fees; ΔTA – (total assets in year (t)/total assets in year (t − 1)) − 1; Big4 = 1 if a firm's external auditor is one of the Big4 firms; equals 0 otherwise; Ineffective – 1 if a firm reported ineffective disclosure/internal controls in year t and did not report such ineffective controls in year t − 1; equals 0 otherwise; Legal – anti-director right rating*law and order rating; ΔRec. & Inv. – [(receivable in year (t) + inventory in year (t)) − (receivable in year (t − 1) + inventory in year (t − 1))]/total assets in year (t − 1); ΔCurrent Ratio – (current ratio in year (t) − current ratio in year (t − 1))/current ratio in year (t − 1); ΔTotal Liab. – (total liabilities in year (t) − total liabilities in year (t − 1))/total assets in year (t − 1)

Table VI.
Regression results using country-level rank regression

V. Conclusions

This study examines the change in audit fees for foreign firms in the first year of Section 404 compliance for fiscal years ending between July 15, 2006 and July 14, 2007. During this time period, foreign large accelerated filers had to provide both auditor and management Section 404 reports while the foreign accelerated filers only had to provide management Section 404 reports without the auditor attestation reports. Foreign non-accelerated filers did not have to provide any Section 404 report. The analysis shows that foreign large accelerated filers have an average increase of 74 percent in audit fees over the sample period. On the other hand, foreign accelerated filers and foreign non-accelerated filers have average increases of audit fees of 33 percent and 42 percent, respectively. This suggests an average additional increase of 30 percent in audit fees for foreign large accelerated filers for complying with the auditor attestation report requirement of Section 404. Further analysis reveals that the increase in audit fees among foreign large accelerated filers is negatively associated with the strength of their home countries' legal environment. This indicates that the increase in audit fees from auditor Section 404 review is significantly lower (higher) for foreign large accelerated filers from countries with stronger (weaker) legal environments. This is consistent with the idea that the expanded scope of audit work under Section 404 has led to an increase in legal liability for auditors. In addition, foreign large accelerated filers already regulated under stronger (weaker) legal environment experience smaller (larger) increase in audit fees.

Notes

1. Don Nicolaisen, the then chief accountant at the SEC, suggested that Section 404 could be the most important aspect of Sarbanes-Oxley, and he also stated that Section 404's "overriding objective is to provide comfort, to provide assurance that the process is there to enable accurate, reliable financial reporting [. . .] for the investor" (*PR Newswire*, 2005).
2. The SEC again delays the auditor Section 404 report requirement for non-accelerated filers to fiscal year ending on or after mid-2010.
3. Bhamornsiri *et al.* (2009) find similar results for a sample of *Fortune* 500 firms. Although the authors speculate that US-listed foreign firms might have similar Section 404 compliance costs, the authors did not analyze changes in audit fees among foreign firms.
4. Our study focuses on the additional cost of US-listing due to Section 404 compliance. The overall trade-off of costs and benefits of US-listing is beyond the scope this study.
5. There are only two groups of US firms in the initial Section 404 compliance year for fiscal year ending on or after November 15, 2004. They are accelerated and non-accelerated filers based on the initial SEC definitions.
6. Chan *et al.* (2008a, b) find that auditors and management missed some material internal control weaknesses in their initial Section 404 reviews and have to subsequently restate their Section 404 opinions.
7. Lys and Watts (1994) document that firms with weak internal controls are more likely to be associated with lawsuits against their auditors.
8. "Law and Order are assessed separately, with each sub-component ranging from zero to three points. The Law sub-component is an assessment of the strength and impartiality of the legal system, while the Order sub-component is an assessment of popular observance of the law" (The PRS Group).

9. Some non-accelerated filers reporting ineffective disclosure controls for management Section 302 reviews also discuss the effectiveness of their internal controls over financial reporting. However, these discussions are not made to comply with Section 404 reviews.
10. A few firms have two external auditors. We combined the audit fees information for the two auditors into a single record for each of these firms.
11. Chan *et al.* (2008a, b) report that the number of material internal control weakness ranges from one to nine in their sample of 149 US firms reporting ineffective internal controls for fiscal year 2004. Among these firms, 68 have more than one internal control weakness.
12. The average (median) total assets for firms without any Section 404 report is higher (lower) than that of the firms with management Section 404 reports. The average total assets of the non-accelerated filers are biased upward by two big financial institutions that listed only preferred stock and debt in the USA and they are not classified as large accelerated or accelerated filers.
13. We conduct diagnostic checks for multicollinearity on the regression results presented in Tables IV and V. A variance inflation factor in excess of 10 is indicative of multicollinearity problems (Neter *et al.*, 1990). The variance inflation factors for our sample are below this threshold.
14. We thank the anonymous reviewer for making this suggestion.

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Appendix 1. Summary of revised SEC rules

US large accelerated or accelerated filer should provide:

- management's Section 404 report for fiscal years ending on or after November 15, 2004; and
- auditor's Section 404 attestation report for fiscal years ending on or after November 15, 2004.

US non-accelerated filer should provide:

- management's Section 404 report for fiscal years ending on or after November 15, 2007; and
- auditor's Section 404 attestation report for fiscal years ending on or after November 15, 2008.

Foreign large accelerated filer should provide:

- management's Section 404 report for fiscal years ending on or after November 15, 2006; and
- auditor's Section 404 attestation report for fiscal years ending on or after November 15, 2006.

Foreign accelerated filer should provide:

- management's Section 404 report for fiscal years ending on or after November 15, 2006; and
- auditor's Section 404 attestation report for fiscal years ending on or after November 15, 2007.

Foreign non-accelerated filer should provide:

- management's Section 404 report for fiscal years ending on or after November 15, 2007; and
- auditor's Section 404 attestation report for fiscal years ending on or after November 15, 2008.

Data Source: US Securities and Exchange Commission's December 15, 2006, press release.

Appendix 2. Three examples of Section 404 requirements

Example No. 1 (both management and auditor Section 404 reports)

An excerpt from the Form 20-F of Huaneng Power International, Inc.:

> Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in the Exchange Act Rules 13a-15(f) and 15d-15(f). Under the supervision and with the participation of our chairman of the board, or principal executive officer, and chief accountant, or principal financial officer, our management conducted an evaluation of the effectiveness of our internal control over financial reporting based upon the framework in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission as of the end of the period covered by this annual report. Based on that evaluation, our management has concluded that our internal control over financial reporting was effective as of December 31, 2006 at providing reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. *Our management's assessment of the effectiveness of our internal control over financial reporting as of December 31, 2006, has been audited by PricewaterhouseCoopers, an independent registered public accounting firm, as stated in their report which appears herein.*

Example No. 2 (only management Section 404 report)

An excerpt from the Form 20-F of Protherics Plc:

> Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). The Company's internal control over financial reporting is a process designed under the supervision of and with the participation of our management, including our principal executive officer and principal financial officer, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's financial statements for external reporting purposes in accordance with IFRS and the required reconciliation to US GAAP. As of the end of the 2007 fiscal year, management conducted an assessment of the effectiveness of internal control over financial reporting in relation to criteria for effective internal control over financial reporting described in "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organizations of the

Treadway Commission and in accordance with the Internal Control Revised Guidance for Directors on the Combined Code (Turnbull). Based on this assessment, our management concluded that our internal control over financial reporting was effective [. . .]

This Annual Report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to transition rules of the Securities and Exchange Commission that permit the Company to provide only management's report in this Annual Report.

Example No. 3 (no Section 404 report)
An excerpt from the Form 20-F of Pointer Telocation Limited:

(a) *Disclosure Controls and Procedures.* Our chief executive officer and chief financial officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) as of the end of the period covered by this annual report, have concluded that, as of such date, our disclosure controls and procedures were effective to ensure that the information required in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms, and such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding required disclosure.

(b) *Management's annual report on internal control over financial reporting. Not Applicable.*

(c) *Attestation report of the registered public accounting firm. Not Applicable.*

About the authors

Kam C. Chan is a Professor of Accounting and Ernst & Young Scholar at the Lubin School of Business at Pace University. He received his PhD degree from the University of South Carolina in 1991. His research interests include capital market research in financial accounting, corporate finance, and investments. He has published in many top journals such as *Accounting, Organizations and Society*; *Auditing: A Journal of Practice and Theory*; *Journal of Accounting and Economics*; *Journal of Business Finance and Accounting*; *Journal of International Accounting Research*; *Journal of Multinational Financial Management* and *Review of Quantitative Finance and Accounting*. Many of his studies are related to the reporting and valuation issues of globalization of financial markets. His research is highly cited in the literature and has been abstracted and reprinted by others.

Dr Rudolph A. Jacob received his professional degrees from New York University. His areas of expertise include financial and managerial accounting, international accounting issues, and accounting education. He has been a Professor at Pace University since 1973. He is a Tenured Full Professor and has been the Chairman of the Accounting Department since 1989. Possessing a strong and abiding dedication to excellence in accounting education, his receipt of the Outstanding Teacher of the Year Award from Pace University recognizes his dedication to his work. He has taught courses in accounting, finance, and management science at both the graduate and undergraduate levels. He has taught in the Executive Education Program at Dartmouth's Tuck School of Business, and has also lectured at New York University and at Shanghai University of Finance and Economics. He has also taught executives from such countries as France, Italy, China, Korea, and the Soviet Union. He has managed to enhance his classroom effectiveness by drawing heavily from more than 24 years of consulting experience in business. He has served as a Consultant to Decision Sciences, Inc., the Small Business Administration and over 200 small businesses in the areas of accounting and finance. He also prepares economic loss and adversarial analysis reports as well as business loss analysis for attorneys and insurance companies, and has testified as a Forensic Economist in numerous

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Picheng Lee is currently a Professor of Accounting at Pace University, New York. He is also a Certified Management Accountant (CMA) and a Member of Editorial Board of the *International Journal of Accounting and Information Management*. He obtained his PhD degree from Rutgers University in 2000 and joined Pace University since then. His research interest is in financial accounting and auditing, and research topics include corporate governance, earnings management, earnings forecasts, financial distress, intangible assets and Sarbanes-Oxley Act. His papers have been published in various journals including *Auditing: A Journal of Practice and Theory*; *Journal of Accounting, Auditing, and Finance*; *Journal of International Accounting Research*; *Journal of Forensic Accounting*; *Review of Quantitative Finance and Accounting*; *IEEE Transaction on Engineering Management* and *Group Decision and Negotiation*. Picheng Lee is the corresponding author and can be contacted at: plee@pace.edu

Gim S. Seow has taught at the University of Connecticut since 1991. He served as Director of the Accounting PhD program from 2001-2007. He teaches financial reporting at the executive, graduate and undergraduate levels and the capital markets seminar at the doctoral level. He consults for US and foreign financial institutions on derivatives and hedge accounting. During 1997-98, he served as Academic Fellow at the Financial Accounting Standards Board, contributed to the Derivatives and Hedging Project, and helped develop the Derivatives Training Manual. He taught capital markets research seminar for PhD students at the Shanghai University of Finance and Economics (July 1999) and Shandong University (November 2010), and was invited to speak at the Chinese Accounting Professors' Association Doctoral Consortium in Shanghai in July 1999. He taught at the University of Washington, Seattle from 1986-2001. He was an expert witness in a polychlorobiphenyl (PCB) contamination case between the Environmental Protection Agency and Washington Natural Gas. His research interests include accounting standard-setting and securities regulation in international capital markets, accounting and valuation of financial derivatives, expertise and audit quality, the effects of corporate risk management policies on firm value, and the international aspects of accounting for intangible assets and business combinations. He has published in *Accounting, Organizations and Society*; *Journal of Accounting and Economics*; *Contemporary Accounting Research*; *Journal of Accounting, Auditing and Finance*; *Journal of Banking & Finance*; *Journal of Forecasting*; *Journal of Multinational Financial Management*; *Review of Quantitative Finance and Accounting*; *Decision Sciences* and *Financial Practice and Education Journal.*

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