

## **Audit Committee Expertise, Securities Class Action Lawsuits, and Risk-Taking**

### **Gopal V. Krishnan\***

Department of Accountancy  
Bentley University  
Waltham, MA 02452  
Phone: (781) 891-2477  
Email: gkrishnan@bentley.edu

### **Jiancheng (Duncan) Liu**

Guangdong University of Finance and Economics  
Guangzhou, China  
Email: duncan.liu@gdufe.edu.cn

### **Wei Shi**

Department of Accounting  
Deakin Business School  
Deakin University  
Melbourne, Australia  
Email: wei.shi@deakin.edu.au

March 10, 2022

\*Corresponding author.

We sincerely appreciate the valuable comments and suggestions on our paper from workshop participants at American University, Concordia University, Deakin University, and University of North Texas.

## Audit Committee Expertise, Securities Class Action Lawsuits, and Risk-Taking

### Abstract

We empirically examine the relation between multiple attributes of audit committee expertise and the risk of securities class action lawsuits. We find that *incremental* to accounting quality and other factors, the audit committee's combined accounting and industry expertise is negatively associated with firm's incidence of accounting-related securities class action lawsuits. This finding also holds for allegations that are unrelated to restatement or GAAP violation. A one standard deviation increase in the combined expertise lowers the litigation risk by 4.32 percent to 19 percent. Next, the amount of total case settlement is lower by about \$10 million for firms with the combined industry and accounting expertise relative to firm-years where the audit committee lacks the combined expertise. Further, using a broader measure of risk, we find that audit committee's combined expertise is negatively associated with firm risk-taking. Our results suggest that the benefits of audit committee's combined accounting and industry expertise extend beyond monitoring of the financial reporting process and mitigate litigation risk.

**Keywords:** *Risk-taking; securities class action lawsuits; audit committee; accounting expertise; industry expertise.*

*“Risk management is no longer simply a business and operational responsibility of management. It has also become a governance issue that is squarely within the oversight responsibility of the board.”*

*Lipton et al. (2018)*

## **1. Introduction**

As underscored by the above quote, the monitoring of corporate risk-taking is emerging as an important issue for the board. In reminding the board’s responsibility with respect to risk oversight, the Federal Reserve (2018) issued an enforcement action against Wells Fargo & Company (WFC) stating, *“It is incumbent upon the board of directors of WFC to carefully evaluate the firm’s risk management capacity and to oversee senior management’s implementation of an adequate risk management framework for the entire firm.”*<sup>1, 2</sup> Further, audit committee members rate risk management as the top issue among those posing the greatest challenges to their companies (KPMG 2018). This indicates that the audit committee’s role extends beyond oversight of financial reporting and internal controls to a broader consideration of future performance and risk (KPMG 2021). Despite the importance of risk oversight by the board and the audit committee, there is a paucity of empirical evidence on the role of audit committees in mitigating firm risk-taking in general.

The objectives of this study are two-fold. First, to empirically examine whether audit committee expertise is associated with the likelihood as well as some key characteristics of securities class action lawsuits. Second, more broadly, to provide empirical evidence on the relation between audit committee expertise and managerial risk-taking. We also examine the relation between expertise of other (non-audit committee) directors and risk-taking. To the best of our knowledge, prior research has not examined the relations between audit committee

---

<sup>1</sup> Wells Fargo Bank disclosed that between 2011 and 2015 employees opened unauthorized accounts in response to demanding sales targets and incentives put in place by the bank’s senior management. Further, Wells Fargo Bank charged hundreds of thousands of borrowers for unneeded guaranteed auto protection or collateral protection insurance for their automobiles (Federal Reserve 2018).

<sup>2</sup> The Federal Reserve censured directors with publicly released letters of reprimand even after they had left the board for lack of board oversight (Lipton et al. 2018).

expertise and the nature of allegations in the securities class action lawsuits (accounting vs. non-accounting issues), settlement amounts, the length of the case, and risk-taking in general.<sup>3</sup> We believe our findings would be of interest to boards of directors, audit committee chairs, managers, and others in recruiting and retaining audit committee directors that have the skill set in mitigating securities class action lawsuits and managerial risk-taking.

Securities class action lawsuits are related to accounting as well as non-accounting issues, such as alleged improper conduct in public transactions (M&A, privatization, and stock buybacks) or insider trading. *Ex ante*, it is not clear whether audit committee expertise is associated with securities class action lawsuits for two reasons. First, prior research finds that securities class action lawsuits, especially those alleging accounting issues are preceded by financial restatements (Jones and Weingram 1997; Palmrose and Scholz 2004), suggesting that accounting quality is a key determinant of securities class action lawsuits. Also, Cohen et al. (2014) find that audit committee member's combined accounting and industry expertise is effective in monitoring the financial reporting process. In addition, prior research finds that firm-specific attributes, industry affiliation, and market variables are associated with securities class action lawsuits (Kim and Skinner 2012). Thus, it is an empirical issue whether audit committee's accounting and industry expertise is *incrementally* associated with securities class action lawsuits after controlling for accounting quality and other determinants of securities class action lawsuits. Second, given the paucity of empirical evidence on audit committee attributes and litigation risk, we do not know whether audit committee expertise is associated with securities class action lawsuits alleging *non-accounting* issues.

Using a sample of securities class action lawsuits for the years 2000 through 2017, we estimate a linear probability model by regressing an indicator variable that equals 1 for firm-

---

<sup>3</sup> While our focus is on downside risk, we recognize that the board of directors plays a role in risk optimization, i.e., balance the risk-return trade-off. We conduct additional analysis to examine whether audit committee's expertise in constraining risk-taking negatively impacts firm performance and those results are discussed in a later section.

years with a securities class action lawsuit, and 0 otherwise on a set of controls (Kim and Skinner 2012). We also conduct supplemental analysis examining the relation between audit committee expertise and two characteristics of lawsuits: case settlement amount and case length. Following Cohen et al. (2014), we employ five measures of audit committee expertise – accounting expertise *without* industry expertise, supervisory expertise *without* industry expertise, industry expertise *without* accounting or supervisory expertise, combined accounting and industry expertise, and combined industry and supervisory expertise.

We document several key findings. First, the likelihood of a securities class action lawsuit is lower for firms where audit committee members have expertise in both accounting and industry than for firms where audit committee members have only industry or accounting or supervisory expertise. The above finding holds for both accounting-related and non-accounting-related allegations in the lawsuits and is robust to three ways of measuring expertise (the proportion of audit committee members with the particular expertise, the number of audit committee members with the particular expertise, and a binary measure). The relation between audit committee expertise and securities class action lawsuits appears to be economically significant – a one standard deviation increase in the combined accounting and industry expertise lowers the litigation risk by 4.32 percent to 19 percent. We obtain consistent results when we use a variety of matched samples, including entropy balancing and matching on propensity scores. We do not find a significant relation between expertise of other (*non*-audit committee) directors and securities class action lawsuits or other measures of risk-taking.

Second, the amount of total case settlement is lower by about \$10 million and the case length is shorter by about 60 days for firms with the combined industry and accounting expertise relative to firm-years where the audit committee lacks the combined expertise. Third, audit committee members' combined industry and accounting expertise is potentially important in mitigating securities class action litigation in firms that are subject to greater litigation

exposure. Fourth, the combined industry and accounting expertise of audit committee members is more valuable in mitigating securities class action lawsuits in firms where the CEO is not the chair of the board or where other board members possess stronger legal expertise. Fifth, using a broader measure of risk, we find audit committee's combined industry and accounting expertise is negatively associated with firm risk-taking. Finally, we find that following a securities class action lawsuit, firms are more likely to recruit directors with accounting and industry expertise to strengthen the audit committee's expertise.

We make several contributions to the literature. First, to the scant literature on the role of the board and the audit committee in risk oversight (Pathan 2009; Aebi et al. 2012; Minton et al. 2014; Cohen et al. 2017),<sup>4</sup> we contribute by providing empirical evidence that the combined accounting and industry expertise of audit committee members mitigates managerial risk-taking in general and, the likelihood of a securities class action lawsuit in particular. We find that the negative relation between securities class action lawsuits and the audit committee's combined expertise holds for *both* accounting-related and non-accounting-related lawsuits. In addition, we find that the audit committee's combined expertise is associated with lower settlement amounts and shorter case length from the lawsuits. Second, we extend the literature on audit committee expertise and financial reporting quality (Krishnan and Visvanathan 2008; Dhaliwal et al. 2010; Krishnan et al. 2011; Cohen et al. 2014; Ashraf et al. 2020) by providing empirical evidence that audit committee expertise is also valuable in mitigating securities class action lawsuits. More importantly, we find that audit committee's combined accounting and industry expertise is incrementally associated with securities class action lawsuits *after* controlling for accounting quality, suggesting that audit committee members with the combined expertise can better identify drivers of litigation that are specific to their industry and be more

---

<sup>4</sup> Pathan (2009), Aebi et al. (2012), and Minton et al. (2014) focus on risk-taking by banks during the financial crisis and do not examine audit committee characteristics. Cohen et al. (2017) conduct semi-structured interviews of audit partners, CFOs, and audit committee members to examine their experiences with regard to the link between enterprise risk management and the financial reporting process.

diligent in not only monitoring the financial reporting process, but also playing an active role in advising the firm on avoiding misleading disclosures, related party transactions, and guiding the firm in risky ventures, which ultimately results in lower *ex post* litigation risk. Third, we also contribute to the debate in the corporate governance literature on which committees of the board or the entire board oversee risk oversight (Ittner and Keusch 2015). Our results provide support for the notion that the audit committee plays an important role in risk oversight. Finally, we extend the prior research on potential drivers of litigation risk (Kim and Skinner 2012) by identifying a new mitigating factor, i.e., audit committee's combined industry and accounting expertise.

The rest of this paper is organized as follows. Section 2 summarizes related research and develops our hypothesis. Section 3 describes the research design, our variables of interest, and the empirical models. Section 4 presents sample selection and univariate results while Section 5 discusses the main results. Section 6 concludes.

## **2. Related research and hypothesis**

### ***Risk oversight function of the board of directors***

Lipton et al. (2018) note that a board's risk oversight responsibilities derive from several sources - state law fiduciary duties, federal and state laws and regulations, stock exchange listing requirements, evolving best practices, and pressure from institutional investors. While the Delaware Supreme Court affords strong protection to directors under the business judgment rule, directors can be liable for a failure of board oversight when there is systemic failure to exercise oversight or when directors ignore red flags reflecting significant problems (Lipton et al. 2018). The Securities and Exchange Commissions (SEC) requires companies to disclose in their annual reports "*factors that make an investment in a registrant's securities speculative and risky*" as well as the board's role in risk oversight (Lipton et al. 2018). Turning to institutional investors, Vanguard (2017, 5) identifies four pillars that they consider

foundational to effective corporate governance: the board, structure, compensation, and risk and states, “*Boards are responsible for effective oversight and governance of the risks most relevant and material to each company in the context of its industry and region.*” This is consistent with the notion that “*directors are shareholders’ eyes and ears on risk*” (Lipton et al. 2018, 3). Similarly, the National Association of Corporate Directors (2009, 8) states, “*the full board should have primary responsibility for risk oversight, with the boards standing committees supporting the board by addressing the risks inherent in their respective areas of oversight.*” Further, the OECD report to G20 finance ministers and Central Bank Governors also emphasizes the board’s risk management responsibility (OECD 2015).

When there is governance failure in risk oversight, the board faces not only enforcement actions from the government, such as the Federal Reserve and the SEC, but also class action lawsuits from investors and others. Our goal is to examine the relation between audit committee expertise and securities class action lawsuits and risk-taking.

### ***Audit committee expertise and risk oversight***

As a standing committee of the board, the above discussion equally applies to the audit committee. For example, KPMG (2021, 12) states, “*Going forward, the audit committee should work ... to help identify the critical risks – such as the tone at the top and culture, legal/regulatory compliance, incentive structures, cybersecurity and data privacy, ESG risks, and global supply chain and outsourcing risks – that pose the greatest threat to the company’s reputation, strategy, and operations ...*”.<sup>5</sup> The New York Stock Exchange also requires audit committee charters to discuss risk assessment and risk management policies (Willkie Farr & Gallagher 2003).

---

<sup>5</sup> Deloitte (2018) identifies an extensive list of issues for the audit committee to consider with regard to risk oversight.

We posit that the audit committee is uniquely qualified to play a vital role in mitigating risk-taking for several reasons. Beasley et al. (2010) survey members of the American Institute of CPAs (AICPA) who are in the AICPA's Business, Industry, and Government group and they rate that among the various board level committees, audit committee is the top choice for the board to be entrusted with risk oversight responsibility.

Minton et al. (2014, 352) state, "*among independent directors, financial experts arguably have lower costs in acquiring information about the complexity and associated risks of certain financial transactions and hence are better able to efficiently monitor senior management.*"<sup>6</sup> DeZoort et al. (2002) note that four elements make an effective audit committee: composition, authority, resources, and diligence. Focusing on audit committee composition, Cohen et al. (2014) provide evidence that audit committee members who are both financial and industry experts are associated with a lower restatement likelihood and lower discretionary accruals, consistent with effective monitoring of the financial reporting process. They also find that in some cases supervisory expertise combined with industry expertise is associated with better monitoring. Focusing on resources, prior research found evidence that audit committee's accounting/financial expertise is favorably associated with financial reporting quality (Xie et al. 2003; Bedard et al. 2004; Agrawal and Chadha 2005; Krishnan 2005; Krishnan and Visvanathan 2008; Dhaliwal et al. 2010; Cohen et al. 2014).

Emphasizing both the composition and resource elements of the audit committee's effectiveness, we conjecture that audit committee directors with both accounting and industry expertise can help identify potential red flags in the financial statements and therefore potentially reduce the *ex ante* probability of being sued as a result of a material misstatement.<sup>7</sup>

---

<sup>6</sup> In a later section, we provide descriptive evidence indicating that audit committee members with accounting and industry expertise are in greater demand relative to directors without the combined expertise.

<sup>7</sup> Maletta and Wright (1996) note that there are significant differences in error characteristics across industries, suggesting deep industry knowledge will enable an audit committee member to be effective in monitoring financial reporting quality. Cohen et al. (2014) provide several examples of how audit committee members with

Beyond risks arising from misstated financial statements, audit committee members with accounting and industry expertise can play an advisory role in evaluating risky projects, including appraising NPV projections, valuing risky assets, and guide the firm on dealings with foreign entities (FCPA compliance) and thus, mitigate firm risk-taking. Further, industry expertise also helps as the litigation tends to cluster in certain industries.<sup>8</sup> The presence of industry experts can bring the industry knowledge to the oversight process and alert the firm about potential areas that can elevate litigation risk. Finally, audit committee members are incentivized to remain diligent and independent to protect their reputation capital.<sup>9, 10</sup> Taken together, audit committee members who are both accounting experts and industry experts are likely to be effective in mitigating risk-taking, including securities class action lawsuits.

While it is reasonable to expect that audit committee's combined accounting and industry expertise could mitigate securities class action lawsuits especially those related to *accounting* issues, it is an empirical question whether audit committee's expertise (whether accounting or industry-based) is informative about the risk of securities class action lawsuits *beyond* accounting quality, industry affiliation, market variables (e.g., stock price volatility), and other determinants of securities class action lawsuits (Kim and Skinner 2012). This is because Rule 10b-5 cases (formally known as employment of manipulative and deceptive devices) are triggered by a misstatement or omission of material information and are directly related to financial reporting and disclosure.<sup>11</sup> There is also evidence that firms sued under

---

experience specific to the firm's industry can enhance the monitoring of the financial reporting process and communicate more effectively with the auditor.

<sup>8</sup> Table 2 presents such evidence.

<sup>9</sup> Krishnan and Visvanathan (2008) provide an example involving Emerging Communications, Inc. that shows the risk of litigation could be higher for directors who are financial experts relative to other directors. Also, findings in Srinivasan (2005) suggest that following a financial restatement, financial experts lose more directorships than non-financial experts, consistent with the labor market disciplining financial experts more than non-financial experts.

<sup>10</sup> In 2016, 16 percent of the securities class action lawsuits were filed against the audit committee (PwC 2017).

<sup>11</sup> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) to employ any device, scheme, or artifice to defraud, (b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made,

Rule 10b-5 for accounting-related allegations have lower earnings quality relative to a control sample of firms that were not subject to accounting-related allegation (Chalmers et al. 2012).<sup>12</sup> In other words, once restatements and other measures of accounting quality are in the model, it is an empirical question whether audit committee expertise is incrementally informative about accounting-related securities class action lawsuits.

Further, we do not know whether audit committee expertise is informative about *non*-accounting-related lawsuits, such as alleged improper conduct in public transactions (M&A, privatization, and stock buybacks), insider trading, kickbacks, FCPA violations, and making insufficient or false and misleading statements. Also, it is an empirical issue which type of expertise matters in mitigating securities class action lawsuits and risk-taking – only accounting expertise, only industry expertise, combined accounting and industry expertise or other forms of expertise. Considering the above lines of arguments, we present our hypothesis in null form as follows:

*HYPOTHESIS: Audit committee expertise is not associated with securities class action lawsuits or risk-taking.*

### **3. Research design**

#### ***Measures of audit committee expertise***

Following Cohen et al. (2014), we employ multiple measures of audit committee members' expertise. Using data from *BoardEx*'s comprehensive history of work experience and detailed professional qualification records of board members, we construct measures of audit committee expertise. Our starting point is the employment history provided by *BoardEx* for each audit committee member, which records the companies and institutions where the

---

not misleading, or (c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security (<https://www.law.cornell.edu/cfr/text/17/240.10b-5>).

<sup>12</sup> The top-3 categories of accounting-related allegations for class action lawsuits in 2016 were, internal controls, revenue recognition, and others which includes related party transactions, earnings smoothing, and off-balance sheet financing (PwC 2017).

audit committee members are/were employed. We define an audit committee member to have industry expertise if the audit committee member is/was employed by another firm in her/his employment history record with the same 2-digit SIC codes (Balsam et al. 2003; Bedard et al. 2010; Carcello et al. 2011) as the firms where she/he is currently serving as an audit committee member.

Following prior research (DeFond et al. 2005; Krishnan and Visvanathan 2008; Carcello et al. 2011; Cohen et al. 2014), we separately measure accounting expertise and supervisory expertise. We follow the SEC's (2003) final rules regarding financial expertise. An audit committee member is defined to possess accounting expertise (*AFE*) if the audit committee member holds a degree/professional certificate related to accounting, auditing or taxation, or has at least one of the following professional qualifications: certified public accountant, chief financial officer, auditor, chief accounting officer, controller, treasurer, or vice president-finance. Similarly, an audit committee member is defined to possess supervisory financial expertise (*SFE*) if she/he has at least one of the following professional qualifications: chief executive officer, chief operating officer, chairman of board, or a president of a company. Following Cohen et al. (2014), we construct the following three mutually exclusive expertise variables: *ONLYAFE* are accounting experts *without* industry or supervisory expertise and *ONLYSFE* are supervisory experts *without* industry or accounting expertise. Audit committee members who are industry experts but are neither accounting nor supervisory experts are defined as *ONLYIND*. We also create two combined expertise variables, *INDAFE* (*INDSFE*) that captures accounting (supervisory) experts *with* industry expertise. In all, we use five measures of audit committee expertise.<sup>13</sup> Variable definitions are in Appendix A and Figure 1 presents a comparison of the five expertise variables.

---

<sup>13</sup> We also examine the effect of legal expertise of audit committee directors as well as other directors and those results are discussed in a later section.

### ***Measures of risk-taking***

Given our broad interest in examining risk-taking, we employ several measures of risk-taking by the firm. Our primary measure is the securities class action lawsuits against the firm. We use class action lawsuits as a measure of risk because litigation is an outcome of risk-taking behavior. We examine several attributes of securities class action lawsuits: all class action lawsuits, accounting-related and non-accounting-related lawsuits, settlement amounts, and the length of the litigation.

We follow Kim and Skinner (2012) to construct the litigation risk variable using the data on filings of securities class action lawsuits from the Stanford Law School Securities Class Action Clearinghouse.<sup>14</sup> We focus on lawsuits filed against public firms listed on the main stock exchanges in the U.S. (e.g., NYSE, AMEX, and NASDAQ) and exclude the lawsuits related to IPO allocations, mutual funds, and analysts. We use an indicator variable *SUED* which equals 1 if there is a securities class action lawsuit filed against the firm in year  $t$ , and 0 otherwise.

Next, we use the standard deviation of Return on Assets (ROA) calculated over a 5-year period as a broader measure of risk-taking. Finally, following Hutton et al. (2009) and Kim et al. (2011), we use multiple measures of crash risk, i.e., the risk of a precipitous fall in stock price as alternate measures of risk-taking.

### ***Empirical model***

We follow prior research (Kim and Skinner 2012; Krishnan et al. 2021) and estimate the following linear probability model (LPM) to test our hypothesis:

$$\begin{aligned}
 SUEd_t = & \beta_0 + \beta_1 ACEXP_t + \beta_2 OTHERAFE_t + \beta_3 OTHERSFE_t + \beta_4 OTHERIND_t + \beta_5 FPS_t + \\
 & \beta_6 SGROWTH_{t-1} + \beta_7 LNASSETS_{t-1} + \beta_8 MTB_{t-1} + \beta_9 RET_{t-1} + \beta_{10} SKEW_{t-1} + \\
 & \beta_{11} RETSTD_{t-1} + \beta_{12} TURNOVER_{t-1} + \beta_{13} AQ_{t-1} + \beta_{14} RESTATED_{t-1} + \\
 & \beta_{15} INSIDER_{t-1} + Industry\ FE + Year\ FE + \varepsilon
 \end{aligned}
 \tag{1}$$

---

<sup>14</sup> This database tracks securities class actions filed in Federal Court after the Private Securities Litigation Reform Act of 1995 came into effect. The database does not track lawsuits filed in state court where there is no parallel federal civil class action or SEC enforcement proceedings (<https://securities.stanford.edu/filings.html>).

We control for accounting expertise (*OTHERAFE*), supervisory expertise (*OTHERSFE*), and industry expertise (*OTHERIND*) of other (non-audit committee) directors. The model includes controls for firms in industries subject to a higher litigation risk: biotechnology, computers, electronics, and retail industries (Francis et al. 1994).<sup>15</sup> *FPS* equals 1 for firms operating in these industries and 0 for firms in other industries. This industry-based proxy is commonly used to measure litigation risk. Next, we include several firm characteristics, specifically, firm size (*LNASSETS*), sales growth (*SGROWTH*), market-to-book ratio (*MTB*), stock returns (*RET*), return volatility (*RETSTD*), skewness of stock return (*SKEW*), share turnover (*TURNOVER*), and insider trading (*INSIDER*) as additional controls (Kim and Skinner 2012; Donelson et al. 2012). Further, we use two measures to control for accounting quality following Henninger (2001), Hennes et al. (2008), and Krishnan et al. (2021). Violations of securities laws require a finding of intent (*scienter*) and a restatement, by definition, signifies a correction of a material financial reporting error and an acknowledgement by the firm that it is correcting a GAAP violation that is material. While restatements (*RESTATED*) capture egregious types of earnings management, we use Dechow and Dichev (2002)'s accrual quality measure (*AQ*) as our second measure of accounting quality to capture within GAAP types of earnings management. Our variable of interest is *ACEXP* which represents the five measures of audit committee expertise discussed above (see Appendix A for variable definitions). In particular, our interest is in examining whether measures of audit committee expertise load *after* controlling for *RESTATED* and *AQ*. As we are interested in

---

<sup>15</sup> We use a linear probability model (LPM) instead of a logit model because estimating the logit regression with fixed effects might incur the classic “incidental parameters problem” (See Greene 2004). Thus, recent literature tends to use OLS in case of categorical dependent variables due to its advantage in handling fixed effects (deHaan 2020). We obtain similar results when we use a logistic model.

examining whether audit committee expertise mitigates securities class action lawsuits, we measure the control variables in the fiscal year before the filing of the lawsuit.<sup>16</sup>

#### 4. Sample

To identify our sample, we begin by searching the *BoardEx* database for the years 2000 through 2017 and this process yields 84,689 observations for which data to calculate the audit committee expertise variables are available. Next, we exclude 23,379 observations with missing data on *Compustat*. We further exclude 35,152 observations for which data on control variables in our empirical models are unavailable. Finally, following Kim and Skinner (2012), we exclude 673 lawsuit-observations related to mutual fund and analyst cases.<sup>17</sup> Our final sample consists of 25,485 firm-year observations. Table 1 summarizes the sample selection. We use the *RecoverMax* database from Institutional Shareholder Services (ISS) to identify the allegation types (i.e., accounting-related VS. non-accounting-related) of the 480 securities class action lawsuits in the sample, with the information reported in Panel C, Table 3.

**[Insert Table 1 About Here]**

Table 2 presents the industry distribution for our sample. The top-3 industries are, respectively, (1) business services, (2) chemicals and allied products, and (3) electronic and electrical equipment and components except computer equipment. Among industries with at least 475 observations, the top-3 industries with the highest likelihood of securities class action lawsuits are, respectively, (1) food and kindred products, (2) chemicals and allied products, and (3) miscellaneous retail.

**[Insert Table 2 About Here]**

---

<sup>16</sup> Measuring the variables such as stock returns over the period during which the lawsuit is filed reflect events that trigger the litigation. We also measure those control variables in the current year, the results are qualitatively similar.

<sup>17</sup> We exclude firms from the following four industries: management investment offices, unit investment trusts, investment advice, and security brokers and dealers.

## 5. Results

Descriptive statistics for the five audit committee expertise measures and other variables are in Panel A, Table 3. About 1.9 percent of firm-years were subject to a securities class action lawsuit (*SUED*), consistent with the 2 percent in Kim and Skinner (2012). On average, there are about 9.2 percent of the audit committee members having both industry and accounting expertise (*INDAFE*) and 19.8 percent having both industry and supervisory expertise (*INDSFE*). The mean values of audit committee members with only industry, accounting, and supervisory expertise are, respectively, 2.1 percent, 8.6 percent, and 32.6 percent. We find that 75.6 percent of all firm-years in our sample have at least one non-audit committee board member with accounting expertise (*OTHEREAFE*). Similarly, 98.5 percent of all firm-years have at least one non-audit committee director with supervisory expertise, and 63.1 percent with industry expertise. About 40 percent of firm-years are in high litigation industry (*FPS*). The mean lagged sales growth (*SGROWTH*) is about 8.4 percent. The mean lagged value of log of total assets is 6.445. The average firm has equally weighted lagged market adjusted return of 2.8 percent. The mean lagged accounting quality ( $AQ_{t-1}$ ) is 0.06.<sup>18</sup> About a third of the sample observations are associated with a restatement in or before the current year.

Panel B presents the results of test of differences in mean and median values for selected variables between sued firm-years and non-sued firm-years. Regarding measures of audit committee expertise, we find that the mean and median values of *INDSFE*, *ONLYIND*, *OTHERSFE*, and *OTHERIND* are higher for sued firm-years relative to non-sued firm-years (significant at the 0.05 or 0.01 levels). Consistent with Kim and Skinner (2012), sued firm-years are more likely to be in the biotech, computers, electronics, and retail industries than non-

---

<sup>18</sup> In general, the above values are consistent with respective mean values in Krishnan et al. (2021).

sued firm-years. Turning to the control variables, mean and median values of  $LNASSETS_{t-1}$ ,  $SGROWTH_{t-1}$ ,  $MTB_{t-1}$ ,  $TURNOVER_{t-1}$  are higher for sued firm-years. On the other hand, mean and median  $RET_{t-1}$  and  $SKEW_{t-1}$  are higher for non-sued firm-years. As expected, the frequency of restatements is higher for sued firm-years than for non-sued firm-years (significant at the 0.01 level) while the mean and median values of lagged  $AQ$  are similar for both groups.

Panel C provides additional information on the types of allegations in the securities class action lawsuits. We broadly classify the allegations into two groups: accounting ( $ACCT\_SUED$ ) and non-accounting ( $NACCT\_SUED$ ) cases. Accounting-related allegations involve GAAP violation, restated earnings, or both. Non-accounting-related allegations involve issues related to violations of Section 10b-5 of the Securities and Exchange Act of 1934 or Section 11 of Securities Act of 1933 or IPO or material inaccurate statements in the Registration Statement and Prospectus or improper conduct in subsequent securities transactions or insider trading. See Appendix B for examples of non-accounting-related allegations. Of the 480 securities class action lawsuits, the number of accounting and non-accounting cases are, respectively, 161 and 319. Among all cases, there were 445 cases involving possible violation of Section 10b-5.<sup>19</sup>

**[Insert Table 3 About Here]**

Pearson correlation coefficients among the variables in model (1) are in Table 4. Correlations in bold and italics indicate statistical significance at the 0.01 level while bold only indicates significance at the 0.05 level and italics only indicate significance at the 0.10 level. The correlation between  $SUED$  and  $INDSFE$ ,  $ONLYIND$ ,  $OTHERSFE$ , and  $OTHERIND$  are positive and significant at the 0.05 level, suggesting that these measures of expertise are associated with elevated risk of securities class action lawsuits. We also find that  $ONLYAFE$  or  $INDAFE$  are not associated with  $SUED$ . Likelihood of a securities class action lawsuit is

---

<sup>19</sup> Note a case may include multiple allegations and the sum of the allegations is greater than the number of cases.

positively associated with  $FPS$ ,  $LNASSETS_{t-1}$ ,  $SGROWTH_{t-1}$ ,  $MTB_{t-1}$ ,  $TURNOVER_{t-1}$ , and  $RESTATED$  and negatively associated with  $RET_{t-1}$ ,  $SKEW_{t-1}$ , and  $INSIDER_{t-1}$ . Next, we discuss the results of multivariate analyses that control for these determinants of securities class action lawsuits.

**[Insert Table 4 About Here]**

### ***Audit committee expertise and securities class action lawsuits***

Tests of hypothesis 1 on the relation between our measures of audit committee expertise and the likelihood of a securities class action lawsuit are in Table 5. We report the results separately for all lawsuits (Panel A), accounting-related lawsuits (Panel B), and non-accounting-related lawsuits (Panel C). In all columns we include fixed effects for industry and year and cluster standard errors by firm and year.<sup>20</sup> We measure each expertise variable in three ways – the proportion of audit committee members with the expertise (see columns 1 and 2), the number of audit committee members with the expertise (column 3), and a binary measure (column 4). In Panel A, we find that only  $INDAFE$  is significant across all four columns.<sup>21</sup> Column 1 does not include the two measures of accounting quality. We do so to test whether measures of audit committee expertise load after controlling for accounting quality (see columns 2-4). The coefficients on  $INDAFE$  are, respectively, -0.021, -0.022, -0.005, and -0.006 (all are significant at the 0.05 level or better). We find that the coefficients on variables representing expertise of non-audit committee members ( $OTHERAFE$ ,  $OTHERSFE$ ,  $OTHERIND$ ) are not significant, indicating that measures of expertise of other board members are not associated with securities class action lawsuits.<sup>22</sup> The significant (insignificant) results

---

<sup>20</sup> All models are estimated with intercept but not tabulated for brevity.

<sup>21</sup> When we include only one expertise measure at a time, we find that only the coefficient on  $INDAFE$  is negative (significant at the 0.01 level); the coefficients on the remaining four measures of audit committee expertise are not significant.

<sup>22</sup> We employ an alternate specification where we replace  $OTHERAFE$ ,  $OTHERSFE$ , and  $OTHERIND$  with joint measures of expertise, i.e., we include the following variables –  $INDAFE\_OTHER$  (joint industry and accounting expertise of non-audit committee members),  $INDSFE\_OTHER$  (joint industry and supervisory expertise of non-audit committee members),  $ONLYAFE\_OTHER$  (only accounting expertise of non-audit committee members),

for audit (non-audit) committee members echo the recent risk oversight convention in the US where 65% of companies formally assign risk oversight responsibility to their audit committee, with the selection rate of the closest non-audit committee choices, such as executive committee or risk committee, being merely 17% and 15% , respectively (Beasley et al. 2010). Turning to control variables, we find that the likelihood of a securities class action lawsuit is positively related to  $FPS$ ,  $SGROWTH_{t-1}$ ,  $LNASSETS_{t-1}$ ,  $MTB_{t-1}$ ,  $RETSTD_{t-1}$ , and  $TURNOVER_{t-1}$ , and negatively related to  $RET_{t-1}$  and  $SKEW_{t-1}$ . These results are generally consistent with prior research.<sup>23,24</sup>

We estimate the economic significance of the result in column 2 as follows. A one standard deviation increase in  $INDAFE$  leads to a decrease in litigation risk by 0.00361 ( $-0.022 \times 0.164$ ) and this translates to an 18.99 percent reduction in the sample mean litigation risk ( $0.00361 / 0.019$ ).<sup>25</sup> Overall, the results in Panel A, Table 5 reject the hypothesis and suggest that the combined expertise is more valuable in mitigating litigation risk than having only industry or accounting or supervisory expertise.<sup>26</sup> One interesting feature of these results is that the coefficient on  $INDAFE$  continues to be negative and significant even *after* controlling for the two measures of accounting quality (see columns 2-4), suggesting that the audit committee's combined industry and accounting expertise negatively impacts securities class action lawsuits *incremental* to accounting quality, especially restatements. In other words, the

---

*ONLYSFE\_OTHER*, *ONLYIND\_OTHER*. We find that only  $INDAFE$  continues to be negative and significant, consistent with the results in Table 5.

<sup>23</sup> The adjusted  $R^2$  is about 2 percent for the LPM model and the pseudo  $R^2$  for the corresponding logit model is 10.60 percent which is comparable to those in Kim and Skinner (2012).

<sup>24</sup> Prior research does not include auditor type in the litigation model (see Kim and Skinner 2012 and Krishnan et al. 2021). We reestimate model (1) with an indicator for Big 4 auditors. We find that the coefficient on the Big 4 dummy is -0.008 (significant at the 0.01 level) and the coefficients on  $INDAFE$  are, -0.019 (significant at the 0.01 level), -0.004 (significant at the 0.05 level), and -0.005 (significant at 0.10), respectively for the proportion, the number, and binary measures of audit committee's combined industry and accounting expertise. These results are similar to the results in Panel B, Table 5. We do not include this variable in our primary analysis because we lose about 610 observations due to missing auditor information.

<sup>25</sup> Using the coefficients in columns 3 and 4, the reduction in litigation risk as a percent of the sample mean litigation risk are, respectively, 4.32 percent and 5.18 percent.

<sup>26</sup> We check variance inflation factors (VIF) to assess multicollinearity and find that  $INDAFE$  in Table 5 has a VIF of 2.09. Other measures of audit committee expertise have a VIF of 4 or less, suggesting multicollinearity is not serious.

audit committee's combined accounting and industry expertise is not merely reflecting the committee's financial reporting expertise.

To further explore this implication, we estimate our model separately for accounting-related allegations (Panel B) and non-accounting-allegations (Panel C). We find that as expected, *RESTATED* is significantly associated with accounting-related lawsuits but  $AQ_{t-1}$  is not. We continue to find negative coefficients on *INDAFE* across all three columns (all are significant at the 0.05 level). Turning to non-accounting-related lawsuits, we find negative coefficients on *INDAFE* in columns 1 and 2 (both are significant at the 0.10 level). To the best of our knowledge, ours is the first study to examine the relation between audit committee expertise and non-accounting-related lawsuits and our study provides evidence that the benefits of audit committee's combined expertise extend beyond the realm of financial reporting. Our results suggest that audit committee members with the combined expertise can better identify drivers of litigation that are specific to their industry and be more diligent in not only monitoring the financial reporting process, but also playing an active role in advising the firm on matters, such as avoiding misleading disclosures, related party transactions, and guiding the firm in risky ventures, which ultimately leads to lower *ex post* litigation risk.<sup>27</sup>

**[Insert Table 5 About Here]**

### ***Robustness tests***

We conduct several tests to assess the robustness of our results to potential self-selection of audit committee members with accounting and industry expertise, alternate samples, reverse causality, and including additional variables. We discuss these tests below.

### ***Matched samples***

---

<sup>27</sup> An alternative explanation for our results could be that audit committee expertise might discourage plaintiffs' attorneys from filing a lawsuit against the firm, i.e., audit committee's combined accounting and industry expertise weakens the likelihood of a successful litigation. Due to data limitations, we are unable to test this conjecture.

We employ multiple matched samples to assess the robustness of our results. First, to address the concern that the treatment and control sample are unbalanced, we match the 480 sued firm-years with unsued firm-years. We use one-to-one, two-to-one, and three-to-one matching and untabulated results indicate that the coefficients on *INDAFE* is negative and significant at the 0.05 level or better for the three measures of audit committee expertise (the proportion, the number, and the binary measure) for all different matching procedures.

Second, we employ entropy matching to reweight the covariates from the control group to have almost identical first moment (mean), second moment (variance), and third moment (skewness) with the covariates in the treatment group. Treatment (control) group is defined as firm-years with (without) accounting and industry AC expertise (*INDAFE*). Using the reweighted sample (entropy balanced sample), we reestimate model (1) separately for accounting and non-accounting-related lawsuits and the results are in Tables 6 (accounting-related lawsuits) and 7 (non-accounting-related lawsuits). We find that the coefficients on *INDAFE* is negative and significant at the 0.05 level or better for all three measures of audit committee expertise for both accounting-related (see Panel A, Table 6) and non-accounting-related lawsuits (see Panel A, Table 7).

Third, the selection of audit committee members with specific expertise categories may not be a random choice, and this selection is potentially driven by firms' characteristics, particularly, size and *ex ante* exposure to litigation risk. To address this endogeneity concern, we use a two-stage matching approach following Minutti-Meza (2013) and employ a matched-pairs design using firms hiring audit committee members with specific expertise and otherwise similar firms not hiring audit committee members with corresponding expertise. We first develop and estimate a determinant model to construct a propensity score matched sample. In the determinant model, the dependent variable is *INDAFE Dummy* which equals 1 for firms having audit committee members with both industry and accounting financial expertise, and 0

otherwise. On the right-hand side, we include *FPS* to capture firms' ex ante litigation risk, *LNASSETS<sub>t-1</sub>* to capture size effect, *MTB<sub>t-1</sub>* to capture growth opportunity, *TURNOVER<sub>t-1</sub>* to capture the effect of trading activities, and we also include stock market variables *RET<sub>t-1</sub>*, *SKEW<sub>t-1</sub>*, *RETSTD<sub>t-1</sub>* as predictors for the appointment of industry and accounting financial experts in the firm's audit committee. The determinant model also includes *SGROWTH<sub>t-1</sub>*, *AQ<sub>t-1</sub>*, *RESTATED*, and *INSIDER<sub>t-1</sub>*, as well as industry and year fixed effects. This logistic model generates a propensity score that can be interpreted as the probability of a firm hiring at least one audit committee member with both industry and accounting financial expertise, conditional on the above observable firm characteristics. We then construct a matched sample by selecting any pair of firms without replacement in the same industry group (by 2-digit SIC code) and year that are classified as having or not having *INDAFE* audit committee members, respectively, but having sufficiently close propensity scores generated by the determinant model (using a caliper of 0.02).

We follow the above approach separately for accounting-related and non-accounting-related lawsuits. For accounting-related (non-accounting-related) lawsuits, our matched sample includes 5,469 (5,511) firm-year observations having audit committee members with both industry and accounting expertise and 5,469 (5,511) matched firm-year observations without such expert audit committee members. We do not observe any significant differences in firm characteristics between the treatment and control groups, suggesting that our matching procedure is successful. Results of the first-stage model are in column 1 of Panel B, Table 6 (accounting-related lawsuits) and Panel B, Table 7 (non-accounting-related lawsuits).

In the second stage, we re-estimate the LPM regression model (1) using a matched sample of 10,938/11,022 observations and include the control variables from the first-stage model. As in Table 5, we also control for industry and year fixed effects and cluster standard errors at the firm and year levels. Results of the second-stage model are in columns 2 through

4 (see Panel B of Tables 6 and 7). As before, we measure audit committee expertise in three ways (proportion, number, and binary). For both accounting-related and non-accounting-related lawsuits, we find that the coefficients on *INDAFE* are negative and significant at the 0.10 level or better for the proportion, the number, and binary measures of audit committee expertise.<sup>28</sup> In summary, these results are consistent with the results based on the full sample and alleviate endogeneity concerns.

**[Insert Table 6 About Here]**

**[Insert Table 7 About Here]**

#### *Additional controls*

We include board size and CEO duality as additional controls and reestimate model (1). We find that the coefficient on board size is positive and significant while CEO duality is not significant. Nevertheless, we continue to find significant and negative coefficient on *INDAFE*, consistent with the results in Table 5.

#### *Reverse causality*

To address concerns about reverse causality, we employ alternate measures of our audit committee expertise variables by using average expertise measured over 3-years (year  $t-2$  to  $t$ ) or over 5-years (year  $t-4$  to  $t$ ) instead of using current year information. We find that results are consistent with the results reported in Table 5.

#### *Controlling for audit committee's legal expertise*

Finally, we also examine whether audit committee members' legal expertise mitigates the risk of securities class action lawsuits. Untabulated results indicate that after controlling for audit committee members' legal expertise, the coefficients on *INDAFE* for the proportion, the number, and binary measures of audit committee expertise are, respectively, -0.022, -0.005,

---

<sup>28</sup> We also estimate our first-stage model to estimate the propensity scores by including an indicator variable for Big 4 auditors and include it as a control in the second-stage model. We continue to find a significant negative coefficient on *INDAFE*, consistent with the results in Tables 6 and 7.

and -0.006 (the first two coefficients are significant at the 0.01 level while the third one is significant at the 0.05 level). Further, the coefficients on audit committee members' legal expertise variables are not statistically significant, suggesting that audit committee members' legal expertise does not directly mitigate the risk of securities class action lawsuits.<sup>29</sup>

### *Additional analyses*

We conduct several additional analyses to further explore the effects of audit committee's combined industry and accounting expertise and we discuss those results below.

#### *Characteristics of lawsuits: settlement amount and case duration length*

First, we examine whether the combined expertise is related to two key characteristics of securities class action lawsuits: total settlement amount and the case length. We collect data on these two characteristics from the *RecoverMax* database of Institutional Shareholder Services for 475 lawsuits and data are unavailable for 5 lawsuits. Mean values of these characteristics for firm-years with and without *INDAFE* are reported in Panel A, Table 8. We find that the mean total settlement amount is greater by \$10.70 million (significant at the 0.10 level) when audit committee lacks the combined industry and accounting expertise. Similarly, the mean case length is greater by about 91 days (significant at the 0.01 level) for firms without the combined industry and accounting expertise relative to firm-years where the audit committee has the combined expertise. Next, we reestimate model (1) by replacing *SUED* with the total settlement amount and the case length and the results are in Panels B and C, respectively. In Panel B, the coefficients on *INDAFE* are negative (significant at the 0.10 level or better) for all three measures of expertise. In terms of economic significance, our results in column 3 suggest that having an audit committee with the combined accounting and industry expertise, a company is able to settle the case with a significantly lower settlement amount (i.e.,

---

<sup>29</sup> One potential reason for the insignificant coefficients on the audit committee's legal expertise is the lack of power due to the lower presence of such expertise in audit committee.

about \$10.352 million lower) compared with a company whose audit committee completely lacks the corresponding expertise. Turning to the results in Panel C, we find that the coefficients on *INDAFE* are negative (significant at the 0.10 level) in columns 1 and 2; the coefficient is negative but insignificant in column 3. A one standard deviation increase in the number of members with the combined accounting and industry expertise lowers the case length by -16.3372 ( $-99.617 \times 0.164$ ) and this translates to about 1.72 percent reduction in the sample mean case length ( $16.3372 / 949.91$ ). Overall, these findings are new to the literature on the effects of audit committee's combined accounting and industry expertise on litigation outcomes.

**[Insert Table 8 About Here]**

*Alternate measures of risk-taking*

Inspired by prior research on CEO and firm risk-taking (Malmendier and Tate 2005; Faccio et al. 2016), we examine whether the audit committee's accounting and industry expertise also constrains firm risk-taking behavior in a broader context beyond securities class action lawsuits and employ several alternative measures of risk-taking. Audit committee members with accounting and industry expertise can play an advisory role in evaluating risky projects, including appraising NPV projections, valuing risky assets, and guide the firm on dealings with foreign entities (FCPA compliance) and thus, mitigate firm risk-taking. To test our conjecture, we replace *SUED* with the standard deviation of ROA (*RISKTKG*) calculated over a 5-year period. We use both backward-looking (standard deviation of ROA over the years  $t-4$  to  $t$ ) and forward-looking (years  $t$  to  $t+4$ ) measures of *RISKTKG*. We use average of audit committee expertise variables over a 5-year period. We tabulate the results based on 5-year measures of *RISKTKG* using two ways of measuring each expertise variable (average proportion of audit committee members with the expertise and the average number of audit committee members with the expertise). The results are in Table 9. Columns 1 and 2 are based on backward-looking measures of *RISKTKG*, while columns 3 and 4 are based on forward-

looking measures. We find that the coefficient on *INDAFE* is negative and significant for all four columns and significant at the 0.01 level in columns 1 and 2 and at the 0.10 level in columns 3 and 4. The coefficients on other expertise variables are not significant. These findings are new to the literature on audit committee effectiveness and suggest that the audit committee's combined accounting and industry expertise also plays a role in constraining firm risk-taking.

**[Insert Table 9 about Here]**

Next, we examine whether audit committee's accounting and industry expertise constrains crash risk, i.e., the risk of a precipitous fall in stock price. Following prior research (Hutton et al. 2009; Kim et al. 2011; Robin and Zhang 2015), we employ three measures of stock price crash risk. Our first measure is an indicator variable that equals 1 if a firm experiences one or more firm-specific weekly returns falling at least three standard deviations below its mean value in a given year, and 0 otherwise. Our second measure is the negative skewness of firm-specific weekly returns during a fiscal year and our final measure is the log of the ratio of the standard deviations of down-week to up-week firm-specific returns during a fiscal year. Untabulated results indicate that for all three measures of crash risk, the coefficient on *INDAFE* is negative and significant for all three measures of expertise, suggesting that the audit committee's combined accounting and industry expertise constrains crash risk. However, these findings are sensitive to inclusion of firm/industry fixed effects, i.e., results are (not) significant when we include firm (industry) fixed effects.

Next, we examine whether audit committee's combined accounting and industry expertise moderates the relation between firm risk-taking and future firm performance. This analysis is motivated to shed some light on whether audit committee's expertise in constraining risk-taking negatively impacts firm performance. We estimate a regression of average ROA (calculated over the years  $t$  through  $t+2$ ) on *RISKTKG*, *INDAFE*, *INDAFE*×*RISKTKG*, and

controls. Untabulated results indicate that while the coefficient on *RISKTKG* is positive and significant, indicating that risk-taking is associated with future firm performance, the coefficient on the interaction variable is not significant. Thus, our results suggest that audit committee's combined accounting and industry expertise does not moderate the relation between risk-taking and future performance. In other words, audit committee expertise constrains risk-taking without negatively impacting future firm performance.

*Value of audit committee industry and accounting expertise in low vs. high litigation risk industries*

We examine whether the value of audit committee's combined industry and accounting expertise varies between firms in low vs. high litigation risk industries. The objective of this analysis is to provide some insight on whether the value of audit committee's expertise is especially valuable in firms that operate in industries with greater risk of litigation relative to firms operating in industries with lower risk of litigation. We interact *FPS* which equals 1 for firms in high litigation exposure industries, and 0 for firms in low litigation risk industries, with our variable of interest, *INDAFE* and re-estimate model (1). We also interact *FPS* with all other independent variables to allow their coefficients to vary between high and low litigation risk industries and untabulated results indicate that the coefficient on *INDAFE* is negative across all three columns but not significant at the 0.10 level. However, the coefficients on *INDAFE*×*FPS* for the proportion, the number, and binary measures are, respectively, -0.024, -0.008, and -0.012 (all are significant at the 0.01 level).

We complement the above analysis by using an *ex ante* measure of litigation risk estimated from Kim and Skinner (2012)'s model (3). We code *HLRD*, an indicator variable that equals 1 for the observations whose predicted probability of litigation is above the median, and 0 otherwise. We interact *HLRD* with *INDAFE* and all other independent variables and those results (not tabulated) indicate that the coefficient on *INDAFE*×*HLRD* for the proportion, the number, and binary measures are, respectively, -0.033 (significant at the 0.10

level), -0.007 and -0.007.<sup>30</sup> Collectively, these results provide support for the notion that audit committee members' combined industry and accounting expertise is potentially important in mitigating securities class action litigation in firms that are subject to greater litigation exposure.

*Value of audit committee industry and accounting expertise and CEO power*

Next, we examine whether the value of audit committee's combined industry and accounting expertise in mitigating securities class action lawsuits varies with audit committee's influence. This analysis is motivated by findings in Badolato et al. (2014) that audit committee with financial expertise plays a more effective role in constraining earnings management when the committee has higher status. We surmise that when a CEO is in a position to exercise significant control over the organization, monitoring of risk-taking could be reduced. One scenario where the CEO wields power is when the CEO also serves as the chairperson of the board of directors (Finkelstein et al. 1994). Davidson et al. (2004) find that earnings management is associated with CEO duality, i.e., the CEO is also the chair of the board. To test our conjecture, we interact *DUALITY* which equals 1 for firms with CEO-chairman duality, and 0 for firms without, with *INDAFE* and re-estimate model (1). We also interact *DUALITY* with all other independent variables to allow their coefficients to vary between the two sub-groups and the results are in Panel A, Table 10. We find that the coefficients on *INDAFE* continue to be negative across all three columns at the significance level of 0.05 or better, consistent with the results in Table 5. The coefficients on *INDAFE*×*DUALITY* for the proportion, the number, and binary measures are, respectively, 0.040, 0.010, (both coefficients are significant at the 0.10 level), and 0.011. These results suggest that the value of audit

---

<sup>30</sup> Untabulated results indicate that the corresponding marginal effects from logistic model of all three variables are higher in the high *ex ante* litigation risk sample than in the low litigation risk sample.

committee's combined accounting and industry expertise in mitigating class action lawsuits is constrained by CEO power.

**[Insert Table 10 about Here]**

*Value of audit committee industry and accounting expertise and other board members' legal expertise*

Next, we examine whether legal expertise of other board members (directors not serving on the audit committee) moderate the relation between the audit committee's combined industry and accounting expertise and the likelihood of securities class action lawsuits. On the one hand, other board members with legal expertise could help facilitate the work of audit committee members and thus their legal expertise could contribute to mitigating securities class action lawsuits. On the other hand, the legal expertise of other board members may exert a direct influence on the firm's litigation risk, and thus override the effect of audit committee members' expertise. Thus, it is an empirical question whether other board members' legal expertise by itself mitigates the risk of securities class action lawsuits or enhances audit committee's industry and accounting expertise. To answer this question, we create a dummy variable *HLEGD* which equals 1 for firm-years where the number of (non-audit committee) board members with legal expertise is above the sample median, and 0 otherwise.

We add *HLEGD* to model (1) and interact it with *INDAFE* and all other independent variables and those results are in Panel B, Table 10. We find that the coefficient on *HLEGD* is not significant across the three columns, indicating that other directors' legal expertise by itself is not associated with securities class action lawsuits. The coefficients on the variable of interest,  $INDAFE \times HLEGD$  for the proportion, the number, and binary measures of audit committee expertise are, -0.031 (significant at the 0.05 level), -0.007 (significant at the 0.05 level), and -0.012 (significant at the 0.01 level), respectively. The results are consistent with the notion that the legal expertise of other board members, although lacking a direct effect on

litigation risk, enhances audit committee's combined industry and accounting expertise in mitigating a firm's *ex post* likelihood of securities class action lawsuits.

*Changes to audit committee following securities class action lawsuits*

Finally, we examine whether securities class action lawsuits motivate firms to make changes to the audit committee i.e., recruit directors with accounting and industry expertise to strengthen the committee's expertise. As an aside, we find that audit committee members with accounting and industry expertise are in greater demand compared to directors without the combined expertise. The mean values of number of audit committees served by members with and without accounting and industry expertise are, respectively, 3.32 and 1.70 (the difference in mean values is significant at the 0.01 level). We employ a generalized difference-in-differences model where the dependent variable is one of the three measures of *INDAFE* (the proportion, the number, and a binary of audit committee members with the combined accounting and industry expertise). The variable of interest is *SUED\_POST* which equals 1 for all years after a firm has been sued, and 0 otherwise. We include both firm fixed effects and year fixed effects and the results are in Table 11. We find that the coefficients on *SUED\_POST* are, 0.016, 0.052, 0.035 (all are significant at the 0.10 level) respectively, for the proportion, the number, and binary measures of audit committee expertise. These results indicate that firms appear to be responsive to securities class action lawsuits and become more likely to recruit directors with accounting and industry expertise to strengthen the audit committee's expertise and reinforce the notion that audit committee members with combined accounting and industry expertise are valuable to the firm.<sup>31</sup>

**[Insert Table 11 about Here]**

---

<sup>31</sup> In a related study, Krishnan and Lee (2009) document a positive association between perceived litigation risk and the likelihood of having accounting expertise in the audit committee. Our results differ from theirs in that we focus on *actual* litigation. Besides, the generalized difference-in-differences approach also alleviates the endogeneity concern.

## 6. Conclusion

While the role of audit committees in monitoring the financial reporting process has received much attention in academic research as well as in practice, very little is known on the implications of the audit committee expertise for constraining managers' risk-taking behavior. This is an important issue because risk-taking may result in litigation which can impose significant legal, reputational, and time costs on the firm, managers, board of directors, and others. We empirically examine the relation between multiple attributes of audit committee expertise and the risk of securities class action lawsuits. Our results suggest that the likelihood of a securities class action lawsuit is lower for firms where audit committee members have expertise in both accounting and industry than for firms where audit committee members have only industry or accounting or supervisory expertise. More importantly, these results are obtained *after* controlling for accounting quality and the expertise from other (non-audit) committee members. Further, when we separate the lawsuits into those related to accounting and non-accounting, we find a negative relation between *non-accounting-related* securities class action lawsuits and the audit committee's combined expertise in accounting and industry. This finding is important because it shows that the audit committee's combined expertise extends beyond the realm of financial reporting in lowering a firm's *ex post* litigation risk. Another key finding is that both the amount of total case settlement and the case length are *lower* for firms with the combined industry and accounting expertise relative to firm-years where the audit committee lacks the combined expertise. These findings are new to the literature on audit committee expertise. Also, we provide evidence that audit committee's combined industry and accounting expertise is negatively associated with firm risk-taking. Finally, following a securities class action lawsuit, firms recruit directors with accounting and industry expertise to strengthen the audit committee's expertise.

Our findings have important implications for boards of directors, audit committee chairs, regulators, managers, and others. The results for audit committee expertise outperforming that of other (non-audit) committees in mitigating litigation risk lend empirical support to the prevailing practice of assigning firm risk oversight responsibility to audit committees. Regarding recruiting and retaining audit committee members, our results underscore the importance of the composition of the audit committee. While accounting expertise of the audit committee has been long emphasized, our findings suggest that accounting expertise combined with industry expertise is more valuable in mitigating securities class action lawsuits, especially in firms that are subject to greater litigation exposure.

## References

- Aebi, V., G. Sabato, and M. Schmid. 2012. Risk management, corporate governance, and bank performance in the financial crisis. *Journal of Banking & Finance* 36: 3213-3226.
- Agrawal, A., and S. Chadha. 2005. Corporate governance and accounting scandals. *Journal of Law and Economics* 48 (October): 371-406.
- Ashraf, M., P. N. Michas, and D. Russomanno. 2020. The impact of audit committee information technology expertise on the reliability and timeliness of financial reporting. *The Accounting Review* 95 (5): 23-56.
- Badolato, P. G., D. C. Donelson, and M. Ege. 2014. Audit committee financial expertise and earnings management: The role of status. *Journal of Accounting and Economics* 58 (2): 208–230.
- Balsam, S., J. Krishnan, and J. S. Yang. 2003. Auditor industry specialization and earnings quality. *Auditing: A Journal of Practice and Theory* 22 (2): 71-97.
- Bedard, J. C., D. Falsetta, G. Krishnamoorthy, and T. C. Omer. 2010. Voluntary disclosure of auditor-provided tax service fees. *Journal of the American Taxation Association* 32 (1): 59-77.
- Bedard, J., S. M. Chtourou, and L. Courteau. 2004. The effect of audit committee expertise, independence, and activity on aggressive earnings management. *Auditing: A Journal of Practice and Theory* 23 (2): 13-35.
- Beasley, M. S., B. C. Branson, and B. V. Hancock. 2010. Enterprise risk oversight. A global analysis. Available at <https://erm.ncsu.edu/az/erm/i/chan/library/erm-aicpa-cima-2010.pdf>.
- Carcello, J. V., Neal, T. L., Palmrose, Z. V., and S. Scholz. 2011. CEO involvement in selecting board members, audit committee effectiveness, and restatements. *Contemporary Accounting Research* 28 (2): 396-430.
- Chalmers, K., V. Naiker, and F. Navissi. 2012. Earnings quality and rule 10b-5 securities class action lawsuits. *Journal of Accounting and Public Policy* 31: 22-43.
- Cohen, J. R., U. Hoitash, G. Krishnamoorthy, and A. M. Wright. 2014. The effect of audit committee industry expertise on monitoring the financial reporting process. *The Accounting Review* 89 (1): 243-273.
- Cohen, J. R., U. Hoitash, G. Krishnamoorthy, and A. M. Wright. 2017. Enterprise risk management and the financial reporting process: the experiences of audit committee members, CFOs, and external auditors. *Contemporary Accounting Research* 34 (2): 1178–1209.
- Davidson, W. N., P. Jiraporn, Y. S. Kim, and C. Nemeč. 2004. Earnings management following duality-creating successions: Ethnostatistics, impression management, and agency theory. *Academy of Management Journal* 47 (2): 267-275.
- Dechow, P. M., and I. D. Dichev. 2002. The quality of accruals and earnings: The role of accrual estimation errors. *The Accounting Review* 77: 35-59.

DeFond, M. L., R. N. Hann, and X. Hu. 2005. Does the market value financial expertise on audit committees of boards of directors? *Journal of Accounting Research* 43 (2): 153-193.

deHaan, E. 2020. *Practical Guidance on Using and Interpreting Fixed Effects Models*. Available at: [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3699777](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3699777) .

Deloitte. 2018. Audit Committee Resource Guide. Available at <https://www2.deloitte.com/us/en/pages/center-for-board-effectiveness/articles/audit-committee-resource-guide.html>

DeZoort, F. T., D. R. Hermanson, D. S. Archambeault, and S. Reed. 2002. Audit committee effectiveness: A synthesis of the empirical audit committee literature. *Journal of Accounting Literature* 21:38–75.

Dhaliwal, D. S., V. Naiker, and F. Navissi. 2010. The association between accruals quality and the characteristics of accounting experts and mix of expertise on audit committees. *Contemporary Accounting Research* 27 (3): 787-827.

Donelson, D. C., J. M. McInnis, R. D. Mergenthaler, and Y. Yu. 2012. The timeliness of bad earnings news and litigation risk. *The Accounting Review* 87 (6): 1967-1991.

Faccio, M., Marchica, M-T., and R. Mura. 2016. CEO gender, corporate risk-taking, and the efficiency of capital allocation. *Journal of Corporate Finance* 39: 193–209.

Federal Reserve. 2018. Performance of the Wells Fargo & Company directors. Available at <https://www.federalreserve.gov/newsevents/pressreleases/files/enf20180202a2.pdf>

Finkelstein, S., and R. A. D'Aveni. 1994. CEO duality as a double-edged sword: how boards of directors balance entrenchment avoidance and unity of command. *The Academy of Management Journal* 37 (5): 1079–1108.

Francis, J., D. Philbrick, and K. Schipper. 1994. Shareholder litigation and corporate disclosures. *Journal of Accounting Research* 32 (2): 137-164.

Greene, W. 2004. The behaviour of the maximum likelihood estimator of limited dependent variable models in the presence of fixed effects. *The Econometrics Journal* 7 (1): 98–119.

Heninger, W. G. 2001. The association between auditor litigation and abnormal accruals. *The Accounting Review* 76 (1): 111-126.

Hennes, K. M., A. J. Leone, and B. P. Miller. 2008. The importance of distinguishing errors from irregularities in restatement research: The case of restatements and CEO/CFO turnover. *The Accounting Review* 83 (6): 1487-1519.

Hutton, A. P., A. J. Marcus, and H. Tehranian. 2009. Opaque financial reports, R2, and crash risk. *Journal of Financial Economics* 94 (1): 67–86.

Ittner, C. D., and T. Keusch. 2015. The influence of board of directors' risk oversight on risk management maturity and firm risk-taking. Working paper, University of Pennsylvania.

Jones, C. and E. Weingram, 1997. The effects of insider trading, seasoned equity offerings, corporate announcements, accounting restatements, and SEC enforcement Actions on 10b-5 litigation risk. Stanford University Graduate School of Business Working Paper Series.

Kim, I., and D. J. Skinner. 2012. Measuring securities litigation risk. *Journal of Accounting and Economics* 53 (1-2): 290-310.

Kim, J.-B., Y. Li, and L. Zhang. 2011. Corporate tax avoidance and stock price crash risk: Firm-level analysis. *Journal of Financial Economics* 100 (3): 639–662.

KPMG. 2018. Is everything under control? Audit committee challenges and priorities. Available at <https://assets.kpmg/content/dam/kpmg/uk/pdf/2018/01/is-everything-under-control.pdf>

KPMG. 2021. On the 2022 audit committee agenda. Available at <https://assets.kpmg/content/dam/kpmg/uk/pdf/2021/11/kpmg-on-the-2022-audit-committee-agenda.pdf>

Krishnan, G. V., and G. Visvanathan. 2008. Does the SOX definition of an accounting expert matter? The association between audit committee directors accounting expertise and accounting conservatism. *Contemporary Accounting Research* 25 (3): 827–858.

Krishnan, G. V., C. Wang, and W. Yu. 2021. Do high ability managers mitigate litigation related to financial reporting? *Journal of Management Accounting Research* 33 (1): 171-196.

Krishnan, J. 2005. Audit committee quality and internal control: an empirical analysis. *The Accounting Review* 80 (2): 649-675.

Krishnan, J., and J. E. Lee. 2009. Audit committee financial expertise, litigation risk, and corporate governance. *Auditing: A Journal of Practice & Theory* 28 (1): 241–261.

Krishnan, J., Y. Wen, and W. Zhao. 2011. Legal expertise on corporate audit committees and financial reporting quality. *The Accounting Review* 86 (6): 2099-2130.

Lipton, M., S. V. Niles, and M. L. Miller. 2018. Risk management and the board of directors. Harvard Law School Forum on Corporate Governance. Available at <https://corpgov.law.harvard.edu/2018/03/20/risk-management-and-the-board-of-directors-5/>

Maletta, M., and A. M. Wright. 1996. Audit evidence planning: an examination of industry error characteristics. *Auditing: A Journal of Practice & Theory* (Spring): 71-86.

Malmendier, U., and G. Tate. 2005. CEO overconfidence and corporate investment. *Journal of Finance*. 60: 2661–2700.

Minton, B. A., J. P. Taillard, and R. Williamson. 2014. Financial expertise of the board, risk taking, and performance: Evidence from bank holding companies. *Journal of Financial and Quantitative Analysis* 49 (2): 351-380.

Minutti-Meza, M. 2013. Does auditor industry specialization improve audit quality? *Journal of Accounting Research* 51 (4): 779-817.

National Association of Corporate Directors. 2009. Report of the NACD Blue Ribbon Commission. Risk Governance: Balancing Risk and Reward. Available at [https://www.wlrk.com/docs/1605831\\_1.pdf](https://www.wlrk.com/docs/1605831_1.pdf)

Organisation for Economic Co-operation and Development. 2015. G20/OECD Principles of Corporate Governance. Available at [https://www.oecd-ilibrary.org/governance/g20-oecd-principles-of-corporate-governance-2015\\_9789264236882-en](https://www.oecd-ilibrary.org/governance/g20-oecd-principles-of-corporate-governance-2015_9789264236882-en)

Palmrose, Z-V. and S. Scholz. 2004. The accounting causes and legal consequences of non-GAAP reporting: evidence from restatements. *Contemporary Accounting Research* 21: 139–180.

Pathan, S. 2009. Strong boards, CEO power and bank risk-taking. *Journal of Banking & Finance* 33: 1340-1350.

PricewaterhouseCoopers. 2017. A rising tide or a rogue wave? 2016 Securities litigation study. Available at <https://www.pwc.com/us/en/forensic-services/assets/313021-2017-securities-litigation-2017-v9.pdf>

Robin, A. J., and H. Zhan. 2015. Do industry-specialist auditors influence stock price crash risk? *Auditing: A Journal of Practice & Theory* 34 (3): 47-79.

Securities and Exchange Commission (SEC). 2003. Disclosure Required by Sections 406 and 407 of the Sarbanes-Oxley Act of 2002. Available at: <https://www.sec.gov/rules/final/33-8177.htm>

Srinivasan, S. 2005. Consequences of financial reporting failure for outside directors: Evidence from accounting restatements and audit committee members. *Journal of Accounting Research* 43 (2): 291-334.

Vanguard. 2017. Investment Stewardship. Annual Report. Available at <https://www.wlrk.com/docs/VanguardInvestmentStewardshipReport2017.pdf>

Willkie Farr & Gallagher. 2003. New NYSE rules for audit committees of listed companies. Available at [https://www.willkie.com/-/media/files/publications/2003/11/new-nyse-rules-for-audit-committees-of-listed-co\\_/files/newnyserulespdf/fileattachment/new\\_nyse\\_rules.pdf](https://www.willkie.com/-/media/files/publications/2003/11/new-nyse-rules-for-audit-committees-of-listed-co_/files/newnyserulespdf/fileattachment/new_nyse_rules.pdf)

Xie, B., W. N. Davidson, and P. J. Dadalt. 2003. Earnings management and corporate governance: The role of the board and the audit committee. *Journal of Corporate Finance* 9 (2): 295-316.

## Appendix A: Variable Definitions

### Litigation variables

|                                |   |
|--------------------------------|---|
| <i>ACCT_SUED<sub>it</sub></i>  | Indicator variable, equals 1 for firm-years where there is at least one securities class action lawsuit alleging GAAP violation, restated earnings, or both, and 0 otherwise.   |
| <i>Case length</i>             | The difference in days between the filing date and the dismissal date (for those dismissed case), or between the filing date and the final settlement date (for those settled cases).                                       |
| <i>NACCT_SUED<sub>it</sub></i> | Indicator variable, equals 1 for firm-years where there is at least one securities class action lawsuit alleging neither GAAP violation nor restated earnings, and 0 otherwise (see Panel C, Table 3 for more information). |
| <i>Settlement amount</i>       | Total settlement amount is obtained from <i>RecoverMax</i> database and is set as 0 for those dismissed cases.  |
| <i>SUED<sub>it</sub></i>       | Indicator variable, equals 1 for firm-years where there is at least one securities class action lawsuit filed against firm <i>i</i> as a defendant in year <i>t</i> , and 0 otherwise.                                      |
| <i>SUED_POST</i>               | Indicator variable, equals 1 for all years after a firm has been sued, and 0 otherwise.   |

### Test variables

|                             |   |
|-----------------------------|---|
| <i>INDAFE<sub>it</sub></i>  | Indicator variable, equals 1 for the audit committee members having both industry expertise and accounting expertise, and 0 otherwise. Industry expertise is defined as audit committee members having work experience in another firm in the same industry with the focal firm, while accounting financial expertise is defined as audit committee members holding a degree/professional certification related to accounting, auditing or taxation, or having accounting related working experience. |
| <i>INDSFE<sub>it</sub></i>  | Indicator variable, equals 1 for the audit committee members having both industry and supervisory expertise, and 0 otherwise. Supervisory expertise is defined as audit committee members previously having supervisory positions such as CEO, COO, chairman of board, or president of a company.   |
| <i>ONLYAFE<sub>it</sub></i> | Indicator variable, equals 1 for the audit committee members having only accounting expertise, and 0 otherwise.   |
| <i>ONLYSFE<sub>it</sub></i> | Indicator variable, equals 1 for the audit committee members having only supervisory expertise, and 0 otherwise.  |
| <i>ONLYIND<sub>it</sub></i> | Indicator variable, equals 1 for the audit committee members having only industry expertise, and 0 otherwise.   |

### Control variables

|                                |  |
|--------------------------------|--|
| <i>FPS<sub>it</sub></i>        | Indicator variable, equals 1 if the firm is in the biotech (SIC codes 2833–2836 and 8731–8734) computer (3570–3577 and 7370–7374), electronics (3600–3674), or retail (5200–5961) industry, and 0 otherwise (Francis et al. 1994). |
| <i>INSIDER<sub>it-1</sub></i>  | Average of year <i>t-1</i> and <i>t-2</i> insider sales net of acquisitions scaled by year <i>t-1</i> revenue.   |
| <i>LNASSETS<sub>it-1</sub></i> | The natural logarithm of total assets in year <i>t-1</i> .   |
| <i>MTB<sub>it-1</sub></i>      | Lagged market-to-book ratio: $prcc\_f \times csho$ divided by common equity.   |
| <i>OTHEREAFE</i>               | Indicator variable, equals 1 if other board members (other than audit committee members) have accounting expertise, and 0 otherwise.   |

|                                |   |
|--------------------------------|---|
| <i>OTHERIND</i>                | Indicator variable, equals 1 if other board members (other than audit committee members) have relevant industry expertise, and 0 otherwise. |
| <i>OTHERSFE</i>                | Indicator variable, equals 1 if other board members (other than audit committee members) have supervisory expertise, and 0 otherwise.       |
| <i>RET<sub>it-1</sub></i>      | Equally-weighted market adjusted stock return for prior fiscal year.  |
| <i>RETSTD<sub>it-1</sub></i>   | Standard deviation of equally-weighted market adjusted stock returns for prior fiscal year;   |
| <i>RISKTKG</i>                 | The standard deviation of ROA calculated over a 3-year or a 5-year period.  |
| <i>SGROWTH<sub>it-1</sub></i>  | Year <i>t-1</i> sales less year <i>t-2</i> sales scaled by beginning of year <i>t-1</i> total assets.                                       |
| <i>SKEW<sub>it-1</sub></i>     | Skewness of the firm's stock returns for prior fiscal year.   |
| <i>TURNOVER<sub>it-1</sub></i> | Average daily turnover (volume/shares outstanding) over the prior fiscal year.  |
| <i>RESTATED</i>                | Indicator variable, equals 1 if the firm's account is restated in or before the current year, and 0 otherwise.                              |
| <i>AQ<sub>it-1</sub></i>       | A proxy for earnings quality estimated as follows:  |

We estimate the following modified Dechow and Dichev (2002) model by industry and loss percentage quintile.

$$CACC_{i,t} = \alpha_0 + \alpha_1 CFO_{i,t-1} + \alpha_2 CFO_{i,t} + \alpha_3 CFO_{i,t+1} + \alpha_4 \Delta SALE_{i,t} + \alpha_5 PPE_{i,t} + \varepsilon_{i,t} \quad (2)$$

Where *CACC* is total current accruals, *CFO* is operating cash flows;  $\Delta SALE$  is change in sales revenue; *PPE* is the gross value of plant, property and equipment. Industries are defined as Fama and French's 48 industries. The loss percentage of firm is measured over the period from year *t-4* to *t*. We require that each industry and year to have at least 20 observations. *AQ* is derived as the standard deviation of the residuals for the period between year *t-4* and year *t* for each firm-year observation. Higher values of *AQ* indicate lower earnings quality.

### **Partitioning variables**

|                           |  |
|---------------------------|--|
| <i>DUALITY</i>            | Indicator variable, equals 1 for firms with CEO-Chairman duality, and 0 otherwise.   |
| <i>HLEGD<sub>it</sub></i> | Indicator variable, equals 1 if the number of other board members having legal expertise is above the sample median, and 0 otherwise.  |
| <i>HLRD<sub>it</sub></i>  | Indicator variable, equals 1 if the predicted litigation risk probability (estimated following the approach by Kim and Skinner (2012) for the firm-year is higher than the sample median litigation risk probability, and 0 otherwise. |

---

## **Appendix B: Examples of Cases against the Board of Directors Alleging Non-Accounting Issues (retrieved from *RecoverMax*)**

### **Compellent Technologies, Inc. (Minnesota District Court)**

On December 12, 2010, Compellent entered into an Agreement and Plan of Merger (the "Merger Agreement") with a wholly-owned subsidiary of Dell Inc. ("Dell"), Dell International L.L.C., and Dell Trinity Holdings Corp., a wholly-owned subsidiary of Dell ("Merger Sub"). Pursuant to the Merger Agreement, Merger Sub will merge with and into Compellent (the "Merger"), with Compellent continuing as the surviving corporation and a wholly-owned subsidiary of Dell. As a result of the Merger, each share of Compellent common stock issued and outstanding immediately prior to the effective time of the Merger (other than shares held by Compellent, Dell, Merger Sub or any of their wholly owned subsidiaries or by stockholders of Compellent who have validly exercised their appraisal rights under Delaware law) will be converted into the right to receive \$27.75 in cash, without interest and subject to any required tax withholding.

The complaint alleges that the members of Compellent's board of directors breached their fiduciary duties of care, loyalty, good faith and independence to Compellent's stockholders by entering into the Merger Agreement because they failed to, among other things (1) fully inform themselves of the market value of Compellent before entering into the Merger Agreement, (2) exercise valid business judgment in connection with the Merger Agreement, (3) act in the best interests of the stockholders, (4) maximize stockholder value, and (5) obtain the best financial and other terms. The complaint also alleges that Dell and Merger Sub aided and abetted Compellent's board of directors in breaching their fiduciary duties.

### **Yahoo! Inc. (2008) (Delaware Chancery Court)**

The Complaint alleges as follows: Yahoo and its board of directors have acted to thwart a non-coercive takeover bid by Microsoft Corp. ("Microsoft"), which would provide a 62% premium over Yahoo's pre-offer share price, and have instead approved improper defensive measures and pursued third party deals that would be destructive to shareholder value. Yahoo's "Just Say No to Microsoft" approach is a result of resentment by the Board, and not any good faith focus on maximizing shareholder value. Microsoft attempted to initiate merger discussions in late 2006 and early 2007, but was rebuffed, supposedly so Yahoo's management could implement existing strategic plans. None of those initiatives improved Yahoo's performance. On February 1, 2008, over a year after its initial approach, Microsoft returned, offering to acquire Yahoo for \$31 per share, representing a 62% premium above the \$19.18 closing price of its stock on January 31, 2008.

On February 22, 2008, Plaintiffs filed a Motion to Expedite, seeking immediate discovery and requesting that a trial date be set in May 2008.

On February 25, 2008, Plaintiffs filed a Motion to Consolidate the several pending shareholder class actions and to appoint lead counsel to prosecute the claims on behalf of Yahoo's shareholders.

Rather than consider Microsoft's offer in good faith, Yahoo's board has taken various steps to defend against Microsoft, destroying or threatening to destroy shareholder value in the process. According to published news reports, the Yahoo board is desperately seeking a deal with third parties, including News Corp., in transaction structures that would evade shareholder review while making it virtually impossible for Microsoft to succeed in its current or any improved offer. In addition, the day after they formally refused Microsoft's offer, the Yahoo board approved a highly unusual severance plan that would provide "golden parachute" payments to every single one of Yahoo's employees. This program is estimated to cost shareholders between \$1 billion and \$3 billion, which represents between 2-7% of the total value of Microsoft's offer. These patently defensive measures are unreasonable and improper. Plaintiffs seek an injunction against any further improper steps and an order invalidating the improper severance packages approved to date. Plaintiffs also seek to ensure that Yahoo's shareholders are given the full and fair opportunity to sell their shares for the maximum price available.

**Figure 1: A Comparison of the Five Audit Committee Expertise Variables**

|                | Accounting<br>Expertise | Industry<br>Expertise | Supervisory<br>Expertise |
|----------------|-------------------------|-----------------------|--------------------------|
| <i>INDAFE</i>  | Y                       | Y                     | Y/N                      |
| <i>INDSFE</i>  | Y/N                     | Y                     | Y                        |
| <i>ONLYIND</i> | N                       | Y                     | N                        |
| <i>ONLYAFE</i> | Y                       | N                     | N                        |
| <i>ONLYSFE</i> | N                       | N                     | Y                        |

This figure presents a comparison of the five audit committee expertise variables. “Y” and “N” denote, respectively, Yes and No. See Appendix A for variable definitions.

**Table 1: Sample Selection**

| Sampling procedure  | Number of observations |
|---|------------------------|
| Number of observations available on <i>BoardEx</i> to calculate the audit committee expertise variables for years 2000 through 2017 | 84,689                 |
| Less: observations not available on <i>Compustat</i>  | (23,379)               |
| Remaining observations  | 61,310                 |
| Less: observations with missing data on control variables   | (35,152)               |
| Less: observations with missing data to estimate Kim and Skinner model  | (673)                  |
| Final number of observations  | 25,485                 |

This table describes sample selection. Data on securities class action lawsuits are obtained from the Stanford Law School Securities Class Action Clearinghouse (supplemented by *RecoverMax* from Institutional Shareholder Services(ISS)).

**Table 2: Industry Distribution of Sample**

| <b>Two-digit SIC</b> |  | <b>N</b> | <b>SUED</b> |
|----------------------|--|----------|-------------|
| 08                   | Forestry   | 2        | 0.00%       |
| 10                   | Metal Mining   | 82       | 0.00%       |
| 13                   | Oil and Gas Extraction   | 1,329    | 1.28%       |
| 14                   | Mining and Quarrying of Nonmetallic Minerals                           | 3        | 0.00%       |
| 15                   | Building Const. General Contractors and Operative Builders             | 109      | 2.75%       |
| 16                   | Heavy Const. other than Building Construction Contractors              | 30       | 0.00%       |
| 17                   | Construction Special Trade Contractors                                 | 10       | 10.00%      |
| 20                   | Food and Kindred Products  | 475      | 16.84%      |
| 23                   | Apparel & other Finished Products from Fabrics and Materials           | 186      | 0.54%       |
| 24                   | Lumber and Wood Products, except Furniture                             | 153      | 0.00%       |
| 25                   | Furniture and Fixtures   | 124      | 1.61%       |
| 26                   | Paper and Allied Products  | 111      | 0.90%       |
| 27                   | Printing, Publishing and Allied Industries                             | 100      | 0.00%       |
| 28                   | Chemicals and Allied Products  | 3,203    | 3.40%       |
| 29                   | Petroleum Refining and Related Industries                              | 197      | 1.02%       |
| 30                   | Rubber and Miscellaneous Plastics Products                             | 64       | 4.69%       |
| 31                   | Leather and Leather Products   | 97       | 1.03%       |
| 32                   | Stone, Clay, Glass and Concrete Products                               | 119      | 0.84%       |
| 33                   | Primary Metal Industries   | 219      | 0.91%       |
| 34                   | Fabricated Metal Products, except Mach & Transportation Equipment      | 307      | 0.33%       |
| 35                   | Industrial and Commercial Machinery and Computer Equipment             | 1,857    | 1.83%       |
| 36                   | Electronic & Electrical Equip and Component. except Computer Equipment | 2,601    | 1.65%       |
| 37                   | Transportation Equipment   | 322      | 2.48%       |
| 38                   | Measuring, Analyzing and Controlling Instruments                       | 1876     | 1.92%       |
| 39                   | Miscellaneous Manufacturing Industries                                 | 1        | 0.00%       |
| 40                   | Railroad Transportation  | 83       | 0.00%       |
| 41                   | Local & Sub Transit & Interurban Highway Passenger Transportation      | 14       | 0.00%       |
| 42                   | Motor Freight Transportation and Warehousing                           | 275      | 0.00%       |
| 44                   | Water Transportation   | 139      | 0.00%       |
| 45                   | Transportation by Air  | 226      | 0.00%       |
| 46                   | Pipeline, except Natural Gas   | 51       | 0.00%       |
| 47                   | Transportation Services  | 81       | 2.47%       |
| 48                   | Communications   | 798      | 2.13%       |
| 49                   | Electric, Gas and Sanitary Services                                    | 1,252    | 2.24%       |
| 50                   | Wholesale Trade-Durable Goods  | 738      | 0.68%       |
| 51                   | Wholesale Trade-Nondurable Goods                                       | 398      | 2.76%       |
| 52                   | Building Mat., Hardware, Garden Supply & Mobile Home Dealers           | 61       | 1.64%       |
| 53                   | General Merchandise Stores   | 284      | 3.17%       |
| 54                   | Food Stores  | 152      | 1.97%       |
| 55                   | Automotive Dealers and Gasoline Service Stations                       | 219      | 0.91%       |
| 56                   | Apparel and Accessory Stores   | 481      | 1.66%       |
| 57                   | Home Furniture, Furnishings and Equipment Stores                       | 135      | 2.96%       |

|                                     |  |               |              |
|-------------------------------------|--|---------------|--------------|
| 58                                  | Eating and Drinking Places   | 378           | 1.58%        |
| 59                                  | Miscellaneous Retail   | 539           | 3.34%        |
| 60                                  | Depository Institutions  | 7             | 0.00%        |
| 61                                  | Non-Depository Credit Institutions                                 | 38            | 0.00%        |
| 62                                  | Security & Commodity Brokers, Dealers, Exchanges & Services        | 2             | 0.00%        |
| 63                                  | Insurance Carriers   | 43            | 2.33%        |
| 64                                  | Insurance Agents, Brokers and Service                              | 98            | 2.04%        |
| 65                                  | Real Estate  | 30            | 0.00%        |
| 67                                  | Holding and other Investment Offices                               | 407           | 1.72%        |
| 70                                  | Hotels, Rooming Houses, Camps and other Lodging Places             | 53            | 0.00%        |
| 72                                  | Personal Services  | 49            | 4.08%        |
| 73                                  | Business Services  | 3,535         | 1.36%        |
| 75                                  | Automotive Repair, Services and Parking                            | 38            | 2.63%        |
| 78                                  | Motion Pictures  | 48            | 8.33%        |
| 79                                  | Amusement and Recreation Services                                  | 214           | 0.47%        |
| 80                                  | Health Services  | 335           | 3.28%        |
| 81                                  | Legal Services   | 4             | 0.00%        |
| 82                                  | Educational Services   | 81            | 9.88%        |
| 83                                  | Social Services  | 5             | 0.00%        |
| 87                                  | Engineering, Accounting, Research, Management and Related Services | 617           | 1.30%        |
| <b>Total number of observations</b> |  | <b>25,485</b> | <b>1.90%</b> |

This table presents the distribution of the sample across industries (based on 2-digit SIC), as well as the percentage of being sued in each industry.

Table 3: Descriptive Statistics

## Panel A: Full sample

| Variable                      | N      | Mean   | S.D.  | P25    | P50    | P75    |
|-------------------------------|--------|--------|-------|--------|--------|--------|
| <i>SUED</i>                   | 25,485 | 0.019  | 0.136 | 0.000  | 0.000  | 0.000  |
| <i>INDAFE</i>                 | 25,485 | 0.092  | 0.164 | 0.000  | 0.000  | 0.200  |
| <i>INDSFE</i>                 | 25,485 | 0.198  | 0.255 | 0.000  | 0.000  | 0.333  |
| <i>ONLYIND</i>                | 25,485 | 0.021  | 0.076 | 0.000  | 0.000  | 0.000  |
| <i>ONLYAFE</i>                | 25,485 | 0.086  | 0.143 | 0.000  | 0.000  | 0.200  |
| <i>ONLYSFE</i>                | 25,485 | 0.326  | 0.257 | 0.000  | 0.333  | 0.500  |
| <i>OTHEREAFE</i>              | 25,485 | 0.756  | 0.429 | 1.000  | 1.000  | 1.000  |
| <i>OTHERSFE</i>               | 25,485 | 0.985  | 0.121 | 1.000  | 1.000  | 1.000  |
| <i>OTHERIND</i>               | 25,485 | 0.631  | 0.482 | 0.000  | 1.000  | 1.000  |
| <i>FPS</i>                    | 25,485 | 0.400  | 0.490 | 0.000  | 0.000  | 1.000  |
| <i>SGROWTH<sub>t-1</sub></i>  | 25,485 | 0.084  | 0.239 | -0.014 | 0.054  | 0.162  |
| <i>LNASSETS<sub>t-1</sub></i> | 25,485 | 6.445  | 2.079 | 4.941  | 6.488  | 7.873  |
| <i>MTB<sub>t-1</sub></i>      | 25,485 | 2.987  | 4.318 | 1.353  | 2.133  | 3.592  |
| <i>RET<sub>t-1</sub></i>      | 25,485 | 0.028  | 0.517 | -0.270 | -0.038 | 0.215  |
| <i>SKEW<sub>t-1</sub></i>     | 25,485 | 0.379  | 1.426 | -0.194 | 0.312  | 0.915  |
| <i>RETSTD<sub>t-1</sub></i>   | 25,485 | 0.028  | 0.016 | 0.017  | 0.024  | 0.035  |
| <i>TURNOVER<sub>t-1</sub></i> | 25,485 | 8.582  | 7.522 | 3.425  | 6.496  | 11.247 |
| <i>AQ<sub>t-1</sub></i>       | 25,485 | 0.060  | 0.111 | 0.014  | 0.024  | 0.051  |
| <i>RESTATED</i>               | 25,485 | 0.336  | 0.472 | 0.000  | 0.000  | 1.000  |
| <i>INSIDER<sub>t-1</sub></i>  | 25,485 | -0.003 | 0.015 | -0.002 | -0.001 | 0.003  |

**Panel B: Comparison of sued vs. non-sued firm-years**

| Variable                      | Sued firm-years<br>(n=480) |        |       | Non-sued firm-years<br>(n=25,005) |        |       | Test of differences in means and<br>medians |            |
|-------------------------------|----------------------------|--------|-------|-----------------------------------|--------|-------|---|------------|
|                               | Mean                       | Median | S.D.  | Mean                              | Median | S.D.  | t-statistic                                 | Wilcoxon z |
| <i>INDAFE</i>                 | 0.095                      | 0.000  | 0.153 | 0.092                             | 0.000  | 0.164 | 0.372                                       | 1.092      |
| <i>INDSFE</i>                 | 0.242                      | 0.200  | 0.272 | 0.198                             | 0.000  | 0.255 | 3.751***                                    | 3.840***   |
| <i>ONLYIND</i>                | 0.027                      | 0.000  | 0.084 | 0.021                             | 0.000  | 0.076 | 1.959**                                     | 2.183**    |
| <i>ONLYAFE</i>                | 0.079                      | 0.000  | 0.137 | 0.086                             | 0.000  | 0.143 | 1.027                                       | -0.921     |
| <i>ONLYSFE</i>                | 0.309                      | 0.286  | 0.266 | 0.327                             | 0.333  | 0.257 | 1.458                                       | -1.773*    |
| <i>OTHEREAFE</i>              | 0.769                      | 1.000  | 0.422 | 0.756                             | 1.000  | 0.430 | -0.655                                      | -0.655     |
| <i>OTHERSFE</i>               | 0.996                      | 1.000  | 0.064 | 0.985                             | 1.000  | 0.122 | 1.965**                                     | 1.965**    |
| <i>OTHERIND</i>               | 0.725                      | 1.000  | 0.447 | 0.630                             | 1.000  | 0.483 | 4.296***                                    | 4.294***   |
| <i>FPS<sub>t</sub></i>        | 0.517                      | 1.000  | 0.500 | 0.398                             | 0.000  | 0.489 | 5.269***                                    | 5.266***   |
| <i>LNASSETS<sub>t-1</sub></i> | 7.351                      | 7.375  | 2.142 | 6.428                             | 6.473  | 2.074 | 9.646***                                    | 8.798***   |
| <i>SGROWTH<sub>t-1</sub></i>  | 0.108                      | 0.068  | 0.243 | 0.083                             | 0.053  | 0.239 | 2.281**                                     | 2.036**    |
| <i>RET<sub>t-1</sub></i>      | -0.026                     | -0.148 | 0.582 | 0.029                             | -0.037 | 0.515 | -2.247**                                    | -4.459***  |
| <i>SKEW<sub>t-1</sub></i>     | -0.042                     | 0.085  | 1.789 | 0.388                             | 0.318  | 1.417 | -6.536***                                   | -6.330***  |
| <i>RETSTD<sub>t-1</sub></i>   | 0.028                      | 0.024  | 0.015 | 0.028                             | 0.024  | 0.016 | 0.348                                       | 1.162      |
| <i>TURNOVER<sub>t-1</sub></i> | 13.35                      | 10.945 | 9.371 | 8.490                             | 6.439  | 7.453 | 14.061***                                   | 13.390***  |
| <i>MTB<sub>t-1</sub></i>      | 3.916                      | 2.689  | 5.658 | 2.970                             | 2.125  | 4.286 | 4.759***                                    | 5.969***   |
| <i>INSIDER<sub>t-1</sub></i>  | -0.004                     | -0.000 | 0.019 | -0.003                            | -0.000 | 0.015 | -1.913*                                     | 0.901      |
| <i>RESTATED</i>               | 0.429                      | 0.000  | 0.495 | 0.334                             | 0.000  | 0.472 | 4.361***                                    | 4.359***   |
| <i>AQ<sub>t-1</sub></i>       | 0.067                      | 0.026  | 0.113 | 0.060                             | 0.024  | 0.111 | 1.288                                       | 1.144      |

**Panel C: Types of allegations in securities class action lawsuits**

|                          | All Cases | Accounting Cases<br>( <i>ACCT_SUED</i> ) | Non-Accounting Cases<br>( <i>NACCT_SUED</i> ) |
|--------------------------|-----------|--|---|
| <i>GAAP violation</i>    | 151       | 161                                      |   |
| <i>Restated earnings</i> | 98        |  |   |
| <i>Section 10(b)</i>     | 445       | 319                                      |   |
| <i>Section 11</i>        | 38        |  |   |
| <i>Transactional</i>     | 28        |  |   |
| <i>Insider trading</i>   | 68        |  |   |
| <i>IPO violation</i>     | 4         |  |   |
| <i>SPO violation</i>     | 20        |  |   |

This table reports the descriptive statistics. Panel A reports the descriptive statistics for the variables in model (1) for the full sample. Panel B reports tests of differences in means and medians for the variables between sued vs. non-sued firm-years. \*\*\*, \*\* and \* indicate, respectively, significance at the 0.01, 0.05, and 0.10 levels. See Appendix A for variable definitions. Panel C provides frequency of different types of allegations in securities class action lawsuits. *GAAP violation* refers to actions that allege violations of General Acceptable Accounting Principles. *Restated earnings* refers to cases that relate to a company's restatement of its financials. *Section 10(b)* refers to cases alleging violations of Rule 10b-5 of the Securities and Exchange Act of 1934. *Section 11* refers to cases alleging violations of Section 11 of Securities Act of 1933 (Civil Liabilities on Account of False Registration Statement). *Transactional* refers to alleged improper conduct in public transactions such as M&A, privatization, stock buybacks. *Insider trading* refers to case relating to insider trading. *IPO violation* refers to cases relating to a company's initial public offering. *SPO (secondary public offering) violation* refers to alleged materially inaccurate statements in the Registration Statement and Prospectus. Since a case may include multiple allegations, the sum of these numbers is greater than the number of cases 480 in our sample. Accounting cases (*ACCT\_SUED*) are defined as those cases including GAAP violation, restated earnings, or both. Non-accounting cases (*NACCT\_SUED*) are defined as those cases including neither GAAP violation nor restated earnings. The sum of accounting cases (161) and non-accounting cases (319) equals the number of lawsuit cases in the sample (480).

Table 4: Correlation Matrix

|                               | 1             | 2             | 3             | 4             | 5             | 6             | 7             | 8             | 9             | 10            | 11            | 12            | 13            | 14           | 15            | 16            | 17            | 18            | 19     |  |
|-------------------------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|--------------|---------------|---------------|---------------|---------------|--------|--|
| <i>SUED</i>                   |               |               |               |               |               |               |               |               |               |               |               |               |               |              |               |               |               |               |        |  |
| <i>INDAFE</i>                 | 0.002         |               |               |               |               |               |               |               |               |               |               |               |               |              |               |               |               |               |        |  |
| <i>INDSFE</i>                 | <b>0.024</b>  | <b>0.566</b>  |               |               |               |               |               |               |               |               |               |               |               |              |               |               |               |               |        |  |
| <i>ONLYIND</i>                | <b>0.012</b>  | <b>0.066</b>  | <b>0.063</b>  |               |               |               |               |               |               |               |               |               |               |              |               |               |               |               |        |  |
| <i>ONLYAFE</i>                | -0.006        | <b>-0.163</b> | <b>-0.193</b> | <b>-0.066</b> |               |               |               |               |               |               |               |               |               |              |               |               |               |               |        |  |
| <i>ONLYSFE</i>                | -0.009        | <b>-0.331</b> | <b>-0.472</b> | <b>-0.180</b> | <b>-0.139</b> |               |               |               |               |               |               |               |               |              |               |               |               |               |        |  |
| <i>OTHEREAFE</i>              | 0.004         | <b>0.178</b>  | <b>0.025</b>  | <b>-0.048</b> | <b>0.155</b>  | <b>-0.191</b> |               |               |               |               |               |               |               |              |               |               |               |               |        |  |
| <i>OTHERSFE</i>               | <b>0.012</b>  | <b>0.046</b>  | <b>0.079</b>  | <b>-0.019</b> | <b>-0.048</b> | <b>0.092</b>  | <b>0.128</b>  |               |               |               |               |               |               |              |               |               |               |               |        |  |
| <i>OTHERIND</i>               | <b>0.027</b>  | <b>0.383</b>  | <b>0.549</b>  | <b>0.197</b>  | <b>-0.115</b> | <b>-0.313</b> | <b>0.094</b>  | <b>0.119</b>  |               |               |               |               |               |              |               |               |               |               |        |  |
| <i>FPS</i>                    | <b>0.033</b>  | <b>0.176</b>  | <b>0.249</b>  | <b>0.119</b>  | <b>-0.072</b> | <b>-0.138</b> | <b>-0.070</b> | <b>0.018</b>  | <b>0.173</b>  |               |               |               |               |              |               |               |               |               |        |  |
| <i>SGROWTH<sub>t-1</sub></i>  | <b>0.014</b>  | <b>-0.042</b> | <b>-0.061</b> | <b>-0.017</b> | 0.009         | <b>0.046</b>  | <b>-0.030</b> | <b>-0.011</b> | <b>-0.065</b> | -0.007        |               |               |               |              |               |               |               |               |        |  |
| <i>LNASSETS<sub>t-1</sub></i> | <b>0.060</b>  | -0.008        | <b>-0.046</b> | <b>-0.063</b> | <b>-0.025</b> | <b>0.092</b>  | <b>0.141</b>  | <b>0.128</b>  | <b>0.088</b>  | <b>-0.193</b> | <i>0.012</i>  |               |               |              |               |               |               |               |        |  |
| <i>MTB<sub>t-1</sub></i>      | <b>0.030</b>  | <b>0.015</b>  | <b>0.028</b>  | <b>0.048</b>  | <b>-0.027</b> | <b>-0.013</b> | <b>-0.027</b> | 0.005         | <b>0.034</b>  | <b>0.090</b>  | <b>0.103</b>  | <b>-0.013</b> |               |              |               |               |               |               |        |  |
| <i>RET<sub>t-1</sub></i>      | <b>-0.014</b> | <b>-0.021</b> | <b>-0.018</b> | -0.001        | 0.004         | <i>0.012</i>  | <b>-0.021</b> | -0.010        | <b>-0.017</b> | 0.004         | <b>0.215</b>  | -0.010        | <b>0.152</b>  |              |               |               |               |               |        |  |
| <i>SKEW<sub>t-1</sub></i>     | <b>-0.041</b> | <i>0.010</i>  | <b>0.015</b>  | <b>0.017</b>  | -0.005        | <b>-0.028</b> | <b>-0.036</b> | <b>-0.048</b> | -0.003        | <b>0.046</b>  | <b>0.032</b>  | <b>-0.189</b> | <b>0.055</b>  | <b>0.295</b> |               |               |               |               |        |  |
| <i>RETSTD<sub>t-1</sub></i>   | 0.002         | <b>0.032</b>  | <b>0.093</b>  | <b>0.070</b>  | <b>-0.031</b> | <b>-0.079</b> | <b>-0.117</b> | <b>-0.084</b> | 0.001         | <b>0.202</b>  | <b>-0.069</b> | <b>-0.549</b> | <b>-0.029</b> | <b>0.067</b> | <b>0.281</b>  |               |               |               |        |  |
| <i>TURNOVER<sub>t-1</sub></i> | <b>0.088</b>  | <b>0.138</b>  | <b>0.133</b>  | <b>0.041</b>  | <b>-0.018</b> | <b>-0.088</b> | 0.004         | <b>0.051</b>  | <b>0.133</b>  | <b>0.155</b>  | <b>0.090</b>  | <b>0.186</b>  | <b>0.067</b>  | <b>0.059</b> | 0.003         | <b>0.182</b>  |               |               |        |  |
| <i>AQ<sub>t-1</sub></i>       | 0.008         | <b>0.090</b>  | <b>0.159</b>  | <b>0.099</b>  | <b>-0.040</b> | <b>-0.104</b> | <b>-0.065</b> | -0.002        | <b>0.101</b>  | <b>0.211</b>  | -0.004        | <b>-0.367</b> | <b>0.069</b>  | 0.000        | <b>0.109</b>  | <b>0.358</b>  | <b>0.029</b>  |               |        |  |
| <i>RESTATED</i>               | <b>0.027</b>  | <b>0.072</b>  | <b>0.031</b>  | -0.009        | <b>0.038</b>  | <b>-0.067</b> | <b>0.067</b>  | 0.004         | <b>0.032</b>  | <b>0.040</b>  | <b>-0.045</b> | <b>-0.017</b> | <b>-0.026</b> | -0.007       | 0.006         | 0.005         | <b>0.041</b>  | <b>0.043</b>  |        |  |
| <i>INSIDER<sub>t-1</sub></i>  | <b>-0.012</b> | <b>-0.055</b> | <b>-0.131</b> | <b>-0.085</b> | <b>0.047</b>  | <b>0.101</b>  | <b>0.026</b>  | <b>0.015</b>  | <b>-0.075</b> | <b>-0.136</b> | <b>0.059</b>  | <b>0.227</b>  | <b>-0.049</b> | 0.004        | <b>-0.080</b> | <b>-0.244</b> | <b>-0.029</b> | <b>-0.250</b> | -0.012 |  |

This table presents the correlation matrix for the main variables in the regression analysis. Coefficients in **bold and italics** indicate significance at the 0.01 level, **bold only** indicates significance at the 0.05 level and *italics only* indicates significance at the 0.10 level. See Appendix A for variable definitions.

Table 5: Audit Committee Expertise and Securities Class action Lawsuits

## Panel A: All lawsuits

|                               | (1)                         | (2)                         | (3)                         | (4)                        |
|-------------------------------|-----------------------------|-----------------------------|-----------------------------|----------------------------|
|                               | <i>SUED</i>                 | <i>SUED</i>                 | <i>SUED</i>                 | <i>SUED</i>                |
|                               | <i>Proportion</i>           | <i>Proportion</i>           | <i>Number</i>               | <i>Binary</i>              |
| <i>INDAFE</i>                 | <b>-0.021***</b><br>(-4.00) | <b>-0.022***</b><br>(-4.16) | <b>-0.005***</b><br>(-3.11) | <b>-0.006**</b><br>(-2.49) |
| <i>INDSFE</i>                 | <b>0.007</b><br>(1.52)      | <b>0.007</b><br>(1.57)      | <b>0.002</b><br>(1.64)      | <b>0.001</b><br>(0.64)     |
| <i>ONLYIND</i>                | <b>0.100</b><br>(0.83)      | <b>0.010</b><br>(0.88)      | <b>0.003</b><br>(0.80)      | <b>0.003</b><br>(0.72)     |
| <i>ONLYAFE</i>                | <b>-0.000</b><br>(-0.07)    | <b>-0.001</b><br>(-0.10)    | <b>-0.001</b><br>(-0.44)    | <b>-0.001</b><br>(-0.58)   |
| <i>ONLYSFE</i>                | <b>0.002</b><br>(0.37)      | <b>0.002</b><br>(0.43)      | <b>0.001</b><br>(0.75)      | <b>-0.002</b><br>(-0.78)   |
| <i>OTHEREAFE</i>              | 0.002<br>(1.11)             | 0.002<br>(1.06)             | 0.002<br>(0.98)             | 0.001<br>(0.73)            |
| <i>OTHERSFE</i>               | 0.002<br>(0.41)             | 0.001<br>(0.27)             | 0.001<br>(0.19)             | 0.003<br>(0.66)            |
| <i>OTHERIND</i>               | -0.000<br>(-0.11)           | -0.000<br>(-0.19)           | -0.001<br>(-0.31)           | -0.000<br>(-0.16)          |
| <i>FPS</i>                    | 0.013***<br>(3.08)          | 0.013***<br>(2.96)          | 0.013***<br>(2.94)          | 0.012**<br>(2.82)          |
| <i>SGROWTH<sub>t-1</sub></i>  | 0.009*<br>(2.09)            | 0.009*<br>(2.09)            | 0.009*<br>(2.08)            | 0.009*<br>(2.06)           |
| <i>LNASSETS<sub>t-1</sub></i> | 0.005***<br>(4.43)          | 0.005***<br>(4.51)          | 0.005***<br>(4.57)          | 0.005***<br>(4.60)         |
| <i>MTB<sub>t-1</sub></i>      | 0.001**<br>(2.20)           | 0.001**<br>(2.22)           | 0.001**<br>(2.23)           | 0.001**<br>(2.19)          |
| <i>RET<sub>t-1</sub></i>      | -0.004*<br>(-1.79)          | -0.004*<br>(-1.77)          | -0.004*<br>(-1.75)          | -0.004*<br>(-1.74)         |
| <i>SKEW<sub>t-1</sub></i>     | -0.003***<br>(-4.63)        | -0.003***<br>(-4.57)        | -0.003***<br>(-4.57)        | -0.003***<br>(-4.64)       |
| <i>RETSTD<sub>t-1</sub></i>   | 0.332***<br>(4.22)          | 0.294***<br>(3.70)          | 0.294***<br>(3.73)          | 0.296***<br>(3.75)         |
| <i>TURNOVER<sub>t-1</sub></i> | 0.001***<br>(5.54)          | 0.001***<br>(5.54)          | 0.001***<br>(5.61)          | 0.001***<br>(5.49)         |
| <i>AQ<sub>t-1</sub></i>       |                             | 0.015*<br>(1.80)            | 0.015*<br>(1.78)            | 0.015*<br>(1.79)           |
| <i>RESTATED</i>               |                             | 0.007***<br>(4.13)          | 0.007***<br>(4.13)          | 0.007***<br>(4.08)         |
| <i>INSIDER<sub>t-1</sub></i>  | -0.000<br>(-0.66)           | -0.000<br>(-0.53)           | -0.000<br>(-0.52)           | -0.000<br>(-0.54)          |
| Fixed Effects                 | Industry/Year               | Industry/Year               | Industry/Year               | Industry/Year              |
| Cluster                       | Firm/Year                   | Firm/Year                   | Firm/Year                   | Firm/Year                  |
| Adj-R <sup>2</sup>            | 0.019                       | 0.023                       | 0.023                       | 0.023                      |
| N                             | 25,485                      | 25,485                      | 25,485                      | 25,485                     |

**Panel B: Accounting-related lawsuits**

|                               | (1)                        | (2)                        | (3)                        |
|-------------------------------|----------------------------|----------------------------|----------------------------|
|                               | <i>ACCT SUED</i>           | <i>ACCT SUED</i>           | <i>ACCT SUED</i>           |
|                               | <i>Proportion</i>          | <i>Number</i>              | <i>Binary</i>              |
| <i>INDAFE</i>                 | <b>-0.007**</b><br>(-2.39) | <b>-0.002**</b><br>(-2.42) | <b>-0.002**</b><br>(-2.46) |
| <i>INDSFE</i>                 | <b>0.001</b><br>(0.23)     | <b>0.001</b><br>(1.16)     | <b>0.001</b><br>(0.49)     |
| <i>ONLYIND</i>                | <b>0.002</b><br>(0.38)     | <b>0.000</b><br>(0.05)     | <b>0.000</b><br>(0.16)     |
| <i>ONLYAFE</i>                | <b>-0.002</b><br>(-0.55)   | <b>-0.000</b><br>(-0.35)   | <b>-0.001</b><br>(-0.72)   |
| <i>ONLYSFE</i>                | <b>0.000</b><br>(0.02)     | <b>0.000</b><br>(0.96)     | <b>0.000</b><br>(0.07)     |
| <i>OTHEREAFE</i>              | 0.001<br>(0.77)            | 0.001<br>(0.85)            | 0.001<br>(0.79)            |
| <i>OTHERSFE</i>               | -0.001<br>(-0.25)          | -0.001<br>(-0.42)          | -0.001<br>(-0.31)          |
| <i>OTHERIND</i>               | 0.001<br>(0.65)            | 0.000<br>(0.43)            | 0.001<br>(0.42)            |
| <i>FPS</i>                    | 0.002<br>(0.81)            | 0.002<br>(0.83)            | 0.002<br>(0.74)            |
| <i>SGROWTH<sub>t-1</sub></i>  | 0.006**<br>(2.11)          | 0.006**<br>(2.10)          | 0.006*<br>(2.09)           |
| <i>LNASSETS<sub>t-1</sub></i> | 0.002**<br>(2.85)          | 0.002**<br>(2.86)          | 0.002***<br>(2.90)         |
| <i>MTB<sub>t-1</sub></i>      | 0.000<br>(0.51)            | 0.000<br>(0.52)            | 0.000<br>(0.51)            |
| <i>RET<sub>t-1</sub></i>      | -0.003***<br>(-3.27)       | -0.003***<br>(-3.28)       | -0.003***<br>(-3.26)       |
| <i>SKEW<sub>t-1</sub></i>     | -0.001*<br>(-1.91)         | -0.001*<br>(-1.90)         | -0.001*<br>(-1.91)         |
| <i>RETSTD<sub>t-1</sub></i>   | 0.085<br>(1.36)            | 0.084<br>(1.35)            | 0.085<br>(1.36)            |
| <i>TURNOVER<sub>t-1</sub></i> | 0.000*<br>(1.92)           | 0.000*<br>(1.94)           | 0.000*<br>(1.92)           |
| <i>AQ<sub>t-1</sub></i>       | 0.003<br>(0.65)            | 0.003<br>(0.62)            | 0.003<br>(0.63)            |
| <i>RESTATED</i>               | 0.004***<br>(3.08)         | 0.004***<br>(3.09)         | 0.004***<br>(3.08)         |
| <i>INSIDER<sub>t-1</sub></i>  | 0.000<br>(1.43)            | 0.000<br>(1.47)            | 0.000<br>(1.39)            |
| Fixed Effects                 | Industry/Year              | Industry/Year              | Industry/Year              |
| Cluster                       | Firm/Year                  | Firm/Year                  | Firm/Year                  |
| Adj-R <sup>2</sup>            | 0.009                      | 0.009                      | 0.009                      |
| N                             | 25,166                     | 25,166                     | 25,166                     |

**Panel C: Non-accounting related lawsuits**

|                               | (1)                        | (2)                       | (3)                      |
|-------------------------------|----------------------------|---------------------------|--------------------------|
|                               | <i>NACCT SUED</i>          | <i>NACCT SUED</i>         | <i>NACCT SUED</i>        |
|                               | <i>Proportion</i>          | <i>Number</i>             | <i>Binary</i>            |
| <i>INDAFE</i>                 | <b>-0.015**</b><br>(-2.59) | <b>-0.003*</b><br>(-1.77) | <b>-0.004</b><br>(-1.61) |
| <i>INDSFE</i>                 | <b>0.006*</b><br>(1.75)    | <b>0.001</b><br>(1.03)    | <b>0.001</b><br>(0.41)   |
| <i>ONLYIND</i>                | <b>0.009</b><br>(0.84)     | <b>0.003</b><br>(0.86)    | <b>0.002</b><br>(0.77)   |
| <i>ONLYAFE</i>                | <b>0.002</b><br>(0.31)     | <b>-0.000</b><br>(-0.27)  | <b>-0.000</b><br>(-0.21) |
| <i>ONLYSFE</i>                | <b>0.002</b><br>(0.59)     | <b>0.000</b><br>(0.40)    | <b>-0.002</b><br>(-1.34) |
| <i>OTHEREAFE</i>              | 0.001<br>(0.59)            | 0.001<br>(0.47)           | 0.000<br>(0.25)          |
| <i>OTHERSFE</i>               | 0.002<br>(0.54)            | 0.002<br>(0.58)           | 0.004<br>(0.99)          |
| <i>OTHERIND</i>               | -0.001<br>(-0.66)          | -0.001<br>(-0.75)         | -0.001<br>(-0.57)        |
| <i>FPS</i>                    | 0.011***<br>(3.14)         | 0.011***<br>(3.08)        | 0.011***<br>(3.03)       |
| <i>SGROWTH<sub>t-1</sub></i>  | 0.004<br>(1.16)            | 0.004<br>(1.16)           | 0.003<br>(1.13)          |
| <i>LNASSETS<sub>t-1</sub></i> | 0.003***<br>(4.18)         | 0.003***<br>(4.23)        | 0.003***<br>(4.30)       |
| <i>MTB<sub>t-1</sub></i>      | 0.000**<br>(2.14)          | 0.000**<br>(2.15)         | 0.000**<br>(2.12)        |
| <i>RET<sub>t-1</sub></i>      | -0.000<br>(-0.23)          | -0.000<br>(-0.22)         | -0.000<br>(-0.20)        |
| <i>SKEW<sub>t-1</sub></i>     | -0.003***<br>(-3.89)       | -0.003***<br>(-3.90)      | -0.003***<br>(-3.93)     |
| <i>RETSTD<sub>t-1</sub></i>   | 0.219***<br>(3.26)         | 0.220***<br>(3.28)        | 0.221***<br>(3.30)       |
| <i>TURNOVER<sub>t-1</sub></i> | 0.001***<br>(3.90)         | 0.001***<br>(3.93)        | 0.001***<br>(3.87)       |
| <i>AQ<sub>t-1</sub></i>       | 0.012<br>(1.63)            | 0.012<br>(1.62)           | 0.012<br>(1.64)          |
| <i>RESTATED</i>               | 0.004*<br>(1.92)           | 0.003*<br>(1.91)          | 0.003*<br>(1.88)         |
| <i>INSIDER<sub>t-1</sub></i>  | -0.000<br>(-0.78)          | -0.000<br>(-0.77)         | -0.000<br>(-0.78)        |
| Fixed Effects                 | Industry/Year              | Industry/Year             | Industry/Year            |
| Cluster                       | Firm/Year                  | Firm/Year                 | Firm/Year                |
| Adj-R <sup>2</sup>            | 0.019                      | 0.019                     | 0.019                    |
| N                             | 25,324                     | 25,324                    | 25,324                   |

This table presents the results of the association between audit committee expertise and securities class action lawsuits in the full sample. All models are estimated with intercept but not tabulated for brevity. In Panel A, the dependent variable (*SUED*) equals 1 for firm-years where there is at least one securities class action lawsuit filed against firm *i* as a defendant in year *t*, and 0 otherwise. In Panel B (C), the dependent

variable *ACCT\_SUED* (*NACCT\_SUED*) equals 1 when there is at least one securities class action lawsuit alleging GAAP violation, restated earnings, or both (neither GAAP violation nor restated earnings), and 0 otherwise. See Appendix A for variable definitions. The *t*-statistics are presented under the coefficients, with the standard errors clustered at both firm and year levels. \*\*\*, \*\* and \* indicate, respectively, significance at the 0.01, 0.05, and 0.10 levels.

Table 6: Results of Matched Samples: Accounting-Related Lawsuits

## Panel A: Entropy matched sample

|                               | (1)                                   | (2)                                   | (3)                                   |
|-------------------------------|---------------------------------------|---------------------------------------|---------------------------------------|
|                               | <i>ACCT SUED</i>                      | <i>ACCT SUED</i>                      | <i>ACCT SUED</i>                      |
|                               | <i>Proportion</i>                     | <i>Proportion</i>                     | <i>Proportion</i>                     |
|                               | <i>1<sup>st</sup> Moment Matching</i> | <i>2<sup>nd</sup> Moment Matching</i> | <i>3<sup>rd</sup> Moment Matching</i> |
| <i>INDAFE</i>                 | -0.007*<br>(-2.06)                    | -0.008**<br>(-2.25)                   | -0.008**<br>(-2.17)                   |
| <i>INDSFE</i>                 | -0.001<br>(-0.32)                     | -0.001<br>(-0.36)                     | -0.001<br>(-0.22)                     |
| <i>ONLYIND</i>                | -0.002<br>(-0.56)                     | -0.003<br>(-1.02)                     | -0.005<br>(-1.41)                     |
| <i>ONLYAFE</i>                | -0.002<br>(-0.32)                     | -0.001<br>(-0.20)                     | -0.002<br>(-0.26)                     |
| <i>ONLYSFE</i>                | -0.001<br>(-0.33)                     | -0.001<br>(-0.25)                     | -0.000<br>(-0.06)                     |
| <i>OTHEREAFE</i>              | 0.001<br>(0.87)                       | 0.002<br>(1.42)                       | 0.002<br>(1.71)                       |
| <i>OTHERSFE</i>               | -0.003<br>(-0.42)                     | -0.003<br>(-0.49)                     | -0.004<br>(-0.52)                     |
| <i>OTHERIND</i>               | 0.002<br>(1.20)                       | 0.002<br>(1.06)                       | 0.002<br>(1.15)                       |
| <i>FPS</i>                    | 0.001<br>(0.47)                       | 0.001<br>(0.42)                       | 0.001<br>(0.36)                       |
| <i>SGROWTH<sub>t-1</sub></i>  | 0.005*<br>(1.80)                      | 0.004<br>(1.27)                       | 0.004<br>(1.18)                       |
| <i>LNASSETS<sub>t-1</sub></i> | 0.002**<br>(2.65)                     | 0.002**<br>(2.35)                     | 0.001*<br>(2.06)                      |
| <i>MTB<sub>t-1</sub></i>      | -0.000<br>(-0.49)                     | -0.000<br>(-0.81)                     | -0.000<br>(-1.27)                     |
| <i>RET<sub>t-1</sub></i>      | -0.003***<br>(-4.11)                  | -0.003***<br>(-4.12)                  | -0.003***<br>(-4.01)                  |
| <i>SKEW<sub>t-1</sub></i>     | -0.001*<br>(-1.85)                    | -0.001<br>(-1.36)                     | -0.000<br>(-1.06)                     |
| <i>RETSTD<sub>t-1</sub></i>   | 0.062<br>(0.86)                       | 0.051<br>(0.65)                       | 0.025<br>(0.34)                       |
| <i>TURNOVER<sub>t-1</sub></i> | 0.000*<br>(1.89)                      | 0.000**<br>(2.34)                     | 0.000**<br>(2.32)                     |
| <i>AQ<sub>t-1</sub></i>       | 0.001<br>(0.30)                       | -0.001<br>(-0.31)                     | 0.000<br>(0.11)                       |
| <i>RESTATED</i>               | 0.004**<br>(2.84)                     | 0.004***<br>(2.92)                    | 0.004***<br>(3.15)                    |
| <i>INSIDER<sub>t-1</sub></i>  | 0.000*<br>(2.03)                      | 0.000*<br>(1.94)                      | 0.000*<br>(1.93)                      |
| Fixed Effects                 | Industry/Year                         | Industry/Year                         | Industry/Year                         |
| Cluster                       | Firm/Year                             | Firm/Year                             | Firm/Year                             |
| Adj-R <sup>2</sup>            | 0.009                                 | 0.009                                 | 0.008                                 |
| N                             | 25,166                                | 25,166                                | 25,166                                |

**Panel B: Propensity score matched sample**

|                               | (1)                 | (2)               | (3)              | (4)              |
|-------------------------------|---------------------|-------------------|------------------|------------------|
|                               | <i>INDAFE Dummy</i> | <i>ACCT SUED</i>  | <i>ACCT SUED</i> | <i>ACCT SUED</i> |
|                               |                     | <i>Proportion</i> | <i>Number</i>    | <i>Binary</i>    |
| <i>INDAFE</i>                 |                     | <b>-0.011**</b>   | <b>-0.003**</b>  | <b>-0.004*</b>   |
|                               |                     | <b>(-2.16)</b>    | <b>(-2.16)</b>   | <b>(-2.01)</b>   |
| <i>INDSFE</i>                 |                     | <b>-0.000</b>     | <b>0.001</b>     | <b>0.000</b>     |
|                               |                     | <b>(-0.12)</b>    | <b>(0.81)</b>    | <b>(0.29)</b>    |
| <i>ONLYIND</i>                |                     | <b>0.008</b>      | <b>0.001</b>     | <b>0.001</b>     |
|                               |                     | <b>(1.10)</b>     | <b>(0.78)</b>    | <b>(0.85)</b>    |
| <i>ONLYAFE</i>                |                     | <b>0.002</b>      | <b>0.001</b>     | <b>0.001</b>     |
|                               |                     | <b>(0.27)</b>     | <b>(0.41)</b>    | <b>(0.51)</b>    |
| <i>ONLYSFE</i>                |                     | <b>-0.003</b>     | <b>-0.000</b>    | <b>-0.002</b>    |
|                               |                     | <b>(-0.66)</b>    | <b>(-0.15)</b>   | <b>(-1.00)</b>   |
| <i>OTHEREAFE</i>              |                     | <b>0.000</b>      | <b>0.000</b>     | <b>0.000</b>     |
|                               |                     | <b>(0.08)</b>     | <b>(0.18)</b>    | <b>(0.03)</b>    |
| <i>OTHERSFE</i>               |                     | 0.005**           | 0.005**          | 0.006***         |
|                               |                     | (2.81)            | (2.51)           | (3.39)           |
| <i>OTHERIND</i>               |                     | 0.003             | 0.003            | 0.003            |
|                               |                     | (1.51)            | (1.39)           | (1.68)           |
| <i>FPS</i>                    | 0.656***            | 0.002             | 0.002            | 0.002            |
|                               | (12.95)             | (0.69)            | (0.65)           | (0.54)           |
| <i>SGROWTH<sub>t-1</sub></i>  | -0.137*             | 0.009*            | 0.009**          | 0.009*           |
|                               | (-1.88)             | (2.09)            | (2.11)           | (2.08)           |
| <i>LNASSETS<sub>t-1</sub></i> | 0.102***            | 0.001             | 0.001            | 0.001            |
|                               | (9.43)              | (1.27)            | (1.27)           | (1.35)           |
| <i>MTB<sub>t-1</sub></i>      | -0.007*             | -0.000            | -0.000           | -0.000           |
|                               | (-1.91)             | (-1.44)           | (-1.40)          | (-1.44)          |
| <i>RET<sub>t-1</sub></i>      | -0.056*             | -0.001            | -0.001           | -0.001           |
|                               | (-1.77)             | (-0.80)           | (-0.80)          | (-0.78)          |
| <i>SKEW<sub>t-1</sub></i>     | 0.009               | -0.001            | -0.001           | -0.001           |
|                               | (0.82)              | (-1.02)           | (-1.02)          | (-1.02)          |
| <i>RETSTD<sub>t-1</sub></i>   | -3.145**            | 0.057             | 0.057            | 0.058            |
|                               | (-2.13)             | (1.09)            | (1.10)           | (1.10)           |
| <i>TURNOVER<sub>t-1</sub></i> | 0.030***            | 0.000**           | 0.000**          | 0.000**          |
|                               | (13.12)             | (2.60)            | (2.61)           | (2.58)           |
| <i>AQ<sub>t-1</sub></i>       | 0.632***            | -0.001            | -0.001           | -0.001           |
|                               | (4.39)              | (-0.19)           | (-0.19)          | (-0.21)          |
| <i>RESTATED</i>               | 0.096***            | 0.004**           | 0.004**          | 0.004**          |
|                               | (2.94)              | (2.58)            | (2.62)           | (2.54)           |
| <i>INSIDER<sub>t-1</sub></i>  | -0.000**            | 0.000**           | 0.000*           | 0.000**          |
|                               | (-2.46)             | (2.15)            | (2.08)           | (2.25)           |
| Fixed Effects                 | Industry/Year       | Industry/Year     | Industry/Year    | Industry/Year    |
| Cluster                       | No                  | Firm/Year         | Firm/Year        | Firm/Year        |
| Log likelihood                | -13122.05           |                   |                  |                  |
| Adj-R <sup>2</sup>            |                     | 0.003             | 0.003            | 0.003            |
| N                             | 24,876              | 10,938            | 10,938           | 10,938           |

This table reports the results of the association between audit committee's expertise and accounting-related securities class action lawsuits for matched samples. In both panels, the dependent variable *ACCT\_SUED* equals 1 when there is at least one securities class action lawsuit alleging GAAP violation, restated earnings,

or both, and 0 otherwise. In Panel A, covariates from the control group are reweighted to have almost identical first moment (mean), second moment (variance), and third moment (skewness) with the treatment group. Panel B reports the results for a propensity score matched sample. Column (1) presents the results for the logit regression where the dependent variable is an indicator variable that equals 1 if audit committee has directors that have the combined accounting and industry expertise, and 0 otherwise. Columns (2)-(4) report the results for the proportion, the number, and an indicator, respectively of audit committee combined accounting and industry expertise using the matched sample. The *t*-statistics are presented under the coefficients, with the standard errors clustered at both firm and year levels. \*\*\*, \*\* and \* indicate, respectively, significance at the 0.01, 0.05, and 0.10 levels. See Appendix A for variable definitions.

Table 7: Results of Matched Samples: Non-Accounting-Related Lawsuits

## Panel A: Entropy matched sample

|                               | (1)                                   | (2)                                   | (3)                                   |
|-------------------------------|---------------------------------------|---------------------------------------|---------------------------------------|
|                               | <i>NACCT SUED</i>                     | <i>NACCT SUED</i>                     | <i>NACCT SUED</i>                     |
|                               | <i>Proportion</i>                     | <i>Proportion</i>                     | <i>Proportion</i>                     |
|                               | <i>1<sup>st</sup> Moment Matching</i> | <i>2<sup>nd</sup> Moment Matching</i> | <i>3<sup>rd</sup> Moment Matching</i> |
| <i>INDAFE</i>                 | <b>-0.018**</b><br>(-2.75)            | <b>-0.019**</b><br>(-2.87)            | <b>-0.016**</b><br>(-2.72)            |
| <i>INDSFE</i>                 | <b>0.005</b><br>(1.28)                | <b>0.005</b><br>(1.36)                | <b>0.006</b><br>(1.57)                |
| <i>ONLYIND</i>                | <b>0.016</b><br>(1.07)                | <b>0.011</b><br>(0.72)                | <b>0.011</b><br>(0.73)                |
| <i>ONLYAFE</i>                | <b>0.003</b><br>(0.51)                | <b>0.004</b><br>(0.55)                | <b>0.000</b><br>(0.07)                |
| <i>ONLYSFE</i>                | <b>0.003</b><br>(0.88)                | <b>0.003</b><br>(0.65)                | <b>0.003</b><br>(0.68)                |
| <i>OTHEREAFE</i>              | 0.002<br>(0.82)                       | 0.001<br>(0.61)                       | -0.000<br>(-0.22)                     |
| <i>OTHERSFE</i>               | 0.005<br>(0.99)                       | 0.006<br>(1.11)                       | 0.008<br>(1.30)                       |
| <i>OTHERIND</i>               | -0.001<br>(-0.33)                     | -0.001<br>(-0.35)                     | -0.002<br>(-0.82)                     |
| <i>FPS</i>                    | 0.013***<br>(3.16)                    | 0.013***<br>(3.12)                    | 0.013***<br>(2.97)                    |
| <i>SGROWTH<sub>t-1</sub></i>  | 0.001<br>(0.25)                       | 0.001<br>(0.14)                       | 0.000<br>(0.06)                       |
| <i>LNASSETS<sub>t-1</sub></i> | 0.003***<br>(3.53)                    | 0.003***<br>(3.18)                    | 0.003***<br>(3.37)                    |
| <i>MTB<sub>t-1</sub></i>      | 0.000<br>(0.31)                       | 0.000<br>(0.28)                       | 0.000<br>(0.29)                       |
| <i>RET<sub>t-1</sub></i>      | 0.002<br>(0.68)                       | 0.003<br>(0.86)                       | 0.002<br>(0.70)                       |
| <i>SKEW<sub>t-1</sub></i>     | -0.003***<br>(-3.28)                  | -0.003***<br>(-3.26)                  | -0.003***<br>(-3.01)                  |
| <i>RETSTD<sub>t-1</sub></i>   | 0.274**<br>(2.59)                     | 0.260**<br>(2.33)                     | 0.270**<br>(2.46)                     |
| <i>TURNOVER<sub>t-1</sub></i> | 0.001***<br>(3.63)                    | 0.001***<br>(3.62)                    | 0.001***<br>(3.59)                    |
| <i>AQ<sub>t-1</sub></i>       | 0.011<br>(1.17)                       | 0.018<br>(1.64)                       | 0.017*<br>(1.79)                      |
| <i>RESTATED</i>               | 0.004<br>(1.57)                       | 0.004<br>(1.38)                       | 0.004<br>(1.31)                       |
| <i>INSIDER<sub>t-1</sub></i>  | -0.000<br>(-0.60)                     | -0.000<br>(-0.77)                     | -0.000<br>(-0.43)                     |
| Fixed Effects                 | Industry/Year                         | Industry/Year                         | Industry/Year                         |
| Cluster                       | Firm/Year                             | Firm/Year                             | Firm/Year                             |
| Adj-R <sup>2</sup>            | 0.024                                 | 0.024                                 | 0.023                                 |
| N                             | 25,324                                | 25,324                                | 25,324                                |

**Panel B: Propensity score matched sample**

|                               | (1)                 | (2)               | (2)               | (4)               |
|-------------------------------|---------------------|-------------------|-------------------|-------------------|
|                               | <i>INDAFE Dummy</i> | <i>NACCT SUED</i> | <i>NACCT SUED</i> | <i>NACCT SUED</i> |
|                               |                     | <i>Proportion</i> | <i>Number</i>     | <i>Binary</i>     |
| <i>INDAFE</i>                 |                     | <b>-0.018**</b>   | <b>-0.004*</b>    | <b>-0.005*</b>    |
|                               |                     | (-2.74)           | (-1.86)           | (-1.96)           |
| <i>INDSFE</i>                 |                     | <b>0.008</b>      | <b>0.001</b>      | <b>0.002</b>      |
|                               |                     | (1.44)            | (0.96)            | (0.85)            |
| <i>ONLYIND</i>                |                     | <b>0.014</b>      | <b>0.004</b>      | <b>0.003</b>      |
|                               |                     | (0.99)            | (0.94)            | (0.79)            |
| <i>ONLYAFE</i>                |                     | <b>0.002</b>      | <b>-0.001</b>     | <b>-0.001</b>     |
|                               |                     | (0.17)            | (-0.38)           | (-0.18)           |
| <i>ONLYSFE</i>                |                     | <b>0.005</b>      | <b>0.000</b>      | <b>-0.002</b>     |
|                               |                     | (0.77)            | (0.35)            | (-1.10)           |
| <i>OTHEREAFE</i>              |                     | 0.003             | 0.003             | 0.002             |
|                               |                     | (1.21)            | (0.97)            | (0.84)            |
| <i>OTHERSFE</i>               |                     | 0.006             | 0.007             | 0.008             |
|                               |                     | (1.25)            | (1.43)            | (1.67)            |
| <i>OTHERIND</i>               |                     | -0.001            | -0.002            | -0.002            |
|                               |                     | (-0.34)           | (-0.47)           | (-0.49)           |
| <i>FPS</i>                    | 0.659***            | 0.013**           | 0.013**           | 0.013**           |
|                               | (13.03)             | (2.57)            | (2.46)            | (2.40)            |
| <i>SGROWTH<sub>t-1</sub></i>  | -0.120*             | -0.010**          | -0.011**          | -0.011**          |
|                               | (-1.66)             | (-2.12)           | (-2.14)           | (-2.13)           |
| <i>LNASSETS<sub>t-1</sub></i> | 0.104***            | 0.003**           | 0.003**           | 0.003**           |
|                               | (9.68)              | (2.30)            | (2.37)            | (2.39)            |
| <i>MTB<sub>t-1</sub></i>      | -0.006              | 0.000             | 0.000             | 0.000             |
|                               | (-1.61)             | (1.19)            | (1.18)            | (1.17)            |
| <i>RET<sub>t-1</sub></i>      | -0.062**            | 0.002             | 0.002             | 0.002             |
|                               | (-1.96)             | (0.63)            | (0.65)            | (0.66)            |
| <i>SKEW<sub>t-1</sub></i>     | 0.007               | -0.002**          | -0.002**          | -0.003**          |
|                               | (0.65)              | (-2.85)           | (-2.87)           | (-2.88)           |
| <i>RETSTD<sub>t-1</sub></i>   | -3.136**            | 0.148             | 0.147             | 0.148             |
|                               | (-2.14)             | (1.50)            | (1.50)            | (1.49)            |
| <i>TURNOVER<sub>t-1</sub></i> | 0.029***            | 0.001**           | 0.001**           | 0.001**           |
|                               | (12.94)             | (2.62)            | (2.64)            | (2.62)            |
| <i>AQ<sub>t-1</sub></i>       | 0.635***            | 0.013             | 0.013             | 0.013             |
|                               | (4.43)              | (1.55)            | (1.55)            | (1.55)            |
| <i>RESTATED</i>               | 0.103***            | 0.004             | 0.004             | 0.004             |
|                               | (3.16)              | (1.62)            | (1.62)            | (1.59)            |
| <i>INSIDER<sub>t-1</sub></i>  | -0.000**            | 0.000             | 0.000             | 0.000             |
|                               | (-2.46)             | (0.33)            | (0.33)            | (0.32)            |
| Fixed Effects                 | Industry/Year       | Industry/Year     | Industry/Year     | Industry/Year     |
| Cluster                       | No                  | Firm/Year         | Firm/Year         | Firm/Year         |
| Log likelihood                | -13219.87           |                   |                   |                   |
| Adj-R <sup>2</sup>            |                     | 0.012             | 0.012             | 0.012             |
| N                             | 25,034              | 11,022            | 11,022            | 11,022            |

This table reports the results of the association between audit committee's expertise and non-accounting-related securities class action lawsuits for matched samples. In both panels, the dependent variable *NACCT\_SUED* equals 1 when there is at least one securities class action lawsuit alleging neither GAAP

violation nor restated earnings, and 0 otherwise. In Panel A, covariates from the control group are reweighted to have almost identical first moment (mean), second moment (variance), and third moment (skewness) with the treatment group. Panel B reports the results for a propensity score matched sample. Column (1) presents the results for the logit regression where the dependent variable is an indicator variable that equals 1 if audit committee has directors that have the combined accounting and industry expertise, and 0 otherwise. Columns (2)-(4) report the results for the proportion, the number, and an indicator, respectively of audit committee combined accounting and industry expertise using the matched sample. The *t*-statistics are presented under the coefficients, with the standard errors clustered at both firm and year levels. \*\*\*, \*\* and \* indicate, respectively, significance at the 0.01, 0.05, and 0.10 levels. See Appendix A for variable definitions.

**Table 8: Audit Committee Expertise and Lawsuit Characteristics****Panel A: Descriptive statistics**

| Variable           | Sample Mean  | <i>INDAFE Dummy</i> =1<br>(152 Obs) | <i>INDAFE Dummy</i> =0<br>(323 Obs) | Difference                                |
|--------------------|--------------|-------------------------------------|-------------------------------------|---|
| Total settlement   | \$20,600,000 | \$13,200,000                        | \$23,900,000                        | \$10,700,000*<br>( <i>p</i> -value=0.074) |
| Case length (days) | 949.91       | 888.22                              | 978.94                              | 90.72*<br>( <i>p</i> -value=0.100)        |

**Panel B: Results of regression on the relation between audit committee expertise and total settlement amount**

|                               | (1)  | (2)                                      | (3)                                      |
|-------------------------------|--|--|--|
|                               | <i>Total settlement</i><br><i>Proportion</i> | <i>Total settlement</i><br><i>Number</i> | <i>Total settlement</i><br><i>Binary</i> |
| <i>INDAFE</i>                 | -46.861**<br>(-2.26)                         | -11.423*<br>(-1.95)                      | -10.352*<br>(-1.76)                      |
| <i>INDSFE</i>                 | 4.574<br>(0.18)                              | 6.546<br>(1.01)                          | 0.067<br>(0.01)                          |
| <i>ONLYIND</i>                | -21.053<br>(-0.85)                           | -3.242<br>(-0.51)                        | -6.032<br>(-0.96)                        |
| <i>ONLYAFE</i>                | -37.374*<br>(-1.88)                          | -6.372<br>(-1.11)                        | -7.803<br>(-1.31)                        |
| <i>ONLYSFE</i>                | -18.095<br>(-1.02)                           | -0.213<br>(-0.04)                        | -3.063<br>(-0.57)                        |
| <i>OTHEREAFE</i>              | 2.030<br>(0.30)                              | 3.438<br>(0.48)                          | 2.871<br>(0.39)                          |
| <i>OTHERSFE</i>               | 8.554<br>(0.57)                              | 5.372<br>(0.36)                          | 7.254<br>(0.63)                          |
| <i>OTHERIND</i>               | 0.426<br>(0.05)                              | -2.649<br>(-0.31)                        | 3.509<br>(0.30)                          |
| <i>FPS</i>                    | 14.003*<br>(1.67)                            | 13.321*<br>(1.82)                        | 13.867*<br>(1.70)                        |
| <i>SGROWTH<sub>t-1</sub></i>  | 31.248**<br>(2.10)                           | 32.336**<br>(2.20)                       | 30.806**<br>(2.10)                       |
| <i>LNASSETS<sub>t-1</sub></i> | 10.514***<br>(4.18)                          | 10.340***<br>(3.48)                      | 10.351***<br>(4.16)                      |
| <i>MTB<sub>t-1</sub></i>      | 1.042**<br>(2.44)                            | 1.029**<br>(2.54)                        | 0.980**<br>(2.27)                        |
| <i>RET<sub>t-1</sub></i>      | -16.632*<br>(-1.94)                          | -16.058*<br>(-1.83)                      | -16.427**<br>(-1.98)                     |
| <i>SKEW<sub>t-1</sub></i>     | 1.560<br>(0.85)                              | 1.618<br>(0.90)                          | 1.651<br>(0.90)                          |
| <i>RETSTD<sub>t-1</sub></i>   | 199.861<br>(1.21)                            | 182.361<br>(1.08)                        | 200.189<br>(1.23)                        |
| <i>TURNOVER<sub>t-1</sub></i> | -0.749**<br>(-2.18)                          | -0.710*<br>(-1.87)                       | -0.766**<br>(-2.19)                      |
| <i>AQ<sub>t-1</sub></i>       | 27.662*<br>(1.86)                            | 28.858*<br>(1.89)                        | 27.917*<br>(1.74)                        |
| <i>RESTATED</i>               | 5.560<br>(0.90)                              | 5.247<br>(0.85)                          | 5.775<br>(1.01)                          |
| <i>INSIDER<sub>t-1</sub></i>  | -0.000<br>(-1.50)                            | -0.000<br>(-1.34)                        | -0.000*<br>(-1.82)                       |

|                    |       |       |       |
|--------------------|-------|-------|-------|
| Robust SE          | Yes   | Yes   | Yes   |
| Adj-R <sup>2</sup> | 0.078 | 0.078 | 0.073 |
| N                  | 475   | 475   | 475   |

**Panel C: Results of regression on the relation between audit committee expertise and case length**

|                               | (1)                         | (2)                        | (3)                       |
|-------------------------------|-----------------------------|----------------------------|---------------------------|
|                               | <i>Case length</i>          | <i>Case length</i>         | <i>Case length</i>        |
|                               | <i>Proportion</i>           | <i>Number</i>              | <i>Binary</i>             |
| <i>INDAFE</i>                 | <b>-410.215*</b><br>(-1.83) | <b>-99.617*</b><br>(-1.74) | <b>-58.999</b><br>(-0.85) |
| <i>INDSFE</i>                 | <b>-92.835</b><br>(-0.48)   | <b>16.088</b><br>(0.34)    | <b>-96.313</b><br>(-1.04) |
| <i>ONLYIND</i>                | <b>110.250</b><br>(0.27)    | <b>25.774</b><br>(0.24)    | <b>-14.339</b><br>(-0.13) |
| <i>ONLYAFE</i>                | <b>-252.884</b><br>(-1.02)  | <b>-65.243</b><br>(-1.06)  | <b>-69.539</b><br>(-1.00) |
| <i>ONLYSFE</i>                | <b>-136.884</b><br>(-0.94)  | <b>-3.057</b><br>(-0.09)   | <b>65.701</b><br>(1.01)   |
| <i>OTHEREAFE</i>              | 90.496<br>(1.15)            | 107.937<br>(1.34)          | 108.481<br>(1.36)         |
| <i>OTHERSFE</i>               | -92.463<br>(-0.19)          | -120.500<br>(-0.25)        | -166.542<br>(-0.35)       |
| <i>OTHERIND</i>               | 70.326<br>(0.78)            | 49.458<br>(0.54)           | 131.598<br>(1.26)         |
| <i>FPS</i>                    | 83.545<br>(1.16)            | 73.322<br>(1.04)           | 82.645<br>(1.13)          |
| <i>SGROWTH<sub>t-1</sub></i>  | 344.026***<br>(2.69)        | 348.219***<br>(2.71)       | 330.967**<br>(2.58)       |
| <i>LNASSETS<sub>t-1</sub></i> | 66.029***<br>(3.30)         | 66.329***<br>(3.21)        | 60.020***<br>(3.12)       |
| <i>MTB<sub>t-1</sub></i>      | 7.999<br>(1.55)             | 7.876<br>(1.51)            | 7.373<br>(1.43)           |
| <i>RET<sub>t-1</sub></i>      | -92.231<br>(-1.44)          | -88.125<br>(-1.36)         | -84.434<br>(-1.32)        |
| <i>SKEW<sub>t-1</sub></i>     | -10.769<br>(-0.55)          | -10.306<br>(-0.53)         | -11.434<br>(-0.59)        |
| <i>RETSTD<sub>t-1</sub></i>   | 2157.669<br>(0.74)          | 2028.930<br>(0.72)         | 1814.129<br>(0.64)        |
| <i>TURNOVER<sub>t-1</sub></i> | -0.883<br>(-0.25)           | -0.581<br>(-0.17)          | -0.910<br>(-0.26)         |
| <i>AQ<sub>t-1</sub></i>       | 176.316<br>(0.71)           | 182.250<br>(0.71)          | 174.130<br>(0.70)         |
| <i>RESTATED</i>               | -71.629<br>(-1.17)          | -68.139<br>(-1.13)         | -64.830<br>(-1.10)        |
| <i>INSIDER<sub>t-1</sub></i>  | -0.001<br>(-0.51)           | -0.000<br>(-0.28)          | -0.000<br>(-0.38)         |
| Robust SE                     | Yes                         | Yes                        | Yes                       |
| Adj-R <sup>2</sup>            | 0.028                       | 0.026                      | 0.029                     |
| N                             | 475                         | 475                        | 475                       |

This table reports the results of the association between audit committee expertise and lawsuit characteristics. Panel A reports the test of differences in mean values between firms with and without audit committee members having the combined industry and accounting expertise for two characteristics of lawsuits: total settlement amount and case length (in days). Case length is defined as the difference in days between the filing date and the dismissal date (for those dismissed case), or

between the filing date and the final settlement date (for those settled cases). Total settlement amount is obtained from *RecoverMax* database and is set as 0 for those dismissed cases. The significance of the difference between two groups is based on a one-tail t-test. Panel B (C) presents the results of a regression of total settlement amount (case length) on audit committee expertise and control variables. The *t*-statistics are presented under the coefficients and based on robust standard errors. \*\*\*, \*\* and \* indicate, respectively, significance at the 0.01, 0.05, and 0.10 levels. See Appendix A for variable definitions.

**Table 9: The Association Between Audit Committee Expertise and Firm Risk-Taking**

|                    | (1)                                  | (2)                                  | (3)                                  | (4)                                  |
|--------------------|--------------------------------------|--------------------------------------|--------------------------------------|--------------------------------------|
|                    | <i>RISKTKG</i><br>( $Y_{t-4}, Y_t$ ) | <i>RISKTKG</i><br>( $Y_{t-4}, Y_t$ ) | <i>RISKTKG</i><br>( $Y_t, Y_{t+4}$ ) | <i>RISKTKG</i><br>( $Y_t, Y_{t+4}$ ) |
|                    | <i>Avg_Proportion</i>                | <i>Avg_Number</i>                    | <i>Avg_Proportion</i>                | <i>Avg_Number</i>                    |
| <i>INDAFE</i>      | <b>-0.079***</b><br><b>(-3.04)</b>   | <b>-0.019***</b><br><b>(-3.11)</b>   | <b>-0.052*</b><br><b>(-1.87)</b>     | <b>-0.012*</b><br><b>(-1.81)</b>     |
| <i>INDSFE</i>      | 0.008<br>(0.27)                      | 0.002<br>(0.37)                      | 0.025<br>(0.93)                      | 0.005<br>(0.85)                      |
| <i>ONLYIND</i>     | -0.015<br>(-0.31)                    | -0.001<br>(-0.09)                    | 0.166<br>(1.64)                      | 0.039<br>(1.67)                      |
| <i>ONLYAFE</i>     | -0.035<br>(-1.36)                    | -0.008<br>(-1.37)                    | -0.022<br>(-0.93)                    | -0.005<br>(-0.93)                    |
| <i>ONLYSFE</i>     | -0.001<br>(-0.11)                    | -0.000<br>(-0.02)                    | 0.004<br>(0.36)                      | 0.002<br>(0.99)                      |
| <i>OTHEREAFE</i>   | 0.009<br>(1.09)                      | 0.009<br>(1.03)                      | 0.010<br>(1.72)                      | 0.009<br>(1.60)                      |
| <i>OTHERSFE</i>    | 0.011<br>(0.70)                      | 0.011<br>(0.71)                      | -0.003<br>(-0.08)                    | -0.004<br>(-0.10)                    |
| <i>OTHERIND</i>    | -0.004<br>(-0.36)                    | -0.005<br>(-0.38)                    | 0.004<br>(0.64)                      | 0.006<br>(0.96)                      |
| <i>FPS</i>         | 0.027***<br>(4.43)                   | 0.026***<br>(4.70)                   | 0.030***<br>(3.53)                   | 0.031***<br>(3.69)                   |
| <i>SGROWTH</i>     | 0.028**<br>(2.44)                    | 0.027**<br>(2.43)                    | -0.011<br>(-1.60)                    | -0.012<br>(-1.63)                    |
| <i>LNASSETS</i>    | -0.012***<br>(-6.58)                 | -0.012***<br>(-6.45)                 | -0.016***<br>(-8.62)                 | -0.016***<br>(-8.58)                 |
| <i>MTB</i>         | -0.001<br>(-0.19)                    | -0.001<br>(-0.19)                    | 0.002*<br>(1.98)                     | 0.002*<br>(1.97)                     |
| <i>RET</i>         | -0.014***<br>(-5.64)                 | -0.014***<br>(-5.63)                 | -0.027***<br>(-3.31)                 | -0.027***<br>(-3.32)                 |
| <i>SKEW</i>        | 0.002<br>(1.40)                      | 0.002<br>(1.39)                      | 0.003<br>(1.39)                      | 0.003<br>(1.39)                      |
| <i>RETSTD</i>      | 0.821<br>(1.36)                      | 0.826<br>(1.37)                      | 1.209***<br>(3.25)                   | 1.214***<br>(3.26)                   |
| <i>TURNOVER</i>    | 0.002**<br>(2.19)                    | 0.002**<br>(2.21)                    | 0.001<br>(1.25)                      | 0.001<br>(1.27)                      |
| <i>AQ</i>          | 0.492***<br>(3.41)                   | 0.492***<br>(3.41)                   | 0.266***<br>(3.86)                   | 0.266***<br>(3.83)                   |
| <i>RESTATED</i>    | 0.006<br>(0.92)                      | 0.006<br>(0.91)                      | -0.009*<br>(-1.81)                   | -0.009*<br>(-1.84)                   |
| <i>INSIDER</i>     | -0.000**<br>(-2.88)                  | -0.000**<br>(-2.89)                  | -0.000**<br>(-2.78)                  | -0.000**<br>(-2.80)                  |
| Fixed Effects      | Industry/Year                        | Industry/Year                        | Industry/Year                        | Industry/Year                        |
| Cluster            | Firm/Year                            | Firm/Year                            | Firm/Year                            | Firm/Year                            |
| Adj-R <sup>2</sup> | 0.076                                | 0.076                                | 0.126                                | 0.125                                |
| N                  | 22,313                               | 22,313                               | 22,252                               | 22,252                               |

This table presents the results of the association between audit committee expertise and firm risk-taking. Columns (1) and (2) report the results for using 5-year *backward-looking* risk-taking measures, whereas columns (3) and (4) report the results using 5-year *forward-looking* risk-taking measures. All the AC expertise variables are calculated based on the average between year  $t-4$  and year  $t$ . The  $t$ -statistics are presented under the coefficients, with the standard errors clustered at both firm and year levels. \*\*\*, \*\* and \* indicate, respectively, significance at the 0.01, 0.05, and 0.10 levels. See Appendix A for variable definitions.

**Table 10: Audit Committee Expertise and Securities Class Action Lawsuits: Moderating Effects of Board Characteristics**

**Panel A: Cross-sectional tests based on CEO duality (*DUALITY*)**

|                                  | (1)               | (2)              | (3)             |
|----------------------------------|-------------------|------------------|-----------------|
|                                  | <i>SUED</i>       | <i>SUED</i>      | <i>SUED</i>     |
|                                  | <i>Proportion</i> | <i>Number</i>    | <i>Binary</i>   |
| <i>INDAFE</i>                    | <b>-0.030***</b>  | <b>-0.007***</b> | <b>-0.008**</b> |
|                                  | <b>(-4.47)</b>    | <b>(-3.78)</b>   | <b>(-2.84)</b>  |
| <i>DUALITY</i>                   | -0.054**          | -0.052**         | -0.051**        |
|                                  | (-2.72)           | (-2.62)          | (-2.54)         |
| <i>INDAFE</i> × <i>DUALITY</i>   | <b>0.040*</b>     | <b>0.010*</b>    | <b>0.011</b>    |
|                                  | <b>(1.79)</b>     | <b>(1.83)</b>    | <b>(1.50)</b>   |
| <i>INDSFE</i>                    | 0.007             | 0.002            | 0.001           |
|                                  | (1.22)            | (1.31)           | (0.24)          |
| <i>ONLYIND</i>                   | 0.017             | 0.005            | 0.006           |
|                                  | (1.16)            | (1.25)           | (1.37)          |
| <i>ONLYAFE</i>                   | -0.000            | -0.001           | 0.000           |
|                                  | (-0.13)           | (-0.37)          | (0.03)          |
| <i>ONLYSFE</i>                   | -0.004            | -0.001           | -0.003          |
|                                  | (-0.88)           | (-0.55)          | (-1.22)         |
| <i>OTHEREAFE</i>                 | 0.004*            | 0.004**          | 0.004*          |
|                                  | (2.05)            | (2.12)           | (1.85)          |
| <i>OTHERSFE</i>                  | 0.002             | 0.001            | 0.003           |
|                                  | (0.32)            | (0.22)           | (0.58)          |
| <i>OTHERIND</i>                  | 0.001             | 0.001            | 0.002           |
|                                  | (0.30)            | (0.21)           | (0.53)          |
| <i>FPS</i>                       | 0.011**           | 0.011**          | 0.011**         |
|                                  | (2.46)            | (2.41)           | (2.32)          |
| <i>SGROWTH</i>                   | 0.006             | 0.006            | 0.006           |
|                                  | (1.53)            | (1.51)           | (1.50)          |
| <i>LNASSETS</i>                  | 0.004***          | 0.004***         | 0.004***        |
|                                  | (3.72)            | (3.67)           | (3.77)          |
| <i>MTB</i>                       | 0.000             | 0.000            | 0.000           |
|                                  | (0.89)            | (0.91)           | (0.87)          |
| <i>RET</i>                       | -0.001            | -0.001           | -0.001          |
|                                  | (-0.52)           | (-0.52)          | (-0.50)         |
| <i>SKEW</i>                      | -0.003***         | -0.003***        | -0.003***       |
|                                  | (-3.46)           | (-3.46)          | (-3.49)         |
| <i>RETSTD</i>                    | 0.215**           | 0.217**          | 0.220**         |
|                                  | (2.26)            | (2.28)           | (2.33)          |
| <i>TURNOVER</i>                  | 0.001***          | 0.001***         | 0.001***        |
|                                  | (6.83)            | (6.76)           | (6.70)          |
| <i>AQ</i>                        | 0.018**           | 0.018**          | 0.018**         |
|                                  | (2.11)            | (2.10)           | (2.13)          |
| <i>RESTATED</i>                  | 0.008***          | 0.008***         | 0.008***        |
|                                  | (3.96)            | (4.00)           | (3.86)          |
| <i>INSIDER</i>                   | -0.000            | -0.000           | -0.000          |
|                                  | (-0.15)           | (-0.17)          | (-0.20)         |
| <i>DUALITY</i> × <i>Controls</i> | Yes               | Yes              | Yes             |
| Fixed Effects                    | Industry/Year     | Industry/Year    | Industry/Year   |
| Cluster                          | Firm/Year         | Firm/Year        | Firm/Year       |
| Adj-R <sup>2</sup>               | 0.020             | 0.020            | 0.020           |
| N                                | 25,485            | 25,485           | 25,485          |

**Panel B: Cross-sectional tests based on other board members' legal expertise (*HLEGD*)**

|                                   | (1)               | (2)             | (3)              |
|-----------------------------------|-------------------|-----------------|------------------|
|                                   | <i>SUED</i>       | <i>SUED</i>     | <i>SUED</i>      |
|                                   | <i>Proportion</i> | <i>Number</i>   | <i>Binary</i>    |
| <i>INDAFE</i>                     | <b>-0.018***</b>  | <b>-0.004**</b> | <b>-0.004</b>    |
|                                   | <b>(-3.38)</b>    | <b>(-2.38)</b>  | <b>(-1.56)</b>   |
| <i>HLEGD</i>                      | -0.025            | -0.024          | -0.020           |
|                                   | (-1.20)           | (-1.18)         | (-0.99)          |
| <b><i>INDAFE</i>×<i>HLEGD</i></b> | <b>-0.031**</b>   | <b>-0.007**</b> | <b>-0.012***</b> |
|                                   | <b>(-2.72)</b>    | <b>(-2.75)</b>  | <b>(-3.38)</b>   |
| <i>INDSFE</i>                     | 0.005             | 0.001           | -0.002           |
|                                   | (1.01)            | (0.97)          | (-0.68)          |
| <i>ONLYIND</i>                    | 0.011             | 0.003           | 0.004            |
|                                   | (0.81)            | (0.79)          | (0.87)           |
| <i>ONLYAFE</i>                    | -0.003            | -0.001          | -0.001           |
|                                   | (-0.40)           | (-0.70)         | (-0.34)          |
| <i>ONLYSFE</i>                    | 0.001             | 0.001           | -0.001           |
|                                   | (0.24)            | (0.48)          | (-0.35)          |
| <i>OTHEREAFE</i>                  | 0.002             | 0.002           | 0.002            |
|                                   | (1.29)            | (1.21)          | (0.89)           |
| <i>OTHERSFE</i>                   | 0.003             | 0.002           | 0.005            |
|                                   | (0.37)            | (0.32)          | (0.69)           |
| <i>OTHERIND</i>                   | 0.001             | 0.000           | 0.002            |
|                                   | (0.43)            | (0.19)          | (0.94)           |
| <i>FPS</i>                        | 0.011**           | 0.011**         | 0.011**          |
|                                   | (2.64)            | (2.60)          | (2.54)           |
| <i>SGROWTH</i>                    | 0.006             | 0.006           | 0.006            |
|                                   | (1.50)            | (1.49)          | (1.46)           |
| <i>LNASSETS</i>                   | 0.004***          | 0.004***        | 0.005***         |
|                                   | (4.78)            | (4.81)          | (4.89)           |
| <i>MTB</i>                        | 0.000             | 0.000           | 0.000            |
|                                   | (1.36)            | (1.37)          | (1.37)           |
| <i>RET</i>                        | -0.003            | -0.003          | -0.003           |
|                                   | (-1.25)           | (-1.23)         | (-1.24)          |
| <i>SKEW</i>                       | -0.003***         | -0.003***       | -0.003***        |
|                                   | (-3.49)           | (-3.51)         | (-3.52)          |
| <i>RETSTD</i>                     | 0.212**           | 0.213**         | 0.215**          |
|                                   | (2.52)            | (2.55)          | (2.56)           |
| <i>TURNOVER</i>                   | 0.001***          | 0.001***        | 0.001***         |
|                                   | (6.03)            | (6.03)          | (5.97)           |
| <i>AQ</i>                         | 0.016*            | 0.016*          | 0.017*           |
|                                   | (1.79)            | (1.80)          | (1.85)           |
| <i>RESTATED</i>                   | 0.007***          | 0.007***        | 0.007***         |
|                                   | (3.72)            | (3.72)          | (3.71)           |
| <i>INSIDER</i>                    | -0.000            | -0.000          | -0.000           |
|                                   | (-0.97)           | (-0.96)         | (-0.99)          |
| <i>HLEGD</i> × <i>Controls</i>    | Yes               | Yes             | Yes              |
| Fixed Effects                     | Industry/Year     | Industry/Year   | Industry/Year    |
| Cluster                           | Firm/Year         | Firm/Year       | Firm/Year        |
| Adj-R <sup>2</sup>                | 0.020             | 0.019           | 0.020            |
| N                                 | 25,485            | 25,485          | 25,485           |

This table presents the results for the moderating effects of board characteristics on the association between audit committee's combined accounting and industry expertise and securities class action lawsuits. Panel A presents the results for firms with versus without CEO duality (*DUALITY*). Columns (1)-(3) report the results for the proportion, the number and an indicator of audit committee combined expertise, respectively. Panel B reports the results for firms having high versus low legal expertise (*HLEGD*) among other (non-audit committee) board members. The *t*-statistics are presented under the coefficients, with the standard errors clustered at both firm and year levels. \*\*\*, \*\* and \* indicate, respectively, significance at the 0.01, 0.05, and 0.10 levels. See Appendix A for variable definitions.

**Table 11: Changes to Audit Committee Following Securities Class Action Lawsuits**

|                         | (1)               | (2)           | (3)           |
|-------------------------|-------------------|---------------|---------------|
|                         | <i>INDAFE</i>     | <i>INDAFE</i> | <i>INDAFE</i> |
|                         | <i>Proportion</i> | <i>Number</i> | <i>Binary</i> |
| <b><i>SUED_POST</i></b> | <b>0.016*</b>     | <b>0.052*</b> | <b>0.035*</b> |
|                         | <b>(2.09)</b>     | <b>(1.76)</b> | <b>(1.76)</b> |
| Fixed Effects           | Firm/Year         | Firm/Year     | Firm/Year     |
| Cluster                 | Firm/Year         | Firm/Year     | Firm/Year     |
| Adj-R <sup>2</sup>      | 0.750             | 0.710         | 0.710         |
| N                       | 25,485            | 25,485        | 25,485        |

This table presents the results of a generalized difference-in-differences model where the dependent variable is *INDAFE* (measured in three ways – proportion, number, and binary of audit committee members with the combined accounting and industry expertise). *SUED\_POST* equals 1 for all years after a firm has been sued, and 0 otherwise. Model is estimated with firm and year fixed effects. The *t*-statistics are presented under the coefficients, with the standard errors clustered at both firm and year levels. \*\*\*, \*\* and \* indicate, respectively, significance at the 0.01, 0.05, and 0.10 levels. See Appendix A for variable definitions.