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**CEO power and the strategic selection of accounting financial experts
to the audit committee**

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CEO power and the strategic selection of accounting financial experts to the audit committee

Abstract

We examine the role of CEO power in the appointment of accounting financial experts (AFEs) to firm audit committees. Our results show that firms with powerful CEOs have a lower likelihood of appointing AFEs to their audit committees. Additionally, effective AFEs—those characterized by experience, high status, and social independence from the CEO—are less likely to be appointed in firms with powerful CEOs. In the presence of powerful CEOs, effective AFEs are also less likely to be designated audit committee chair. The absence of effective AFEs is associated with the use of accounting discretion by powerful CEOs to meet or just beat analyst earnings forecasts. We find no evidence that AFEs choose to avoid serving on the boards of firms with powerful CEOs. Our findings are consistent with powerful CEOs influencing board appointments post-SOX through informal channels, including through their social ties with nominating committees. Our results suggest that current regulations prohibiting CEO involvement in the director nomination process and specifying who qualifies as a financial expert may be insufficient to ensure audit committee effectiveness and financial reporting quality.

Keywords: accounting financial experts, audit committee, CEO power, nominating committee

Data availability: Data are publicly available from sources identified in the article.

1. INTRODUCTION

Following several major accounting scandals in the early 2000s, the Sarbanes-Oxley Act of 2002 (SOX) introduced requirements to improve audit committee effectiveness and mandated that firms disclose whether their audit committees include at least one financial expert (US SEC 2003). In support of these requirements, academic evidence from the post-SOX period suggests that audit committees with accounting financial experts (AFEs) are more effective in monitoring the financial reporting process (Dhaliwal et al. 2010; Chychyla et al. 2019). However, it remains unclear why some firms fail to appoint AFEs to their audit committees despite the associated monitoring benefits (Erkens and Bonner 2013; Chychyla et al. 2019).

Prior research suggests that CEOs prefer less monitoring by the board of directors (Adams and Ferreira 2007).¹ In turn, CEOs who wield a certain level of power can reduce board monitoring by influencing the director appointment process (Hermalin and Weisbach 1998; Graham et al. 2020). Building on these arguments, we contend that powerful CEOs influence the appointment of AFEs to audit committees with the aim of minimizing monitoring of the financial reporting process. Specifically, we argue that CEOs prefer greater discretion over the financial reporting process because this allows them to meet or just beat earnings targets (Kasznik and McNichols 2002; Mande and Son 2012). Meeting or just beating earnings targets generates positive firm outcomes (Bartov et al. 2002; Jiang 2008) and allows CEOs to uphold their reputations. Given AFEs' greater ability relative to that of other audit committee members to monitor the financial reporting process, our first objective in this study is to empirically examine whether CEO power is negatively associated with the appointment and presence of AFEs on audit committees.

¹ In his 2020 letter to shareholders, Berkshire Hathaway CEO Warren Buffet contended that CEOs seek out less effective directors (“cocker spaniels”) over more aggressive monitors (“pit bulls”), with the latter “silently” disfavored in the appointment process (Zukis 2020).

While public scrutiny may discourage some powerful CEOs from seeking to prevent AFE audit committee appointments (Gal-Or et al. 2018), they may still employ more nuanced tactics to reduce the effectiveness of audit committee monitoring. Specifically, powerful CEOs prefer AFEs who are less able or less inclined to limit the CEOs' accounting discretion. Prior research documents that "less effective AFEs," whom we define as those with less experience, of lower status,² or with more social ties to the CEO, are associated with a lower ability and willingness to limit earnings management (Badolato et al. 2014; Bruynseels and Cardinaels 2014). These AFEs are less likely to question management or side with the auditor on accounting issues. Consequently, by strategically choosing AFEs, powerful CEOs can assemble audit committees that are less likely to restrain earnings management (Adams and Ferreira 2007). Therefore, our second objective in this study is to examine whether CEO power is negatively associated with effective AFEs' appointment to and presence on audit committees.

The audit committee chair has greater authority than other committee members (Gal-Or et al. 2018; Free et al. 2021). Critically, to effectively monitor financial reporting, the audit committee chair must have the willingness and authority to oppose management and sufficient accounting expertise to identify, interpret, and understand financial reporting issues. Consequently, we propose that in the presence of powerful CEOs, effective AFEs are less likely to be designated audit committee chair, which reduces the quality of audit committee oversight (Krishnamoorthy et al. 2022). Accordingly, our third objective in this study is to examine whether CEO power is negatively associated with effective AFEs' designation as audit committee chair. Finally, on the basis of our previous research objectives, we conjecture that the limiting of effective

² AFE status refers to an AFE's ability to command authority and influence outcomes based on perceived skills and personal traits. The factors that influence status in a corporate setting, include the number of private and public board directorships and university degrees from elite institutions.

AFE representation on the audit committee could reduce monitoring over financial reporting. This, in turn, could increase powerful CEOs' discretion over financial reporting decisions. Hence, our fourth objective is to examine whether the absence of effective AFEs is associated with an increased likelihood of firms with powerful CEOs of using discretionary accruals to meet or just beat analyst earnings forecasts.

We test our predictions using a sample of 21,039 US firm-year observations from 2006 through 2017. Consistent with Finkelstein (1992), we construct a measure of CEO power based on the following dimensions of power: structural power, ownership power, expert power, and prestige power.³ In addition, because CEOs are prohibited under SOX from serving on the nominating committee, we include relational power as an additional dimension of CEO power. This dimension captures CEOs' ability to exploit their own social ties (i.e., professional, educational, and other ties) to influence members of the nominating committee. We find a negative association between the presence of a powerful CEO and AFEs' appointment to and presence on the audit committee. Specifically, we find that a move from the 25th to the 75th percentile of CEO power corresponds to a 23.08% lower probability that an AFE is appointed to the audit committee.⁴ Firms with powerful CEOs are less likely to have effective AFEs (defined as AFEs with experience, high status, and social independence). Among firms with AFEs, those with powerful CEOs are less likely to have effective AFEs serving as audit committee chair. Finally, our results show that firms

³ These four dimensions of power are described in Finkelstein (1992). Structural power captures the formal power held by the CEO through their hierarchy within the organizational structure. Ownership power captures the CEO's ability to exert power over the election of directors through share ownership. Prestige power captures the personal prestige of the CEO, which influences perceptions of the CEO's importance. Expert power is gained through experience and expertise in dealing with external contingencies and contributing to organizational success. The measurement of each dimension of power is described in Section 3.2.1.

⁴ We calculate all likelihoods on a relative basis. For example, in an average firm, the unconditional likelihood of appointment of an AFE is 13%. Our regression results in Table 3 show that a one-unit increase in *CEO Power* is associated with a 1% lower likelihood of an AFE appointment. This indicates a relative economic effect of $(1\% / 13\% =) 7.69\%$.

with powerful CEOs and higher discretionary accruals are more likely to meet or just beat analyst forecasts when the AFEs on their audit committees are less effective.

Our results are consistent with the argument that powerful CEOs strategically select AFEs. However, it is possible that the results are driven by AFEs' avoidance of firms with powerful CEOs. To shed light on the direction of causality, we examine the evidence for this alternative explanation. Our analyses are based on the theoretical argument that an AFE's decision to join a firm is driven by reputational incentives, as proxied by litigation risks and firm reputation (Fama and Jensen 1983; Fich and Shivdasani 2007; Knyazeva et al. 2013; Brochet and Srinivasan 2014; Masulis and Mobbs 2014; Naaraayanan and Nielsen 2021; Donelson et al. 2022). We argue that if AFEs do indeed avoid firms with powerful CEOs, the extent of the avoidance should vary because AFEs have stronger incentives to provide their services to more reputable firms or to firms with lower litigation risk even in the presence of powerful CEOs. However, if firm reputation or litigation risk does not reduce the negative relation between CEO power and AFE presence, it is less likely that AFE reputational incentives drive the results. The results of these tests provide no evidence to suggest that AFE reputational incentives influence the negative relation between CEO power and AFE presence.

Although AFEs' decisions to avoid firms with powerful CEOs are not observable, we can observe their decisions to leave a firm, and we posit, following prior literature, that they are more likely to do so if they perceive the appointment to pose a risk to their reputation (Beasley et al. 2009; Dou 2017). However, we find no evidence of a higher incidence of AFE departures in the presence of powerful CEOs. Finally, if AFEs are less willing to join firms with powerful CEOs, we should expect them to demand higher compensation to offset the increased reputational risk (Linck et al. 2009; Fedaseyeu et al. 2018; Ghannam et al. 2019). Again, we find no evidence

supporting this conjecture. Overall, we find no evidence to support the alternative view that AFEs avoid firms with powerful CEOs. Moreover, our examination of the individual dimensions of CEO power shows that a CEO's social ties with the nominating committee are an important determinant of AFE representation. This suggests that powerful CEOs bypass the SOX prohibition on their involvement in board nomination decisions and tacitly influence the nominating committee. Overall, our results support the notion that powerful CEOs limit audit committee effectiveness by influencing the AFE selection process.

Our study contributes to the literature on audit committee effectiveness by providing evidence consistent with CEOs' undermining of audit committee monitoring through their influence on director selection and designation. In contrast with prior studies that focus on the characteristics of existing audit committee members (Dhaliwal et al. 2010; Cohen et al. 2014; Lisic et al. 2016), we focus on the strategic selection of AFEs as a mechanism to reduce monitoring over the financial reporting process. In doing so, we also address recent calls to investigate CEOs' influence over strategic director appointments (Graham et al. 2020; Drymiotes and Sivaramakrishnan 2021). Our findings also have implications for studies on AFE selection (Erkens and Bonner 2013; Chychyla et al. 2019).

In addition, the findings enhance our understanding of how powerful CEOs indirectly influence nominating committees. In documenting that powerful CEOs exploit their social ties with nominating committees to drive favorable board appointments, we corroborate qualitative evidence that powerful CEOs are able to circumvent the SOX requirements intended to prevent CEO involvement in director nominations (Cohen et al. 2013; Clune et al. 2014). These findings extend our understanding of how powerful CEOs undermine a fundamental tenet of effective corporate governance practices: independence in the director selection process (Jensen and

Meckling 1976). Thus, our findings have implications for regulators who have thus far focused only on preventing CEOs from directly serving on nominating committees.

Finally, our results have implications for regulators focused on defining who counts as a financial expert and on related disclosure requirements (SEC 2015). Although the literature supports the narrowing of the definition of who is considered a financial expert to include only AFEs, we find that this distinction is insufficient because not all AFEs are equally effective. Consistent with calls from practitioners, our findings support the need for increased disclosure requirements with respect to AFEs' monitoring ability (i.e., prior experience, status, and independence from the CEO) and justification of the choice of audit committee chair (Conway 2015; Dickey 2015; EY 2015).⁵ Overall, our findings support the view that current regulatory requirements regarding the designation of financial experts are insufficient in promoting audit committee effectiveness.

The remainder of the paper is structured as follows. Section 2 develops our hypotheses. Section 3 outlines the sample selection and research design. Section 4 reports the descriptive statistics and results, and Section 5 provides concluding remarks.

2. BACKGROUND AND HYPOTHESIS DEVELOPMENT

2.1. Background

The SEC considers audit committees critical to overseeing the financial reporting process and protecting shareholder interests. Audit committee members are typically required to monitor the firm's financial reporting and internal control process, manage relationships with the external auditor, and evaluate complex accounting estimates made by management. To promote audit

⁵ As stated in an EY comment letter to the SEC, "Companies could disclose the relevant experience of audit committee members that supports the conclusion that they are financial experts. we believe that investors would benefit from a better understanding of the composition of the audit committee and the skills and experiences that all audit committee members bring to the table" (EY 2015, p. 9).

committee effectiveness and improve financial reporting quality, SOX-related rules introduced by the SEC, the NASDAQ, and the NYSE in 2003 require firms to disclose whether they have a financial expert on their audit committee and, if not, to explain why not (SEC 2003).

Consistent with improvements following these disclosure requirements, several studies find a positive association between the presence of AFEs on the audit committee and financial reporting quality (Dhaliwal et al. 2010; Cohen et al. 2014; Farber et al. 2018; Chychyla et al. 2019; Lisic et al. 2019; Hansen et al. 2021). Moreover, AFEs play a positive role in preventing and detecting egregious financial reporting manipulation (Carcello et al. 2011). Publicized instances of financial misreporting often result in forced CEO turnover and major stock price declines (Karpoff et al. 2008; Hazarika et al. 2012; Agrawal and Cooper 2017). Therefore, both CEOs and their firms benefit from having AFEs on the audit committee. Despite these benefits, some firms still fail to appoint AFEs. The reasons for this lack of AFE appointments remain unclear (Dhaliwal et al. 2010).

2.2. Hypothesis development

Prior research suggests that CEOs prefer less monitoring (Hermalin and Weisbach 1998) and, hence, fewer AFEs on the audit committee. Although CEOs are prohibited under SOX from serving on the nominating committee, evidence suggests that CEOs continue to have incentives and the ability to influence director appointments (Graham et al. 2020; Drymiotes and Sivaramakrishnan 2021). For example, Cohen et al. (2013) report that 73% of interviewed directors stated that CEOs influence the selection of audit committee members under SOX. Similarly, Clune et al. (2014) document that 53% of interviewed directors report that CEOs have significant influence on the nomination of new directors, with one interviewee stating, “CEOs have too much influence over the director nomination process.”

Powerful CEOs are more likely to possess the ability to influence board selection, with Bruynseels and Cardinaels (2014) documenting that the audit committees of firms with powerful CEOs are often comprised of directors from the CEOs' personal networks who are sympathetic to the CEOs' financial reporting choices. CEOs face financial and reputational pressure to maintain firm performance (Kasznik and McNichols 2002; Lopez and Rees 2002; Jiang 2008; Edmonds et al. 2011), which in turn incentivizes them to exercise discretion in financial reporting to meet earnings expectations. Accordingly, we posit that powerful CEOs seek to limit appointments of AFEs to the audit committee as a means of hampering audit committee effectiveness. Although prior research argues that powerful CEOs impair audit committee effectiveness by employing tactics such as withholding financial information to reduce AFEs' monitoring intensity (e.g., Lisic et al. 2016), this requires sustained CEO effort. In contrast, we argue that an alternative channel through which powerful CEOs can potentially reduce audit committee monitoring intensity is the director selection process. Thus, we propose that powerful CEOs undermine audit committee effectiveness by limiting the appointment of AFEs to the audit committee. Our first hypothesis, stated in the alternative form, is:

Hypothesis 1 (H1). Firms with powerful CEOs have fewer AFEs on their audit committees.

Even if powerful CEOs are averse to AFE monitoring, they may still be pressured to appoint an AFE (Gal-Or et al. 2018) to send a positive signal to the market about the quality of their financial reporting (Davidson et al. 2004; Defond et al. 2005).⁶ In such instances, we expect powerful CEOs to disfavor effective AFEs, whom we define as AFEs with sufficient ability and

⁶ For example, following a material accounting restatement, financial media, academics, and practitioners criticized Groupon Inc. (NASDAQ: GRPN) for not having an AFE on its audit committee. Within months, Groupon responded by appointing Robert Bass, an ex-vice chair and partner of Deloitte, as the new audit committee chair (<https://www.reuters.com/article/net-us-groupon-board/analysis-groupon-accounting-problems-put-spotlight-on-board-idUSBRE83B0F920120412>, last accessed August 29, 2022).

willingness to monitor financial reporting. Accordingly, we focus on three attributes of AFE effectiveness: (1) financial reporting experience, (2) status, and (3) independence from the CEO. First, AFEs with greater experience in preparing or verifying financial statements are better able to question management reporting decisions (McDonald et al. 2008). Experienced AFEs often side with external auditors over management during disputes (DeZoort 1998; DeZoort and Salterio 2001). Second, when AFEs have high status, they should influence financial reporting outcomes because they have greater ability, willingness, and determination to monitor management's financial reporting discretion (Badolato et al. 2014). Third, audit committee members are more active monitors when they are socially independent from the CEO (Bruynseels and Cardinaels 2014; Wilbanks et al. 2017).⁷ Therefore, we expect powerful CEOs to disfavor the appointment of effective AFEs—that is, AFEs who are more experienced, have higher status, and are socially independent from the CEO. This expectation is consistent with Beasley et al. (2009) reporting that several audit committee members believe some firms seek directors who are independent in name only. Considering the points above, we state our second hypothesis in the alternative form as follows:

Hypothesis 2 (H2). Firms with powerful CEOs have fewer effective AFEs on their audit committees.

The audit committee chair plays a vital role in ensuring audit committee effectiveness by providing leadership in setting the committee agenda and managing relationships with the external

⁷ Prior evidence shows that audit committee appointees often have professional, educational, and other network ties with the CEO (Klein 2002; Beasley et al. 2009; Bruynseels and Cardinaels 2014), with Beasley et al. (2009) reporting that 40% of the audit committee nominees in their sample had significant previous contact with management and noting that “in some cases, the selection of directors is consistent with managerial hegemony (get friends on the board)”.

auditor (DeZoort et al. 2002; Turley and Zaman 2007; Bédard and Gendron 2010; KPMG 2019). In this role, the audit committee chair also possesses significant information advantages over other audit committee members by having the opportunity to acquire additional information through pre-meeting briefings with the CFO and the external auditor (Free et al. 2021). The audit committee chair controls the flow of information to the rest of the committee and has considerable power in terms of whether to dismiss or pursue investigations of financial reporting issues.

For audit committee chairs to effectively discharge their financial reporting duties, a strong understanding of financial information is essential. Possessing relevant financial reporting expertise enables audit committee chairs to understand financial information (Bédard and Gendron 2010; Conway 2015; Gal-Or et al. 2018). Furthermore, external auditors are more willing to flag concerns about financial reporting when the committee chair has adequate expertise (Knapp 1987; Free et al. 2021).⁸ Prior studies show that firms with audit committee chairs who are AFEs have higher financial reporting quality and timelier disclosure of accounting issues (Schmidt and Wilkins 2013; Krishnamoorthy et al. 2022). Accordingly, both academics (Engel et al. 2010) and practitioners (Conway 2015; Dickey 2015) agree that, among audit committee members, AFEs are most qualified to chair the committee.

When firms with powerful CEOs are unable to prevent the presence of AFEs on the audit committee, they can limit the AFEs' effectiveness by recommending that a non-AFE chair the audit committee.⁹ CEOs' influence on the selection of committee chairs is supported by Clune et al. (2019), who report that 50% of governance committee members interviewed state that CEOs

⁸ In response to an SEC (2015) request for comment on the designation of financial experts, Robert Conway, a previous member of the PCAOB and an audit partner at KPMG, stated that “few audit committee chairpersons are knowledgeable enough about the complexities of financial reporting and the conduct of the audit to be able to take full charge of the auditor relationship,” and Boh Dickey, an audit committee chair, suggested that firms should “require that the committee have a ‘financial expert’ as its chair. And strengthen the definition of ‘financial expert’ to eliminate the ability of a non-financial person to qualify as a ‘financial expert’”.

⁹ Neither the NASDAQ nor the NYSE have a specific requirement regarding which party appoints committee chairs.

are often heavily involved in the selection of committee chairs, with one study participant stating, “The CEO takes the lead on [board committee membership and leadership].” CEOs’ power over the appointment of the audit committee chair may also explain the prior finding that audit committee chairs are more likely to have personal ties to management and fewer years of audit committee experience (Beasley et al. 2009). Similarly, the influence of powerful CEOs over nominating committee members can influence the appointment of the audit committee chair (Clune et al. 2014).¹⁰ Because having an AFE in the role of audit committee chair should increase monitoring over financial reporting (Krishnamoorthy et al. 2022), we expect firms with powerful CEOs to be less likely to have effective AFEs as audit committee chairs. Accordingly, our third hypothesis, stated in the alternative form, is:

Hypothesis 3 (H3). Firms with powerful CEOs are less likely to have effective AFEs as chairs of their audit committees.

Finally, we investigate a consequence of powerful CEOs’ successful disfavoring of an effective AFE presence on their firms’ audit committees. We argue that less effective AFEs enable powerful CEOs to use accounting discretion to meet or just beat analyst earnings forecasts in order to achieve equity market and compensation-related benefits. Prior studies document that firms meeting or beating analyst earnings forecasts experience positive capital market outcomes, such as higher returns and a lower cost of debt (Kasznik and McNichols 2002; Lopez and Rees 2002; Jiang 2008; Edmonds et al. 2011), whereas firms missing analyst earnings forecasts experience negative consequences (Skinner and Sloan 2002; Graham et al. 2005). Moreover, meeting or

¹⁰ Consistent with CEOs having influence, an anecdote in Hermanson et al. (2012) describes one CEO’s intervention in the appointment of a subcommittee chair: “The former compensation committee chair was older and had board experience. When he stepped down, the CEO and compensation committee chair asked me if I would serve due to my background in HR.”

beating performance benchmarks can increase CEO incentive pay, including cash bonuses and equity-based pay (Matsunaga and Park 2001). In contrast, CEOs experience unfavorable effects when their firms miss earnings targets in the form of reduced compensation (Matsunaga and Park 2001; Mergenthaler et al. 2012) and an increased risk of being replaced (Farrell and Whidbee 2003; Mergenthaler et al. 2012).

Regarding how CEOs are able to achieve their desired financial reporting outcomes, prior studies find that discretionary accruals are used to meet or just beat analyst earnings forecasts (Bartov et al. 2002; Matsumoto 2002; Jiang 2008; Huang et al. 2017). Because powerful CEOs have the ability to circumvent financial monitoring, they are likely to use discretionary accruals for this purpose (Mande and Son 2012; Dikolli et al. 2021). However, since effective AFEs provide higher-quality monitoring than less effective and non-AFE committee members, they can mitigate powerful CEOs' ability to influence accounting choices (Beck and Mauldin 2014). Specifically, the presence of an AFE who is experienced, independent, and high status or who chairs the audit committee may reduce the ability of a powerful CEO to overrule the AFE's concerns regarding the use of discretionary accruals. Therefore, we expect powerful CEOs to be able to influence discretionary accruals enough to meet or just beat analyst earnings forecasts only when AFEs' effectiveness is weak. Our final hypothesis, stated in the alternative form, is as follows:

Hypothesis 4 (H4). The combined effect of CEO power and discretionary accruals on meeting or just beating analyst earnings forecasts is present only when AFE effectiveness is weak.

3. RESEARCH DESIGN

3.1. Sample selection

Table 1 describes our sample selection process. After our matching of governance and financial data from the BoardEx and Compustat databases, respectively, our initial sample

comprises 59,019 firm-year observations for US listed companies from 2006 through 2017. We obtain CEO compensation and ownership data from Incentive Lab and ExecuComp, respectively, financial data from Compustat, audit data from Audit Analytics, and board member employment history, education, personal characteristics, and other governance data from BoardEx. We remove firm-year observations with missing audit committee data (N=622), CEO compensation and ownership data (N=35,469), financial data (N=740), audit fee data (N=243), and CEO data (N=906) from the sample. The final sample comprises 21,039 firm-year observations.

Table 1 also describes the subsamples that we use to draw inferences. Our analysis of AFE appointments to audit committees uses a subsample in which at least one audit committee appointment is made during the year (N=5,990). Our investigation of the firms' likelihood of appointing experienced, high status, and independent AFEs uses a subsample of 2,776 firm-year observations in which an AFE appointment to the audit committee occurred. Our analysis of AFE appointments to audit committee chair uses observations where there is at least one AFE on the audit committee at the end of the year (N=17,900). All other subsamples are described in the notes accompanying the tables.

[Insert Table 1 about here]

3.2. CEO power and the presence and effectiveness of AFEs

To examine the role of CEO power in reducing AFEs' presence and effectiveness (H1, H2, and H3), we estimate the following regression model:

$$AC_Effectiveness_{it} = \alpha_0 + \alpha_1 CEO_Power_{it} + \alpha_{2-x} Controls_{it} + \sum IndustryEffects + \sum YearEffects \quad (1)$$

Model (1) is estimated as either an OLS regression model or a linear probability regression model because *AC_Effectiveness* is proxied by both continuous (*AFE_Prcnt*) and binary (*AFE_Appoint*, *AFE_Chair*) dependent variables (Greene 2004; J. B. Kim et al. 2018).¹¹ Following Badolato et al. (2014), we define AFEs as directors with prior experience in the direct preparation or audit of public firm financial statements. We identify directors with accounting experience as those having held a position as chief financial officer, accounting officer, chief accountant, financial controller, financial officer, head of accounting, vice president of accounting, treasurer, or an audit-based role (e.g., audit partner, audit director, audit senior officer, audit manager, or a certified public accountant in a public accounting firm).

To test H1, we specify two dependent variables: *AFE_Appoint* and *AFE_Prcnt*. *AFE_Appoint* is a binary variable that takes the value of one if an AFE is appointed to the audit committee, and zero otherwise. *AFE_Prcnt* is the proportion of audit committee members classified as AFEs. In our testing of H2, the dependent variables focus on AFEs who possess greater experience (*AFE_Exp_Appoint*, *AFE_Exp_Prcnt*), status (*AFE_Status_Appoint*, *AFE_Status_Prcnt*), and social independence from the CEO (*AFE_Indep_Appoint*, *AFE_Indep_Prcnt*). To test H3, we use *AFE_Chair* as the dependent variable, defined as a binary variable that takes the value of one if an AFE serves as the chair on the audit committee, and zero otherwise. In addition, we create three binary dependent variables to examine the effectiveness of AFE chairs based on their experience (*AFE_Exp_Chair*), status (*AFE_Status_Chair*) and independence from the CEO (*AFE_Indep_Chair*).

¹¹ Given our large sample and the concerns about drawing inferences from nonlinear models in Greene (2004), we conduct our analyses of AFE and AFE chair appointments using a linear probability model.

3.2.1 CEO power

Our variable of interest is CEO power (*CEO_Power*). Following Finkelstein (1992), Lisic et al. (2016), and Ke et al. (2021), we begin by constructing an index based on four dimensions of CEO power: (1) structural power, (2) ownership power, (3) expert power, and (4) prestige power. Structural power reflects the CEO's formal authority within the organization. It is quantified by an indicator for whether the CEO holds the position of board chair (*Chair*) and an index of the CEO's compensation relative to that of the next-highest-paid executive (*Relative_Comp*). Ownership power captures the CEO's ability to exert power over the election of directors through share ownership. We measure ownership power by identifying the percentage of shares owned by the CEO (*Shares_Owned*) and whether the CEO founded the firm (*Founder*). Expert power can be gained through greater experience and expertise, measured by the CEO's tenure in the current role (*Tenure*) and the number of years that the CEO has held executive positions in the firm (*Years_Exp*).¹² Prestige power captures the personal prestige of the CEO, which influences the perception of the CEO's importance. It is measured by the number of public and private board seats held by the CEO (*Publ_Board_Seats*, *Priv_Board_Seats*) and whether the CEO obtained a university degree from an elite institution (*Elite*).

Studies focused on the pre-SOX setting demonstrate the importance of considering CEO influence over the nominating committee in the context of board appointments (Shivdasani and Yermack 1999; Carcello et al. 2011). Under SOX, CEOs are prohibited from serving on the nominating committee. However, we argue that powerful CEOs can still influence the nomination

¹² We consider the following executive positions in our measure of *Years_Exp*: president, CFO, chief operating officer, vice president, vice chair, and general manager. Unlike Lisic et al. (2016), we do not consider the number of executive positions that the CEO has held prior to becoming CEO due to the high correlation of this measure (79.3%) with *Years_Exp*. However, untabulated results show that including this additional variable in our CEO power measure does not change our inferences.

process through their social ties with nominating committee members. As outlined in Finkelstein (1992) and Ke et al. (2021), the CEO power construct needs to be adapted to the specific research context. Therefore, we extend the CEO power measure from Finkelstein (1992) and introduce a fifth dimension of CEO power that we dub relational power.¹³ We define relational power as the CEO's ability to influence the nominating committee through social ties with committee members. This definition is consistent with managerial hegemony theory, which states that CEOs appoint individuals who will not curtail their actions (Cohen et al. 2008; Bruynseels and Cardinaels 2014). Relational power (*Relational*) is captured with three binary variables reflecting whether (1) the proportion of the nominating committee with professional ties to the CEO is higher than the yearly sample median (where *NC_Professional_Ties_D* is equal to one if so, and zero otherwise), (2) the proportion of the nominating committee with educational ties to the CEO is higher than the yearly sample median (where *NC_Educational_Ties_D* is equal to one if so, and zero otherwise), and (3) the proportion of the nominating committee with nonprofessional ties to the CEO is higher than the yearly sample median (where *NC_Community_Ties_D* is equal to one if so, and zero otherwise). We include *Relational*, which ranges from 0 through 3, as an additional dimension of *CEO_Power* in our main analyses.

To operationalize the CEO power index, we convert all continuous measures into binary variables (denoted by the suffix “_D”) that take the value of one if the continuous measure value exceeds the yearly sample median across all CEOs, and zero otherwise. We then construct the index measure *CEO_Power* as the sum of each of the 12 binary measures (*Chair*, *Relative_Comp_D*, *Shares_Owned_D*, *Founder*, *Tenure_D*, *Years_Exp_D*, *Publ_Board_Seats_D*,

¹³ Similarly, Ke et al. (2021) adapt the CEO power measure for the Chinese institutional setting. The authors include three additional dimensions of power capturing political connections, seniority (age), and gender as sources of power specific to the Chinese cultural setting.

Priv_Board_Seats_D, *Elite_D*, *NC_Professional_Ties_D*, *NC_Educational_Ties_D*, and *NC_Community_Ties_D*). *CEO_Power* ranges from 0 (lowest power) through 12 (highest power).

3.2.2 Control variables

Our model controls for firm characteristics influencing the appointment and presence of AFEs (Defond et al. 2005; Erkens and Bonner 2013; Chychyla et al. 2019). Firms with higher status are reluctant to appoint low-status AFEs but will do so when the supply of high status AFEs is low (Erkens and Bonner 2013). Therefore, we control for firm status and the supply of high status AFEs. Firm status (*Firm Status*) is measured as a factor score derived from a principal components factor analysis of standardized measures of market value of equity, the number of interlocked firms, and the overall score on *Fortune*'s "Most Admired Companies" list.¹⁴ To measure the supply of high status AFEs (*Supply_HS_AFE*), we adapt the measure of local director supply developed in Knyazeva et al. (2013). Firms with poor corporate governance practices are less likely to appoint AFEs (Defond et al. 2005; Erkens and Bonner 2013). Accordingly, we control for the firm's corporate governance quality using the governance index (*Gov_Index*) from Erkens and Bonner (2013). In addition, since an audit committee with more collective experience can provide enhanced monitoring quality (Dhaliwal et al. 2010), we include the average tenure of the audit committee members (*AC_Tenure*) as a control variable.

We also take into account various audit committee characteristics, governance structure, and firm characteristics that are likely to have an impact on the appointment of AFEs. As the decision to appoint an AFE is likely to be determined by the existing representation of AFEs on

¹⁴ *Fortune*'s Most Admired Companies score is manually collected from *Fortune* and *CNN Money*'s websites. The *Fortune* website (<https://fortune.com/worlds-most-admired-companies/>) only reports scores from 2014 onward, but *CNN Money* (<https://money.cnn.com/magazines/fortune/mostadmired/>) reports annual scores from 2006 through 2014.

the audit committee (Ghannam et al. 2019), we control for the number of sitting AFEs (*Num_AFE*) and former AFE committee members who have departed the audit committee (*AFE_Left*). In addition, firms receive information about the benefits of an AFE presence on the audit committee through their connections to other firms (Erkens and Bonner 2013). We therefore control for the number of interlocks between the focal firm and other firms via directorships (*Interlocks*) or the external auditor (*Prcnt_Client_AFE*). Because directors connected to the CEO are likely to be favored in the appointment process (Beasley et al. 2009), we control for the total number of AFEs connected to the CEO through professional, social, and educational networks (*CEO_AFE_Connection*). Furthermore, as companies that dedicate greater resources to external verification of their financial statements are more likely to appoint AFEs (Engel et al. 2010; Carcello et al. 2011), we include controls for auditor size (*Big_Four*) and audit fees (*Audit_Fees*).

In line with previous studies (Defond et al. 2005; Boone et al. 2007; Erkens and Bonner 2013), we control for attributes such as firm age (*Firm_Age*), profitability (*MTB*, *ROA*), and incidence of loss (*Loss*), as these factors may influence a firm's propensity to avoid appointing AFEs. As companies with poor financial reporting quality and complex financial reporting have a greater demand for AFEs (Dhaliwal et al. 2010; Chychyla et al. 2019), we control for the firm's accruals (*Accruals*), earnings volatility (*Earnings_Vol*), number of geographical segments (*Geo_Segment*), restructuring activity (*Restructuring*) and acquisition activity (*Acquisition*).

In our analyses of AFEs serving as audit committee chair (H3), we include additional variables to control for the possibility that more effective AFEs are favored for audit committee chair positions (*AFE_Exp_Prcnt*, *AFE_Status_Prcnt*, *AFE_Indep_Prcnt*, *AFE_Chair_Prcnt*, *AFE_Tenure*). We include industry (*IndustryEffects*) and year (*YearEffects*) fixed effects based on

two-digit General Industry Classification Standard (GICS) industry codes and the fiscal year respectively. We provide variable descriptions in Appendix 1.

3.3. Do effective AFEs limit the accounting discretion of powerful CEOs?

To examine whether effective AFEs limit the ability of powerful CEOs to use accounting discretion to meet or just beat analyst earnings forecasts (H4), we estimate the following regression model as a linear probability regression model:

$$\begin{aligned} Meet_Beat_{it} = & \beta_0 + \beta_1 CEO_Power_{it} + \beta_2 Disc_Accruals + \beta_3 CEO_Power * \\ & Disc_Accruals + \beta_{4-x} Controls_{it} + \sum IndustryEffects + \sum YearEffects \quad (2) \end{aligned}$$

Prior research finds that CEOs are strongly incentivized to meet firm performance targets and may exploit discretion in financial reporting to meet these targets (Graham et al. 2005; McVay et al. 2006; Cao et al. 2012; Chiu et al. 2013; Omer et al. 2020). We perform our tests using a subsample of firms with analyst forecast data available from the I/B/E/S database. The dependent variable, *Meet_Beat*, is measured as a binary variable taking the value of one if the realized I/B/E/S EPS of firm *i* equals or exceeds the median analyst forecast by one cent or less (i.e., [0.0, 0.1]), and zero otherwise (Cheng and Warfield 2005; Lim and Tan 2008; Brochet et al. 2015). Further, Mande and Son (2012) observe that powerful CEOs are more likely to utilize discretionary accruals to meet earnings benchmarks. They also note that audit committee characteristics such as greater financial expertise do not necessarily mitigate this effect. Given this, we include an independent variable, *Disc_Accruals*, measured as the signed performance-adjusted abnormal (discretionary) accruals, based on Jones (1991) and Kothari et al. (2005). Our test variable is the interaction between *CEO_Power* and *Disc_Accruals*. This interaction variable captures the association between the presence of a powerful CEO and the level of discretionary accruals. It also

indicates whether these firms have a greater likelihood of meeting or just beating analyst earnings forecasts.

To determine whether powerful CEOs successfully use greater financial reporting discretion to meet earnings targets in the absence of effective AFEs, we partition the sample based on AFE effectiveness using the median of *AFE_Effectiveness*. To measure *AFE_Effectiveness*, we construct an index that sums seven binary variables. These variables take the value of one under the following conditions: there is at least one experienced AFE on the audit committee; there is at least one high status AFE on the audit committee; there is at least one AFE who is independent from the CEO on the audit committee; an AFE serves as chair of the audit committee; an experienced AFE serves as chair of the audit committee; a high status AFE serves as chair of the audit committee; an independent AFE serves as the chair of the audit committee. When the corresponding conditions are not met, the variables take the value zero.

Consistent with prior studies on the determinants of meeting or beating analyst earnings forecasts, we control for the dispersion in forecasts using the standard deviation of individual analysts' final EPS forecasts (*SD_Dis*) and the number of analysts contributing to the forecast (*Num_Analyst*) (Bissessur and Veenman 2016). We further control for common determinants of accounting quality, including audit and governance quality (*Big_Four*, *Audit_Fees*, *New_Auditor*) as well as the following firm characteristics: size (*Ln_Assets*), risk (*Leverage*, *FPS*), stability (*Firm_Age*, *MTB*, *Sales_Growth*), performance (*Ln_CFO*, *ROA*), and ownership (*Inst_Own*) (Zhang 2019). We include industry (*IndustryEffects*) and year (*YearEffects*) fixed effects based on two-digit GICS industry codes and the fiscal year, respectively. We provide variable descriptions in Appendix 1.

4. RESULTS

4.1. Descriptive statistics

Panel A of Table 2 reports summary statistics for all the variables used in our primary analyses. Panel B reports summary statistics for our dependent variables when the sample is partitioned on the basis of whether the firm has a nonpowerful ($CEO_Power_D=0$) or a powerful ($CEO_Power_D=1$) CEO and compares audit committee AFE characteristics. Our CEO power measure (CEO_Power) has a mean (median) value of 4.37 (4). The values of all the other variables are consistent with those in prior studies. When comparing audit committee AFEs between the high- and low-CEO power subsamples in Panel B, we find that firms with powerful CEOs appoint fewer AFEs ($AFE_Appoint$) and have fewer AFEs on the audit committee (AFE_Prct). In addition, we find that AFEs selected to audit committees in firms with powerful CEOs have less experience (AFE_Exp_Prct), are of lower status (AFE_Status_Prct), and are less socially independent (AFE_Indep_Prct). Finally, AFEs in the high-CEO power subsample are less likely to be audit committee chairs. These univariate results provide preliminary support for H1, H2, and H3.

[Insert Table 2 about here]

Our preliminary inferences derived from the descriptive statistics are corroborated by Figure 1, which presents the values for various AFE characteristics at various levels of CEO power. The figure shows that the proportion of firms with AFEs on their audit committees (AFE_Prct) and with a presence of effective AFEs (AFE_Exp_Prct , AFE_Indep_Prct , and AFE_Chair) decreases as CEO power increases. Panel C of Table 2 tests whether firms with powerful CEOs (defined as CEO_Power above the median) have AFEs as effective as those of their counterparts

with less powerful CEOs but the same number of AFEs. The results show that firms with powerful CEOs tend to have fewer experienced (*AFE_Exp_Prcnt*), high status (*AFE_Status_Prcnt*), and socially independent (*AFE_Indep_Prcnt*) AFEs irrespective of the number of AFEs on the audit committee. In short, firms with powerful CEOs tend to have fewer AFEs and, among those with equal numbers of AFEs, less effective AFEs.

[Insert Figure 1 about here]

4.2. Regression results

Columns 1 and 2 of Table 3 present the results from our estimation of Model (1), which analyzes whether CEO power is associated with the probability of an AFE being appointed to the audit committee and the proportion of AFEs on the audit committee (H1). Consistent with our expectations, we find that *CEO_Power* is negatively associated with both the appointment of an AFE to (*AFE_Appoint*) and percentage of AFEs on (*AFE_Prcnt*) the audit committee. With respect to economic magnitudes, our results show that a move from the 25th to the 75th percentile of CEO power corresponds to a 23.08% lower probability of an AFE appointment.¹⁵ Consistent with findings in Erkens and Bonner (2013), we find that AFE appointments occur less frequently among high status firms (*Firm_Status*). Additionally, the number of AFEs on the audit committee (*Num_AFE*) is negatively associated with the appointment of an AFE. AFE appointments occur more frequently following the departure of an AFE (*AFE_Left*) and when there are more firm interlocks (*Interlocks*). Overall, these findings support H1 and are consistent with the argument that firms with powerful CEOs have an incentive and motivation to disfavor the presence of AFEs on their audit committees.

¹⁵ A one-unit change in CEO power is associated with a 7.69% (0.01/0.13) lower probability of an AFE appointment, and a 2.7% (0.01/0.37) reduction in the proportion of AFEs on the audit committee, all other things equal.

[Insert Table 3 about here]

Columns 3, 5, and 7 of Table 3 use the subsample of firms in which at least one AFE appointment was made during the year (N=2,776). We find that CEO power (*CEO_Power*) is negatively associated with the status (*AFE_Status_Appoint*) and independence of the appointed AFEs (*AFE_Indep_Appoint*). Columns 4, 6, and 8 use the subsample of firms with at least one AFE on the audit committee (N=17,900). We find that CEO power (*CEO_Power*) is negatively associated with the proportion of experienced (*AFE_Exp_Prcnt*), high status (*AFE_Status_Prcnt*), and independent (*AFE_Indep_Prcnt*) AFEs on the audit committee. Overall, our results provide support for H2, with CEO power being associated with the presence of fewer effective AFEs.

Column 1 of Table 4 uses the subsample of firms with at least one AFE on the audit committee (N=17,900) and presents the results from our tests of H3. The results show that firms with a powerful CEO (*CEO_Power*) are less likely to appoint an AFE to chair the audit committee (*AFE_Chair*). A move from the 25th to the 75th percentile of CEO power corresponds to a 3.9% lower probability that an AFE serves as audit committee chair. Consistent with expectations, the presence of longer tenured (*AFE_Tenure*) and more experienced (*AFE_Exp_Prcnt*, *AFE_Chair_Prcnt*) AFEs increases the likelihood that the chair is an AFE. These results provide support for H3, in that powerful CEOs are associated with lower AFE effectiveness because AFEs play a limited role in chairing audit committees.

[Insert Table 4 about here]

Columns 2 through 4 consider the role of AFE chair characteristics using subsamples of firms where there is an experienced (N=13,197), high status (N=1,238), or socially independent (N=14,486) AFE present on the audit committee, respectively. The results support H3, with

CEO_Power being negatively associated with the appointment of an audit committee chair who is experienced (*AFE_Exp_Chair*) or socially independent (*AFE_Indep_Chair*). Our finding that CEO power is negatively associated with a socially independent audit committee chair is consistent with the result of Beasley et al. (2009), who find that before joining the board, audit committee chairs are more likely to have personal connections with executives. However, we find no significant association between the presence of a powerful CEO in a firm and its likelihood of having a high status AFE as chair of the audit committee.

Overall, Tables 3 and 4 present results that support our expectations. Consistent with H1, firms with powerful CEOs are less likely to appoint AFEs to the audit committee and have fewer AFEs present on their audit committees. Consistent with H2, when AFEs are present on the audit committees of firms with powerful CEOs, the AFEs are less likely to be experienced, of high status, or socially independent from the CEO. Finally, consistent with H3, in the presence of powerful CEOs, AFEs are less likely to chair the audit committee, and AFE chairs are less likely to be experienced or socially independent. The inferences are robust to the use of propensity score matching and entropy balancing. Results from additional analyses using the individual dimensions of CEO power, changes from a powerful to a nonpowerful CEO, and other AFE and audit committee chair characteristics are described in Appendix S1.¹⁶ Overall, the results suggest that powerful CEOs favor AFEs who may be less capable of detecting or preventing the CEOs from exercising financial reporting discretion.

Although we argue that powerful CEOs may try to prevent appointments of AFEs in general and of effective AFEs in particular, there are situations where an effective AFE and a powerful CEO are both present. Table 5 presents the results from our estimation of Model (2). If

¹⁶ See Appendix S1 in the Supporting Information.

managing earnings using discretionary accruals is a channel through which powerful CEOs meet or just beat analyst earnings forecasts, then we should expect the interaction between *CEO_Power* and *Disc_Accruals* to be positive and significant. In Column 1, we find a positive association between *CEO_Power*×*Disc_Accruals* and *Meet_Beat* in the full sample of observations with analyst forecast data (N=12,317). This is consistent with results from prior studies documenting that powerful CEOs use accounting discretion to meet and beat earnings benchmarks (Mande and Son 2012; Dikolli et al. 2021).

[Insert Table 5 about here]

To test H4, we examine whether this result is observed only when AFE effectiveness is weak. Accordingly, we partition the sample into subsamples based on AFE effectiveness (Columns 2 and 3). In Column 2 of Table 5, we continue to find a positive association between *CEO_Power*×*Disc_Accruals* and *Meet_Beat* for firms with weak AFE effectiveness. However, the association between *CEO_Power*×*Disc_Accruals* and *Meet_Beat* becomes insignificant in the presence of effective AFEs (Column 3). These findings support H4 and extend the results of Mande and Son (2012) and Dikolli et al. (2021) by demonstrating that effective AFEs have heightened financial monitoring ability. Overall, these results help to explain our earlier findings by showing that powerful CEOs have the incentive and ability to disfavor effective AFEs in the appointment process.

4.3. Do AFEs avoid firms with powerful CEOs?

Our finding that firms with powerful CEOs have fewer AFE appointments and have a limited presence of AFEs on their audit committees is consistent with powerful CEOs disfavoring AFEs. However, an alternative explanation is that AFEs avoid firms with powerful CEOs. We

examine this possibility next. Our analyses are based on the view that the two primary incentives for AFEs to join a board of directors are reputation (Fama and Jensen 1983) and compensation considerations (Adams and Ferreira 2008).

4.3.1. Litigation risk

Prior studies document that reputational risk associated with litigation is a significant concern for directors (Fich and Shivdasani 2007; Brochet and Srinivasan 2014; Naaraayanan and Nielsen 2021). Directors can resign from or decline to serve on a board if management integrity concerns are apparent (Beasley et al. 2009). Building on these prior studies, we argue that any concerns on the part of AFEs about joining the boards of firms with powerful CEOs should be magnified when the firms are subject to greater litigation risk.

We take advantage of variation in the adoption of universal demand (UD) laws in the United States to measure litigation risk. Because UD laws require shareholders to obtain board approval before a lawsuit can commence, these laws significantly decrease director litigation risk. According to Masulis et al. (2020), the adoption of UD laws increased the willingness of higher-quality directors to serve on the boards of firms incorporated in UD states (which we capture in our analysis with the variable *UD_Law*). If effective AFEs avoid firms with powerful CEOs out of concern over increased litigation risk, the presence of UD laws should alleviate that risk and increase effective AFEs' willingness to serve. In this vein, we include *UD_Law* as an additional independent variable in the specification from the main analysis. We expect a positive coefficient on *CEO_Power* × *UD_Law* if effective AFEs are more willing to join firms with powerful CEOs in UD states. In Panel A of Table 6, we find that the coefficient on the interaction term

$CEO_Power \times UD_Law$ is insignificant, indicating that AFEs are not less likely to avoid powerful CEOs when reputational concerns associated with litigation risk are alleviated.¹⁷

[Insert Table 6 about here]

4.3.2. Firm reputation

If AFEs are concerned about their reputation and are selective in accepting director appointments, they should value the reputational benefits and social status arising from being associated with more reputable firms (Weiss and Fershtman 1998; Cao et al. 2012; Cao et al. 2015; Focke et al. 2017). We measure firm reputation using the firm's inclusion on *Fortune's* list of "Most Admired Companies" (*Fortune*) (Cao et al. 2012; Cao et al. 2015; Focke et al. 2017). As this list is created by an external party, the measure is unlikely to be directly influenced by the firm (Focke et al. 2017). If AFEs avoid joining firms with powerful CEOs, the reputational gains associated with serving on the board of a reputable firm should mitigate the negative associations between AFE appointments/presence/effectiveness and CEO power. Panel B of Table 6 shows that the negative association between the AFE variables and CEO power remains after we control for the firm's reputation (*Fortune*). The coefficients on $CEO_Power \times Fortune$ are mostly insignificant, with the exception of those in Columns 2 and 6, where they are negative and significant. Importantly, because a better firm reputation does not mitigate the negative association between CEO power and AFE appointments, our results do not support the view that AFE reputational concerns drive AFE appointments in firms.

¹⁷ We also use industry membership as an ex ante measure of litigation risk (I. Kim and Skinner 2012) and continue to find a negative and significant association between the AFE variables and CEO power but no impact of industry litigation risk.

4.3.3. AFE departures

Although we are unable to observe AFEs' decisions to avoid firms with powerful CEOs, we can observe their decisions to leave. Prior evidence documents that directors leave board positions in anticipation of negative events that can impose reputational costs (Dou 2017; Fahlenbrach et al. 2017; Gao et al. 2017). Consistent with these findings, we argue that if AFEs are concerned about the conduct of powerful CEOs, *CEO_Power* should be associated with more AFE departures, especially given that CEO power increases over time. Panel A of Table 7 reports the results from our estimation of Model (1) with *AFE_Left* as the dependent variable. The results show that AFEs are less likely to leave firms with powerful CEOs. We also re-estimate the model for effective AFEs because these AFEs may have stronger incentives to depart from firms with powerful CEOs. The results show that experienced, high status, or socially independent AFEs are less likely to depart from firms with powerful CEOs.

[Insert Table 7 about here]

4.3.4. AFE compensation

If AFEs are unwilling to join firms with powerful CEOs and/or powerful CEOs demand directors with greater monitoring ability (Baldeuius et al. 2014), we argue that higher compensation should be required to attract AFEs to join firms with powerful CEOs. We identify three reasons why we should expect to observe increased AFE compensation in the presence of powerful CEOs. First, if AFEs are unwilling to join firms with powerful CEOs, the supply of suitable AFEs should be reduced, and increased compensation should be required to attract AFE talent (Ghannam et al. 2019). Second, AFEs may perceive reputational or financial risks associated with accepting directorships and may therefore demand higher compensation (Linck et al. 2009). Third, AFEs could perceive the audit committee role to require heightened monitoring efforts and

demand increased compensation accordingly (Engel et al. 2010). For these reasons, we examine the average compensation of AFEs on audit committees to determine whether AFEs demand higher compensation from firms with powerful CEOs. Following Fedaseyeu et al. (2018), we specify the dependent variable *AFE_Comp* as the natural log of the average compensation received by AFEs on audit committees.

Table 8 reports the results for a sample of firms with at least one AFE on their audit committee. The results show that AFE compensation is significantly lower for firms with powerful CEOs. This finding is inconsistent with AFEs demanding more compensation to offset the costs of serving on the audit committees of firms with powerful CEOs. To ensure that this result is not driven by differences in AFE effectiveness, we also specify the dependent variable as the average compensation of AFEs who are experienced (*AFE_Exp_Comp*), have high status (*AFE_Status_Comp*), or are socially independent from the CEO (*AFE_Indep_Comp*), and we restrict the sample to firms with at least one experienced AFE (Column 2), high status AFE (Column 3), or AFE who is socially independent from the CEO (Column 4). The results suggest that the compensation of effective AFEs who are experienced or socially independent from the CEO is lower for firms with powerful CEOs. However, we do not find a significant coefficient on *AFE_Status_Comp*. Overall, these results do not support the view that AFEs demand higher compensation due to the perceived risk of joining firms with powerful CEOs.

[Insert Table 8 about here]

5. CONCLUSION

This study examines whether powerful CEOs influence the appointment of AFEs to weaken audit committee monitoring and increase their discretion over financial reporting to meet or just beat analyst earnings forecasts. Using a measure of CEO power that incorporates CEO

influence over the nominating committee, we add to the existing literature by documenting that firms with powerful CEOs are less likely to appoint AFEs to their audit committees and have lower overall AFE representation on their boards. Furthermore, firms with powerful CEOs are negatively associated with the board presence of effective AFEs (defined as AFEs who are more experienced, have higher status, and are socially independent from the CEO), who have a greater ability and willingness to monitor. More effective AFEs are also less likely to chair the audit committees of firms with powerful CEOs. We also find that firms with powerful CEOs engage in more benchmark-beating in the absence of effective AFEs. Results from additional analyses rule out the alternative explanation that AFEs prefer not to work with powerful CEOs. Overall, our results respond to an SEC (2015) request for comment on how to define who qualifies as a financial expert. Our results further align with practitioners' calls for enhanced disclosure requirements. The additional required disclosures should cover AFEs' individual characteristics, as this information is indicative of AFEs' capacity to effectively monitor the financial reporting process (Conway 2015; Dickey 2015; EY 2015).

Our examination of the dimensions of CEO power suggests that CEOs' influence over the nominating committee serves as a way for them to discourage AFE appointments. These findings address calls for more research on the role of powerful CEOs in director nominations (Graham et al. 2020). Furthermore, the findings have implications for academics and regulators regarding powerful CEOs' ongoing ability to influence board appointment decisions despite the regulatory requirements that prohibit CEOs from joining nominating committees. Thus, this study addresses longstanding concerns on the part of both practitioners and academics regarding the absence of AFEs on some audit committees. Our findings also highlight the need for effective AFEs on audit

committees to constrain the financial reporting discretion of management (Abbott et al. 2004; Dhaliwal et al. 2010; Chychyla et al. 2019).

Our study is subject to several limitations. First, our analyses do not consider the literature examining the role of CFO characteristics on financial reporting. Previous studies suggest that the CFO has a significant influence on financial reporting decisions and acts as more than just an agent of the CEO (Jiang et al. 2010). Additionally, Hoitash et al. (2016) and Condie et al. (2021) find that the presence of CFOs with accounting and auditing experience is associated with more conservative financial reporting. In the presence of a powerful CEO, we speculate that the influence of the CFO on financial reporting outcomes may be reduced; however, this relation is not investigated in our study and could be investigated in future research. Second, our results are based on cross-sectional analyses, which limit our ability to draw causal inferences. Despite the limitations, our findings contribute to understanding the role of CEO power in the composition of audit committees. They also suggest that the current regulatory requirements might not be sufficient to ensure the effectiveness of audit committees and the quality of financial reporting.

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APPENDIX 1: VARIABLE DEFINITIONS

Variable	Definition
Dependent variables	
<i>AFE_Appoint</i>	Binary variable that takes the value of one if one or more AFEs are appointed to the audit committee in firm <i>i</i> in year <i>t</i> , and zero otherwise
<i>AFE_Prcnt</i>	Proportion of audit committee members in firm <i>i</i> in year <i>t</i> who are AFEs
<i>AFE_Exp_Appoint</i>	Binary variable that takes the value of one if at least one AFE with prior accounting experience exceeding the median AFE's accounting experience is appointed to the audit committee in firm <i>i</i> in year <i>t</i> , and zero otherwise
<i>AFE_Exp_Prcnt</i>	Proportion of AFEs in firm <i>i</i> in year <i>t</i> with prior accounting experience exceeding the median AFE's accounting experience
<i>AFE_Status_Appoint</i>	Binary variable that takes the value of one if at least one AFE with relative status exceeding the CEO is appointed to the audit committee in firm <i>i</i> in year <i>t</i> , and zero otherwise. An AFE has higher relative status if they have (1) a greater number of directorships on public boards, (2) a greater number of directorships on private boards, and (3) a higher number of degrees from elite institution than the CEO
<i>AFE_Status_Prcnt</i>	Proportion of AFEs in firm <i>i</i> in year <i>t</i> who have relative status exceeding that of the CEO
<i>AFE_Indep_Appoint</i>	Binary variable that takes the value of one if at least one AFE with no social, educational, and professional ties to the CEO is appointed to the audit committee in firm <i>i</i> in year <i>t</i> , and zero otherwise
<i>AFE_Indep_Prcnt</i>	Proportion of AFEs in firm <i>i</i> in year <i>t</i> who have no social, educational, or professional ties to the CEO
<i>AFE_Chair</i>	Binary variable that takes the value of one if an AFE serves as the chair of the audit committee in firm <i>i</i> in year <i>t</i> , and zero otherwise
<i>AFE_Exp_Chair</i>	Binary variable that takes the value of one if an AFE with prior accounting experience exceeding the median AFE's accounting experience serves as the chair of the audit committee in firm <i>i</i> in year <i>t</i> , and zero otherwise
<i>AFE_Status_Chair</i>	Binary variable that takes the value of one if an AFE with relative status exceeding that of the CEO serves as audit committee chair in firm <i>i</i> in year <i>t</i> , and zero otherwise
<i>AFE_Indep_Chair</i>	Binary variable that takes the value of one if an AFE with no social, educational, or professional ties to the CEO serves as audit committee chair in firm <i>i</i> in year <i>t</i> , and zero otherwise
<i>Meet_Beat</i>	Binary variable that takes the value of one if the actual EPS in firm <i>i</i> in year <i>t</i> is equal to or exceeds the median I/B/E/S consensus analyst forecast by 1 cent or less, and zero otherwise. The median analyst forecast is reported in the I/B/E/S unadjusted file
Independent variables	
<i>CEO_Power</i>	Index of CEO power, measured as the sum of <i>Chair</i> , <i>Relative_Comp_D</i> , <i>Shares_Owned_D</i> , <i>Founder</i> , <i>Tenure_D</i> , <i>Years_Exp_D</i> , <i>Publ_Board_Seats_D</i> , <i>Priv_Board_Seats_D</i> , <i>Elite_D</i> , <i>NC_Community_Ties_D</i> , <i>NC_Educational_Ties_D</i> , and <i>NC_Professional_Ties_D</i>
<i>Chair</i>	Binary variable that takes the value of one if the CEO holds the title of board chairperson in firm <i>i</i> in year <i>t</i> , and zero otherwise
<i>Relative_Comp</i>	Ratio of the CEO's total compensation to the total compensation of the highest (non-CEO) executive's total compensation in firm <i>i</i> in year <i>t</i>
<i>Relative_Comp_D</i>	Binary variable that takes the value of one if <i>Relative_Comp</i> is above the median in year <i>t</i> , and zero otherwise
<i>Shares_Owned</i>	Percentage of ordinary shares owned by the CEO in firm <i>i</i> in year <i>t</i>
<i>Shares_Owned_D</i>	Binary variable that takes the value of one if <i>Shares_Owned</i> is above the median in year <i>t</i> , and zero otherwise
<i>Founder</i>	Binary variable that takes the value of one if the CEO in firm <i>i</i> in year <i>t</i> is the founder of the firm, and zero otherwise
<i>Tenure</i>	Number of years that the CEO in firm <i>i</i> in year <i>t</i> has served in the current role
<i>Tenure_D</i>	Binary variable that takes the value of one if <i>Tenure</i> is above the median in year <i>t</i> , and zero otherwise

<i>Years_Exp</i>	Number of years that the CEO in firm <i>i</i> held executive positions in the same firm prior to being appointed to the current role as of year <i>t</i>
<i>Years_Exp_D</i>	Binary variable that takes the value of one if <i>Years_Exp</i> is above the median in year <i>t</i> , and zero otherwise
<i>Publ_Board_Seats</i>	Number of outside public board seats held by the CEO in firm <i>i</i> in year <i>t</i>
<i>Publ_Board_Seats_D</i>	Binary variable that takes the value of one if <i>Publ_Board_Seats</i> is above the median in year <i>t</i> , and zero otherwise
<i>Priv_Board_Seats</i>	Number of outside private board seats held by the CEO in firm <i>i</i> in year <i>t</i>
<i>Priv_Board_Seats_D</i>	Binary variable that takes the value of one if <i>Priv_Board_Seats</i> is above the median in year <i>t</i> , and zero otherwise
<i>Elite</i>	Ordinal value of 3 if the CEO received an undergraduate and postgraduate degree from an elite institution, 2 if the CEO received one degree from an elite institution, 1 if the CEO has a formal higher education degree, and 0 if the CEO in firm <i>i</i> in year <i>t</i> does not have a formal higher education degree. See Appendix 2 for the list of elite institutions
<i>Elite_D</i>	Binary variable that takes the value of one if <i>Elite</i> is above the median in year <i>t</i> , and zero otherwise
<i>NC_Professional_Ties</i>	Proportion of the nominating committee with professional ties to the CEO
<i>NC_Educational_Ties</i>	Proportion of the nominating committee with educational ties to the CEO
<i>NC_Community_Ties</i>	Proportion of the nominating committee with nonprofessional ties (including shared memberships in leisure clubs, charities, country clubs or other nonprofit institutions) to the CEO
<i>NC_Professional_Ties_D</i>	Binary variable that takes the value of one if the proportion of the nominating committee with professional ties to the CEO is above the sample median in year <i>t</i> , and zero otherwise
<i>NC_Educational_Ties_D</i>	Binary variable that takes the value of one if the proportion of the nominating committee with educational ties to the CEO is above the sample median in year <i>t</i> , and zero otherwise
<i>NC_Community_Ties_D</i>	Binary variable that takes the value of one if the proportion of the nominating committee with nonprofessional ties to the CEO is above the sample median in year <i>t</i> , and zero otherwise
<i>Structural_Ownership</i>	Sum of <i>Chair</i> and <i>Relative_Comp_D</i>
<i>Expert</i>	Sum of <i>Tenure_D</i> and <i>Years_Exp_D</i>
<i>Prestige</i>	Sum of <i>Public_Board_Seats_D</i> , <i>Private_Board_Seats_D</i> , and <i>Elite_D</i>
<i>Relational</i>	Sum of <i>NC_Community_Ties_D</i> , <i>NC_Educational_Ties_D</i> and <i>NC_Professional_Ties_D</i>
<i>Disc_Accruals</i>	Total value of discretionary accruals measured as the residual from the following model (Jones 1991; Dechow et al. 1995; Kothari et al. 2005): $TA_{it} = \tau_0 + \tau_1 1/AT_{it-1} + \tau_2(REV_{it} - AR_{it}) + \tau_3 PPE_{it} + \tau_4 ROA_{it-1} + \varepsilon_{it}$ where <i>TA</i> is total accruals, calculated as the difference between income before extraordinary items and operating cash flows. <i>AT</i> is total assets. <i>REV</i> is the change in revenue. <i>AR</i> is the change in receivables. <i>PPE</i> is gross property, plant, and equipment. <i>ROA</i> is income before extraordinary items. Variables are scaled by beginning assets. The model is estimated by industry-year
<i>AFE_Effectiveness</i>	Composite measure based on seven binary variables, where each takes a value of one when the corresponding audit committee characteristic among the following is present and takes zero otherwise: at least one experienced AFE on the audit committee; at least one high status AFE on the audit committee; at least one AFE who is independent from the CEO on the audit committee; an AFE as chair of the audit committee; an experienced AFE as chair of the audit committee; a high status AFE as chair of the audit committee; and an independent AFE as chair of the audit committee
Control variables	
<i>Firm_Status</i>	Factor score derived from a principal components factor analysis of standardized measures of market value of equity, number of interlocked firms, and scores from <i>Fortune</i> 's "Most Admired Companies" list. The measures are standardized on the basis of the mean and standard deviation of each measure for all firms in the S&P 1500 index

<i>Supply_HS_AFE</i>	Proportion of firms with high status AFEs serving on audit committees located within a 50-mile radius of firm <i>i</i> in year <i>t</i>
<i>Gov_Index</i>	Binary variable that takes the value of one if the governance index score of firm <i>i</i> in year <i>t</i> is above the median of the S&P 1500 for the respective year, and zero otherwise. The governance index score is equal to the sum of the following six dichotomized corporate governance measures: (1) Board size (equals one when the number of directors on a firm's board is less than the median, and zero otherwise), (2) Board independence (equals one when the number of nonexecutive board members scaled by board size is greater than 60%, and zero otherwise), (3) Audit committee size (equals one when the number of audit committee members scaled by board size is greater than the median, and zero otherwise), (4) Audit committee independence (equals one when all audit committee members are nonexecutive directors, and zero otherwise), (5) Shareholder rights index based on Bebchuk et al. (2009) (equals one when the value is less than the median, and zero otherwise, and (6) Institutional ownership (equals one when the proportion of outstanding shares owned by institutional investors exceeds the median, and zero otherwise)
<i>Num_AFE</i>	Number of AFEs on the audit committee in firm <i>i</i> in year <i>t</i> at the beginning of the year
<i>AFE_Left</i>	Binary variable that takes the value of one if an AFE departs the audit committee in firm <i>i</i> in year <i>t</i> , and zero otherwise
<i>AFE_Tenure</i>	Average tenure of AFEs present on the audit committee in firm <i>i</i> in year <i>t</i>
<i>AC_Tenure</i>	Average tenure of audit committee members in firm <i>i</i> in year <i>t</i>
<i>Firm_Age</i>	Age of firm <i>i</i> in year <i>t</i> , based on the earliest date for which data in Compustat are available
<i>Accruals</i>	Income before extraordinary items less cash flow from operating activities, scaled by total assets for firm <i>i</i> in year <i>t</i>
<i>Interlocks</i>	Number of nonexecutive directors on the board in firm <i>i</i> in year <i>t</i> shared with other S&P 1500 firms with one or more AFEs on the audit committee
<i>Audit_Fees</i>	Natural logarithm of reported audit fees paid to the auditor of firm <i>i</i> in year <i>t</i>
<i>Prcnt_Client_AFE</i>	Percentage of clients with at least one AFE on the audit committee of the auditor in firm <i>i</i> in year <i>t</i>
<i>CEO_AFE_Connection</i>	Natural logarithm of one plus the total number of professional, social, and educational connections that the CEO in firm <i>i</i> in year <i>t</i> has with AFEs, excluding connections formed with existing AFEs on the board in firm <i>i</i>
<i>MTB</i>	Book value of equity scaled by the beginning market value of equity of firm <i>i</i> in year <i>t</i>
<i>Geo_Segment</i>	Natural logarithm of one plus the number of geographical segments in which firm <i>i</i> operates during year <i>t</i>
<i>ROA</i>	Earnings before extraordinary items scaled by the beginning-of-year total assets of firm <i>i</i> in year <i>t</i>
<i>Loss</i>	Binary variable that takes the value of one if firm <i>i</i> in year <i>t</i> experienced a loss in either the current or previous year, and zero otherwise
<i>Restructuring</i>	Binary variable that takes the value of one if there is a restructuring event for firm <i>i</i> in year <i>t</i> , and zero otherwise
<i>Acquisition</i>	Binary variable that takes the value of one if there is a merger or acquisition for firm <i>i</i> in year <i>t</i> , and zero otherwise
<i>Big_Four</i>	Binary variable that takes the value of one if firm <i>i</i> in year <i>t</i> is audited by KPMG, Deloitte, PWC or EY, and zero otherwise
<i>Earnings_Vol</i>	Standard deviation of earnings scaled by total assets calculated for firm <i>i</i> in year <i>t</i> for the five preceding years
<i>New_Auditor</i>	Binary variable that takes the value of one if the auditor of firm <i>i</i> in year <i>t</i> has a tenure of two years or less, and zero otherwise
<i>AFE_Chair_Prcnt</i>	Proportion of AFEs on the audit committee in firm <i>i</i> in year <i>t</i> with prior experience serving as chair of an audit committee
<i>Ln_Assets</i>	Natural logarithm of total assets of firm <i>i</i> in year <i>t</i>
<i>FPS</i>	Binary variable that takes the value of one if firm <i>i</i> operates in one of the following industries and takes 0 otherwise: biotech (SIC 2833–2836 and SIC 8731–8734),

	computer (SIC 3570–3577 and SIC 7370–7374), electronics (SIC 3600–3674), or retail (SIC 5200–5961)
<i>SD_Dis</i>	Standard deviation of individual analysts' latest EPS forecasts before the earnings announcement, in cents per share for firm <i>i</i> in year <i>t</i>
<i>Num_Analyst</i>	Number of analysts contributing to the consensus forecast for firm <i>i</i> in year <i>t</i>
<i>Sales_Growth</i>	Current-year sales minus prior-year sales scaled by prior-year sales of firm <i>i</i> in year <i>t</i>
<i>Ln_CFO</i>	Natural log of cash flow from operations for firm <i>i</i> in year <i>t</i>
<i>Leverage</i>	Ratio of total liabilities to total assets for firm <i>i</i> in year <i>t</i>
<i>Inst_Own</i>	Percentage of common shares in firm <i>i</i> in year <i>t</i> owned by institutional shareholders

APPENDIX 2: LIST OF ELITE INSTITUTIONS

We define the educational institutions below as elite, following Finkelstein (1992) as adapted in Badolato et al. (2014):

Amherst College	Pomona College
Brown University	Princeton University
California Institute of Technology	Stanford University
Carleton College	Swarthmore College
Columbia University	United States Military Academy
Cornell University	United States Naval Academy
Dartmouth College	University of California, Berkeley
Duke University	University of California, Los Angeles
Emory University	University of Chicago
Grinnell College	University of Michigan
Harvard University	University of Pennsylvania
Haverford College	Washington University in St Louis
John Hopkins University	Wellesley College
Massachusetts Institute of Technology	Wesleyan University
New York University	Williams College
Northwestern University	Yale University
Oberlin College	

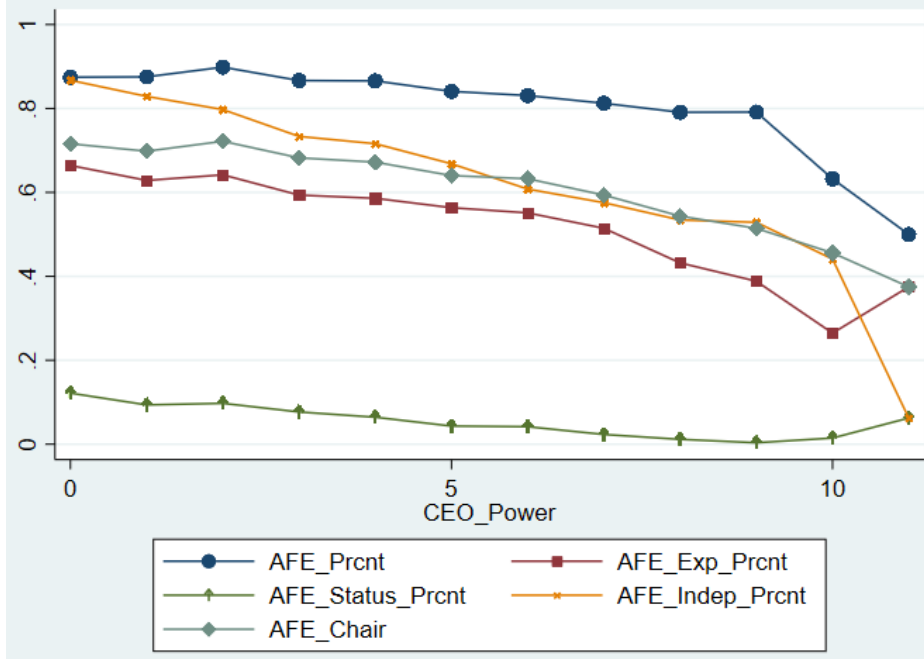


FIGURE 1 Percentage of firms with AFE characteristics by CEO power.

Table 1: Sample selection

All firm-year observations available on both BoardEx and Compustat between 2006 and 2017	59,019
Less:	
Audit committee data missing on BoardEx	622
Compensation or ownership data missing on ExecuComp and Incentive Lab	35,469
Financial data missing on Compustat	740
No audit fee data available on Audit Analytics	243
CEO data missing	906
Total deletions	37,980
Total sample	21,039
Subsample with at least one audit committee appointment	5,990
Subsample with at least one audit committee AFE appointment	2,776
Subsample with at least one AFE on the audit committee	17,900

Table 2**Panel A: Descriptive statistics for the total sample of observations**

Variables	N	Mean	Median	1 st percentile	25 th percentile	75 th percentile	99 th percentile
<i>CEO_Power</i>	21,039	4.37	4.00	0.00	3.00	6.00	9.00
<i>Chair</i>	21,039	0.47	0.00	0.00	0.00	1.00	1.00
<i>Relative_Comp</i>	21,039	2.12	1.91	0.15	1.33	2.57	6.28
<i>Shares_Owned</i>	21,039	0.03	0.01	0.00	0.00	0.02	0.32
<i>Founder</i>	21,039	0.08	0.00	0.00	0.00	0.00	1.00
<i>Tenure</i>	21,039	7.76	5.56	0.16	2.56	10.59	34.52
<i>Years_Exp</i>	21,039	4.67	1.73	0.00	0.00	7.93	25.12
<i>Publ_Board_Seats</i>	21,039	0.46	0.00	0.00	0.00	1.00	3.00
<i>Priv_Board_Seats</i>	21,039	0.62	0.00	0.00	0.00	1.00	5.00
<i>Elite</i>	21,039	1.22	1.00	0.00	1.00	2.00	3.00
<i>NC_Educational_Ties_D</i>	21,039	0.04	0.00	0.00	0.00	0.00	0.50
<i>NC_Community_Ties_D</i>	21,039	0.11	0.00	0.00	0.00	0.20	0.75
<i>NC_Professional_Ties_D</i>	21,039	0.17	0.00	0.00	0.00	0.25	1.00
<i>AFE_Prcnt</i>	21,039	0.37	0.33	0.00	0.25	0.50	1.00
<i>AFE_Appoint</i>	21,039	0.13	0.00	0.00	0.00	0.00	1.00
<i>AFE_Exp_Appoint</i>	21,039	0.08	0.00	0.00	0.00	0.00	1.00
<i>AFE_Status_Appoint</i>	21,039	0.01	0.00	0.00	0.00	0.00	0.00
<i>AFE_Indep_Appoint</i>	21,039	0.10	0.00	0.00	0.00	0.00	1.00
<i>AFE_Exp_Prcnt</i>	17,900	0.60	0.67	0.00	0.00	1.00	1.00
<i>AFE_Status_Prcnt</i>	17,900	0.04	0.00	0.00	0.00	0.00	1.00
<i>AFE_Indep_Prcnt</i>	17,900	0.74	1.00	0.00	0.50	1.00	1.00
<i>AFE_Chair</i>	17,900	0.77	1.00	0.00	1.00	1.00	1.00
<i>AFE_Exp_Chair</i>	17,900	0.49	0.00	0.00	0.00	1.00	1.00
<i>AFE_Tenure</i>	17,900	6.60	5.70	0.30	3.40	8.75	21.62
<i>AFE_Status_Chair</i>	17,900	0.03	0.00	0.00	0.00	0.00	1.00
<i>AFE_Indep_Chair</i>	17,900	0.56	1.00	0.00	0.00	1.00	1.00
<i>AFE_Effectiveness</i>	21,039	2.94	3.00	0.00	1.00	5.00	7.00
<i>Num_AFE</i>	21,039	1.35	1.00	0.00	1.00	2.00	4.00
<i>AFE_Left</i>	21,039	0.10	0.00	0.00	0.00	0.00	1.00
<i>AC_Tenure</i>	21,039	7.42	6.90	0.50	4.60	9.63	19.50
<i>Firm_Status</i>	21,039	0.00	-0.24	-0.65	-0.42	0.08	2.99
<i>Supply_HS_AFE</i>	21,039	0.26	0.27	0.00	0.21	0.32	0.47
<i>Gov_Index</i>	21,039	3.50	3.00	2.00	3.00	4.00	6.00
<i>Firm_Age</i>	21,039	26.71	21.00	4.00	13.00	39.00	66.00
<i>Accruals</i>	21,039	-0.06	-0.04	-0.42	-0.08	-0.01	0.14
<i>Interlocks</i>	21,039	4.68	4.00	0.00	2.00	7.00	16.00
<i>CEO_AFE_Connection</i>	21,039	3.52	3.80	0.69	2.71	4.61	5.93
<i>Audit_Fees</i>	21,039	14.47	14.38	12.38	13.76	15.14	16.82
<i>Prcnt_Client_AFE</i>	21,039	0.81	0.82	0.64	0.78	0.84	0.87
<i>MTB</i>	21,039	3.02	2.11	-11.45	1.33	3.55	27.94
<i>Geo_Segment</i>	21,039	2.83	2.00	0.00	1.00	4.00	15.00
<i>ROA</i>	21,039	0.04	0.04	-0.41	0.01	0.09	0.33
<i>Loss</i>	21,039	0.18	0.00	0.00	0.00	0.00	1.00

<i>Restructuring</i>	21,039	0.64	1.00	0.00	0.00	1.00	1.00
<i>Acquisition</i>	21,039	0.49	0.00	0.00	0.00	1.00	1.00
<i>Big_Four</i>	21,039	0.90	1.00	0.00	1.00	1.00	1.00
<i>Earnings_Vol</i>	21,039	0.04	0.02	0.00	0.01	0.04	0.36
<i>AFE_Chair_Prcnt</i>	21,039	0.29	0.00	0.00	0.00	0.50	1.00
<i>Meet_Beat</i>	12,317	0.16	0.00	0.00	0.00	0.00	1.00
<i>Disc_Accruals</i>	12,317	0.01	0.01	-0.24	-0.02	0.04	0.22
<i>Ln_Assets</i>	12,317	7.70	7.60	4.33	6.50	8.75	12.03
<i>FPS</i>	12,317	0.70	1.00	0.00	0.00	1.00	1.00
<i>SD_Dispr</i>	12,317	0.08	0.03	0.00	0.01	0.06	0.60
<i>Num_Analyst</i>	12,317	10.66	9.00	1.00	5.00	15.00	34.00
<i>Sales_Growth</i>	12,317	0.19	0.07	-0.49	-0.01	0.17	1.33
<i>Ln_CFO</i>	12,317	4.41	4.21	2.38	3.55	5.09	7.95
<i>Leverage</i>	12,317	0.21	0.20	0.00	0.04	0.33	0.84
<i>Inst_Own</i>	12,317	0.82	0.85	0.22	0.72	0.94	1.20
<i>New_Auditor</i>	12,317	0.03	0.00	0.00	0.00	0.00	1.00

Panel B: AFE descriptive statistics by CEO power

Variables	<i>CEO_Power_D=0</i>		<i>CEO_Power_D=1</i>		Test of differences
	N	Mean	N	Mean	Mean diff
<i>AFE_Appoint</i>	3,328	0.326	2,662	0.295	0.031***
<i>AFE_Prcnt</i>	9,821	0.449	8,079	0.415	0.034***
<i>AFE_Exp_Appoint</i>	1,639	0.633	1,137	0.609	0.025
<i>AFE_Exp_Prcnt</i>	9,821	0.622	8,079	0.821	0.404***
<i>AFE_Status_Appoint</i>	1,639	0.055	1,137	0.024	0.031***
<i>AFE_Status_Prcnt</i>	9,821	0.057	8,079	0.025	0.043***
<i>AFE_Indep_Appoint</i>	1,639	0.833	1,137	0.700	0.133***
<i>AFE_Indep_Prcnt</i>	9,821	0.806	8,079	0.654	0.152***
<i>AFE_Chair</i>	9,821	0.789	8,079	0.746	0.043***
<i>AFE_Exp_Chair</i>	9,821	0.519	8,079	0.452	0.065***
<i>AFE_Status_Chair</i>	9,821	0.042	8,079	0.017	0.025***
<i>AFE_Indep_Chair</i>	9,821	0.624	8,079	0.478	0.115***

Panel C: AFE descriptive statistics by CEO power and number of AFEs

AFE characteristic	Number of AFEs							
	One AFE		Two AFEs		Three AFEs		Four AFEs	
	Non-powerful	Powerful	Non-powerful	Powerful	Non-powerful	Powerful	Non-powerful	Powerful
<i>AFE_Exp_Prcnt</i>	0.620	0.586	0.609	0.556	0.584	0.551	0.612	0.587
<i>AFE_Status_Prcnt</i>	0.057	0.022	0.058	0.029	0.057	0.030	0.053	0.029
<i>AFE_Indep_Prcnt</i>	0.766	0.633	0.818	0.662	0.827	0.631	0.817	0.563
<i>AFE_Chair</i>	0.703	0.655	0.867	0.835	0.916	0.938	0.949	0.956

Notes: Panel A reports descriptive statistics on all the variables used in our primary analysis. The full sample of observations comprises 21,039 firm-year observations. The sample of firms with at least one AFE on the audit committee comprises 17,900 firm-year observations. Panel B reports descriptive statistics for dependent variables where the sample is partitioned on the basis of whether the firm has a powerful CEO (*CEO_Power_D=1*) or nonpowerful CEO (*CEO_Power_D=0*). Panel C reports the descriptive statistics for dependent variables where the sample is partitioned on the basis of the number of AFEs and on whether the firm has a powerful CEO (*CEO_Power_D=1*) or nonpowerful CEO (*CEO_Power_D=0*). All financial variables are winsorized at the 1% level. *, **, *** reflect significance at the 0.10, 0.05, and 0.01 levels, respectively (two-tailed tests). All variables are defined in Appendix 1.

Table 3: CEO power and AFE appointments, presence, and effectiveness

Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	<i>AFE Appoint</i>	<i>AFE Prcnt</i>	<i>AFE Exp Appoint</i>	<i>AFE Exp Prcnt</i>	<i>AFE Status Appoint</i>	<i>AFE Status Prcnt</i>	<i>AFE Indep Appoint</i>	<i>AFE Indep Prcnt</i>
<i>CEO_Power</i>	-0.010*** (-3.238)	-0.010*** (-5.669)	-0.003 (-0.538)	-0.008** (-2.381)	-0.012*** (-5.480)	-0.010*** (-7.652)	-0.032*** (-7.772)	-0.042*** (-13.158)
<i>Firm_Status</i>	-0.034*** (-3.434)	-0.046*** (-7.248)	-0.061*** (-3.772)	-0.043*** (-3.093)	0.007 (1.069)	0.007 (1.437)	-0.032* (-1.934)	-0.048*** (-3.658)
<i>Supply_HS_AFE</i>	0.035 (1.040)	0.039* (1.792)	0.027 (0.544)	0.089** (2.075)	-0.020 (-0.834)	-0.010 (-0.787)	0.082* (1.731)	0.015 (0.446)
<i>Gov_Index</i>	0.004 (0.644)	-0.009** (-2.440)	0.017* (1.805)	0.005 (0.679)	0.002 (0.483)	0.007*** (2.696)	0.022*** (2.756)	0.019*** (3.101)
<i>Num_AFE</i>	-0.043*** (-5.298)		-0.025** (-2.038)		0.005 (1.211)		-0.006 (-0.554)	
<i>AFE_Left</i>	0.051*** (2.984)		0.059*** (2.991)		0.001 (0.152)		0.024 (1.433)	
<i>AC_Tenure</i>	0.001 (0.835)	-0.007*** (-7.547)	-0.002 (-0.698)	-0.006*** (-3.186)	-0.000 (-0.281)	-0.000 (-0.187)	0.004** (2.083)	0.009*** (4.169)
<i>Firm_Age</i>	-0.001 (-1.434)	-0.001** (-2.441)	-0.001 (-0.881)	-0.000 (-0.605)	0.000 (0.342)	-0.000 (-1.600)	0.000 (0.608)	0.002*** (3.239)
<i>Accruals</i>	0.069 (1.008)	-0.024 (-0.869)	-0.148 (-1.583)	-0.039 (-0.707)	0.083** (2.042)	0.033* (1.753)	-0.196** (-2.442)	-0.094* (-1.757)
<i>Interlocks</i>	0.010*** (4.591)	0.006*** (4.912)	0.010*** (3.408)	0.009*** (3.815)	0.001 (1.153)	0.003*** (4.433)	0.000 (0.019)	-0.002 (-0.795)
<i>CEO_AFE_Connection</i>	0.008* (1.680)	0.002 (0.835)	-0.005 (-0.674)	0.007 (1.232)	-0.005 (-1.414)	-0.003 (-1.630)	-0.015** (-2.499)	-0.010** (-2.177)
<i>Audit_Fees</i>	0.011 (1.133)	0.003 (0.450)	0.017 (1.159)	-0.001 (-0.117)	0.002 (0.363)	0.008* (1.841)	-0.001 (-0.109)	0.019* (1.879)
<i>Prcnt_Client_AFE</i>	0.175 (1.377)	0.061 (0.793)	-0.172 (-0.722)	0.055 (0.444)	0.019 (0.242)	0.029 (0.585)	-0.001 (-0.002)	-0.006 (-0.051)
<i>MTB</i>	0.002* (1.886)	-0.000 (-0.215)	0.001 (0.661)	0.000 (0.042)	0.001 (1.375)	0.000 (0.789)	-0.001 (-0.501)	-0.002* (-1.948)
<i>Geo_Segment</i>	0.004 (0.367)	0.005 (0.768)	0.015 (0.934)	0.022* (1.659)	-0.005 (-0.837)	-0.008* (-1.960)	0.059*** (4.264)	0.047*** (4.216)
<i>ROA</i>	-0.023 (-0.376)	0.037 (1.151)	0.017 (0.202)	0.039 (0.636)	0.019 (0.464)	-0.017 (-0.187)	-0.004 (1.382)	0.141** (2.233)
<i>Loss</i>	0.016 (0.795)	-0.006 (-0.803)	0.032 (1.138)	0.019 (1.293)	0.021 (1.551)	0.003 (0.567)	0.029 (1.169)	0.015 (1.093)
<i>Restructuring</i>	0.016 (1.167)	-0.005 (-0.826)	0.002 (0.082)	-0.016 (-1.319)	0.005 (0.587)	-0.006 (-1.231)	-0.013 (-0.760)	-0.017 (-1.602)
<i>Acquisition</i>	-0.012 (-0.889)	-0.004 (-0.718)	-0.040** (-2.049)	-0.015 (-1.310)	-0.011 (-1.378)	-0.003 (-0.625)	0.043** (2.545)	0.004 (0.362)
<i>Big_Four</i>	-0.013 (-0.464)	0.025 (1.569)	0.055 (1.284)	0.010 (0.319)	0.019 (1.377)	-0.019 (-1.475)	0.044 (1.319)	0.072** (2.486)
<i>Earnings_Vol</i>	-0.010 (-0.144)	-0.009 (-0.310)	-0.088 (-0.808)	-0.043 (-0.828)	0.000 (0.007)	-0.001 (-0.045)	-0.053 (-0.481)	-0.059 (-1.055)
Constant	-0.007 (-0.045)	0.339*** (3.416)	0.398 (1.497)	0.503*** (2.723)	0.041 (0.440)	-0.034 (-0.527)	0.680*** (2.738)	0.392** (2.352)
N	5,990	21,039	2,776	17,900	2,776	17,900	2,776	17,900

R^2	0.019	0.068	0.037	0.038	0.028	0.029	0.116	0.139
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Notes: This table presents the results of the regression described in Model (1) with the key variable of interest *CEO Power*. Column 1 uses a sample of AFE appointments (N=5,990) to estimate the probability that a firm appoints an AFE to its audit committee. The dependent variable (*AFE_Appoint*) is a binary variable that takes the value of one if one or more AFEs are appointed to the audit committee of firm *i* in year *t*, and zero otherwise. Column 2 uses the full sample (N=21,039) of observations to estimate the percentage of AFEs present on the audit committee. The dependent variable (*AFE_Prcnt*) is defined as the proportion of audit committee members in firm *i* in year *t* who are AFEs. Columns 3, 5, and 7 use a sample of AFE appointments (N=2,776) to estimate the probability that at least one AFE: with prior accounting experience exceeding the median AFE's accounting expertise is appointed to the audit committee in firm *i* in year *t*, and zero otherwise (*AFE_Exp_Appoint*), that an AFE with relative status exceeding that of the CEO is appointed to the audit committee in firm *i* in year *t*, and zero otherwise (*AFE_Status_Appoint*), or that an AFE with no social, educational and professional ties to the CEO is appointed to the audit committee in firm *i* in year *t*, and zero otherwise (*AFE_Indep_Appoint*), respectively. Columns 4, 6, and 8 use a sample of firms in which at least one AFE is present on the audit committee (N=17,900) and estimates the proportion of audit committee members classified as being experienced (*AFE_Exp_Prcnt*), high status (*AFE_Status_Prcnt*), or socially independent from the CEO (*AFE_Indep_Prcnt*), respectively. Two-tailed tests of significance are reported. Standard errors are clustered by firm. ***< 0.01, **< 0.05 and *< 0.1. All variables are defined in Appendix 1.

Table 4: CEO power and audit committee chair characteristics

Variables	(1) <i>AFE Chair</i>	(2) <i>AFE Exp Chair</i>	(3) <i>AFE Status Chair</i>	(4) <i>AFE Indep Chair</i>
<i>CEO_Power</i>	-0.010*** (-2.923)	-0.008* (-1.835)	-0.008 (-0.634)	-0.009** (-2.401)
<i>AFE_Exp_Prcnt</i>	0.048*** (2.627)	0.556*** (15.684)	0.110* (1.674)	0.054*** (2.692)
<i>AFE_Status_Prcnt</i>	-0.006 (-0.160)	-0.010 (-0.232)	0.662*** (8.050)	-0.036 (-0.829)
<i>AFE_Indep_Prcnt</i>	-0.037** (-2.072)	-0.009 (-0.413)	-0.108 (-1.636)	0.689*** (16.089)
<i>AFE_Chair_Prcnt</i>	0.087*** (5.380)	0.076*** (3.799)	0.072 (1.206)	0.092*** (5.117)
<i>AFE_Tenure</i>	0.008*** (5.266)	0.004** (2.112)	-0.002 (-0.364)	0.009*** (4.512)
<i>Firm_Status</i>	-0.025* (-1.878)	-0.037** (-2.233)	0.022 (0.709)	-0.032** (-2.010)
<i>Supply_HS_AFE</i>	-0.002 (-0.047)	0.016 (0.340)	0.078 (0.722)	0.017 (0.396)
<i>Gov_Index</i>	-0.002 (-0.344)	0.003 (0.369)	-0.040* (-1.935)	-0.000 (-0.068)
<i>Firm_Age</i>	-0.002*** (-3.055)	-0.001* (-1.651)	0.001 (0.577)	-0.001* (-1.693)
<i>Accruals</i>	0.004 (0.079)	-0.021 (-0.351)	-0.068 (-0.334)	-0.044 (-0.744)
<i>Interlocks</i>	-0.002 (-1.048)	-0.000 (-0.058)	-0.009 (-1.221)	-0.000 (-0.058)
<i>CEO_AFE_Connection</i>	0.006 (1.315)	0.001 (0.093)	-0.005 (-0.343)	0.004 (0.771)
<i>Audit_Fees</i>	-0.021* (-1.913)	-0.027** (-2.045)	-0.031 (-0.922)	-0.021* (-1.686)
<i>Prcnt_Client_AFE</i>	-0.050 (-0.463)	0.120 (0.660)	0.059 (0.172)	-0.131 (-0.955)
<i>MTB</i>	-0.000 (-0.038)	0.001 (0.728)	0.005** (1.970)	-0.000 (-0.202)
<i>Geo_Segment</i>	0.019* (1.648)	0.040*** (2.810)	-0.044 (-1.100)	0.024* (1.813)
<i>ROA</i>	0.034 (0.645)	0.036 (0.560)	-0.198 (-1.022)	0.102 (1.592)
<i>Loss</i>	0.024* (1.742)	0.029* (1.668)	-0.124*** (-2.594)	0.024 (1.589)
<i>Restructuring</i>	0.006 (0.473)	-0.004 (-0.258)	-0.064 (-1.479)	0.026* (1.926)
<i>Acquisition</i>	-0.010 (-0.876)	-0.011 (-0.797)	0.067* (1.740)	-0.008 (-0.621)
<i>Big_Four</i>	0.039 (1.430)	0.004 (0.113)	0.151 (1.641)	0.051 (1.533)
<i>Earnings_Vol</i>	0.043 (0.746)	-0.081 (-1.150)	0.208 (0.711)	0.101 (1.586)
Constant	1.048*** (6.136)	0.448* (1.947)	0.528 (0.930)	0.282 (1.414)
N	17,900	13,197	1,238	14,486
R ²	0.055	0.126	0.197	0.148
Industry FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes

Notes: This table presents the results of the regression described in Model (1) with the key variable of interest *CEO_Power*. Column 1 uses a sample of firms in which at least one AFE is present on the audit committee (N=17,900) and estimates the probability that a firm appoints an AFE as the audit committee chair (*AFE Chair*). The dependent variable (*AFE Chair*) is a binary variable that takes the value of one if an AFE serves as the chair on the audit committee of firm *i* in year *t*, and zero otherwise. Column 2 uses a sample of firms in which at least one experienced AFE is

present on the audit committee (N=13,197) and estimates the probability that a firm appoints an experienced AFE as the audit committee chair (*AFE_Exp_Chair*). *AFE_Exp_Chair* is a binary variable that takes the value of one if an AFE with prior accounting experience exceeding the yearly median serves as the chair of the audit committee of firm *i* in year *t*, and zero otherwise. Column 3 uses a sample of firms in which at least one high status AFE is present on the audit committee (N=1,238) and estimates the probability that a firm appoints a high status AFE as the audit committee chair (*AFE_Status_Chair*). *AFE_Status_Chair* is a binary variable that takes the value of one if an AFE with relative status exceeding that of the CEO serves as the chair of the audit committee of firm *i* in year *t*, and zero otherwise. Column 4 uses a sample of firms in which a socially independent AFE is present on the audit committee (N=14,486) and estimates the probability that a firm appoints a socially independent AFE as the audit committee chair (*AFE_Indep_Chair*). *AFE_Indep_Chair* is a binary variable that takes the value of one if an AFE with no social, educational, or professional ties to the CEO serves as the chair of the audit committee of firm *i* in year *t*, and zero otherwise. Two-tailed tests of significance are reported. Standard errors are clustered by firm. ***< 0.01, **< 0.05 and *< 0.1. All variables are defined in Appendix 1.

Table 5: CEO power, audit committee effectiveness, and meeting or just beating analyst earnings forecasts

Variables	(1)	(2)	(3)
	<i>Full Sample</i>	<i>Weak</i> <i>AFE Effectiveness</i>	<i>Strong</i> <i>AFE Effectiveness</i>
	<i>Meet Beat</i>	<i>Meet Beat</i>	<i>Meet Beat</i>
<i>CEO_Power</i>	0.000 (0.153)	0.002 (0.598)	-0.002 (-0.747)
<i>Disc_Accruals</i>	-0.154 (-1.460)	-0.243* (-1.693)	-0.117 (-0.756)
<i>CEO_Power</i> × <i>Disc_Accruals</i>	0.046** (1.999)	0.055* (1.852)	0.049 (1.393)
<i>Ln_Assets</i>	-0.059*** (-7.806)	-0.057*** (-5.634)	-0.064*** (-5.743)
<i>MTB</i>	-0.000 (-0.250)	-0.001 (-1.187)	0.001 (0.641)
<i>FPS</i>	-0.004 (-0.298)	0.004 (0.258)	-0.016 (-0.929)
<i>SD_Dispatch</i>	-0.012** (-2.208)	-0.009*** (-2.659)	-0.068** (-2.038)
<i>Num_Analyst</i>	0.003*** (3.731)	0.002** (2.102)	0.004*** (3.377)
<i>Sales_Growth</i>	-0.001*** (-2.690)	-0.001*** (-3.173)	-0.006*** (-3.349)
<i>Ln_CFO</i>	0.088*** (11.553)	0.097*** (9.570)	0.075*** (6.898)
<i>Firm_Age</i>	0.000 (1.395)	0.000 (0.931)	0.000 (1.221)
<i>Leverage</i>	0.044* (1.902)	0.023 (0.758)	0.071** (2.171)
<i>Inst_Own</i>	0.028 (1.177)	0.040 (1.352)	0.006 (0.162)
<i>ROA</i>	0.075** (2.087)	0.058 (1.170)	0.077 (1.462)
<i>Big_Four</i>	-0.017 (-1.130)	-0.015 (-0.802)	-0.016 (-0.694)
<i>Audit_Fees</i>	-0.004 (-0.420)	-0.012 (-1.040)	0.007 (0.472)
<i>New_Auditor</i>	-0.020 (-1.050)	-0.032 (-1.258)	-0.004 (-0.137)
Constant	0.231** (2.215)	0.290** (2.215)	0.184 (1.126)
N	12,317	6,789	5,528
R ²	0.044	0.049	0.046
Industry FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes

Notes: This table presents the results of the regression described in Model (2) with the key variable of interest *CEO Power* and *Disc Accruals*. The dependent variable (*Meet Beat*) is a binary variable that takes the value of one if the actual EPS in firm *i* in year *t* are equal to or exceed the median I/B/E/S consensus analyst forecast by 1 cent or less, and zero otherwise. Column 1 uses a sample of firms with analyst forecast data from the I/B/E/S database (N=12,317). Column 2 uses a subsample of firms with *AFE Effectiveness* equal to or below the median (N=6,789). Column 3 uses a subsample of firms with *AFE Effectiveness* above the median (N=5,528). Two-tailed tests of significance are reported. Standard errors are clustered by firm. ***< 0.01, **< 0.05 and *< 0.1. All variables are defined in Appendix 1.

Table 6: AFE appointments and reputational risk
Panel A: CEO power and AFE's litigation risk (universal demand)

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Variables	<i>AFE_Appoint</i>	<i>AFE_Prcnt</i>	<i>AFE_Exp_Appoint</i>	<i>AFE_Exp_Prcnt</i>	<i>AFE_Status_Appoint</i>	<i>AFE_Status_Prcnt</i>	<i>AFE_Indep_Appoint</i>	<i>AFE_Indep_Prcnt</i>
<i>CEO_Power</i>	-0.010*** (-2.892)	-0.010*** (-5.133)	-0.005 (-0.880)	-0.008** (-1.988)	-0.013*** (-5.342)	-0.010*** (-7.613)	-0.030*** (-6.811)	-0.041*** (-11.839)
<i>UD_Law</i>	0.015 (0.319)	0.000 (0.010)	-0.109* (-1.744)	0.010 (0.206)	-0.042* (-1.727)	-0.010 (-0.450)	0.067 (1.372)	0.058 (1.493)
<i>CEO_Power</i> × <i>UD_Law</i>	-0.004 (-0.404)	-0.002 (-0.376)	0.013 (1.055)	-0.006 (-0.647)	0.007 (1.594)	0.003 (0.740)	-0.016 (-1.376)	-0.013 (-1.453)
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	5,990	21,039	2,776	17,900	2,776	17,900	2,776	17,900
R ²	0.019	0.068	0.039	0.039	0.029	0.029	0.116	0.140
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Panel B: CEO power and AFE's reputation (*Fortune's* "Most Admired Companies")

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Variables	<i>AFE_Appoint</i>	<i>AFE_Prcnt</i>	<i>AFE_Exp_Appoint</i>	<i>AFE_Exp_Prcnt</i>	<i>AFE_Status_Appoint</i>	<i>AFE_Status_Prcnt</i>	<i>AFE_Indep_Appoint</i>	<i>AFE_Indep_Prcnt</i>
<i>CEO_Power</i>	-0.009*** (-2.650)	-0.009*** (-4.774)	-0.004 (-0.687)	-0.007** (-1.981)	-0.011*** (-4.616)	-0.009*** (-6.717)	-0.032*** (-7.256)	-0.043*** (-12.565)
<i>Fortune</i>	0.037 (0.806)	0.042* (1.771)	0.032 (0.458)	0.100** (2.087)	0.044 (1.114)	-0.004 (-0.194)	0.050 (0.816)	0.006 (0.147)
<i>CEO_Power</i> × <i>Fortune</i>	-0.009 (-0.965)	-0.007* (-1.771)	0.008 (0.577)	-0.006 (-0.697)	-0.009 (-1.417)	-0.006** (-2.138)	0.002 (0.156)	0.008 (1.048)
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	5,990	21,039	2,776	17,900	2,776	17,900	2,776	17,900
R ²	0.019	0.068	0.038	0.040	0.029	0.031	0.116	0.140
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Notes: Panel A presents the results of the regression described in Model (1) with the key variables of interest *UD* and *CEO_Power*×*UD_Law* included. *UD_Law* is a binary variable equal to one when a firm is incorporated in a state that has passed a universal demand (UD) law, and zero otherwise. The states that have passed UD laws are as follows: Georgia, Michigan, Florida, Wisconsin, Montana, Utah, Virginia, Mississippi, New Hampshire, North Carolina, Arizona, Nebraska, Connecticut, Maine, Pennsylvania, Texas, Wyoming, Idaho, Hawaii, Iowa, Massachusetts, Rhode Island, and South Dakota. Column 1 uses a sample of AFE appointments (N=5,990) to estimate the probability that a firm appoints an AFE to its audit committee. The dependent variable (*AFE_Appoint*) is a binary

variable that take the value of one if one or more AFEs are appointed to the audit committee in firm i in year t , and zero otherwise. Column 2 uses the full sample ($N=21,039$) of observations to estimate the percentage of AFEs present on the audit committee. The dependent variable (AFE_Prnt) is defined as the proportion of audit committee members in firm i in year t who are AFEs. Columns 3, 5, and 7 use a sample of AFE appointments ($N=2,776$) to estimate the probability that a firm appoints an AFE that is experienced ($AFE_Exp_Appoint$), high status ($AFE_Status_Appoint$), or socially independent from the CEO ($AFE_Indep_Appoint$) to the audit committee, respectively. Columns 4, 6, and 8 use a sample of firms in which at least one AFE is present on the audit committee ($N=17,900$) and estimates the proportion of audit committee members classified as being AFEs who are experienced (AFE_Exp_Prnt), of high status (AFE_Status_Prnt), or socially independent from the CEO (AFE_Indep_Prnt), respectively. Panel B presents the results of the regression described in Model (1) with the key variables of interest *Fortune* and $CEO_Power \times Fortune$ included. *Fortune* is a binary variable equal to one if a firm is included in *Fortune*'s list of "America's Most Admired Companies," and zero otherwise. Column 1 uses a sample of AFE appointments ($N=5,990$) to estimate the probability that a firm appoints an AFE to its audit committee. The dependent variable ($AFE_Appoint$) is a binary variable equal to one when firm i appoints an AFE to its audit committee in year t , and zero otherwise. Column 2 uses the full sample ($N=21,039$) of observations to estimate the percentage of AFEs present on the audit committee. The dependent variable (AFE_Prnt) is defined as the proportion of audit committee members in firm i in year t who are AFEs. Columns 3, 5, and 7 use a sample of AFE appointments ($N=2,776$) to estimate the probability that a firm appoints an AFE that is experienced ($AFE_Exp_Appoint$), high status ($AFE_Status_Appoint$), or socially independent from the CEO ($AFE_Indep_Appoint$) to the audit committee, respectively. Columns 4, 6, and 8 use a sample of firms in which at least one AFE is present on the audit committee ($N=17,900$) and estimates the proportion of audit committee members classified as being AFEs who are experienced (AFE_Exp_Prnt), of high status (AFE_Status_Prnt), or socially independent from the CEO (AFE_Indep_Prnt), respectively. Two-tailed tests of significance are reported. Standard errors are clustered by firm. *** < 0.01 , ** < 0.05 and * < 0.1 . All other variables are defined in Appendix 1.

Table 7: CEO power and AFE departures

Variables	(1) <i>AFE_Left</i>	(2) <i>AFE_Exp_Left</i>	(3) <i>AFE_Status_Left</i>	(4) <i>AFE_Indep_Left</i>
<i>CEO_Power</i>	-0.004*** (-3.311)	-0.003** (-2.496)	-0.004* (-1.669)	-0.007*** (-6.161)
<i>Firm_Status</i>	-0.003 (-0.731)	-0.010** (-2.554)	-0.001 (-0.269)	-0.012*** (-2.948)
<i>Supply_HS_AFE</i>	-0.000 (-0.007)	0.009 (0.854)	0.003 (0.199)	0.001 (0.117)
<i>Gov_Index</i>	-0.002 (-0.678)	-0.001 (-0.538)	-0.002 (-0.695)	-0.001 (-0.664)
<i>Num_AFE</i>	0.102*** (24.804)	0.058*** (18.401)	0.013*** (2.627)	0.090*** (24.483)
<i>Firm_Age</i>	0.000* (1.920)	0.000 (0.695)	0.000 (1.367)	0.000*** (2.694)
<i>Accruals</i>	0.021 (0.710)	-0.008 (-0.279)	-0.147** (-2.273)	0.034 (1.125)
<i>Interlocks</i>	-0.000 (-0.502)	0.001 (1.345)	-0.000 (-0.264)	0.001 (0.752)
<i>CEO_AFE_Connection</i>	0.004** (2.308)	0.002 (1.584)	-0.004* (-1.871)	0.002 (1.019)
<i>Audit_Fees</i>	0.013*** (3.481)	0.009*** (2.683)	0.003 (0.703)	0.008** (2.146)
<i>Prcnt_Client_AFE</i>	0.006 (0.108)	0.063 (1.565)	-0.036 (-0.592)	0.073 (1.368)
<i>MTB</i>	-0.000 (-0.374)	-0.000 (-1.046)	-0.000 (-0.968)	-0.001 (-1.430)
<i>Geo_Segment</i>	-0.003 (-0.795)	0.003 (0.884)	0.007 (1.351)	0.005 (1.303)
<i>ROA</i>	-0.059** (-2.069)	-0.033* (-1.661)	-0.050 (-0.853)	-0.050* (-1.889)
<i>Loss</i>	0.009 (1.100)	0.003 (0.451)	-0.015 (-1.039)	0.009 (1.236)
<i>Restructuring</i>	-0.017*** (-3.138)	-0.003 (-0.633)	-0.004 (-0.454)	-0.007 (-1.326)
<i>Acquisition</i>	-0.018*** (-3.557)	-0.007 (-1.535)	-0.006 (-0.846)	-0.008* (-1.756)
<i>Big_Four</i>	-0.015 (-1.568)	-0.002 (-0.193)	-0.007 (-0.459)	-0.022** (-2.282)
<i>Earnings_Vol</i>	0.062* (1.780)	-0.006 (-0.350)	-0.010 (-0.206)	0.045* (1.693)
Constant	-0.205*** (-3.206)	-0.222*** (-4.169)	0.010 (0.122)	-0.195*** (-3.212)
N	17,664	13,197	1,238	14,486
R ²	0.064	0.048	0.051	0.076
Industry FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes

Notes: This table presents the results of an augmented Model (1) with AFE departure as the dependent variable. Column 1 has the dependent variable *AFE_Left*, which is a binary variable equal to one when an AFE departs the audit committee in firm *i* in year *t*, and zero otherwise. Column 2 uses the dependent variable *AFE_Exp_Left*, which is a binary variable equal to one when an experienced AFE has left a firm's audit committee, and zero otherwise. Column 3 uses the dependent variable *AFE_Status_Left*, which is a binary variable equal to one when a high status AFE departs a firm's audit committee, and zero otherwise. Column 4 uses the dependent variable *AFE_Indep_Left*, which is a binary variable equal to one when an independent AFE departs a firm's audit committee, and zero otherwise. Two-tailed tests of significance are reported. Standard errors are clustered by firm. ***< 0.01, **< 0.05 and *< 0.1. All other variables are defined in Appendix 1.

Table 8: CEO power and AFE compensation

Variables	(1) <i>AFE Comp</i>	(2) <i>AFE Exp Comp</i>	(3) <i>AFE Status Comp</i>	(4) <i>AFE Indep Comp</i>
<i>CEO_Power</i>	-0.009**	-0.008*	-0.001	-0.009**
	(-2.564)	(-1.821)	(-0.101)	(-2.445)
<i>Supply_HS_AFE</i>	0.020	0.005	0.112	0.042
	(0.512)	(0.133)	(1.107)	(0.987)
<i>Gov_Index</i>	0.038***	0.035***	0.005	0.035***
	(6.257)	(5.030)	(0.302)	(5.276)
<i>Firm_Age</i>	-0.003***	-0.003***	-0.002*	-0.003***
	(-6.460)	(-5.894)	(-1.695)	(-5.871)
<i>Accruals</i>	-0.224***	-0.215***	-0.230	-0.235***
	(-3.705)	(-2.996)	(-1.045)	(-3.506)
<i>Interlocks</i>	0.009***	0.011***	0.002	0.010***
	(4.638)	(5.177)	(0.387)	(4.415)
<i>Audit_Fees</i>	0.114***	0.094***	0.115***	0.114***
	(8.453)	(6.111)	(3.238)	(7.483)
<i>Ln_MVE</i>	0.133***	0.129***	0.134***	0.128***
	(17.015)	(13.829)	(6.577)	(15.090)
<i>Prcnt_Client_AFE</i>	0.071	0.091	0.151	0.001
	(0.346)	(0.321)	(0.527)	(0.007)
<i>MTB</i>	-0.000	-0.000	-0.000	-0.001
	(-0.398)	(-0.165)	(-0.078)	(-0.562)
<i>Geo_Segment</i>	0.014	0.020	-0.007	0.006
	(1.215)	(1.494)	(-0.152)	(0.496)
<i>ROA</i>	0.107	0.179*	0.286	0.133*
	(1.338)	(1.841)	(1.630)	(1.669)
<i>Loss</i>	0.079***	0.068***	0.086*	0.066***
	(4.865)	(3.289)	(1.671)	(3.957)
<i>Restructuring</i>	-0.027**	-0.026*	-0.044	-0.016
	(-2.366)	(-1.877)	(-1.085)	(-1.301)
<i>Acquisition</i>	-0.010	-0.006	0.047	-0.006
	(-0.875)	(-0.439)	(1.285)	(-0.477)
<i>Big_Four</i>	0.129***	0.158***	-0.123	0.109***
	(3.759)	(3.825)	(-1.528)	(2.825)
<i>Earnings_Vol</i>	0.084	0.060	0.121	0.108
	(1.002)	(0.633)	(0.434)	(1.383)
Constant	2.150***	2.403***	2.336***	2.243***
	(9.743)	(8.461)	(5.455)	(9.604)
N	14,813	11,273	1,081	12,506
R ²	0.460	0.388	0.412	0.421
Industry FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes

Notes: This table presents the results of an OLS regression estimating AFE compensation. Column 1 has the dependent variable *AFE_Comp*, measured as the natural log of average compensation received by AFEs on the audit committee. Column 2 has the dependent variable *AFE_Exp_Comp*, measured as the natural log of average compensation received by experienced AFEs on the audit committee. Column 3 has the dependent variable *AFE_Status_Comp*, measured as the natural log of average compensation received by high status AFEs on the audit committee. Column 4 has the dependent variable *AFE_Indep_Comp*, measured as the natural log of average compensation received by independent AFEs on the audit committee. The additional control variable *Ln_MVE* is the natural log of the market value of equity at year end. Two-tailed tests of significance are reported. Standard errors are clustered by firm. ***< 0.01, **< 0.05 and *< 0.1. All other variables are defined in Appendix 1.