Consequences of a Two-tiered Regulatory Model: Evidence from Audit Fees and Change in Foreign Private Issuer Status

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ABSTRACT

To investigate the consequences of a two-tiered regulatory approach, we exploit that some foreign-domiciled firms are forced to commence compliance with certain U.S. domestic securities regulation. The U.S. Securities and Exchange Commission permits exemptions from U.S. domestic securities regulation for firms that qualify as Foreign Private Issuers (FPIs). We study the change in audit fees for foreign-domiciled firms that lose or gain FPI status for an arguably exogenous reason while maintaining their cross-listing status. After loss of FPI status, foreign firms are required to comply with U.S. domestic issuers' reporting requirements, disclosure of insider trading, and compliance with corporate governance requirements of U.S. domestic issuers. We document an increase in audit fees when foreign firms lose their exemptions and must comply with regulatory requirements of U.S. domestic issuers. Further, we find that compliance with the financial statement requirements and disclosure of insider information is associated with an increase in audit fees while fully adopting U.S. corporate governance requirements is associated with a decrease in audit fees.

Keywords: Audit Fees; Corporate Governance; Financial Reporting; Foreign Private Issuer.

JEL Classifications: M41, M42, M48

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I. INTRODUCTION

Based on mandated public disclosures of audit fees, an extensive literature documents audit fee determinants across firms and across countries, see DeFond and Zhang (2014) for a survey. To facilitate causal inferences, many recent studies focus on smaller samples. Some studies focus on subsamples with specific identifiable changes that may affect audit fees. Willenborg (1999) and Venkataraman et al. (2008), among others, study audit fees around Initial Public Offerings where firms are subject to higher litigation of the Securities Act of 1933. Similarly, Abbott et al. (2017) investigate the change in audit fees for firms around reverse mergers. Badertscher et al. (2014) documents the change in audit fees when firms with publicly traded debt initiate or discontinue public equity because these firms do not have a change in reporting requirements due their publicly traded debt. Our paper follows this approach as we look at change in audit fees around specific identifiable changes in reporting requirements and corporate governance requirements due to change in FPI status.

Specifically, the U.S. Securities and Exchange Commission's (SEC) regulatory framework designates most foreign-domiciled firms as foreign private issuers (FPI) which must follow regulatory and disclosure requirements that are more stringent than their home-country requirements, but that are less stringent than the requirements for U.S. domestic issuers. We exploit that some foreign-domiciled firms change FPI status over time, for an arguably exogenous reason[1] while maintaining their cross-listing status, to study audit fees of foreign-domiciled firms trading in the U.S.

[1] Specifically, we identify foreign firms that cross the threshold of 50% of shares owned by U.S. residents. We

Prior literature uses U.S. cross-listed foreign firms to study the determinants of audit fees. Seetharaman, Gul, and Lynn (2002) and Choi, Kim, Liu, and Simunic (2009) find that foreign firms pay higher audit fees when they cross-list in the U.S. and attribute the increase in fees to higher litigation risk. Bronson, Ghosh, and Hogan (2017) recognizes that cross-listing in the U.S. involves a significant increase in reporting and audit requirements, in addition to increased litigation risk. Using a three-way matched research design to identify the effects of auditor effort from additional reporting requirements, Bronson et al. (2017) estimate that 29 to 48 percent of the incremental increase in audit fees for cross-listed firms is attributable to incremental audit effort.

While related to the literature on audit fees of U.S. cross-listed firms, our focus is not on explaining the higher audit fees for foreign firms that are cross-listed in the U.S. relative to those that are not. Instead, our goal is to present evidence regarding what audit fees of U.S. firms might be if they had faced fewer regulatory requirements. Specifically, we use the changes in U.S. cross-listed firms' foreign private issuer status as a setting to study the relationship between audit fees and reporting requirements, disclosure of insider information, and corporate governance. Our setting has three advantages. First, it holds both auditors' expected legal liability and the auditing standards constant since the firms' securities trade in the U.S. both before and after the change in status. Second, a fundamental challenge to audit research is that auditing is one among many monitoring mechanisms available to mitigate agency problems in

exclude all firms that had a major corporate event (e.g., stock-for-stock merger) that might have caused a firm to cross the U.S. ownership threshold. We also examined all firm disclosures surrounding the change in FPI status as well as searched all major media outlets. The vast majority of firms disclose that they crossed the 50% threshold without disclosing the actual percentages before and after the change in FPI status. To investigate the robustness of our results to significant open market share purchases by a small number of institutional investors, we collected institutional ownership from Form 13f filings in the quarter prior to and after the change in FPI status. We identified six firms that had a greater than five percent change in institutional ownership during the quarter preceding the change in FPI status. Results are qualitatively and quantitatively similar after removing these six firms from our analysis.

firms and the importance of the monitoring role of auditing depends on the broader corporate governance. Our setting has intuitive appeal because the changes in regulatory and disclosure requirements are arguably exogenous since they are involuntary and outside the direct control of managers. Third, the changes in regulatory and disclosure requirements are meaningful. Burnett, Pollard, and Jorgensen (2017) find the market reacts negatively to an increase in financial statement requirements and reacts positively to fully adopting U.S. corporate governance requirements.

When foreign-domiciled firms *lose* their FPI status with the SEC, they continue their listing in the U.S. but become subject to the same, stricter regulatory requirements as U.S. domestic issuers. Conversely, when foreign-domiciled firms that are U.S. domestic filers with the SEC *gain* FPI status, they continue their U.S. listing but are permitted exemptions from certain regulatory requirements. Identifying the specific consequences of regulatory requirements on audit fees for firms that lose or gain their FPI status informs regulators regarding the costs and benefits of the current two-tiered regulatory approach for foreign firms.[2]

A change in FPI status likely leads to a change in the supply and demand for audit services and the risk associated with accepting an audit engagement. Consistent with this, we document that on average audit fees significantly increase $0.199 million (22%) when firms

[2] One could argue that SEC has a multi-tiered regulatory framework for U.S. firms as well. Brüggemann, Kaul, Leuz and Werner (2018) study firms listed in the US markets that are usually ignored in prior research in accounting and finance. Most prior research investigates firms with shares trading on the largest stock US exchanges (including AMEX, NASDAQ, and NYSE) because these firms (I) are listed with the federal regulator, the U.S. Securities and Exchange Commission (SEC) and (II) have empirical-archival data readily available to academics, through CRSP and Compustat. However, compliance with SEC regulations is perceived as quite costly, in particular for smaller firms. Brüggemann et al. (2018) documents that many US firms are not listed with the SEC and, hence, likely are excluded from the commonly-used databases. Instead, these firms register with each state regulator in the states where they wish to offer securities for sale (the article has extensive institutional insights neatly summarized in the appendices, including information about the exemptions). Specifically, OTC markets have variation in level of compliance: Some OTC firms are subject to stricter continuous disclosure requirements regulation and enforcement from the SEC, while other OTC firms face weaker regulation and enforcement. Their paper provides evidence that weaker regulation and enforcement is associated with poorer capital market conditions (which they measure as higher crash risk and lower liquidity).

lose their FPI status. When firms gain their FPI status, on average audit fees decrease $0.014 million (9%), but we fail to find that this is statistically different from zero. The univariate analysis assumes all the regulatory and disclosure requirements have the same relation with audit fees.

Following Burnett, Jorgensen, and Pollard (2017), we consider how the three broad categories of requirement differences affect audit fees. First, we consider the change in audit effort required by the audit firm after a change in FPI status related to additional financial statement disclosures. Firms that lose FPI status are required to commence filing quarterly financial statements, meet accelerated filing deadlines, complete an audit of internal controls, report according to United States generally accepted accounting principles (U.S. GAAP), and disclose segment information if they were not already complying with these disclosures. These items, which we categorize as *FINANCIAL STATEMENTS,* increase the amount of work required by the auditor and should therefore increase audit fees.

Second, since FPIs are exempt from disclosure of insider trading, prior literature hypothesizes that lawsuits are less frequent for foreign-domiciled firms. Upon loss of FPI status, foreign-domiciled firms face mandatory *DISCLOSURE OF INSIDER INFORMATION* such that managers demand higher quality audits (Ball, Jayaraman, and Shivakumar 2012). Alternatively, loss of FPI status may lead auditors to increase the assessed engagement risk leading auditors to decrease detection risk and supply higher audit effort and charge a higher pure litigation risk premium in audit fees (Seetharaman, Gul, and Lynn 2002). Both demand and supply effects would suggest increased (decreased) audit fees when foreign-domiciled firms lose (regain) FPI status.

CORPORATE GOVERNANCE may change the auditor's assessment of firm

management and potentially alter the auditor's assessment of the risk of material misstatement. Loss of FPI status can significantly alter corporate governance as FPIs are exempt from multiple provisions required of U.S. domestic firms. Improved governance reduces agency costs and limits managers' ability to expropriate shareholder wealth (Shleifer and Vishny 1997). In response to a stronger internal control environment auditors reduce substantive work. Stronger governance reduces litigation risk as well (Core 2000). Nonetheless, strengthened governance in the form of greater board independence may create greater demand for audit services (Abbott et al. 2003; Carcello, Hermanson, Neal, and Riley 2002). Thus, stronger corporate governance could be associated with an increase or decrease in audit fees.

Using entropy balancing, we compare foreign-domiciled firms that change FPI status to foreign-domiciled firms cross-listed in the U.S. that do not change FPI status and find evidence consistent with our hypotheses. Specifically, we find positive and statistically significant association with the change in the natural logarithm of audit fees and *ΔFINANCIAL STATEMENTS* as well as *ΔDISCLOSURE OF INSIDER INFORMATION*. The financial statement requirements require auditors to expend greater effort while the disclosure of insider information represents a shock to litigation risk that leads auditors to expend greater effort and/or charge a litigation risk premium. Finally, we find a negative and statistically significant correlation with *ΔCORPORATE GOVERNANCE.* This suggests auditors perceive the FPI exemptions from U.S. domestic corporate requirements as affecting the risk of material misstatement; enhanced governance results in reduced audit fees. Our results are robust to propensity score matching and separately analyzing Canadian and non-Canadian firms. Overall, these results improve our understanding of the role and compliance costs of U.S. securities regulation on shareholders and should be of interest to investors and regulators.

Our paper makes the following contributions to the literature. First, our identification strategy relies on arguably exogenous changes in our firms' reporting and corporate governance requirements due to change in FPI status. Because foreign-domiciled firms face increased reporting requirements when they lose their FPI status, the estimated audit hours needed on an audit engagement increases. The increase in reporting requirements includes adopting U.S. GAAP. This finding is consistent with the findings of Bronson et al. (2017) who compare FPIs to both U.S. firms and non-U.S. cross-listed firms from the same country. Prior literature finds mixed evidence with respect to corporate governance and audit fees. The exogenous change to corporate governance addresses the primary challenge in this literature, which is that audit services and corporate governance are jointly determined. Our evidence supports decreased audit fees after improvements in corporate governance.

Second, in contrast to the literature documenting how cross-listing affects audit fees charged to foreign-domiciled firms, our firms are all subject to regulatory oversight from the SEC both before and after the change in FPI status. Consequently, we can more directly document the consequences of the SEC two-tiered regulatory approach. Our paper adds to a growing body of evidence that FPIs benefit from the corporate governance requirements of U.S. domestic issuers (Burnett et al. 2017, Foley et al. 2018), which should be of interest to U.S. regulators.

The paper proceeds as follows. Section 2 describes institutional details about FPIs and the potential effects of a change in FPI status on audit fees. Section 3 contains our hypothesis development. Section 4 identifies the sample firms and details the research design. Section 5 presents audit fee tests surrounding a change in FPI status. Section 6 reports robustness tests. Section 7 concludes and offers suggestions for future research.

II. FOREIGN PRIVATE ISSUERS AND AUDIT FEES

Foreign companies cross listed on a U.S. stock exchange have different reporting requirements depending on whether they qualify as a FPI. According to Securities Act Rule 405 and Exchange Act Rule 3b-4, the SEC defines a FPI as follows:

> A foreign company will qualify as a foreign private issuer if 50% or less of its outstanding voting securities are held by U.S. residents; *or* if more than 50% of its outstanding voting securities are held by U.S. residents and *none* of the following three circumstances applies: the majority of its executive officers or directors are U.S. citizens or residents; more than 50% of the issuer's assets are located in the United States; or the issuer's business is administered principally in the United States.

The two tests to determine FPI status are generally referred to as the *Ownership Test* and *Business Contacts Test.* The *Ownership Test* refers to the relative degree to which the issuer's shares are owned by U.S. residents. Issuers are required to look through their record ownership as well as consider beneficial ownership reports to determine whether more than 50 percent of its outstanding voting securities are held by U.S. residents.

The *Business Contacts Test* refers to level of business contacts the issuer has with the U.S., which is a three-pronged test. The issuer evaluates the citizenship or residency of each director or executive officer (i.e. any individual performing a policy making function) to determine whether a majority are connected with the U.S. Second, the issuer examines the location of its tangible and intangible assets. Finally, the issuer determines whether it is administered principally from the U.S. For this prong, issuers could consider the location of the board and shareholder meetings, its company headquarters, location of key executives, and/or the location of its principal business segments.

If more than 50 percent of the issuer's share ownership is held by U.S. residents and any one of the three *Business Contacts Tests* show a U.S. business contact, the issuer fails to qualify

as a FPI and must comply with all the regulatory requirements of a U.S. domestic issuer. Otherwise, the issuer is exempt from several key reporting and governance requirements.

Thus, the U.S. has a mixed regulatory model. Issuers listed in U.S. markets are a mixture of 1) U.S.-domiciled firms that must comply with all regulatory standards, 2) foreign-domiciled firms that must comply with all regulatory standards, and 3) foreign-domiciled firms that qualify as FPIs and are exempt from several key regulatory requirements.

Table 1, which is from Burnett et al. (2017), documents each of the individual disclosure and regulatory requirements that are relaxed for FPIs. We group the exemptions in reporting and regulatory requirements of FPIs into four broad categories: *FINANCIAL STATEMENTS*, *DISCLOSURE OF INSIDER INFORMANTION*, *CORPORATE GOVERNANCE*, and *INITIAL REGISTRATION WITH THE SEC.* We discuss the requirements in each of the first three categories and the prior literature related to each requirement. We do not discuss requirements related to *INITIAL REGISTRATION WITH THE SEC* given that those requirements relate to initial registration and our sample firms are already listed and trading in the U.S.

The reporting requirements grouped in the *FINANCIAL STATEMENTS* category relate to the timeliness, quality and quantity of information disclosed in the financial statements. The SEC initially mandated annual financial statements under the 1934 Exchange Act (Exchange Act). Over time, the SEC has increased continuous disclosures to require semi-annual reporting in 1955 and quarterly reporting in 1970. Currently, according to Rule 13a-13(b)(2) of the Exchange Act, FPIs are exempt from quarterly reporting in the U.S. unless their home country requires it. Prior research finds that increased interim reporting impacts the timeliness of earnings as well as the marginal information content of annual reports (McNichols and

Manegold 1983; Butler, Kraft and Weiss 2007). SEC (1999) discusses the need for investor confidence in high quality financial reporting and emphasizes investors' demand for reliable information. Thus, effective January 31, 2000 the SEC mandated that issuers' quarterly reports must be reviewed by their independent auditors before filing their Forms 10-Q (SEC 1999):

> "The amendments would require that independent auditors follow 'professional standards and procedures for conducting such reviews, as established by generally accepted auditing standards, as may be modified or supplemented by the Commission.' Under current auditing standards, this means that the auditors would be required to follow the procedures set forth in SAS 71, or such other auditing standards that may in time modify, supplement, or replace SAS 71. As noted above, we believe that more discipline is needed for the quarterly financial reporting process. We believe that the reviews required will facilitate early identification and resolution of material accounting and reporting issues because the auditors will be involved earlier in the year."

Next, FPIs are not required to meet accelerated filing requirements. FPIs are permitted four months from fiscal year end to file Form 20-F[3] as opposed to domestic filers which have 75 days to file their Form 10-K. Lambert et al. (2017) examine the impact of SEC rule changes 33-8128 and 33-8644 which reduced the 10-K filing period. Their survey evidence indicates that audit partners felt increased time pressure that was significantly associated with the number of days which the deadline was reduced. Further, Lambert et al. (2017) report that partners' "best practices" to mitigate time pressure include working more hours and performing additional interim testing.

FPIs received an extension from full compliance with requirements of Sarbanes Oxley Act of 2002 (SOX). In particular, FPIs were not required to include an auditor's attestation report on the company's internal controls until their first Form 20-F for a fiscal year ending on

[3] FPIs typically file their financial statements with the US SEC on either Form 20-F or, for some Canadian firms, on Form 40-F. We collectively refer to annual financial statements as filed on Form 20-F. Prior to December 15, 2011, FPIs were required to file their financial statements with the SEC within six month of their fiscal year end. Bryant-Kutcher, Peng and Weber (2013) and Doyle and Magilke (2013) provide evidence of a tradeoff between timeliness and reliability for U.S. domestic filers subject to shortened filing deadlines.

or after July 15, 2007. Section 404 of SOX requires that auditors provide an attestation to management's report on internal controls. Prior research documents a significant increase in audit fees for the additional audit effort required to provide this additional attestation report (Iliev 2010; Krishnan et al. 2008).

FPIs may file non-U.S. GAAP financial statements. For example, they are permitted to file financial statements prepared using accounting standards permitted by their home country or exchange as long as it includes a reconciliation to U.S. GAAP. For fiscal years ending after November 15, 2007, FPIs can prepare financials statements in accordance with International Financial Reporting Standards (IFRS) without a reconciliation to U.S. GAAP. After this date, a foreign-domiciled issuer not reporting under IFRS that lost its FPI status would, at that point, become required to begin filing financial statements prepared according to U.S. GAAP. We are unaware of research highlighting the impact of U.S. GAAP adoption on audit fees. However, several studies examine the impact of a change in GAAP on audit fees, in particular the adoption of IFRS (De George et al. 2013; Griffin et al. 2009; Lin and Yen 2016; Vieru and Schadewitz 2010). Kim et al. (2012) provide theory, an analytical model and evidence of the impact of adopting a different set of accounting standards on audit pricing. While Kim et al. (2012) examine IFRS adoption, their theoretical arguments could apply to U.S. GAAP adoption as well. Specifically, they find that audit task complexity, financial reporting quality, and legal regime play critical roles in audit pricing.

Domestic issuers are required to make segment disclosures consistent with Statement of Financial Accounting Standard (SFAS) No. 131, *Disclosures about Segments of an Enterprise and Related Information*. Prior to fiscal years ending after December 15, 2009, FPIs had the option to omit segment data from their financial statements. Prior literature finds that segment disclosures impact market valuations and the market's ability to predict firms' future earning

(Berger and Hann 2003; Ettredge, Kwon, Smith and Zarowin 2005). Hurtt et al. (2013) examine segment-level manipulations as a measure of classification shifting and find increased audit fees due to additional audit effort for segment level disclosures.

The reporting requirements grouped in the *DISCLOSURE OF INSIDER INFORMATION* category relate to the disclosure of inside information, such as insider ownership and sales as well as private disclosure of management information. FPIs are also exempt from filing beneficial ownership reports in accordance with Section 16(a) of the Exchange Act which requires insiders to disclose their holdings and changes in beneficial ownership of the company's securities. Additionally, they are not subject to the short-swing trading rules under 16(b), which require insiders to return to the company any profit realized from a purchase and sale (or sale and purchase) within a six-month period.

Domestic issuers must comply with Regulation Fair Disclosure (FD) since 2000. The purpose of Regulation FD is to ensure that a group of investors are not privy to non-public information before other investors. This includes communications with analysts, investors, creditors, and other stakeholders. If an issuer discloses material nonpublic information to certain individuals or entities, the issuer must make public disclosure of that information within twenty-four hours of discovering the disclosure. In this way, the SEC aims to promote full and fair disclosure. Unless otherwise directed by their home country requirements, FPIs are not required to comply with Regulation FD. The risk of noncompliance with Regulation FD, particularly when disclosing in multiple jurisdictions, is likely to increase litigation risk and lead auditors to charge higher fees.

The last category of reporting requirements grouped in *CORPORATE GOVERNANCE* relate to corporate governance. Theoretical and empirical evidence supports that stronger (weaker) corporate governance is associated with better (poorer) operating performance, which

the market rewards with higher prices (Core et al. 2006). FPIs are exempt from the proxy rules under Section 14 of the Exchange Act which governs the disclosures required to solicit shareholders' votes for select corporate actions such as shareholder meetings, election of directors, stock splits, name changes, mergers, corporate reorganizations, auditor approvals, etc.

FPIs are also exempt from some of the corporate governance requirements applicable to domestic issuers. The AMEX, NASDAQ, and NYSE all grant substantial flexibility to FPIs by allowing them to follow their home country corporate governance practices rather than the stock exchange corporate governance requirements. FPIs may opt out of the following categories of governance: board independence requirements, board committee requirements, audit committee requirements, general corporate practices, and good governance practices. Foley et al. (2018) document 80.2% of the FPIs in their sample opt out of at least one governance provision, and a majority opt out of many more (consistent with our sample where 82% opt out of at least one governance provision – see Panel C of Table 2). Prior research reports mixed results on the relation between corporate governance and audit fees. Several studies argue that improved corporate governance will permit the external auditor to reduce substantive testing which will result in lower audit fees (Simunic 1980, 1984; Griffin et al. 2008; Garg et al. 2017). Similarly, Cassell, Giroux, Myers, and Omer (2012) find evidence consistent with Big N auditors being more likely to shed clients that score lower on an index of corporate governance quality. Others argue, and find evidence, that directors concerned with strong corporate governance will demand additional audit effort to protect themselves from liability or reputational damage (Abbott et al. 2003; Carcello et al. 2002; Hay et al. 2008; Zaman et al. 2011). A particular challenge with prior research is identifying the effect of corporate governance on audit fees since they are endogenously determined.

To illustrate, we reproduce below the disclosure by Energy Fuels Inc. related to its loss of FPI status, which details that complying with the U.S. domestic issuer reporting requirements will require changes in financial reporting, insider disclosure, and corporate governance.

> "As of June 30, 2015 we determined that we no longer qualify as a "foreign private issuer"… This means we are now required to comply with all of the periodic disclosure and current reporting requirements of the Exchange Act applicable to U.S. domestic issuers, such as Forms 10-K, 10-Q and 8-K… We are accordingly required to prepare our financial statements filed with the SEC in accordance with US GAAP… As of January 1, 2016 we have also been required to comply with the provisions of U.S. securities laws applicable to U.S. domestic issuers including, without limitation, the U.S. proxy rules, Regulation FD, and the Section 16 beneficial ownership reporting and short swing profit rules. We have modified certain of our policies to comply with good governance practices associated with U.S. domestic issuers. In addition, we have lost our ability to rely upon exemptions from certain corporate governance requirements on the NYSE MKT that are available to foreign private issuers.
>
> As a result of such compliance with these additional securities laws… the regulatory and compliance costs to us under U.S. securities laws may be significantly higher than the cost we would incur as a foreign private issuer. We therefore expect that the loss of foreign private issuer status will increase our legal and financial compliance costs and make some activities highly time-consuming and costly."
>
> Source: Form 10-K dated March 15, 2016

III. HYPOTHESIS DEVELOPMENT

We examine whether a change in FPI status is associated with a change in audit fees. As discussed above, a change in FPI status can change the firm's reporting requirements. Therefore, changes in reporting requirements related to *FINANCIAL STATEMENTS* likely increase the amount of work required of the firm's auditor. For example, if the firm lost its FPI status and was not previously filing quarterly financial statements, nor undergoing an audit of its internal control, its auditor would likely have to increase audit fees to cover the additional costs related to reviewing quarterly statements and performing an audit of the firm's internal control system. A change in the company's GAAP, accelerated filing requirements, and

segment disclosure could also have similar effects on audit effort. Accordingly, theory predicts that changes in *FINANCIAL STATEMENTS* are likely to increase audit fees. Our first hypothesis in null form is:

> **H1:** The number of regulatory requirements that change in the *FINANCIAL STATEMENTS* category following a change in FPI status has no effect on firms' audit fees.

Prior literature hypothesizes that lawsuits are less frequent for foreign-domiciled firms because they are exempt from insider trading disclosures. Upon loss of FPI status, foreign-domiciled firms face mandatory insider trading disclosures under Section 16 of the Exchange Act such that managers *demand* higher quality audits (Ball et al. 2012). Additionally, loss of FPI status may lead auditors to increase the assessed engagement risk leading auditors to *supply* higher audit effort and higher pure litigation risk premium in audit fees (Seetharaman et al. 2002). As such, we posit that loss (gain) of a firm's FPI status that causes changes to *DISCLOSURE OF INSIDER INFORMATION* will be associated with an increase (decrease) in audit fees compared to the prior year. Our second hypothesis in null form is:

> **H2:** The number of regulatory requirements that change in the *DISCLOSURE OF INSIDER INFORMATION* category following a change in FPI status has no effect on firms' audit fees.

Lastly, *CORPORATE GOVERNANCE* may change the auditor's assessment of firm management and potentially alter the auditor's assessment of the risk of material misstatement. Loss of FPI status can significantly alter corporate governance as FPIs can opt out of the following categories of governance: board independence requirements, board committee requirements, audit committee requirements, general corporate practices, and good governance practices. Improved governance reduces agency costs and limits managers' ability to expropriate shareholder wealth (Shleifer and Vishny 1997). In response to a stronger internal

control environment auditors can reduce substantive work. Additionally, stronger governance reduces litigation risk (Core 2000). On the other hand, directors could demand increased audit scope or effort because they do not directly pay for improved auditing and it could shield themselves against potential reputational damage and/or liability from financial statement misreporting (Abbott et al. 2003; Carcello et al. 2002). Thus, the effect of a change in *CORPORATE GOVERNANCE* on audit fees is unclear. Our third hypothesis in null form is:

H3: The number of regulatory requirements that change in the *CORPORATE GOVERNANCE* category following a change in FPI status has no effect on firms' audit fees.

IV. RESEARCH DESIGN

Sample

Our sample period is from 2000 to 2018 because 2000 is the first year audit fees are available in the U.S. We use two different methods to identify foreign-domiciled firms that lost or gained their FPI status. First, we identified annual lists of international companies registered and reporting with the SEC.[4] These lists, published by the SEC, indicate that on average for the period 2000 to 2015 (the last year they were published) 1,121 foreign-domiciled firms were listed in the U.S.[5] Using these annual lists, we are able to identify the years in which a foreign-domiciled firm appeared for the first time or was removed. Second, we used the SEC's Edgar system to identify all firms that have ever filed annual financial statements on Form 20-F or Form 40-F.[6] Similar to the SEC's annual lists, we identified firms that filed a Form 20-F or

[4] The SEC's lists can be found at http://www.sec.gov/divisions/corpfin/internatl/companies.shtml
[5] As documented in other work (e.g., Doidge, Karolyi and Stulz 2010), the number of foreign-domiciled firms accessing the U.S. capital markets exhibit a downward trend over time; 1,310 foreign-domiciled firms were listed in 2000 while only 940 foreign-domiciled firms were listed in 2013.
[6] A FPI may also voluntarily file on Form 10-K; however, the FPI then has to meet all the reporting requirements of domestic filers. Thus a change in FPI status would not be associated with any change in its disclosures for this firm, which is the primary focus of our study.

Form 40-F and subsequently began filing a Form 10-K or firms that filed a Form 10-K and subsequently began filing either a Form 20-F or Form 40-F. In this manner, we are able to identify firms that likely experienced a change in FPI status. To verify our search procedures, we examined the financial statements and disclosures of each identified observation before and after the identified period to confirm that each firm did indeed change FPI status and remained trading in the U.S. after the switch. Results from these search procedures are presented in Table 2. In Panel A, we identify a total of 171 firms that lost their FPI status and 80 firms that gained FPI status.

Given that a significant corporate event, such as a stock-based merger, could cause the change in FPI status, we search the financial statements for the year before and after the switch in FPI status and exclude any observation that contemporaneously experienced a structural change (i.e., stock-based merger or acquisition, share offering, or bankruptcy). This restriction prevents these confounding effects from influencing results. While this precludes 46 (38) firms that lost (gained) FPI status from being included in our tests, it permits a stronger test of the relation between reporting requirements and audit fees. Next, per evaluation of financial statements, we identified 40 (8) firms that *voluntarily* started or stopped reporting as a domestic filer. We removed these firms from the sample to avoid concerns about firms' incentives to self-select into a set of reporting standards. Finally, for 16 (11) firms, we were unable to obtain sufficient data to run our tests.

As discussed previously, a foreign firm determines its FPI status by applying the *Ownership Test* and *Business Contacts Test* (i.e., the relative degree of its U.S. share ownership and level of business contact). For the purpose of our study, the reason for the change in FPI status is an important distinction because certain portions of these tests are in direct control of the firm while others are not. For example, the *Ownership Test* is outside the

firm's direct influence as management cannot control the country of residence of investors that purchase their stock. On the other hand, the firm is in direct control of the location of its corporate offices. The firm also controls the location of its assets and could have some influence over the nationality of executives that it chooses to lead the firm. As such, a firm that loses or gains FPI status because of the *Business Contacts Test* could be susceptible to firm incentives to do so. Accordingly, we limit our sample to firms that change FPI status due to the *Ownership Test* because it is determined outside the firm's influence and remove 14 (4) firms that lose (gain) FPI status due to the *Business Contacts Tests*. Thus, our final sample contains 55 firms that lost FPI status and became fully compliant with U.S. securities regulation, and 19 firms that gained FPI status and discontinued meeting the reporting standards of domestic filers.

Table 1 lists each of the relaxed disclosure and regulatory requirements for FPIs. Not all of these requirements affect each FPI equally because some FPIs' home countries share the same requirements with the U.S. For example, if quarterly reporting is mandated in the firm's home country, but the country does not mandate corporate governance standards similar to those required by AMEX, NASDAQ, and NYSE, then for each firm from that country a change in FPI status would not impact the auditor's effort related to quarterly reporting, however they would experience a significant change in corporate governance of the firm. As such, we examine each firm's SEC filings to identify which of the disclosure and regulatory requirement actually change when the firm changes FPI status.

Table 2, Panel B reports substantial changes related to the timeliness and quality of financial statements. Upon losing (gaining) FPI status, 49% of firms changed to (from) accelerated filing, 47% changed to (from) U.S. GAAP, 20% altered their segment disclosures,

24% initiate (cease) auditor's attestation of internal controls, and 14% of firms change to (from) quarterly reporting. Changes to the disclosure of insider information related to share ownership and sales affected 49% of firms while Regulation FD affected 53% of firms. The majority of firms experienced changes related to corporate governance upon losing (gaining) FPI status: 78% began (terminated) compliance with proxy rules, and 82% changed compliance with U.S. stock exchange governance standards.

Table 2, Panel C documents that 46% of the firms that gain and lose FPI status are from Canada. This appears to be a fairly representative sample given that from 2000 to 2018, Canadian firms represented 37% of all foreign-domiciled firms cross-listed in the U.S., consistent with the geographic proximity and substantial integration between the U.S. and Canadian capital markets (Jackson 2006).[7]

Descriptive Statistics

The FPI exemptions relate to three main categories: *FINANCIAL STATEMENTS*, *DISCLOSURE OF INSIDER INFORMATION*, and *CORPORATE GOVERNANCE*. Since the changes in FPI requirements in each category may have different effects on audit fees, we create three variables that count firms' compliance with the requirements in these three areas before and after the change in FPI status. We then calculate the change (Δ) in each of these areas as the score after the change in FPI status less the score before the change in FPI status. *FINANCIAL STATEMENTS* relates to the timeliness, quality, and quantity of information disclosed in financial statements. It is calculated as the number of the following five requirements that a firm complies with: Quarterly Filings, Accelerated Filing, Auditor's Attestation on Internal Controls, U.S. GAAP, and Segment Disclosure. *DISCLOSURE OF*

[7] In 2018, 50% of foreign direct investment in Canada was from the U.S. (Statistics Canada).

INSIDER INFORMATION relates to information on insider ownership and sales as well as selective disclosure of material inside information. This is calculated as the number of the following two requirements that a firm complies with: Disclosure of Insider Ownership and Sales and Regulation FD. Lastly, *CORPORATE GOVERNANCE* is calculated as the number of the following two requirements that a firm complies with: Proxy Rules and U.S. Stock Exchange Corporate Governance. *ΔFINANCIAL STATEMENTS*, *ΔDISCLOSURE OF INSIDER INFORMATION*, and *ΔCORPORATE GOVERNANCE* are positive (negative) for firms that lose (gain) FPI status. Table 3, Panel A details that the average score for *ΔFINANCIAL STATEMENTS*, *ΔDISCLOSURE OF INSIDER INFORMATION*, and *ΔCORPORATE GOVERNANCE* for firms that lose FPI status is 1.5, 1.1, and 1.6, respectively.

Table 3, Panel B reports firm characteristics for the year before and after firms lose their FPI status. Overall, losing FPI status is associated with an increase in audit fees. Mean *AUDIT FEES* statistically significantly increase from $916,220 to $1,115,650 while median *AUDIT FEES* statistically significantly increase from $500,000 to $628,480. The average increase of 22% in audit fees suggests that losing FPI status changes the supply and demand for audit services. Firms remain similar in size before and after losing their FPI status, though the median of the natural of logarithm of assets decreases slightly. On average, firms that lose their FPI status have modest leverage and incur losses. Mean *ROA* decreases slightly after the loss of FPI status, but median ROA remains similar. 22 percent of firms engage in cash-based acquisitions (we excluded stock-based acquisitions), which increases to 35 percent after the change in status; complying with full U.S. domestic issuer reporting requirements may facilitate acquiring other firms. As expected almost all firms (95 percent) have international operations and 80 percent employ a Big N auditor. Firms that employed a Big N auditor tend

to stay with Big N auditors with only one firm switching from a Big N auditor to a non-Big N auditor.

Table 3, Panel C details that the average score for *ΔFINANCIAL STATEMENTS*, *ΔDISCLOSURE OF INSIDER INFORMATION*, and *ΔCORPORATE GOVERNANCE* for firms that gain FPI status is -1.6, -0.4, and -1.2, respectively. Table 3, Panel D shows that firms that gain their FPI status are smaller than firms that lose FPI status. In the year prior to the change in status, *LNA* is 9.54 for firms that gain their FPI status compared to 11.97 for firms that lose their FPI status. Audit fees remain similar before and after the change in FPI status. Mean *AUDIT FEES* decrease from $161,190 to $146,980 while median *AUDIT FEES* increase from $63,850 to $84,600, neither change is statistically significantly different. The other firm characteristics remain similar before and after firms gain their FPI status. These firms employ modest leverage, incur losses, engage in few cash-based acquisitions, have significant foreign operations, and tend not to employ Big N auditors.

Audit Fee Model

We initially examine the consequences of the change in FPI status on audit fees using a parsimonious model since our sample consists of 74 firms. Specifically we estimate the following model:

$$\Delta LNFEES = \beta_0 + \beta_1 * \Delta FINANCIAL\ STATEMENTS + \beta_2 * \Delta DISCLOSURE\ OF\ INSIDER\ INFORMATION + \beta_3 * \Delta CORPORATE\ GOVERNANCE + \beta_4 * \Delta LNA + \varepsilon \quad (1)$$

The dependent variable, *ΔLNFEES*, is the change in the natural logarithm of fees paid to the audit firm. The effects of more (less) stringent reporting requirements from losing (gaining) FPI status are measured by *ΔFINANCIAL STATEMENTS*, *ΔDISCLOSURE OF INSIDER*

INFORMATION, and *ΔCORPORATE GOVERNANCE.* The coefficient on *ΔFINANCIAL STATEMENTS*, β_1, estimates the effects of changes in the financial statement reporting requirements on audit fees and is expected to be positive. The coefficient on *ΔDISCLOSURE OF INSIDER INFORMATION*, β_2, estimates the effects of changes in insider trading and ownership as well as selective disclosure on audit fees and is expected to be positive. The coefficient on *ΔCORPORATE GOVERNANCE*, β_3, estimates the effects of changes in corporate governance on audit fees and could be positive or negative. For firms that do not change FPI status, the change in these categories of requirements is zero. *ΔLNA* is the change in the natural logarithm of total assets and proxies for the effect of changes in client size on audit fees.

Entropy Balancing

To help control for changes in audit fees unrelated to the effects from changing FPI status, we compare firms that change FPI status to foreign-domiciled firms cross-listed in the U.S. that do not change FPI status. We employ entropy balancing to mitigate differences in observable firm characteristics (i.e., audit fee determinants) between our treatment and control samples.[8] Entropy balancing preserves the full sample and weights the audit fee determinants of the control sample to equalize the mean, variance, and skewness of the treated and control samples.

Including control firms also enables us to estimate a more traditional audit fee model. We formally examine the impact of a change in FPI status on audit fees by estimating the following model:

$$\Delta LNFEES = \beta_0 + \beta_1 * \Delta FINANCIAL\ STATEMENTS + \beta_2 * \Delta DISCLOSURE\ OF$$

[8] E.g., Hainmueller (2012), Bonsall and Miller (2017), Wilde (2017), Agarwal, Vashishtha, and Venkatachlam (2018), Quinn (2018), Chapman, Miller, White (2019), Glendening, Mauldin, and Shaw (2019), and McMullin and Schonberger (2020).

$$INSIDER\ INFORMATION + \beta_3*\Delta CORPORATE\ GOVERNANCE + \beta_4*\Delta LNA$$
$$+ \beta_5*\Delta LEV + \beta_6*\Delta ROA + \beta_7*\Delta LOSS + \beta_8*\Delta INVREC + \beta_9*\Delta ACQ$$
$$+ \beta_{10}*\Delta FOREIGN + \beta_{11}*\Delta MTB + \beta_{12}*\Delta SPECIAL\ ITEMS$$
$$+ \beta_{13}*\Delta BIGN + \text{YEAR FIXED EFFECTS} + \varepsilon \quad (2)$$

The variables *ΔLNFEES*, *ΔFINANCIAL STATEMENTS*, *ΔDISCLOSURE OF INSIDER INFORMATION*, *ΔCORPORATE GOVERNANCE*, and *ΔLNA* are as defined in model 1. Changes in leverage (*ΔLEV*) and financial performance (*ΔROA* and *ΔLOSS*) capture changes in client business risk. *ΔINVREC*, *ΔACQ*, and *ΔFOREIGN* capture changes in audit complexity from auditing inventory, receivables, mergers and acquisitions, and foreign operations. *ΔMTB*, changes in the market-to-book ratio, proxies for changes in growth opportunities. Auditing special items may require additional audit effort and is measured by *ΔSPECIAL ITEMS*. Lastly, Big N auditors are associated with fee premiums and *ΔBIGN* captures any change to or from a Big N auditor. While the changes in FPI status are not clustered in time, we still include year fixed effects to control for heterogeneity concerning economy-wide factors.

V. EMPIRICAL RESULTS

Effect of Change in FPI Status on Audit Fees

Table 4 presents the results from the ordinary least squares regression of the change in log of audit fees on the changes in the categories of reporting requirements for the sample of firms that lose or gain FPI status. Consistent with the requirements included in *FINANCIAL STATEMENTS* leading to more work for auditors, *ΔFINANCIAL STATEMENTS* is positive and statistically significant with a coefficient (t-statistic) of 0.114 (2.68). To interpret of the economic magnitude of this coefficient estimate, consider a median firm that lost FPI status and

must initiate compliance with one additional *FINANCIAL STATEMENTS* requirement, see panel A of Table 3. The median firm that lost its FPI status experiences 12.1% (= exp(0.114*1) – 1) higher growth in audit fees.[9] Consider instead a median firm that regained FPI status and discontinued compliance with two *FINANCIAL STATEMENTS* requirements, see panel C of Table 3. The median firm that regained FPI status experiences 20.4% (= exp(0.114*(-2)) – 1) lower growth in audit fees. This result is consistent with additional audit effort required to comply with additional reporting requirements and is overall consistent with the findings of Bronson et al. (2017).

Consistent with auditors' incentives to supply and mangers' incentives to demand higher audit quality in response to potentially higher litigation risk, we find a positive and statistically significant coefficient (t-statistic) of 0.109 (1.64) on *ΔDISCLOSURE OF INSIDER INFORMATION*. The median firm that lost its FPI status in Panel A of Table 3 complies with one additional category and experiences 11.5% higher growth in audit fees.[10]

Finally, we document a negative and statistically significant coefficient (p-value) of -0.115 (-2.02) on *ΔCORPORATE GOVERNANCE*. This is consistent with auditors decreasing audit fees in the presence of stronger corporate governance requirements. The median firm that lost its FPI status in Panel A of Table 3 complies with two additional *CORPORATE GOVERNANCE* requirements and experiences 20.6% lower growth in audit fees.[11] Conversely,

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[9] Since change in the natural logarithm of audit fees is our dependent variable, recall that this equals the natural logarithm of the increase in audit fees: $\Delta LNFEES_t = LN(FEES_t / FEES_{t-1})$. Applying the exponential function (exp) on both sides of equation (1), we rewrite growth in audit fees as:

$$(FEES_t / FEES_{t-1}) = \exp(\beta_0) * \exp(\beta_1 * \Delta FINANCIAL\ STATEMENTS) * \exp(\beta_2 * \Delta DISCLOSURE\ OF\ INSIDER\ INFORMATION) * \exp(\beta_3 * \Delta CORPORATE\ GOVERNANCE) * \exp(\beta_4 * \Delta LNA) * \varepsilon$$

Now note that $\exp(\beta_1 * 1) = \exp(0.114 * 1) = 1.121$. The corresponding effect for the mean firm that lost FPI status would be 18.7% since: $\exp(\beta_1 * 1.5) = \exp(0.114 * 1.5) = 1.187$.

[10] 11.5% = exp(0.109*1) – 1.

[11] -20.6% = exp(-0.115*2) – 1.

the median firm that regains FPI status in Panel C of Table 3 complies with one less *CORPORATE GOVERNANCE* requirements and experiences 12.2% higher growth in audit fees.[12]

Overall, our evidence supports rejecting the null in hypotheses 1 - 3 and demonstrates differential effects for each category of exemptions from U.S. domestic reporting requirements.

Entropy Balancing

Table 5 reports entropy balancing successfully minimizes differences in the distributions of observable audit fee determinants between the treated and control firms. The control firms consist of foreign-domiciled firms cross-listed in the U.S. that do not change FPI status with the available audit fee and financial statement data (11,011 firm-years) from Audit Analytics and Compustat, respectively. Before entropy balancing, Panel A reports multiple differences in the first three moments of the distributions of the audit fee determinants between the firms that do and do not change FPI status. After entropy balancing, distributions of the audit fee determinants appear indistinguishable between the treated and weighted control samples.

Table 6 presents the multivariate results on the association between changes in FPI reporting requirements and changes in audit fees. The results are consistent with those presented in Table 5. *ΔFINANCIAL STATEMENTS* is positive and statistically significant with a coefficient (t-statistic) of 0.106 (2.56) consistent with additional auditor effort to comply with these requirements. The median firm that lost its FPI status experiences 11.2% higher growth in audit fees relative to control firms after entropy balancing while the median firm that regained FPI status experiences 19.1% lower growth in audit fees relative to control firms after entropy

[12] 12.2% = exp(-0.115*(-1)) – 1.

balancing.[13]

Next, we find a positive and statistically significant coefficient (t-statistic) of 0.177 (3.92) on *ΔDISCLOSURE OF INSIDER INFORMATION*. The median firm that lost its FPI status in Panel A of Table 3 complies with one additional category and experiences 19.4% (= exp(0.177) – 1) higher growth in audit fees relative to control firms after entropy balancing. This is consistent with auditors' incentives to supply and mangers' incentives to demand higher audit quality in response to potentially higher litigation risk.

Finally, we document a negative and statistically significant coefficient (p-value) of -0.102 (-2.08) on *ΔCORPORATE GOVERNANCE* and suggests auditors decrease audit fees in the presence of stronger corporate governance requirements. The median firm that lost its FPI status in Panel A of Table 3 complies with two additional *CORPORATE GOVERNANCE* requirements and experiences 18.5% lower growth in audit fees relative to control firms after entropy balancing. Conversely, the median firm that regains FPI status in Panel C of Table 3 complies with one less *CORPORATE GOVERNANCE* requirements and experiences 10.7% higher growth in audit fees relative to control firms after entropy balancing.[14]

Using entropy-balanced control firms and a more robust audit fee model, we continue to find evidence that supports rejecting the null in hypotheses 1 - 3 and continues to demonstrate differential effects for each category of exemptions from U.S. domestic reporting requirements.

VI. ROBUSTNESS TESTS

Propensity Score Matching

In essence, entropy balancing is a generalization of propensity-score weighting and a

[13] Because 11.2% = exp(0.106) – 1 and -19.1% = exp(0.106 * (-2)) – 1.
[14] Because -18.5% = exp(-0.102*2) – 1 and 10.7% = exp(-0.102*(-1)) – 1.

synthetic control method (Hainmueller 2012; McMullin and Schonberger 2020). It has significant advantages of preserving the full sample and achieving balance across the first three moments of the distribution, not just the first moment. One critique is that the synthetic controls may result in comparing treatment firms to control firms with characteristics that real firms may not have. As an alternative approach, we propensity-score match firms that change FPI status to a firm that does not change FPI status in the same fiscal year without replacement and based on a caliper width of 0.03.[15] In the year prior to the change in FPI status, we match on size (*LNA*), leverage (*LEV*), financial performance (*ROA* and *LOSS*), and growth opportunities (*MTB*) using a logistic regression. The area under the receiver operating characteristics (ROC) curve for the propensity score model is 80.8%.

Table 7 shows that propensity-score matching achieves covariate balance across the matching dimensions. Before matching, firms that change FPI status are smaller, have lower ROA, more losses, and higher market-to-book ratios than foreign-domiciled firms cross-listed in the U.S. that do not change FPI status. After propensity score matching, the means of the matching variables for the treatment and control firms are not statistically different.

Table 8 presents the multivariate results on the association between changes in FPI reporting requirements and changes in audit fees for the propensity-score matched sample. The coefficient estimates appear similar to the results from our entropy balancing analysis presented in Table 6. Both *ΔFINANCIAL STATEMENTS* and *ΔDISCLOSURE OF INSIDER INFORMATION* are positive and statistically significantly associated with the change in the natural logarithm of audit fees while *ΔCORPORATE GOVERNANCE* is negatively and significantly associated with the change in the natural logarithm of audit fees. Thus, matching to actual firms continues to provide evidence that the changes in FPI reporting requirements

[15] Results are robust to using other common caliper widths of 0.01 and 0.05.

significantly affect audit fees.

Canadian Firms

Approximately 46 percent of our Treatment sample firms (34 firms) are domiciled in Canada which may affect the generalizability of our results to other countries. As such, we re-perform our entropy balancing analysis for Canadian treatment and control firms separately from non-Canadian treatment and control firms. Table 9 reports our main results hold for both subsamples of firms. For both Canadian and non-Canadian firms, *ΔFINANCIAL STATEMENTS* and *ΔDISCLOSURE OF INSIDER INFORMATION* are positive and statistically significantly associated with the change in the natural logarithm of audit fees while *ΔCORPORATE GOVERNANCE* is negative and significantly associated with the change in the natural logarithm of audit fees. Canada and the U.S. have similar regulatory reporting systems as evidenced by the Multi-Jurisdictional Disclosure System established in 1991 between the two countries, nevertheless substantial differences exist.

VII.CONCLUSION AND FUTURE WORK

We study the change in audit fees for foreign domiciled firms with a change in foreign private issuer status with the U.S. SEC. This sample, while smaller, facilitates causal inferences because the change in FPI status occurs for an arguably exogenous reason while maintaining their cross-listing status. When firms lose their FPI status, and therefore must commence full compliance with U.S. domestic securities regulation, their audit fees also increase by 18 percent. We believe that this increase in audit fees is likely attributable to the increased financial statement requirements which require increased audit effort (consistent with the negative market reaction discussed above) and by the increased disclosures regarding insiders trading. Our evidence suggests additional insider disclosures increase litigation risk,

and auditors respond by charging higher fees.

Prior literature finds mixed evidence with respect to corporate governance and audit fees (Abbott et al. 2003; Carcello et al. 2002; Garg et al. 2017; Griffin et al. 2008; Hay et al. 2008; Simunic 1980, 1984; Zaman et al. 2011). The exogenous change to corporate governance addresses the primary challenge in this literature, which is that audit services and corporate governance are jointly determined. We find a statistically significant negative association between corporate governance and audit fees. This suggests auditors perceive the FPI exemptions from U.S. domestic corporate requirements as materially altering the risk of material misstatement. Our paper contributes evidence on the economic consequences of the SEC's two-tiered regulatory approach. Specifically, our paper adds to a growing body of evidence that FPIs benefit from the corporate governance requirements of U.S. domestic issuers (Burnett et al. 2017, Foley et al. 2018), which should be of interest to U.S. regulators.

Since other countries emulate the two-tiered U.S. securities regulatory framework, future research could investigate the effect of foreign private issuer status in other countries with different financial reporting and audit requirements. Further, change in FPI status may affect contracting within firms and have real effects. For example, as firms lose FPI status and switch from IFRS to U.S. GAAP, performance measures used in executive compensation may change around the change in FPI status, which in turn could affect external financial reporting.

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APPENDIX A

Variable Definitions

Variable		Definition
ACQ	=	1 if the firm engages in an acquisition, and 0 otherwise.
AUDIT FEES	=	the fees paid to the audit firm (in thousands).
BIGN	=	1 if the auditor is a Big N auditor (Arthur Andersen, Deloitte, Ernst & Young, KPMG, or PricewaterhouseCoopers), and 0 otherwise.
CORPORATE GOVERNANCE	=	the number of the following two requirements that a firm complies with: Proxy Rules and U.S. Stock Exchange Corporate Governance.
DISCLOSURE OF INSIDER INFORMATION	=	the number of the following two requirements that a firm complies with: Disclosure of Insider Ownership and Sales and Regulation FD.
FINANCIAL STATEMENTS	=	the number of the following five requirements that a firm complies with: Quarterly Filings, Accelerated Filing, Auditor's Attestation on Internal Controls, U.S. GAAP, and Segment Disclosure.
FOREIGN	=	1 if the firm has international operations, and 0 otherwise.
INVREC	=	the sum of inventory and receivables divided by total assets.
LEV	=	total debt divided by total assets.
LNA	=	the natural logarithm of total assets (in thousands).
LNFEES	=	the natural logarithm of fees paid to the audit firm.
LOSS	=	1 if the firm reports income before extraordinary items less than 0, and 0 otherwise.
MTB	=	the market value of equity divided by the book value of equity.
ROA	=	income before extraordinary items divided by total assets.
SPECIAL ITEMS	=	1 if the firm reports a special item, and 0 otherwise.

TABLE 1

Requirements of U.S. Registrants and FPIs.

Requirement	U.S. Registrant	FPI
Financial Statements		
Accelerated Filing	Yes	No
U.S. GAAP	Yes	No
Segment Disclosure	Yes	No
Auditor's Attestation on Internal Controls (prior to 2007)	Yes	No
Quarterly Filings	Yes	No
Disclosure of Insider Information		
Disclosure of Share Ownership and Sales	Yes	No
Regulation FD	Yes	No
Corporate Governance		
Proxy Rules	Yes	No
U.S. Stock Exchange Corporate Governance	Yes	No*
Initial Registration with the SEC		
Direct Registration Program (Sec 17A, '34 Act)	Yes	No
Confidential First Time Registration Statements	No	Yes

The table details the regulatory requirements that are different between U.S. domestic firms and FPI status firms. This table is from Burnett et al. (2017).

*Exception: The AMEX, NASDAQ, and NYSE permit FPIs substantial flexibility to follow their home country corporate governance practices provided that the FPI discloses any differences in corporate governance practices from those followed by U.S. domestic companies and that the FPI follows the Audit Committee requirements of Rule 10A-3 under the Exchange Act, which includes the requirement that each audit committee member be an independent member of the board of directors.

TABLE 2

Sample Formation and Description

Panel A: Sample Formation

	Lose FPI Status	Gain FPI Status
Firms identified from SEC lists and filings from 2000 to 2018	171	80
Firms with fundamental change (e.g., stock-based merger)	(46)	(38)
Firms voluntarily complying with U.S. reporting requirements	(40)	(8)
Firms without sufficient data	(16)	(11)
Change in FPI Status due to Business Contacts Test	(14)	(4)
	55	19

Panel B: Frequency of Specific Requirements that Change

Requirement	Frequency	Percentage
Financial Statements		
Accelerated Filing	36	49%
U.S. GAAP	35	47%
Segment Disclosure	15	20%
Auditor's Attestation on Internal Controls (prior to 2007)	18	24%
Quarterly Filings	10	14%
Disclosure of Insider Information		
Disclosure of Share Ownership and Sales	36	49%
Regulation FD	39	53%
Corporate Governance		
Proxy Rules	58	78%
U.S. Stock Exchange Corporate Governance	61	82%

(continued on next page)

TABLE 2 (continued)

Panel C: Countries

Country	Frequency	Percentage
Australia	2	3%
Bermuda	4	5%
British Virgin Islands	4	5%
Canada	34	46%
Cayman Islands	4	5%
China	1	1%
France	2	3%
Ireland	5	7%
Israel	8	11%
Liberia	1	1%
Marshall Islands	1	1%
Netherlands	1	1%
Netherlands Antilles	1	1%
New Zealand	1	1%
Switzerland	1	1%
United Kingdom	4	5%
	74	100%

The table reports the formation of the sample of firms that change FPI status (Panel A), which specific requirements actually change following a change in FPI status (Panel B), and the foreign domicile of firms that change status (Panel C). We removed firms that changed their FPI status due to fundamental changes, which we defined as a stock-based merger or acquisition, major share offering, or bankruptcy. Additionally, we removed firms that were technically FPIs, but voluntarily filing under full U.S. reporting requirements, that voluntarily chose to switch to FPI reporting using a 20-F or 40-F.

TABLE 3

Descriptive Statistics

Panel A: Changes in Reporting Requirements for Firms that Lose FPI Status (N=55)

Variable	Mean	Median	Std. Dev.
ΔFINANCIAL STATEMENTS	1.5	1.0	1.1
ΔDISCLOSURE OF INSIDER INFORMATION	1.1	1.0	0.8
ΔCORPORATE GOVERNANCE	1.6	2.0	0.7

Panel B: Firms Characterisics of Firms that Lose FPI Status (N=55)

	Year Prior			Year After		
Variable	**Mean**	**Median**	**Std. Dev.**	**Mean**	**Median**	**Std. Dev.**
AUDIT FEES (in 1,000s)	916.22	500.00	1,228.39	1,115.65 ***	628.48 ***	1,374.00
LNFEES	6.07	6.21	1.37	6.38 ***	6.44 ***	1.26
LNA	11.97	11.83	1.87	12.03	11.63 **	1.84
LEV	0.12	0.03	0.17	0.16	0.04	0.28
ROA	-0.21	-0.07	0.37	-0.31 *	-0.03	0.55
LOSS	0.58	1.00	0.50	0.62	1.00	0.49
INVREC	0.16	0.08	0.17	0.16	0.10	0.17
ACQ	0.22	0.00	0.42	0.35 *	0.00	0.48
FOREIGN	0.95	1.00	0.23	0.95	1.00	0.23
MTB	3.38	2.30	5.30	3.37	2.45	5.60
SPECIAL ITEMS	0.71	1.00	0.46	0.60	1.00	0.49
BIGN	0.80	1.00	0.40	0.78	1.00	0.42

(continued on next page)

TABLE 3 (continued)

Panel C: Changes in Reporting Requirements for Firms that Gain FPI Status (N=19)

Variable	Mean	Median	Std. Dev.
ΔFINANCIAL STATEMENTS	-1.6	-2.0	1.2
ΔDISCLOSURE OF INSIDER INFORMATION	-0.4	0.0	0.8
ΔCORPORATE GOVERNANCE	-1.2	-1.0	1.2

Panel D: Firm Characteristics of Firms that Gain FPI Status (N=19)

	Year Prior			Year After		
Variable	**Mean**	**Median**	**Std. Dev.**	**Mean**	**Median**	**Std. Dev.**
AUDIT FEES (in 1,000s)	161.19	63.85	313.29	146.98	84.60	237.71
LNFEES	4.30	4.16	1.11	4.41	4.44	1.01
LNA	9.54	9.39	1.62	9.57	9.26	1.61
LEV	0.26	0.06	0.37	0.31	0.10	0.42
ROA	-0.44	-0.29	0.59	-0.60	-0.35	0.68
LOSS	0.74	1.00	0.45	0.74	1.00	0.45
INVREC	0.20	0.05	0.28	0.18	0.09	0.21
ACQ	0.11	0.00	0.32	0.05	0.00	0.23
FOREIGN	0.79	1.00	0.42	0.79	1.00	0.42
MTB	4.21	2.88	9.12	3.09	2.71	10.90
SPECIAL ITEMS	0.42	0.00	0.51	0.42	0.00	0.51
BIGN	0.32	0.00	0.48	0.32	0.00	0.48

The table provides descriptive statistics about the changes in reporting requirements as well as audit fees and firm characteristics of firms that lose their FPI status (Panel A) and firms that gain their FPI status (Panel B). *, **, and *** represent statistical significance at the 10%, 5%, and 1% levels, respectively, based on two-tailed t-tests for the mean and Wilcoxon signed-rank tests for the median.

TABLE 4

Regression of Change in Audit Fees on the Changes in FPI Reporting Requirements

Variable	**Expectation**	***ΔLNFEES***
ΔFINANCIAL STATEMENTS	+	0.114***
		2.68
ΔDISCLOSURE OF INSIDER INFORMATION	+	0.109*
		1.64
ΔCORPORATE GOVERNANCE	+ / -	-0.115**
		-2.02
ΔLNA	+	0.392***
		3.83
Constant	?	0.177
		2.81
N		74
Adjusted R^2		16.3%

The table examines the association between the change in the natural logarithm of audit fees and changes in reporting requirements. The sample consists of firms that change FPI status. The coefficient estimates and t-statistics are from estimating an ordinary least squares regression of the changes in reporting requirements. *, **, and *** represent statistical significance at the 10%, 5%, and 1% levels, respectively, for a two-tailed test (one-tailed when predicted direction). t-statistics are based on robust standard errors. See Appendix A for variable definitions.

TABLE 5

Entropy Balancing

Panel A: Sample Descriptive Statistics Before Entropy Balancing

	Treatment (N=74)			Control (N=11,011)		
Variable	**Mean**	**Variance**	**Skewness**	**Mean**	**Variance**	**Skewness**
ΔLNA	0.07	0.19	0.24	0.08	0.09	0.68
ΔLEV	0.03	0.03	1.02	0.01	0.01	1.04
ΔROA	-0.09	0.17	-0.38	-0.01	0.03	-0.51
ΔLOSS	0.03	0.11	0.52	0.01	0.20	0.03
ΔINVREC	0.00	0.00	-0.37	0.00	0.00	-0.31
ΔACQ	0.08	0.24	0.20	0.00	0.23	0.00
ΔFOREIGN	0.00	0.00	0.00	0.01	0.08	0.18
ΔMTB	-0.28	32.27	-0.21	-0.09	7.34	-0.24
ΔSPECIAL ITEMS	-0.08	0.29	-0.06	0.02	0.28	0.02
ΔBIGN	-0.01	0.01	-8.43	0.00	0.01	-2.30

Panel B: Sample Descriptive Statistics After Entropy Balancing

	Treatment (N=74)			Control (N=11,011)		
Variable	**Mean**	**Variance**	**Skewness**	**Mean**	**Variance**	**Skewness**
ΔLNA	0.07	0.19	0.24	0.07	0.19	0.24
ΔLEV	0.03	0.03	1.02	0.03	0.03	1.01
ΔROA	-0.09	0.17	-0.38	-0.09	0.17	-0.38
ΔLOSS	0.03	0.11	0.52	0.03	0.11	0.52
ΔINVREC	0.00	0.00	-0.37	0.00	0.00	-0.37
ΔACQ	0.08	0.24	0.20	0.08	0.24	0.20
ΔFOREIGN	0.00	0.00	0.00	0.00	0.07	0.00
ΔMTB	-0.28	32.27	-0.21	-0.28	32.28	-0.21
ΔSPECIAL ITEMS	-0.08	0.29	-0.06	-0.08	0.29	-0.06
ΔBIGN	-0.01	0.01	-8.43	-0.01	0.01	-8.11

The table reports the mean, variance, and skewness for each control variable before (Panel A) and after (Panel B) entropy balancing. The Treatment sample consists of firm-years of firms that change FPI status. The Control sample consists of firms-years of foreign domiciled cross-listed in the U.S. that do not change FPI status during the sample period (2000-2018).

TABLE 6

Regression of Change in Audit Fees on the Changes in FPI Reporting Requirements After Entropy Balancing

Variable	Expectation	*ΔLNFEES*
ΔFINANCIAL STATEMENTS	+	0.106***
		2.56
ΔDISCLOSURE OF INSIDER INFORMATION	+	0.177***
		3.92
ΔCORPORATE GOVERNANCE	+ / -	-0.102**
		-2.08
ΔLNA	+	0.322***
		6.14
ΔLEV	+/-	-0.173
		-1.60
ΔROA	+/-	0.030
		0.49
ΔLOSS	+	0.003
		0.03
ΔINVREC	+	1.121***
		2.42
ΔACQ	+	-0.060
		-0.94
ΔFOREIGN	+	0.000
		0.01
ΔMTB	+	-0.001
		-0.22
ΔSPECIAL ITEMS	+	0.004
		0.09
ΔBIGN	+	-0.157
		-0.70
Constant	?	0.202
		1.55
Year Fixed Effects		Included
N		11,085
Adjusted R^2		31.5%

The table examines the association between the change in the natural logarithm of audit fees and changes in reporting requirements using entropy balancing. The sample consists of firms that change FPI status and foreign domiciled firms cross-listed in the U.S. that do not change FPI status. The coefficient estimates and t-statistics are from estimating an ordinary least squares regression of the changes in reporting requirements. *, **, and *** represent statistical significance at the 10 percent, 5 percent, and 1 percent levels, respectively, for a two-tailed test (one-tailed when predicted direction). t-statistics are based on robust standard errors. See Appendix A for variable definitions.

TABLE 7

Propensity Score Matching

P(Change FPI Status) = f(size, leverage, financial performance, growth opportunities)

Panel A: Full Sample

	Treatment (N=74)	Control (N=11,011)		
Variable	**Mean**	**Mean**	**Difference**	
LNASSETS	11.35	14.36	-3.01	***
LEV	0.16	0.36	-0.20	
ROA	-0.27	-0.07	-0.20	***
LOSS	0.62	0.31	0.32	***
MTB	3.59	2.45	1.14	**

Panel B: Propensity-Score Matched Sample

	Treatment (N=74)	Control (N=74)	
Variable	**Mean**	**Mean**	**Difference**
LNASSETS	11.35	11.27	0.08
LEV	0.16	0.24	-0.08
ROA	-0.27	-0.26	0.00
LOSS	0.62	0.57	0.05
MTB	3.59	3.94	-0.35

The table presents the descriptive statistics before (Panel A) and after (Panel B) firms that change FPI status are propensity score matched to foreign firms that do not change FPI status. The Treatment sample consists of firm-years of firms that change FPI status. The Control sample consists of firms-years of foreign domiciled cross-listed in the U.S. that do not change FPI status during the sample period (2000-2018). Firms that change FPI status are propensity score matched based on data from the year prior to the change in FPI status using a logistic regression based on size (*LNA*), leverage (*LEV*), financial performance (*ROA* and *LOSS*), and growth opportunities (*MTB*) in the same fiscal year without replacement based on a caliper width of 0.03. *, **, and *** represent statistical significance at the 10 percent, 5 percent, and 1 percent levels, respectively, based t-tests of difference in means. See Appendix A for variable definitions.

TABLE 8

Regression of Change in Audit Fees on the Changes in FPI Reporting Requirements After Propensity-Score Matching

Variable	Expectation	*ΔLNFEES*
ΔFINANCIAL STATEMENTS	+	0.127**
		2.52
ΔDISCLOSURE OF INSIDER INFORMATION	+	0.140***
		2.04
ΔCORPORATE GOVERNANCE	+ / -	-0.116*
		-1.82
ΔLNA	+	0.470***
		3.79
ΔLEV	+/-	-0.213
		-0.71
ΔROA	+/-	-0.082
		-0.49
ΔLOSS	+	-0.001
		-0.01
ΔINVREC	+	0.903*
		1.34
ΔACQ	+	-0.026
		-0.26
ΔFOREIGN	+	0.121*
		1.40
ΔMTB	+	-0.009
		-1.16
ΔSPECIAL ITEMS	+	-0.024
		-0.39
ΔBIGN	+	0.752
		1.28
Constant	?	0.090**
		2.08
N		148
Adjusted R^2		19.9%

The table reports the ordinary least squares regression of the change in the natural logarithm of audit fees on the changes in reporting requirements for firms that change FPI status and their propensity-score matched pairs. *, **, and *** represent statistical significance at the 10 percent, 5 percent, and 1 percent levels, respectively, for a two-tailed test (one-tailed when predicted direction). t-statistics are based on robust standard errors. See Appendix A for variable definitions.

TABLE 9

Regression of Change in Audit Fees on the Changes in FPI Reporting Requirements After Entropy Balancing and Partitioned by Canada

Variable	Expectation	Canadian *ΔLNFEES*	Non-Canadian *ΔLNFEES*
ΔFINANCIAL STATEMENTS	+	0.203***	0.054*
		3.14	1.55
ΔDISCLOSURE OF INSIDER INFORMATION	+	0.290***	0.190***
		3.81	3.45
ΔCORPORATE GOVERNANCE	+ / -	-0.210**	-0.114***
		-2.49	-3.02
ΔLNA	+	0.171**	0.281**
		2.24	4.80
ΔLEV	+/-	-0.123	-0.482***
		-0.80	-3.01
ΔROA	+/-	0.133	-0.148
		1.46	-1.88
ΔLOSS	+	0.094	-0.127
		1.35	-0.86
ΔINVREC	+	1.487**	0.106
		2.15	0.23
ΔACQ	+	-0.015	-0.016
		-0.20	0.00
ΔFOREIGN	+	0.104**	-0.009
		2.06	-0.17
ΔMTB	+	-0.005	-0.003
		-0.88	-0.63
ΔSPECIAL ITEMS	+	0.044	0.035
		0.94	0.69
ΔBIGN	+	-0.127	0.327
		-0.65	2.75
Constant	?	0.548	-0.047
		1.23	-0.29
Year Fixed Effects		Included	Included
N		2,552	8,553
Adjusted R^2		40.5%	29.9%

The table examines the association between the change in the natural logarithm of audit fees and changes in reporting requirements separately for Canadian and non-Canadian firms. The coefficient estimates and t-statistics are from estimating an ordinary least squares regression of the changes in reporting requirements. *, **, and *** represent statistical significance at the 10 percent, 5 percent, and 1 percent levels, respectively, for a two-tailed test (one-tailed when predicted direction). t-statistics are based on robust standard errors. See Appendix A for variable definitions.