

## 경영자 재임 초기와 감사인의 지역성 Early-tenure CEOs and Auditor Locality

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Recent literature suggests that locals have an informational advantage over nonlocals (Coval and Moskowitz 2001; Ivkovic and Weisbenner 2005; Bae et al. 2008; Lim and Nguyen 2021). In line with this, local auditors, compared to non-local auditors, provide higher-quality auditing services (Choi et al. 2012). Previous studies have also found that the CEO's personal traits influence the firm's decisions and performance (Hambrick 2007). For example, earnings overstatement is more pronounced in the early years than in the later years of CEOs' service due to their career concerns (Ali and Zhang 2015). Building on this literature, we investigate the early-tenure CEO's effect on the firm's auditor selection, especially auditor locality. Our empirical analyses reveal that firms are less likely to choose local auditors in the early years of a CEO's service compared to the later years. While exploring the underlying reasons, we find that firms with early-tenure CEOs are more likely to have lower-quality financial statements and a higher probability of financial fraud than firms led by CEOs with later years of service. We contribute to the auditing literature by highlighting how CEOs' individual traits affect auditor selection.

Keyword: CEO career concerns; CEO tenure; Early-tenure CEOs; Local auditors

### 1. Introduction

During the early years of a CEO's service, there is likely to be greater uncertainty about their capabilities in the market (Gibbons and Murphy 1992). As a result, the impact of earnings reported during this period on the market's perception of their competence is

more pronounced (Fama 1980; Gibbons and Murphy 1992; Hermalin and Weisbach 1998; Holmstrom 1999). Holmstrom (1982) suggests that due to career concerns, managers are motivated to exert greater effort during their early years of service when their abilities are actively evaluated by the market. Consequently, the market often relies on the current performance of new CEOs to assess their capa-

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bilities (Fama 1980; Holmstrom 1999).

To prevent being labeled as having low ability, which could negatively impact their future compensation, autonomy, and potentially lead to dismissal, CEOs are strongly motivated to demonstrate positive performance during the early years of their service. Aligning with this perspective, Ali and Zhang (2015) observe a higher prevalence of earnings overstatement in the early years compared to the later years of CEOs' service. Therefore, investigating the impact of CEO career concerns, especially in the early years, on the firm is crucial.

Locals have an informational advantage over nonlocals (Coval and Moskowitz 2001; Ivkovic and Weisbenner 2005; Bae et al. 2008; Lim and Nguyen 2021). In alignment with this advantage, local auditors are expected to have superior knowledge about their clients compared to non-local auditors, given their enhanced access to both financial and non-financial information. Local auditors can gather crucial client-specific information from local media, conveniently visit clients' business units, and maintain more frequent communication with suppliers and employees. Additionally, they may establish closer personal ties and more reliable communication channels with clients in the same locale. Consequently, local auditors are likely to deliver higher-quality audits than their non-local counterparts, assuming all other factors remain equal (Choi

et al. 2012). Client firms decide to change auditors based on the decision-making and control functions within the firms (Fama and Jensen 1983). Consistent with this, Roberts et al. (1990) suggest that firms experiencing lower audit fees, weaker internal controls, and a reduced likelihood of compliance with laws and regulations are more inclined to change auditors. Prior studies also find a significant association between CEO and auditor changes (Zhang 2014; Hapsari et al. 2023., etc.). For example: Prior studies have documented the substantial influence of CEOs on the selection of auditors, particularly among Big 4 auditors (Yu et al. 2021). Additionally, prior studies have found that CEOs have an effect on auditor changes (Yu et al. 2021). These discussions suggest that client firm's characteristics, conditions, and CEOs significantly influence auditor changes. The U.S. has a regulation that mandates public companies to periodically change and rotate auditor partners. This regulation requires rotation after five years of the engagement partner overseeing audits of a corporate client. However, the relation between early-tenure CEOs and audit localities has not been investigated in prior studies. We predict that early-tenure CEOs relate to auditor locality in two opposing ways.

On the one hand, the information advantage facilitates communication between local auditors and their clients, alleviating information asymmetry and enabling more ac-

curate assessments of client-specific risks. Geographically proximate local auditors are inherently more familiar with clients in the same locale, providing them with information advantages in their engagements compared to non-local auditors. They have easier access to private information through direct communications with executives and other employees of client firms, as well as the ability to obtain client-specific information from local media. Furthermore, local auditors can conveniently gather crucial client-specific information, visit clients' business units, and maintain more frequent communication with suppliers and employees.

The market tends to be uncertain about the abilities of newly appointed CEOs (Gibbons and Murphy 1992). In contrast, the positive outcomes in subsequent years are attributed to the new manager's performance, thereby enhancing their reputation. As a result, early-tenure CEOs are more likely to have heightened career concerns, as labor market participants adjust their beliefs about the CEO's ability with the arrival of new information regarding their performance. Consequently, current accounting earnings influence the manager's reputation and, subsequently, their future compensation. The verification of accounting information is conducted by an auditor, an individual authorized to review and confirm the accuracy of financial records, ensuring companies comply with tax laws.

Therefore, auditors also influence one of the crucial factors that early-tenure CEOs pay attention to. In this scenario, early-tenure CEOs are less likely to choose local auditors due to the high-quality auditing services provided by local auditors, their information advantages, and lower information asymmetry.

The board of directors is more likely to be drawn from the local business network (Knyazeva et al. 2013). Individuals shape their social identity by categorizing and defining themselves and others within different groups (Ashforth and Mael 1989). Members within these social groups tend to exhibit higher levels of trust in each other. In such cases, there may be a close relationship between local auditors and stakeholders, including the board of directors. Therefore, in certain instances, choosing local auditors may serve as one method to assess the integrity of an organization's processes, systems, and information, encompassing both financial and non-financial aspects. In such instances, CEOs with higher career concerns are less inclined to opt for local auditors.

On the other hand, the geographic proximity of auditor locality may impair auditor independence. Auditor independence is important because it has an impact on audit quality. Auditors may face incentives to yield to client pressure, particularly in retaining major clients and those purchasing more-profitable non-audit services, potentially leading to com-

promised independence (Tepalagull and Lin 2015).

Due to the relatively closer ties between local auditors and their clients, local auditors are more likely to collude with them and acquiesce to client pressure for allowing sub-standard reporting than non-local auditors, potentially leading to lower-quality audits. This introduces a negative association between audit quality and auditor locality, signifying the potential impairment of auditor independence due to geographic proximity of auditor locality. Also, in these cases, CEOs with higher career concerns are more likely to choose local auditors because of the lower independence of local auditors. Geiger and Raghunandan (2002) suggest that audit failures are more probable in the early years of the auditor - client relationship. Thus, new CEOs may be more likely to change auditors because new auditors may have limited knowledge about the client firm. Therefore, in such cases, early-tenure CEOs may be more inclined to select local auditors. Building on these scenarios, we view it as an empirical question: "Do early-tenure CEOs more likely to choose local auditors or non-local auditors?"

We analyze U.S. firms from 2000 to 2019. To determine auditor locality, we assess auditor locality through state-based differentiation, as various states have different regulatory regimes,

jurisdictions, and features. Additionally, each state has its own CPA institute for registration (Choi et al. 2012). We gauge a CEO's career concerns using *EARLY\_YEARS*, an indicator variable set to one for firm years corresponding to the first three years of a CEO's service, and zero otherwise (Ali and Zhang 2015). Our findings reveal that firms led by early-tenure CEOs are less likely to opt for local auditors. We confirm the robustness of this baseline result using the propensity-matched sample, entropy balancing, and another alternative specification. While investigating the underlying reasons, we discover that firms with early-tenure CEOs are more prone to having lower-quality financial statements and a higher likelihood of financial fraud.<sup>1)</sup>

We contribute to the existing literature in a few important ways. First, prior studies (Mitra et al. 2007; Huang et al. 2014; Billings et al. 2014; Krishnan and Wang 2015; Chen et al. 2015; Kim et al. 2015; Mitra et al. 2019) have focused on the impact of managerial attributes such as CEO equity incentives, CEO turnover, managerial ability, and ownership interest on audit fees and audit risks. This study expands on this literature by investigating auditors' selection during the initial three years of CEOs' service. Second, we contribute to the CEO literature by examining the effects of CEO career concerns on firms'

1) We could not find a significant result on auditors' going concern opinions. We believe that the negative relation between auditor locality and early tenure CEOs may be due to lower financial quality and other reasons that we mentioned.

decisions, especially those related to audits. This study is relevant to Korean readers. While prior studies have investigated the effect of early-tenure CEOs on earnings management (Kim and Choi 2016), and value relevance (Gong 2016) using Korean-listed firm data, this paper utilizes a unique database that includes auditor locality, social capital, and CEO locality and try to show how geographic preferences affect firm decisions.

The subsequent sections of the paper are structured as follows. Section 2 provides a review of the literature and develops the hypothesis. Sections 3 and 4 describe the research design and data, respectively. Sections 5 to 7 present the empirical results. Section 8 concludes.

## II. Literature review and hypothesis development

The literature suggests that CEOs' personal characteristics and experiences play an important role in shaping their managerial styles and corporate strategies (Hambrick 2007). These traits not only impact the strategic decisions and responses of CEOs but also influence organizational performance (Hambrick and Mason 1984). Additionally, the personal traits of CEOs can extend their influence to various aspects of firm policies (Arslan-

Ayaydin et al. 2020).

Gibbons and Murphy (1992) argue that the market tends to be uncertain about the abilities of newly appointed CEOs. Oyer (2008) and Axelson and Bond (2009) propose a significant level of adverse selection at the beginning of CEOs' service, suggesting that when managers report poor outcomes and get labeled as "low ability" managers, it negatively impacts their reputations and future compensation. This argument implies that even high-ability CEOs might inflate earnings to avoid reporting poor performance in the early years of their service, even if the poor outcome is not a result of poor managerial ability. In line with this reasoning, Ali and Zhang (2015) demonstrate that earnings management increases in the early years of CEOs' service. Consequently, higher earnings management in the early years of CEOs may impact the firm's decisions, including financial reporting quality and auditor-related choices. Client firms decide to change auditors based on the decision-making and control functions within the firms (Fama and Jensen 1983). Consistent with this, Roberts et al. (1990) suggest that firms with weaker internal controls, and a diminished likelihood of compliance with laws and regulations are more likely to undergo auditor changes.

In the U.S. environment, characterized by a market-based system, collusion between auditors and clients may also occur, especially when they are geographically close. Additionally,

U.S. equity market investors exhibit a preference for locally headquartered firms, indicating a fondness for local stocks due to familiarity and information advantages. As local auditors are geographically proximate, they enjoy enhanced access to private information and can establish closer personal ties, potentially influencing audit quality (Choi et al. 2012). We predict that early-tenure CEOs relate to auditor locality in two opposing ways.

On the one hand, the information advantage facilitates communication between local auditors and their clients, alleviating information asymmetry and enabling more accurate assessments of client-specific risks. This positive association between audit quality and auditor locality is referred to as ‘the information perspective’. Geographically proximate local auditors are inherently more familiar with clients in the same locale, providing them with information advantages in their engagements compared to non-local auditors. They have easier access to private information through direct communications with executives and other employees of client firms, as well as the ability to obtain client-specific information from local media. Furthermore, local auditors can conveniently gather crucial client-specific information, visit clients’ business units, and maintain more frequent communication with suppliers and employees.

Several studies have documented big bath accounting, where CEOs increase discretionary

expenses during their first year in charge (Moore 1973; Strong and Meyer 1987; Murphy and Zimmerman 1993; Pourciau 1993; Reitenga and Tearney 2003). The existing literature argues that incoming CEOs adopt earnings baths to reduce performance targets and reserve earnings for future periods. This practice is prevalent because the poor performance in the first year, often a partial year, is typically attributed to the previous CEO, thus having minimal impact on the new CEO’s reputation (Hensel and Schöndube 2022). The market tends to be uncertain about the abilities of newly appointed CEOs (Gibbons and Murphy 1992). In contrast, the positive outcomes in subsequent years are attributed to the new manager’s performance, thereby enhancing their reputation. As a result, early-tenure CEOs are more likely to have heightened career concerns, as labor market participants adjust their beliefs about the CEO’s ability with the arrival of new information regarding their performance. Consequently, current accounting earnings influence the manager’s reputation and, subsequently, their future compensation. The verification of accounting information is conducted by an auditor, an individual authorized to review and confirm the accuracy of financial records, ensuring companies comply with tax laws. Therefore, auditors also influence one of the crucial factors that early-tenure CEOs pay attention to. In this scenario, early-tenure CEOs are less

likely to choose local auditors due to the high-quality auditing services provided by local auditors, their information advantages, and lower information asymmetry.

The board of directors is more likely to be drawn from the local business network (Knyazeva et al. 2013). Individuals shape their social identity by categorizing and defining themselves and others within different groups (Ashforth and Mael 1989). Members within these social groups tend to exhibit higher levels of trust in each other. In such cases, there may be a close relationship between local auditors and stakeholders, including the board of directors. Therefore, in certain instances, choosing local auditors may serve as one method to assess the integrity of an organization's processes, systems, and information, encompassing both financial and non-financial aspects. In such instances, CEOs with higher career concerns are less inclined to opt for local auditors.

On the other hand, the geographic proximity of auditor locality may impair auditor independence. Auditor independence is important because it has an impact on audit quality. Auditors may face incentives to yield to client pressure, particularly in retaining major clients and those purchasing more-profitable non-audit services, potentially leading to compromised independence (Tepalagull and Lin 2015).

Due to the relatively closer ties between local auditors and their clients, local audi-

tors are more likely to collude with them and acquiesce to client pressure for allowing sub-standard reporting than non-local auditors, potentially leading to lower-quality audits. This introduces a negative association between audit quality and auditor locality, signifying the potential impairment of auditor independence due to geographic proximity or auditor locality. Also, in these cases, CEOs with higher career concerns are more likely to choose local auditors because of the lower independence of local auditors. Geiger and Raghunandan (2002) suggest that audit failures are more probable in the early years of the auditor - client relationship. Thus, new CEOs may be more likely to change auditors because new auditors may have limited knowledge about the client firm. Therefore, in such cases, early-tenure CEOs may be more inclined to select local auditors. Based on the discussions above, we propose our hypothesis as follows:

*H: CEO tenure has no impact on the firms' choice between local and nonlocal audit firms.*

### III. Research design

To test our hypothesis, we estimate the following model:



$$\begin{aligned}
LOCAL\_AUDIT = & \beta_0 + \beta_1 EARLY\_YEARS \\
& + \beta_2 LNASSETS + \beta_3 DEBT + \beta_4 ROA \\
& + \beta_5 LOSS + \beta_6 UNQ\_OPINION \\
& + \beta_7 INH\_RISK + \beta_8 SEGMENTS \\
& + \beta_9 BIG4 + \beta_{10} FYEAREND \\
& + \beta_{11} AU\_CHANGE + \beta_{12} RURAL \\
& + \beta_{13} LN\_INPERCAP + \beta_{14} LNPOP \\
& + \beta_{15} POPG + \beta_{16} LITERACY \\
& + \beta_{17} LAST\_YEAR + Year FE \\
& + Ind FE + \varepsilon
\end{aligned} \tag{1}$$

where we omit year and industry subscripts for brevity. The dependent variable, *LOCAL\_AUDIT*, equals 1 if the auditing firm is located in the same state as the firm's headquarters, and 0 otherwise. We assess auditor locality through state-based differentiation, as various states have different regulatory regimes, jurisdictions, and features. Additionally, each state has its own CPA institute for registration (Choi et al. 2012). The key independent variable, *EARLY\_YEARS*, is an indicator variable set to one for the first three years of CEOs' service and zero otherwise. The coefficient ( $\beta_1$ ) indicates the relationship between early-tenure CEOs and auditor locality.

We follow prior studies by including control variables (e.g., Hay et al. 2006; Fung et al. 2012; Choi et al. 2012; Jha and Chen 2015; Ali and Zhang 2015). Control variables include firm-related characteristics such as firm size (*LNASSETS*), leverage (*DEBT*), profitability (*ROA*, *LOSS*), audit concern

(*UNQ\_OPINION*), inherent risk (*INH\_RISK*), and the number of clients' geographic segments (*SEGMENTS*). Auditor-related characteristics include auditor type (*BIG4*), busy audit seasonality (*FYEAREND*), and auditor change (*AU\_CHANGE*). County and region-related characteristics, including population density (*RURAL*), income per capita (*LN\_INPERCAP*), population (*LNPOP*), population growth (*POPG*), and literacy rate (*LITERACY*), are also controlled for. Lastly, we also include the last year of CEO (*LAST\_YEAR*), which equals one if the observation is for the last year of CEOs' service, and zero otherwise. In certain situations, the final year of a former CEO's tenure may have a significant impact on the selection of auditors. Industry and year-fixed effects are included, and standard errors are clustered at the firm level. Variable definitions are provided in the Appendix.

#### IV. Data and sample description

We obtain financial data from Compustat, CEO-related data from ExecuComp, and audit-related data from Audit Analytics. Region-related data were obtained from BEA and the Census Bureau. Firm headquarters location data were retrieved from the Software Repository for Accounting and Finance at the University of Notre Dame. We collect CEO birthplace



information for the identified CEOs through a comprehensive process. Initially, we refer to The Complete Marquis Who's Who Biographies via LexisNexis Academic. Additionally, we conduct searches on Wikipedia, Bloomberg, Google, NNDB, and other sources to identify

birthplace information for CEOs in U.S.-based firms.

⟨Table 1⟩ tabulates our sample selection procedure. Initially, we utilize the audit locality database, matching the location of the auditing company's headquarters with that of

⟨Table 1⟩ Sample selection

Audit locality information	118,943
Less:	
Observations missing CEO tenure information	-82,355
Observations missing necessary control variables	-6,694
Observations of financial firms	-2,579
Final sample	27,315

Notes: ⟨Table 1⟩ summarizes the sample selection procedure for firm - year observations.

⟨Table 2⟩ Summary statistics

Panel A. Descriptive statistics

Variable	N	Mean	Std.	Min	Q1	Med	Q3	Max
<i>LOCAL_AUDIT</i>	27,315	0.875	0.331	0	1	1	1	1
<i>EARLY_YEARS</i>	27,315	0.384	0.486	0	0	0	1	1
<i>LNASSETS</i>	27,315	7.451	1.655	3.633	6.287	7.349	8.536	11.674
<i>DEBT</i>	27,315	0.533	0.244	0.082	0.362	0.528	0.678	1.385
<i>ROA</i>	27,315	0.124	0.107	-0.357	0.082	0.124	0.175	0.405
<i>LOSS</i>	27,315	0.069	0.253	0	0	0	0	1
<i>UNQ_OPINION</i>	27,315	0.628	0.483	0	0	1	1	1
<i>INH_RISK</i>	27,315	0.246	0.165	0.012	0.113	0.222	0.341	0.742
<i>SEGMENTS</i>	27,315	2.489	1.775	1	1.414	2	3.162	9.950
<i>BIG4</i>	27,315	0.891	0.311	0	1	1	1	1
<i>FYEAREND</i>	27,315	0.674	0.469	0	0	1	1	1
<i>AU_CHANGE</i>	27,315	0.046	0.208	0	0	0	0	1
<i>RURAL</i>	27,315	0.512	0.500	0	0	1	1	1
<i>LN_INPERCAP</i>	27,315	10.814	0.345	10.156	10.574	10.78	10.995	11.910
<i>LNPOP</i>	27,315	13.759	1.080	10.553	13.208	13.758	14.38	16.105
<i>POPG</i>	27,315	0.884	1.061	-1.110	0.159	0.722	1.423	4.605
<i>LITERACY</i>	27,315	38.319	10.344	14.421	31.45	38.107	46.13	59.835
<i>LAST_YEAR</i>	27,315	0.154	0.361	0	0	0	0	1

Notes: Panel A of ⟨Table 2⟩ presents the descriptive statistics of the variables used in our main model. The summary statistics include the number of observations, mean, median, standard deviation, minimum, maximum, and the percentiles (25% and 75%) distribution of the variables.

〈Table 2〉 Summary statistics (continue)

Panel B. Correlation matrix

Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
(1) <i>EARLY_YEARS</i>	1.00							
(2) <i>LOCAL_AUDIT</i>	-0.02**	1.00						
(3) <i>LNASSETS</i>	-0.09***	0.01	1.00					
(4) <i>DEBT</i>	0.03***	-0.05***	0.35***	1.00				
(5) <i>ROA</i>	-0.03***	0.02***	0.18***	-0.06***	1.000			
(6) <i>LOSS</i>	0.05***	-0.00	-0.30***	-0.01**	-0.66***	1.00		
(7) <i>UNQ_OPINION</i>	-0.06***	0.01	-0.07***	-0.09***	0.05***	-0.02***	1.00	
(8) <i>INH_RISK</i>	0.01	0.04***	-0.19***	0.01	0.05***	-0.04***	0.03***	1.00
(9) <i>SEGMENTS</i>	-0.03***	-0.01	0.24***	0.12***	0.02***	-0.08***	-0.03***	0.01
(10) <i>BIG4</i>	-0.02***	0.07***	0.31***	0.13***	0.09***	-0.12***	-0.07***	-0.07***
(11) <i>FYEAREND</i>	-0.00	-0.06***	0.09***	0.10***	-0.05***	0.01**	-0.03***	-0.18***
(12) <i>AU_CHANGE</i>	0.02***	-0.03***	-0.09***	-0.01	-0.05***	0.06***	-0.02**	0.01*
(13) <i>RURAL</i>	-0.01**	-0.07***	-0.05***	0.00	0.02***	-0.03***	0.00	0.04***
(14) <i>LN_INPERCAP</i>	-0.05***	0.02***	0.11***	0.02***	-0.05***	0.04***	0.07***	-0.10***
(15) <i>LNPOP</i>	0.02**	0.21***	0.02**	-0.04***	-0.09***	0.08***	-0.01	-0.05***
(16) <i>POPG</i>	0.03***	0.01	-0.02***	-0.02***	0.03***	-0.01	0.02***	-0.04***
(17) <i>LITERACY</i>	0.02**	0.10***	-0.07***	-0.09***	-0.08***	0.10***	-0.02***	-0.07***
(18) <i>LAST_YEAR</i>	-0.04***	-0.01	-0.02***	0.05***	-0.07***	0.07***	-0.02***	0.00

  

Variables	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)
(9) <i>SEGMENTS</i>	1.00								
(10) <i>BIG4</i>	0.06***	1.00							
(11) <i>FYEAREND</i>	0.05***	-0.01	1.00						
(12) <i>AU_CHANGE</i>	-0.02***	-0.12***	0.01	1.00					
(13) <i>RURAL</i>	-0.03***	0.04***	-0.03***	0.01*	1.00				
(14) <i>LN_INPERCAP</i>	0.02**	-0.01**	0.01	-0.05***	-0.24***	1.00			
(15) <i>LNPOP</i>	0.02***	-0.04***	0.03***	0.00	-0.47***	0.22***	1.00		
(16) <i>POPG</i>	-0.05***	-0.02***	0.04***	0.01**	0.19***	-0.10***	-0.07***	1.00	
(17) <i>LITERACY</i>	-0.03***	0.03***	-0.03***	-0.01	-0.19***	0.54***	0.19***	-0.01	1.000
(18) <i>LAST_YEAR</i>	0.01	-0.01	-0.02***	0.01	-0.01	0.01	0.01	-0.01	0.012**

Notes: Panel B presents the correlation matrix. The variable definitions are given in the Appendix

the client firm. This step results in 118,943 firm-year observations. Subsequently, we restrict our sample to non-financial industries excluding firms with SIC codes from 6000 to 6999. Additionally, observations with missing control variables and CEO tenure information are excluded. The final sample consists of

27,315 firm-year observations from 2000 to 2019. To address outliers, all continuous variables are winsorized at the 1st and 99th percentiles.

In Panel A of 〈Table 2〉, we present summary statistics for variables used in our analysis. Approximately 87.5 percent of the entire sample

opts for local auditors (*LOCAL\_AUDIT*), which is comparable to the percentages found in prior studies (Choi et al. 2012; Bazrafshan and Madise 2020). The mean value of the variable early years (*EARLY\_YEARS*) is 0.384, indicating that around 38.4 percent of the firm-year observations correspond to the early years of CEOs' service. This aligns with percentages reported in prior studies (Ali and Zhang 2015; Ding and Jaggi 2022). The descriptive statistics of the other variables are similar to those in prior studies (Hay et al. 2006; Fung et al. 2012; Choi et al. 2012; Jha and Chen 2015; Bolor-Erdene et al. 2024).

The correlation matrix in Panel B presents a negative association between early years (*EARLY\_YEARS*) and auditor locality (*LOCAL\_AUDIT*). Additionally, it indicates a negative and significant association between the early years dummy (*EARLY\_YEARS*) and firm size (*LNASSETS*), profitability (*ROA*), and Big 4 auditors (*BIG4*). There is a positive and significant relation between loss (*LOSS*) and auditor change (*AU\_CHANGE*).

## V. Main results

### 5.1 Early-tenure CEOs and audit locality

⟨Table 3⟩ presents the results of estimating Equation (1). The coefficient on *EARLY\_YEARS*

is negative and significant at the 5 percent level in column 1 (coefficient = -0.072, *t*-stat = -2.38). This finding suggests that firms led by early-tenure CEOs are less likely to choose local auditors compared to firms led by low-career-concern CEOs. Additionally, the results indicate that firms with high debt (*DEBT*) and financial year-end (*FYEAREND*) are also less likely to choose local auditors. The coefficient of *LAST\_YEAR* is insignificant (coefficient = -0.038, *t*-stat = -1.37), suggesting that former CEOs do not have a significant effect on auditor locality.

### 5.2 Early-tenure CEOs and financial reporting quality

To better understand the relationship between CEO career concerns and audit locality we try to investigate early-tenure CEO's effect on financial reporting quality and likelihood of financial fraud which is measured by F-scores. The proxies for financial reporting quality, namely *FRQ1* and *FRQ2*, represent measures derived from discretionary accruals, calculated according to the methodology presented by Dechow and Dichev (2002). It's important to note that higher values of *FRQ1* and *FRQ2* indicate lower-quality financial reporting. Additionally, we gauge financial reporting fraud using the F-score, as established by Dechow et al. (2011), to assess the probability of identifying and predicting ma-

〈Table 3〉 Early-tenure CEOs and auditor's locality

	Dependent variable= <i>LOCAL_AUDIT</i>	
	(1) Coeff	(2) <i>t</i> -value
<i>EARLY YEARS</i>	-0.072**	(-2.38)
<i>Firm-related variables</i>		
<i>LNASSETS</i>	0.026	(1.06)
<i>DEBT</i>	-0.368***	(-3.05)
<i>ROA</i>	0.408	(1.40)
<i>LOSS</i>	0.142	(1.39)
<i>UNQ_OPINION</i>	0.028	(0.79)
<i>INH_RISK</i>	0.402	(1.54)
<i>SEGMENTS</i>	-0.007	(-0.65)
<i>Auditor-related variables</i>		
<i>BIG4</i>	0.362***	(4.22)
<i>FYEAREND</i>	-0.234***	(-3.05)
<i>AU_CHANGE</i>	-0.114**	(-2.18)
<i>Region-related variables</i>		
<i>RURAL</i>	0.146*	(1.96)
<i>LN_INPERCAP</i>	-0.521***	(-3.96)
<i>LNPOP</i>	0.347***	(9.01)
<i>POPG</i>	-0.012	(-0.46)
<i>LITERACY</i>	0.017***	(4.30)
<i>Other variables</i>		
<i>LAST_YEAR</i>	-0.038	(-1.37)
Intercept	0.985	(0.70)
Observations	27,315	
Year FE	Yes	
Ind FE	Yes	
Cluster	Firm	
Pseudo R <sup>2</sup>	0.122	

Notes: 〈Table 3〉 presents the main results based on Eq. (1). This table tabulates the relation between early-tenure CEOs and auditor locality. \*, \*\*, and \*\*\* denote statistical significance at the 10 percent, 5 percent, and 1 percent levels, respectively. All specifications are estimated with robust standard errors clustered by firm, and year and industry-fixed effects are included. Definitions for all variables are provided in the Appendix.

(Table 4) Early-tenure CEOs and financial reporting quality

	FRQ1	FRQ2	F SCORE
	(1)	(2)	(3)
<i>EARLY_YEARS</i>	0.008*** (3.94)	0.005*** (2.61)	0.045*** (2.60)
<i>Firm-related variables</i>			
<i>LNASSETS</i>	-0.016*** (-13.51)	-0.017*** (-15.76)	0.089*** (8.48)
<i>DEBT</i>	0.040*** (3.51)	0.029*** (3.06)	-0.092 (-1.49)
<i>ROA</i>	-0.035* (-1.73)	-0.034* (-1.70)	-0.656*** (-4.95)
<i>LOSS</i>	0.054*** (8.54)	0.057*** (8.41)	-0.281*** (-2.91)
<i>UNQ_OPINION</i>	-0.004** (-2.01)	-0.000 (-0.13)	-0.043*** (-2.66)
<i>INH_RISK</i>	-0.095*** (-7.55)	-0.115*** (-9.18)	1.666*** (14.36)
<i>SEGMENTS</i>	-0.002*** (-3.93)	-0.002*** (-3.76)	-0.010** (-2.08)
<i>Auditor-related variables</i>			
<i>BIG4</i>	-0.013*** (-2.78)	-0.010** (-2.04)	-0.052 (-1.37)
<i>FYEAREND</i>	-0.001 (-0.45)	0.001 (0.27)	0.054* (1.84)
<i>AU_CHANGE</i>	0.005 (1.17)	0.007* (1.81)	0.033 (0.85)
<i>Region-related variables</i>			
<i>RURAL</i>	0.007*** (2.79)	0.008*** (2.61)	-0.005 (-0.17)
<i>LN_INPERCAP</i>	0.006 (1.22)	0.003 (0.62)	0.030 (0.52)
<i>LNPOP</i>	0.003*** (2.80)	0.006*** (3.99)	0.013 (1.08)
<i>POPG</i>	-0.000 (-0.47)	-0.000 (-0.29)	0.008 (0.85)
<i>LITERACY</i>	0.000* (1.79)	0.000** (2.20)	-0.002 (-1.21)
<i>Other variables</i>			
<i>LAST_YEAR</i>	-0.000 (-0.05)	0.000 (0.21)	-0.033 (-1.44)
<i>LOCAL_AUDIT</i>	-0.004 (-1.26)	-0.003 (-1.00)	-0.062* (-1.90)
Intercept	0.159*** (3.24)	0.169*** (3.04)	0.538 (0.89)
Observations	25,671	23,849	24,067
Year FE	Yes	Yes	Yes
Ind FE	Yes	Yes	Yes
Cluster	Firm	Firm	Firm
Adjusted R <sup>2</sup>	0.137	0.258	0.155

Notes: Table 4 presents the relationship between early-tenure CEOs and financial reporting quality. \*, \*\*, and \*\*\* denote statistical significance at the 10 percent, 5 percent, and 1 percent levels, respectively. All specifications are estimated with robust standard errors clustered by firm, and year and industry-fixed effects are included. Definitions for all variables are provided in the Appendix.

terial violations in financial statements. To examine whether hiring higher career concerns are associated with misreporting risks, we estimate the following models:

$$\begin{aligned}
 FRQ \text{ or } F\_SCORE = & \beta_0 + \beta_1 EARLY\_YEARS \\
 & + \beta_2 LNASSETS + \beta_3 DEBT + \beta_4 ROA \\
 & + \beta_5 LOSS + \beta_6 UNQ\_OPINION \\
 & + \beta_7 INH\_RISK + \beta_8 SEGMENTS \\
 & + \beta_9 BIG4 + \beta_{10} FYEAREND \\
 & + \beta_{11} AU\_CHANGE + \beta_{12} RURAL \\
 & + \beta_{13} LN\_INPERCAP + \beta_{14} LNPOP \\
 & + \beta_{15} POPG + \beta_{16} LITERACY \\
 & + \beta_{17} LAST\_YEAR + \beta_{18} LOCAL\_AUDIT \\
 & + Year FE + Ind FE + \varepsilon \quad (2)
 \end{aligned}$$

Standard errors clustered at the firm level. We are interested in  $\beta_1$ , which represents the relationship between early-tenure CEOs and financial reporting quality. A higher  $\beta_1$  presents a lower financial reporting quality or a higher probability of financial fraud.

⟨Table 4⟩ presents the results of estimating Equation (2). The coefficients of *EARLY\_YEARS* are positive and significant at the 1 percent level in all columns (coefficient = 0.008, *t*-stat = 3.94 in column [1]; coefficient = 0.005, *t*-stat = 2.61 in column [2]; coefficient = 0.045, *t*-stat = 2.60 in column [3]). This suggests that firms led by CEOs in their early years of service exhibit lower financial reporting quality and a higher likelihood of

financial fraud compared to the later years of CEOs' service.

## VI. Additional tests

### 6.1 Financial reporting quality's effect on auditor locality

In this subsection, we try to investigate the effect of financial reporting quality on the relationship between the early-tenure CEOs and the auditor locality. To test the relationship between financial reporting quality on auditor's selection, we estimate the following equations:

$$\begin{aligned}
 LOCAL\_AUDIT = & \beta_0 + \beta_1 EARLY\_YEARS \\
 & + \beta_2 LOW\_FRQ + \beta_3 EARLY\_YEARS * LOW\_FRQ \\
 & + \beta_{4-19} Controls + Year FE \\
 & + Ind FE + \varepsilon \quad (3)
 \end{aligned}$$

FRQ measurement is based on the model of Dechow and Dichev (2002). We employ the same control variables as in Equation (1), with standard errors clustered at the firm level. We are interested in  $\beta_3$ , which represents the relationship between the mediating effect of FRQ on the relation between early-tenure CEOs and auditor's selection.

⟨Table 5⟩ presents the results of estimating

〈Table 5〉 Financial reporting quality

	Dependent variable = <i>LOCAL_AUDIT</i>			
	(1) Coeff	(2) <i>t</i> -value	(1) Coeff	(2) <i>t</i> -value
<i>EARLY_YEARS</i>	-0.039	(-1.04)	-0.040	(-0.44)
<i>LOW_FRQ1</i>	0.052*	(1.89)		
<i>EARLY_YEARS*LOW_FRQ1</i>	-0.077*	(-1.80)		
<i>LOW_FRQ2</i>			-0.010	(-0.22)
<i>EARLY_YEARS*LOW_FRQ2</i>			-0.012	(-0.20)
<i>Firm-related variables</i>				
<i>LNASSETS</i>	0.032	(1.21)	0.022	(0.82)
<i>DEBT</i>	-0.356***	(-2.80)	-0.224*	(-1.67)
<i>ROA</i>	0.386	(1.26)	0.580*	(1.77)
<i>LOSS</i>	0.148	(1.38)	0.109	(0.93)
<i>UNQ_OPINION</i>	0.020	(0.56)	0.005	(0.12)
<i>INH_RISK</i>	0.502*	(1.82)	0.509**	(2.32)
<i>SEGMENTS</i>	-0.006	(-0.51)	-0.018	(-1.61)
<i>Auditor-related variables</i>				
<i>BIG4</i>	0.331***	(3.75)	0.348***	(3.68)
<i>FYEAREND</i>	-0.234***	(-2.96)	-0.214***	(-2.83)
<i>AU_CHANGE</i>	-0.122**	(-2.28)	-0.122**	(-2.18)
<i>Region-related variables</i>				
<i>RURAL</i>	0.147*	(1.89)	0.116	(1.46)
<i>LN_INPERCAP</i>	-0.500***	(-3.65)	-0.430***	(-3.17)
<i>LNPOP</i>	0.344***	(8.67)	0.347***	(8.48)
<i>POPG</i>	-0.012	(-0.45)	0.006	(0.22)
<i>LITERACY</i>	0.018***	(4.24)	0.015***	(3.54)
<i>Other variables</i>				
<i>LAST_YEAR</i>	-0.048	(-1.53)	-0.032	(-0.99)
Intercept	0.762	(0.53)	0.141	(0.10)
Observations	25,671		23,849	
Year FE	Yes		Yes	
Ind FE	Yes		Yes	
Cluster	Firm		Firm	
Pseudo R <sup>2</sup>	0.124		0.087	

Notes: 〈Table 5〉 presents the mediating role of FRQ in the relationship between early-tenure CEOs and auditor locality. \*, \*\*, and \*\*\* denote statistical significance at the 10 percent, 5 percent, and 1 percent levels, respectively. All specifications are estimated with robust standard errors clustered by firm, and year and industry-fixed effects are included. Definitions for all variables are provided in the Appendix.



Equation (3). We find that the interactions of *EARLY\_YEARS* and *LOW\_FRQ* are negative in all columns (coefficient = -0.077, *t*-stat = -1.80 in column [1]; coefficient = -0.012, *t*-stat = -0.20 in column [2]). This

implies that when early-tenure CEOs demonstrate lower-quality financial reporting, they are less likely to choose local auditors, providing supporting evidence for our main results.

〈Table 6〉 Propensity score matching

Panel A. The first stage of the propensity score matching

	Dependent variable = <i>EARLY_YEARS</i>	
	(1) Coeff	(2) <i>t</i> -value
<i>Firm-related variables</i>		
<i>LNASSETS</i>	-0.140***	(-8.83)
<i>DEBT</i>	0.598***	(6.69)
<i>ROA</i>	-0.121	(-0.54)
<i>LOSS</i>	0.117	(1.35)
<i>UNQ_OPINION</i>	-0.044	(-1.19)
<i>INH_RISK</i>	-0.374**	(-2.29)
<i>SEGMENTS</i>	0.002	(0.21)
<i>Auditor-related variables</i>		
<i>BIG4</i>	0.096	(1.47)
<i>FYEAREND</i>	0.046	(0.98)
<i>AU_CHANGE</i>	0.080	(1.23)
<i>Region-related variables</i>		
<i>RURAL</i>	-0.086*	(-1.87)
<i>LN_INPERCAP</i>	-0.140	(-1.47)
<i>LNPOP</i>	0.032	(1.54)
<i>POPG</i>	0.040**	(2.02)
<i>LITERACY</i>	0.002	(0.79)
<i>Other variables</i>		
<i>LAST_YEAR</i>	-0.328***	(-8.61)
Intercept	2.215**	(2.14)
Observations	27,315	
Year FE	Yes	
Ind FE	Yes	
Cluster	Firm	
Pseudo R <sup>2</sup>	0.040	

<Table 6> Propensity score matching (continue)

	Before matching				After matching			
	EARLY YEARS=1	EARLY YEARS=0	Diff	t-stats	EARLY YEARS=1	EARLY YEARS=0	Diff	t-stats
<i>Firm-related variables</i>								
LNASSETS	7.263	7.568	-0.305***	-14.86	7.341	7.368	-0.026	-1.13
DEBT	0.541	0.527	0.014***	4.56	0.538	0.537	0.001	0.27
ROA	0.119	0.127	-0.007***	-5.63	0.122	0.122	-0.001	-0.36
LOSS	0.086	0.058	0.027***	8.66	0.077	0.074	0.003	0.67
UNQ_OPINION	0.592	0.651	-0.059***	-9.84	0.597	0.597	0.000	-0.01
INH_RISK	0.248	0.245	0.003	1.51	0.247	0.247	0.000	0.18
SEGMENTS	2.424	2.530	-0.106***	-4.80	2.459	2.479	-0.020	-0.80
<i>Auditor-related variables</i>								
BIG4	0.884	0.896	-0.012***	-3.06	0.889	0.889	0.001	0.11
FYEAREND	0.673	0.675	-0.002	-0.30	0.673	0.669	0.004	0.62
AU_CHANGE	0.051	0.042	0.009***	3.54	0.049	0.050	-0.001	-0.33
<i>Region-related variables</i>								
RURAL	0.504	0.517	-0.012**	-1.98	0.508	0.508	-0.001	-0.09
LN_INPERCAP	10.790	10.828	-0.038***	-8.82	10.796	10.797	-0.001	-0.19
LNPOP	13.779	13.747	0.032**	2.40	13.771	13.760	0.011	0.75
POPG	0.917	0.863	0.055***	4.14	0.893	0.896	-0.003	-0.17
LITERACY	38.512	38.199	0.313**	2.43	38.400	38.388	0.012	0.09
<i>Other variables</i>								
LAST_YEAR	0.135	0.166	-0.031***	-6.86	0.140	0.140	0.000	0.06

〈Table 6〉 Propensity score matching (continue)

Panel C. Results with the matched sample

	Dependent variable = <i>LOCAL_AUDIT</i>	
	(1)	(2)
	Coeff	<i>t</i> -value
<i>EARLY YEARS</i>	-0.088***	(-2.66)
<i>Firm-related variables</i>		
<i>LNASSETS</i>	0.037	(1.56)
<i>DEBT</i>	-0.352***	(-2.89)
<i>ROA</i>	0.319	(1.08)
<i>LOSS</i>	0.148	(1.39)
<i>UNQ_OPINION</i>	0.045	(1.19)
<i>INH_RISK</i>	0.421	(1.63)
<i>SEGMENTS</i>	-0.014	(-1.29)
<i>Auditor-related variables</i>		
<i>BIG4</i>	0.344***	(4.15)
<i>FYEAREND</i>	-0.201***	(-2.63)
<i>AU_CHANGE</i>	-0.083	(-1.39)
<i>Region-related variables</i>		
<i>RURAL</i>	0.110	(1.49)
<i>LN_INPERCAP</i>	-0.510***	(-3.85)
<i>LNPOP</i>	0.337***	(8.96)
<i>POPG</i>	0.003	(0.10)
<i>LITERACY</i>	0.015***	(3.82)
<i>Other variables</i>		
<i>LAST_YEAR</i>	-0.042	(-1.15)
Intercept	0.979	(0.69)
Observations	19,682	
Year FE	Yes	
Ind FE	Yes	
Cluster	Firm	
Pseudo R <sup>2</sup>	0.118	

Notes: 〈Table 6〉 reports the results of the propensity score matching (PSM) analysis. \*, \*\*, and \*\*\* denote statistical significance at the 10 percent, 5 percent, and 1 percent levels, respectively. All specifications are estimated with robust standard errors clustered by firm, and year and industry-fixed effects are included. Definitions for all variables are provided in the Appendix.

〈Table 7〉 Entropy balancing

	Dependent variable = <i>LOCAL_AUDIT</i>	
	(1)	(2)
	Coeff	t-value
<i>EARLY YEARS</i>	-0.080***	(-2.60)
<i>Firm-related variables</i>		
<i>LNASSETS</i>	0.026	(1.09)
<i>DEBT</i>	-0.361***	(-3.08)
<i>ROA</i>	0.216	(0.77)
<i>LOSS</i>	0.116	(1.16)
<i>UNQ_OPINION</i>	0.033	(0.95)
<i>INH_RISK</i>	0.447*	(1.79)
<i>SEGMENTS</i>	-0.009	(-0.82)
<i>Auditor-related variables</i>		
<i>BIG4</i>	0.336***	(4.07)
<i>FYEAREND</i>	-0.231***	(-3.09)
<i>AU_CHANGE</i>	-0.111**	(-2.04)
<i>Region-related variables</i>		
<i>RURAL</i>	0.126*	(1.72)
<i>LN_INPERCAP</i>	-0.538***	(-4.13)
<i>LNPOP</i>	0.339***	(9.02)
<i>POPG</i>	-0.007	(-0.30)
<i>LITERACY</i>	0.017***	(4.37)
<i>Other variables</i>		
<i>LAST_YEAR</i>	-0.042	(-1.36)
Intercept	1.256	(0.89)
Observations	27,315	
Year FE	Yes	
Ind FE	Yes	
Cluster	Firm	
Pseudo R <sup>2</sup>	0.117	

Notes: 〈Table 7〉 reports the results of the entropy balancing. \*, \*\*, and \*\*\* denote statistical significance at the 10 percent, 5 percent, and 1 percent levels, respectively. All specifications are estimated with robust standard errors clustered by firm, and year and industry-fixed effects are included. Definitions for all variables are provided in the Appendix.

## 6.2 Propensity score matching

Our results may be driven by the endogenous characteristics of *EARLY\_YEARS*. Certain types of firms are more likely to hire new CEOs. To address this concern, we conduct a propensity score matching analysis. We first develop a model of the likelihood of a firm hiring new CEOs using the following logit model:

$$\begin{aligned} Pr(EARLY\_YEARS=1) = & \beta_0 + Var \\ & + Year\ FE + Ind\ FE + \varepsilon. \end{aligned} \quad (4)$$

For *Var*, we include the full set of control variables used in Equation (1) following Shipman et al. (2017). We then match observations with early-tenure CEOs (*Treat group*) to those with non-early-tenure CEOs (*Control group*) based on propensity scores. We do so by one-to-one matching without replacement.

Panel A of <Table 6> reports the results of estimating Equation (5). The matching procedure allows to matching of 9,841 observations of firms with early-tenure CEOs with the same number of observations of firms without early-tenure CEOs.

Panel B presents the difference-in-means of variables between the two subgroups. Before matching, most of the means are significantly different between the treatment and the control groups. After matching, however, the differences become narrower and statistically insignificant, suggesting that the matching

procedure is successful.

Panel C of <Table 6> reports the results of estimating Equation (1) using the matched sample. The coefficient on *EARLY\_YEARS* remains negative and significant at the 1 percent level in column 1 (coefficient = -0.088, *t*-stat = -2.66), indicating that firms led by early-tenure CEOs are less likely to choose local auditors than those led by non-early-tenure CEOs. This result addresses endogeneity concerns and provides additional support for our main findings that firms with CEOs exhibiting high career concerns are less likely to choose local auditing firms than those with CEOs exhibiting lower career concerns.

## 6.3 Entropy balancing

The coefficient on *EARLY\_YEARS* remains negative and significant at the 1 percent level in <Table 7> (coefficient = -0.080, *t*-stat = -2.60), even after implementing entropy balancing.

# VII. Robustness checks

## 7.1 Subsample analysis

### 7.1.1 CEO Locality

Much of the literature documents that locals

have an informational advantage (Coval and Moskowitz 1999; 2001; Ivkovic and Weisbenner 2005; Malloy 2005; Bae et al. 2008; Lim and Nguyen 2021). Prior studies find that firms with local CEOs experience lower audit fees, reduced business risk, and lower misreporting risk (Bolor-Erdene et al. 2024). They are also less likely to make myopic decisions (Lai et al. 2020). Local auditors may have greater knowledge of client firms in the same community and may have a close relationship with local CEOs. This discussion implies that the observed CEO career concerns - audit selection relation might be influenced by the presence of local CEOs. We divide the sample into two groups depending on whether the firms are led by local CEOs or not. We identified local CEOs based on whether the CEO's birthplace and undergraduate university state matched the state in which his/her firm is headquartered; otherwise, CEOs were considered nonlocal.

In Panel A of <Table 8>, we find that the coefficient on *EARLY\_YEARS* is negative and significant in all columns (coefficient = -0.389, *t*-stat = -1.77 in column [1]; coefficient = -0.073, *t*-stat = -2.39 in column [2]) and the difference between the two subsamples is insignificant (diff = -0.316, *t*-stat = -1.43). These results confirm that CEO locality does not serve as a correlated omitted variable in our findings.

### 7.1.2 Social capital

Economists have long acknowledged the significance of social capital, particularly trust, as a crucial element for economic success in society (Arrow 1972; Coleman 1990; Putnam 1993; Fukuyama 1995). High levels of social capital foster trust among individuals, promoting greater participation in financial transactions.

Social capital is defined as the norms and networks that encourage collective actions in society (Woolcock 2001; Chenhall et al. 2010). Individuals in regions with high social capital often share a common set of beliefs and values, forming a basis for mutual trust (Guiso et al. 2004). Jha and Chen (2015) provide evidence that auditors demand lower audit fees for firms headquartered in high social capital regions because the binding social norms in those regions encourage honest financial reporting by managers. Firms located in high social capital counties experience lower audit efforts and reduced litigation risks (Jha and Chen 2015). Therefore, social capital may influence the relationship between CEO career concerns and the selection of local auditors.

We partitioned the sample based on whether the level of social capital in the county where a firm is located is higher than the sample median and examined whether our main findings differ across the subsamples. Social capital is measured at the county level, following the

〈Table 8〉 Subsample analyses

## Panel A. CEO locality

	Dep/variable = <i>LOCAL_AUDIT</i>	
	(1)	(2)
	Local	Non-local
<i>EARLY_YEARS</i>	-0.389* (-1.77)	-0.073** (-2.39)
Difference		-0.316 (-1.43)
Intercept	6.991 (1.21)	1.359 (0.95)
Controls	Included	Included
Observations	1,326	25,989
Year FE	Yes	Yes
Ind FE	Yes	Yes
Cluster	Firm	Firm
Pseudo R <sup>2</sup>	0.518	0.126

## Panel B. Social capital

	Dep/variable = <i>LOCAL_AUDIT</i>	
	(1)	(2)
	High	Low
<i>EARLY_YEARS</i>	-0.086* (-1.78)	-0.094** (-2.00)
Difference		0.008 (0.13)
Intercept	1.958 (1.22)	-5.086 (-1.61)
Controls	Included	Included
Observations	10,218	10,386
Year FE	Yes	Yes
Ind FE	Yes	Yes
Cluster	Firm	Firm
Pseudo R <sup>2</sup>	0.191	0.145



〈Table 8〉 Subsample analyses (continue)

## Panel C. Big 4 auditor

	Dep/variable= <i>LOCAL_AUDIT</i>	
	(1)	(2)
	Big 4	Non-big 4
<i>EARLY_YEARS</i>	-0.073** (-2.24)	-0.105 (-1.27)
Difference		0.032 (0.37)
Intercept	1.364 (0.89)	-2.060 (-0.77)
Controls	Included	Included
Observations	24,342	2,973
Year FE	Yes	Yes
Ind FE	Yes	Yes
Cluster	Firm	Firm
Pseudo R <sup>2</sup>	0.110	0.277

## Panel D. Duality

	Dep/variable= <i>LOCAL_AUDIT</i>	
	(1)	(2)
	Dual	Non-dual
<i>EARLY_YEARS</i>	-0.034 (-0.42)	-0.076** (-2.43)
Difference		0.042 (0.51)
Intercept	4.541*** (3.15)	0.968 (0.67)
Controls	Included	Included
Observations	3,382	23,933
Year FE	Yes	Yes
Ind FE	Yes	Yes
Cluster	Firm	Firm
Pseudo R <sup>2</sup>	0.201	0.121

Notes: 〈Table 8〉 reports the results of the subsample analysis. \*, \*\*, and \*\*\* denote statistical significance at the 10 percent, 5 percent, and 1 percent levels, respectively. All specifications are estimated with robust standard errors clustered by firm, and year and industry-fixed effects are included. Definitions for all variables are provided in the Appendix.

methodology outlined by Rupasingha et al. (2006). Since social capital data is available for the years 1997, 2005, 2009, and 2014, linear interpolation is used to estimate values for the intervening years.

In Panel B of <Table 8>, we find that the coefficients on *EARLY\_YEARS* are negatively significant in all columns (coefficient = -0.086,  $t$ -stat = -1.78 in column [1]; coefficient = -0.094,  $t$ -stat = -2.00 in column [2]). The coefficient of *EARLY\_YEARS* is slightly higher for the firms located in low social capital regions, meaning that our results are stronger in firms located in low social capital regions because career concerns and trust are negatively associated. However, the difference between the two sub-samples is insignificant (diff = 0.008,  $t$ -stat = 0.13). These results suggest that our findings do not depend on social capital and trust, which are potentially correlated omitted variables.

### 7.1.3 Big 4 auditing firms

Numerous studies have investigated whether Big-4 audit firms offer superior audit quality compared to non-Big-4 firms, both in terms of substance and perception. In the case of public firms, there is empirical evidence supporting a Big-4 effect (DeFond and Zhang 2014). However, in the private client segment, the empirical findings are more limited and exhibit some inconsistency (Langli and

Svanstrom 2014, Vanstraelen and Schelleman 2017). Theoretical predictions align with the notion that larger audit firms are likely to provide higher audit quality than their smaller counterparts (Dopuch and Simunic 1980, DeAngelo 1981). This is attributed to factors such as the superior incentive and quality control systems of Big-4 firms, they have more experts in auditing, accounting, taxes, and valuation (Francis 2011; Knechel et al. 2013).

Hence, in this subsection, we try to test the impact of Big 4 audit firms on our main results. We divide the sample based on whether the firm is audited by a Big 4 auditor or not, and we assess whether our key findings vary across these subsamples. In Panel C of <Table 8>, we observe that the coefficients on *EARLY\_YEARS* are significantly negative for the Big 4 firms (coefficient = -0.073,  $t$ -stat = -2.24 in column [1]), while they are insignificant for the non-Big 4 firms (coefficient = -0.105,  $t$ -stat = -1.27 in column [2]). This implies that firms with CEOs exhibiting high career concerns are less likely to opt for local Big 4 auditing firms compared to firms led by CEOs with low career concerns. However, the difference between the two sub-samples is insignificant (diff = 0.032,  $t$ -stat = 0.37). These results suggest that our findings do not depend on the presence of Big 4 firms.

#### 7.1.4 Duality

Yuan et al. (2017) have documented that CEOs experience fewer concerns when they also hold the position of the chairperson or when they have served for an extended period in their roles within the same organization. Consequently, we anticipate that our results will be less pronounced when CEOs also serve as chairpersons of the board. To investigate this, we divide the sample into two groups based on whether the CEO is also the chairperson of the board or not. We then examine how the relationship between early-tenure CEOs and auditor selections varies across these two subsamples.

In Panel D of (Table 8), the coefficients on *EARLY\_YEARS* are negatively significant for firms led by non-chairman CEOs (coefficient = -0.076,  $t$ -stat = -2.43 in column (2)), while they are insignificant for firms led by CEOs who also serve on the board of directors (coefficient = -0.034,  $t$ -stat = -0.42 in column (1)). However, the difference between the two subsamples is insignificant (diff = 0.042,  $t$ -stat = 0.51). These results suggest that our findings do not depend on whether CEOs also serve on the board of directors.

#### 7.2 Reversal of auditor's selection after early years of CEOs' service

To justify using the first three years of

service as the cutoff for defining *EARLY\_YEARS*, we estimated Equation (1) by replacing *EARLY\_YEARS* with indicator variables for each of the first seven years of CEOs' service: *FIRST\_YEAR*, *SECOND\_YEAR*, *THIRD\_YEAR*, *FOURTH\_YEAR*, *FIFTH\_YEAR*, *SIXTH\_YEAR*, and *SEVENTH\_YEAR*. *FIRST\_YEAR* takes the value of one if the observation is for the first year of CEOs' service and zero otherwise, and so forth. (Table 9) presents the regression results for the reversal of auditor's selection after the early years of the CEO's service. The coefficients on *FIRST\_YEAR* are significant in all columns (coefficient = -0.175,  $t$ -stat = -1.85 in column (1); coefficient = -0.178,  $t$ -stat = -1.85 in column (2)). The coefficients on *SECOND\_YEAR* are significant in all columns (coefficient = -0.195,  $t$ -stat = -2.07 in column (1); coefficient = -0.199,  $t$ -stat = -2.07 in column (2)), and the coefficients on *THIRD\_YEAR* are significant in all columns (coefficient = -0.194,  $t$ -stat = -2.08 in column (1); coefficient = -0.198,  $t$ -stat = -2.09 in column (2)). However, the coefficients become insignificant after the first three years of the CEO's service. These results suggest that auditor selection is statistically significant only in the first three years of CEOs' service due to the high career concerns of CEOs.

#### 7.3 CEO tenure

In this subsection, we try to investigate the

〈Table 9〉 Reversal of auditor’s selection after early years of CEOs’ service.

	Dependent variable = <i>LOCAL_AUDIT</i>	
	(1)	(2)
<i>FIRST_YEAR</i>	-0.175* (-1.85)	-0.178* (-1.85)
<i>SECOND_YEAR</i>	-0.195** (-2.07)	-0.199** (-2.07)
<i>THIRD_YEAR</i>	-0.194** (-2.08)	-0.198** (-2.09)
<i>FOURTH_YEAR</i>	-0.148 (-1.62)	-0.150 (-1.63)
<i>FIFTH_YEAR</i>	-0.133 (-1.48)	-0.135 (-1.49)
<i>SIXTH_YEAR</i>	-0.164* (-1.92)	-0.165* (-1.93)
<i>SEVENTH_YEAR</i>	-0.039 (-0.51)	-0.040 (-0.52)
<i>LAST_YEAR</i>		-0.061 (-1.10)
Intercept	8.840*** (2.79)	8.866*** (2.80)
Controls	Included	Included
Observations	27,315	27,315
Year FE	Yes	Yes
Ind FE	Yes	Yes
Cluster	Firm	Firm
Pseudo R <sup>2</sup>	0.130	0.130

Notes: 〈Table 9〉 presents the results regarding the reversal of auditor’s selection after the early years of CEOs’ service. \*, \*\*, and \*\*\* denote statistical significance at the 10 percent, 5 percent, and 1 percent levels, respectively. All specifications are estimated with robust standard errors clustered by firm, and year and industry-fixed effects are included. Definitions for all variables are provided in the Appendix.

relationship between CEO tenure and the selection of local auditors.

$$\begin{aligned}
 LOCAL\_AUDIT = & \beta_0 + \beta_1 CEO\_TENURE \\
 & + \beta_{2-16} Controls + Year FE \\
 & + Ind FE + \varepsilon
 \end{aligned}
 \tag{5}$$

〈Table 10〉 presents the regression results for the relationship between the CEO tenure and local auditors. The coefficient on *CEO\_TENURE* is significant at the 1 percent level (coefficient = 0.015, *t*-stat = 2.63), indicating that CEOs with longer tenures are more in-

〈Table 10〉 CEO tenure

	Dependent variable = <i>LOCAL_AUDIT</i> (1)
<i>CEO_TENURE</i>	0.015*** (2.63)
Intercept	5.017*** (2.90)
Controls	Included
Observations	27,315
Year FE	Yes
Ind FE	Yes
Cluster	Firm
Pseudo R <sup>2</sup>	0.129

Notes: Table 10 presents the results concerning the relationship between CEO tenure and auditor selection. \*, \*\*, and \*\*\* denote statistical significance at the 10 percent, 5 percent, and 1 percent levels, respectively. All specifications are estimated with robust standard errors clustered by firm, and year and industry-fixed effects are included. Definitions for all variables are provided in the Appendix.

clined to choose local auditors than CEOs with shorter tenures, likely due to their close ties with local auditors.

## 7.4 Robustness checks

### 7.4.1 Control for corporate governance

Enhanced governance is associated with reduced business risk and more effective internal controls. To ensure that the results are not driven by corporate governance metrics rather than CEO tenure, we control the corporate governance index (*GINDEX*) developed by Gompers et al. (2003). Following the inclusion of the corporate governance index, the coefficient on *EARLY\_YEARS* continues to be

negative and significant.

### 7.4.2 Control for region fixed-effects

To address omitted variable concerns in this section, we control for county-fixed effects, and the results are tabulated in Panel B of 〈Table 11〉. The coefficient of *EARLY\_YEARS* (coefficient = -0.076, *t*-stat = -1.90) remains significant even after controlling for county-fixed effects.

### 7.4.3 Alternative definition of CEO's career concerns

Gibbons and Murphy (1992) highlight that career concerns become more pronounced when

〈Table 11〉 Robustness checks

## Panel A. Control corporate governance

Dependent variable = <i>LOCAL_AUDIT</i>	
(1)	
<i>EARLY_YEARS</i>	-0.157* (-1.82)
<i>GINDEX</i>	0.067*** (3.62)
Intercept	1.386 (0.62)
Controls	Included
Observations	1,853
Year FE	Yes
Ind FE	Yes
Cluster	Firm
Pseudo R <sup>2</sup>	0.209

## Panel B. Control for county fixed effect

Dependent variable = <i>LOCAL_AUDIT</i>	
(1)	
<i>EARLY_YEARS</i>	-0.076* (-1.90)
Intercept	-10.827** (-2.42)
Controls	Included
Observations	20,645
Year FE	Yes
Ind FE	Yes
County FE	Yes
Cluster	Firm
Pseudo R <sup>2</sup>	0.427

(Table 11) Robustness checks (continue)

Panel C. Young CEOs

	Dependent variable = <i>LOCAL_AUDIT</i> (1)
<i>YOUNG_CEO</i>	-0.178* (-1.76)
Intercept	-1.051 (-0.48)
Controls	Included
Observations	9,518
Year FE	Yes
Ind FE	Yes
Cluster	Firm
Pseudo R <sup>2</sup>	0.154

Notes: (Table 11) presents the results of robustness checks. \*, \*\*, and \*\*\* denote statistical significance at the 10 percent, 5 percent, and 1 percent levels, respectively. All specifications are estimated with robust standard errors clustered by firm, and year and industry-fixed effects are included. Definitions for all variables are provided in the Appendix.

managers are further away from retirement, as the potential gains from influencing the market's perception of their abilities increase. We include the *YOUNG\_CEO* dummy variable, which equals 1 if the CEO's age is below 50 years old and zero otherwise (Li et al. 2017). In Panel C of (Table 11), the coefficient of *YOUNG\_CEO* is negative and significant at the 10 percent level (coefficient = -0.178,  $t$ -stat = -1.76), suggesting that firms with CEOs exhibiting higher career concerns are less likely to choose local auditors.

## VIII. Conclusion

Our empirical analyses reveal that firms are less likely to choose local auditors in the early years of a CEO's service compared to the later years. While exploring the underlying reasons, we find that firms with CEOs exhibiting high career concerns are more likely to have lower-quality financial statements and a higher probability of financial fraud than firms with CEOs experiencing low career concerns. Additionally, we find that when early-tenure CEOs have low-quality financial



reporting, they are likely to choose nonlocal auditors. The results remain robust when using the matched sample, entropy balancing, controlling for potentially correlated variables, and considering other alternative specifications.

We contribute to the auditing literature by highlighting how CEOs' individual traits affect auditor selection. This study is relevant to Korean readers. While prior studies have investigated the effect of early-tenure CEOs on earnings management (Kim and Choi 2016), and value relevance (Gong 2016) using Korean-listed firm data, this paper utilizes a unique database that includes auditor locality, social capital, and CEO locality.

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## 〈Appendix〉 Variable definitions

<i>Variables</i>	<i>Definition</i>
<b>Main variables</b>	
<i>LOCAL_AUDIT</i>	One if the auditing firm is located in the same state as the client firm's headquarters, and 0 otherwise.
<i>EARLY_YEARS</i>	One if the firm-year corresponds to the first three years of CEOs' service and is zero otherwise.
<b>Control variables</b>	
<i>LNASSETS</i>	The natural logarithm of total assets.
<i>DEBT</i>	The ratio of total liabilities to total assets.
<i>ROA</i>	The ratio of net income to total assets.
<i>LOSS</i>	One if the ROA is negative, and zero otherwise.
<i>UNQ_OPINION</i>	One if the auditor issues an unqualified opinion without any explanatory language, and zero otherwise.
<i>INH_RISK</i>	The sum of receivables and inventory is divided by total assets.
<i>SEGMENTS</i>	The square root of the number of geographic segments.
<i>BIG4</i>	One if the firm is audited by a Big 4 auditor, and zero otherwise.
<i>FYEAREND</i>	One if the fiscal year ends in December, and zero otherwise.
<i>AU_CHANGE</i>	One if the auditor was replaced in the fiscal year, and zero otherwise.
<i>RURAL</i>	One if the county's population density is below the median, and zero otherwise. Population density is calculated as the ratio of population to land area. Database: BEA
<i>LN_INPERCAP</i>	The natural logarithm of the income per capital of the county. Database: BEA
<i>LNPOP</i>	The natural logarithm of the county's population. Database: BEA
<i>POPG</i>	The percentage of the county's population growth from the year $t-1$ . Database: BEA
<i>LITERACY</i>	The ratio of individuals aged 25 years and over with a bachelor's degree or higher to the county's total population. Database: Census Bureau
<i>LAST_YEAR</i>	One if the observation is for the last year of CEOs' service, and zero otherwise.
<b>Other variables</b>	
<i>FRQ1</i>	A measure of financial reporting quality derived from the discretionary accruals, following the model used by Dechow and Dichev (2002), as implemented in the study by Francis et al. (2005). The model involves regressing the change in working capital accruals on 1-year-lagged, current, and 1-year-ahead cash flows from operations, as well as the changes in revenue and property, plant, and equipment. The estimation is performed by industry-year, utilizing two-digit SIC industry codes. The absolute values of the residuals from the model are then taken.

(continue)

<i>Variables</i>	<i>Definition</i>
<i>FRQ2</i>	A measure of financial reporting quality based on discretionary accruals, following the model proposed by Dechow and Dichev (2002), as implemented in the study by Francis et al. (2005). The model comprises a regression of the change in working capital accruals on 1-year-lagged, current, and 1-year-ahead cash flows from operations, as well as the changes in revenue and property, plant, and equipment. The estimation is conducted by industry-year, utilizing two-digit SIC industry codes. Subsequently, the standard deviation of residuals from the model is calculated over the years $t-4$ through $t$ .
<i>LOW_FRQ</i>	One if the financial reporting quality is below the median, and zero otherwise
<i>F_SCORE</i>	A fraud score, developed by Dechow et al. (2011), is utilized as a measure of the likelihood of financial fraud.
<i>LOCAL_CEO</i>	One if both the CEO's birthplace and undergraduate university state are in the same state in which his/her firm is headquartered, and zero otherwise.
<i>SOCIAL_CAPITAL</i>	Social capital index, constructed at the county level following the methodology outlined by Rupasingha et al. (2006). The index is derived using data for the years 1997, 2005, 2009, and 2014, with linear interpolation applied to estimate values for intervening years. Database: Northeast Regional Center for Rural Development (NERCRD)
<i>DUALITY</i>	One if the CEO is the chairman of the board of directors.
<i>FIRST_YEAR</i>	One if the observation is for the first year of CEOs' service, and zero otherwise.
<i>SECOND_YEAR</i>	One if the observation is for the second year of CEOs' service, and zero otherwise.
<i>THIRD_YEAR</i>	One if the observation is for the third year of CEOs' service, and zero otherwise.
<i>FOURTH_YEAR</i>	One if the observation is for the fourth year of CEOs' service, and zero otherwise.
<i>FIFTH_YEAR</i>	One if the observation is for the fifth year of CEOs' service, and zero otherwise.
<i>SIXTH_YEAR</i>	One if the observation is for the sixth year of CEOs' service, and zero otherwise.
<i>SEVENTH_YEAR</i>	One if the observations is for the seventh year of CEOs' service, and zero otherwise.
<i>CEO_TENURE</i>	CEO's tenure.
<i>GINDEX</i>	Corporate governance index (Gompers et al. 2003).
<i>YOUNG_CEO</i>	One if the CEO's age is below 50 years old, and zero otherwise.

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