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Auditor Ratification in Light of Shareholder Dissatisfaction with the Audit Committee—Evidence from Germany

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SYNOPSIS: Auditor ratification gives shareholders a voice in the auditor selection process. Although votes against auditor ratification primarily relate to the auditor, they also signal shareholder dissatisfaction with the audit committee that is responsible for recommending the auditor. In Germany, shareholders are required to separately vote on auditor ratification and, in addition, ratify the acts of the supervisory board (including the audit committee), allowing us to separately consider whether shareholder dissatisfaction is directed toward the auditor or the audit committee. We find that votes against audit committees' acts (rather than votes against auditor ratification) are associated with a higher likelihood of subsequent auditor dismissal, suggesting that audit committees particularly respond to shareholder dissatisfaction when their own reputation is at stake. In addition, subsequent audit outcomes (i.e., audit report lag and modified audit opinions) appear to also be affected by shareholder dissatisfaction with the audit committee.

Data Availability: Data are available from the sources cited in Appendix A.

JEL Classifications: M4; M42; M48; G3; G39.

Keywords: auditor ratification; shareholder dissatisfaction; auditor dismissal; audit report lag; modified audit opinions; annual meeting.

I. INTRODUCTION

Shareholder ratification of auditors (SRA) is an important corporate governance tool that gives shareholders a voice in the auditor selection process. Primarily, SRA voting results indicate whether shareholders are satisfied with the proposed auditor. However, given that the audit committee is responsible for recommending the auditor to the shareholders and evaluating the auditor's performance, SRA voting results also reflect shareholders' (dis)satisfaction with the audit committee. Therefore, votes against auditor ratification affect auditors' reputations and are also considered a threat to audit committees' reputations (Barua, Raghunandan, and Rama 2017; Grundfest 1993; Tanyi, Rama, Raghunandan, and Martin 2020). Hence, it remains ambiguous whether SRA voting results relate to discontent with the auditor, the audit committee, or both.

Prior studies in the United States show that votes against auditor ratification are associated with a higher likelihood of subsequent auditor dismissal (Barua et al. 2017) and affect subsequent audit outcomes, for example, audit report lag (Tanyi et al. 2020). Both studies emphasize the role of the audit committee and its incentive to act on shareholder

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dissatisfaction. However, particularly regarding subsequent audit outcomes, it remains unclear whether responses to shareholder dissatisfaction are driven by auditors' or audit committees' reputational concerns (Tanyi et al. 2020).

In Germany, shareholders are required to separately vote on auditor ratification and, in addition, approve the acts of the supervisory board. The supervisory board is the monitoring body in the German two-tier governance system and includes the audit committee that is typically considered the most important committee of the supervisory board (Bischoff 2010). Accordingly, the vote allows shareholders to signal whether they agree with the work performed by the supervisory board and, in particular, the audit committee. The ratification of audit committee's acts is a vote specific to Germany when compared with other settings, particularly the United States, where the majority of auditor ratification research is conducted. By having shareholders vote separately on the ratification of audit committee's acts and auditor ratification, the German setting allows us to distinguish whether shareholder dissatisfaction is directed toward the audit committee or the auditor. Accordingly, we can draw conclusions on which parties' reputational concerns appear to be the primary driver behind the observed responses to shareholder dissent.

We perform multivariate analyses on 1,086 firm-year observations related to German companies listed in the General Standard and Prime Standard market segments (CDAX) of the Frankfurt Stock Exchange at the end of 2013–2016. In line with Barua et al. (2017), we examine the association between shareholder dissatisfaction and auditor dismissals. In addition to auditor dismissals, we focus on audit outcomes readily observable by shareholders (i.e., audit report lag and modified audit opinions) as we expect these to be carefully considered in case of shareholder dissent. We find that shareholder votes against audit committees' acts (rather than votes against auditor ratification) are associated with a higher likelihood of subsequent auditor dismissal, longer audit report lag, and a higher likelihood of a modified audit opinion.

We contribute to practice by showing that audit committees particularly respond to shareholder dissatisfaction when their own reputation is at stake. Presumably, shareholders' disapproval of audit committee's acts increases their incentive to incur the costs associated with changing the auditor. In addition, subsequent audit outcomes appear to also be driven by audit committees' reputational concerns. Our findings illustrate the audit committee's vital role in responding to shareholder dissatisfaction.

The remainder of this study is structured as follows. After discussing the specifics of SRA in Germany, we review previous research on SRA and develop our hypotheses. After a brief methodical outline, we provide the main results and our conclusion. For robustness tests, we refer to the Online Appendix, Methods and Supplemental Information.

II. SRA IN GERMANY

In general, research on SRA in non-U.S. settings is limited, as illustrated by related calls for research (Krishnan and Ye 2005; Mayhew 2017). We discuss below several key differences regarding SRA between Germany and the United States.

SRA is mandatory in Germany. German law explicitly states that shareholders have to ratify the statutory auditor proposed by the supervisory board (Aktiengesetz (AktG) 2023, section 119(1), no. 5; Handelsgesetzbuch (HGB) 2023, section 318(1) and section 124(3)). However, previous studies in the United States have illustrated that the vast majority of U.S. companies (e.g., more than 90 percent of large companies) voluntarily seek ratification (ACAP 2008; Cunningham 2017), regardless of expected voting outcomes (Krishnan and Ye 2005). Considering the widespread implementation of SRA in the United States, we do not expect that self-selection bias constitutes a significant difference between the SRA regimes.

Additionally, SRA voting results are binding in Germany. Thus, the supervisory board cannot appoint the proposed auditor if the majority of shareholders vote against auditor ratification. Literature on the psychological and reputational mechanisms associated with binding votes is scarce. Supposedly, binding votes could be perceived as carrying more weight than nonbinding votes (Koch, Rothacker, and Scharfbillig 2023). However, the binding nature of votes does not result in substantially different expectations from those of prior studies given that auditors and audit committees already respond to nonbinding votes. Therefore, we consider two other institutional differences to be of particular interest.

First, German law requires shareholders to approve the acts of the supervisory board (AktG 2023, section 120(1)). This is a separate vote from both auditor ratification and the appointment of supervisory board members.[1] Votes against the supervisory board's (including the audit committee's) acts signal shareholders' dissatisfaction with their work. Among others, reasons for shareholders' disapproval could stem from the supervisory board's involvement in pending allegations or convicted fraud or insufficient response to material shareholder concerns (Glass Lewis 2023). Overall,

[1] Notably, the approval of audit committees' acts is also different from the election of directors in the United States as it exclusively refers to the governing body of the two-tier governance structure and more directly relates to the audit committee's performance rather than focusing on board characteristics (e.g., independence).

nonratification of supervisory boards' acts implies shareholders' mistrust in the supervisory board's ability to fulfill its monitoring duties. Notably, the disapproval of supervisory board's acts has no immediate (legal) consequences, albeit for severe reputational damage and the possibility of ensuing legal claims (MünchKomm AktG 2022, section 120, paragraph 38).

Second, Germany is characterized by a comparatively lenient auditor liability regime and substantially lower litigation risk than the United States (Bigus and Zimmermann 2008; Ratzinger-Sakel 2013). Specifically, during our sample period, auditors' civil liability was capped at €4 million for statutory audits of listed companies (Handelsgesetzbuch (HGB) 2021, section 323(2)).[2] In addition, given the comparatively high burden of proof in civil cases in Germany (La Porta, Lopez-de-Silanes, and Shleifer 2006; Ratzinger-Sakel 2013), shareholders are unlikely to file lawsuits against auditors in the first place (Weber, Willenborg, and Zhang 2008). Hence, compared with the high auditor liability exposure in the United States (Reinstein, Pacini, and Green 2020), auditors in Germany face a considerably lower risk of (material) shareholder litigation.

III. PREVIOUS RESEARCH ON SRA AND HYPOTHESIS DEVELOPMENT

In general, prior literature on SRA can be classified into two main research streams, focusing on the determinants and consequences of (1) voluntarily seeking ratification (e.g., Dao, Raghunandan, and Rama 2012; Mayhew and Pike 2004) and (2) actual SRA voting results.

Determinants of SRA voting results include auditor type, issuance of unexpected going concern opinions (Sainty, Taylor, and Williams 2002), certain nonaudit services (Mishra, Raghunandan, and Rama 2005; Raghunandan 2003), (disclosure of) auditor tenure (Dao, Mishra, and Raghunandan 2008; Dunn, Lundstrom, and Wilkins 2021; Tanyi, Rama, and Raghunandan 2021), shareholder type (Cassell, Kleppe, and Shipman 2024; Dong, Eugster, and Vazquez 2024), and low accounting or audit quality (Brown and Popova 2019; Hermanson, Krishnan, and Ye 2009; Liu, Raghunandan, and Rama 2009).

Regarding the consequences of SRA voting results, the most important prior research findings in the context of our study refer to Barua et al. (2017) and Tanyi et al. (2020). Barua et al. (2017) report that a higher proportion of shareholders voting against auditor ratification is associated with subsequent auditor dismissals. As approval rates are expected to reach values of up to 98 or 99 percent, "there are bound to be questions from the audit committee" (Dao et al. 2012, 154) once the shareholders express even slight disappointment. Accordingly, Barua et al. (2017) state reputational concerns as reason for audit committees to react to even slight shareholder dissatisfaction. After all, negative votes on auditor ratification delegitimize the audit committee as they indicate that shareholders do not trust in its auditor proposal.

In line with prior research, we expect votes against auditor ratification to be positively associated with subsequent auditor dismissal (H1a). However, as outlined above, audit committees might feel particularly pressured to respond to shareholder dissatisfaction expressed in the vote against audit committee's acts. Subsequent auditor dismissal could be used as a signal that the audit committee intensifies its monitoring activities. Accordingly, we expect votes against audit committee's acts to be positively associated with subsequent auditor dismissal (H1b).

H1a: There is a positive association between shareholder votes against auditor ratification and subsequent auditor dismissal.

H1b: There is a positive association between shareholder votes against audit committee's acts and subsequent auditor dismissal.

When examining auditors' and audit committees' response to shareholder dissatisfaction in case of auditor retention, we focus on two audit outcomes that are readily observable by shareholders: audit report lag (Cassell, Hunt, Narayanamoorthy, and Rowe 2019), that is, the number of days between the client's fiscal year end and the date of the audit report, and the issuance of modified audit opinions (He, Pan, and Tian 2017). Given that shareholders can observe both audit report lag and modified audit opinions, we expect that auditors and audit committees are particularly inclined to carefully consider the consequences of these audit outcomes in case of shareholder dissent.

Audit report lag is most commonly used as a proxy for audit effort (Knechel and Sharma 2012). Audit committees (auditors) could respond to shareholder dissatisfaction by demanding (increasing) audit effort, which—if spent effectively—could also imply higher audit quality. Correspondingly, Tanyi et al. (2020) find a positive association between

[2] In 2021, the German legislation raised the liability cap to €16 million for audits of public interest entities and introduced unlimited liability in case of gross negligence (HGB 2023, section 323(2)). However, even after these adjustments, Germany is still considered one of the more lenient auditor liability regimes.

votes against auditor ratification and subsequent audit report lag. A longer audit report lag could also be caused by coordination efforts (Henderson and Kaplan 2000), for example, if audit committees intensify their monitoring activities and demand more frequent meetings with the auditor. On the other hand, audit committees and auditors might consider reducing audit report lag given that shareholders tend to appreciate reporting timeliness (Trueman 1990). Overall, given the plausible explanations for both a positive and a negative association between shareholder dissatisfaction and audit report lag, we formulate undirected hypotheses that, as outlined above, distinguish between votes against auditor ratification (H2a) and votes against audit committee's acts (H2b).

H2a: There is an association between shareholder votes against auditor ratification and subsequent audit report lag.

H2b: There is an association between shareholder votes against audit committee's acts and subsequent audit report lag.

In general, issuing a modified audit opinion (e.g., qualified or going concern opinion) reflects auditor reporting conservatism (Firth, Mo, and Wong 2012). For example, auditors could feel pressured to issue a modified audit opinion if audit failures are met with high litigation risk, which, however, is not the case in Germany (as outlined above). By contrast, audit committees and/or auditors might want to avoid a modified audit opinion, considering that they tend to be ill perceived by shareholders (Tanyi et al. 2021). However, an (incorrectly) withheld modified audit opinion could even further increase shareholders' concerns. Instead, audit committees (auditors) could respond to shareholder dissatisfaction by demanding (increasing) auditor independence, which could result in modified audit opinions (Firth et al. 2012). In general, modified audit opinions tend to require, but could also be the result of, additional audit effort that is necessary to discover (or address) financial/reporting issues (Habib 2013). Thus, in line with our expectations for audit report lag, we formulate undirected hypotheses, expecting shareholder dissatisfaction to be associated with modified audit opinions, once again distinguishing between shareholder dissatisfaction directed toward the auditor (H3a) and the audit committee (H3b).

H3a: There is an association between shareholder votes against auditor ratification and the subsequent issuance of a modified audit opinion.

H3b: There is an association between shareholder votes against audit committee's acts and the subsequent issuance of a modified audit opinion.

In general, the timeline of the German auditor selection process is similar to that in the United States (Tanyi et al. 2020, 198, Appendix A). According to German law, annual meetings must be held at most eight months after the start of the fiscal year (AktG 2023, section 175(1)) and typically take place between April and July. The supervisory board then appoints the ratified auditor who proceeds with the engagement acceptance or continuance process and initial risk assessment procedures. Accordingly, auditors (and audit committees) are well aware of the voting results before auditors commence their work and, in turn, are able to influence audit outcomes. Thus, we examine the impact of voting results of the annual meeting in t (August latest) on the audit fieldwork that typically starts around the fourth quarter of t.[3] Therefore, we use subscript t for both the dependent variable and all controls in our audit outcome models. This reasoning is in line with Tanyi et al. (2020).

IV. RESEARCH DESIGN

The regression models outlined below are used to test our hypotheses. In our models, we control for industry- and year-fixed effects and cluster standard errors at the firm level. All variables are defined in Appendix A. Index i denotes firm, and index t denotes year.

Regarding H1a and H1b, we base our model on Barua et al. (2017).

$$\begin{aligned} SWITCH_{it+1} = {} & \beta_0 + \beta_1 VOTEAUDITOR_{it} + \beta_2 VOTEBOARD_{it} + \beta_3 BIG4_{it} + \beta_4 SIZE_{it} \\ & + \beta_5 LOSS_{it} + \beta_6 LEVERAGE_{it} + \beta_7 ROA_{it} + \beta_8 BTM_{it} + \beta_9 SALESGROWTH_{it} \\ & + \beta_{10} RESTATEMENT_{it} + \beta_{11} GCO_{it} + \beta_{12} TENURE_{it} + \beta_{13} CEOTURN_{it} \\ & + \beta_{14} CFOTURN_{it} + \beta_{15} INDEX_{it} + \text{fixed effects} + \varepsilon. \end{aligned} \quad (1)$$

The dependent variable *SWITCH* is a dummy variable equal to 1 if there is an auditor dismissal in the fiscal year following the observed shareholder votes and 0 otherwise. As test variables, we use *VOTEAUDITOR* and *VOTEBOARD*,

[3] The auditor is not allowed to start audit fieldwork before being ratified.

which represent the proportion of shareholders voting against ratification of the auditor or the audit committee's acts, respectively. We focus on the ratio of negative votes (without abstaining votes) compared with overall votes.[4]

Our model controls for client size, complexity, and financial condition as well as further established client characteristics. In addition, we control for auditor type, as non-Big 4 audit firms typically receive more negative SRA votes (Sainty et al. 2002). In line with Barua et al. (2017), we include CEO and CFO turnovers to account for potential changes in corporate culture that might affect auditor preference. Audit firm tenure is included as, for example, client-specific knowledge or auditor-client bonding (Ghosh and Moon 2005) might impact the audit committee's dismissal decision.

With respect to H2a and H2b, our audit report lag model is based on Habib, Bhuiyan, Huang, and Miah (2019). Due to the specifics of the German setting, we do not consider corporate governance characteristics that do not apply to the two-tier governance structure.

$$\begin{aligned} LNARL_{it} = {} & \beta_0 + \beta_1 VOTEAUDITOR_{it} + \beta_2 VOTEBOARD_{it} + \beta_3 BIG4_{it} + \beta_4 SIZE_{it} \\ & + \beta_5 LOSS_{it} + \beta_6 LEVERAGE_{it} + \beta_7 CFO_{it} + \beta_8 BTM_{it} + \beta_9 ISSUANCE_{it} \\ & + \beta_{10} NAF_{it} + \beta_{11} M\&A_{it} + \beta_{12} INVREC_{it} + \beta_{13} FYEND_{it} + \beta_{14} INDEX_{it} + \text{fixed effects} + \varepsilon. \end{aligned} \tag{2}$$

The dependent variable *LNARL* is defined as the natural logarithm of the number of days between the client's fiscal year-end and the date of the auditor's report. We include controls that capture time constraints or time-consuming audit procedures, for example, a busy season effect and instances of mergers and acquisitions.

For H3a and H3b, we examine modified audit opinions (captured by the dummy variable *MODOP*). We include common controls for client size and other established client characteristics. Further, we add various performance measures (including financial distress and likelihood of bankruptcy) in line with prior research in European settings (Karjalainen, M. Niskanen, and J. Niskanen 2018):

$$\begin{aligned} MODOP_{it} = {} & \beta_0 + \beta_1 VOTEAUDITOR_{it} + \beta_2 VOTEBOARD_{it} + \beta_3 BIG4_{it} + \beta_4 SIZE_{it} \\ & + \beta_5 LOSS_{it} + \beta_6 LEVERAGE_{it} + \beta_7 CFO_{it} + \beta_8 BTM_{it} + \beta_9 ISSUANCE_{it} \\ & + \beta_{10} INVREC_{it} + \beta_{11} SALESGROWTH_{it} + \beta_{12} PPEGROWTH_{it} \\ & + \beta_{13} ALTMANZ_{it} + \text{fixed effects} + \varepsilon. \end{aligned} \tag{3}$$

V. SAMPLE SELECTION AND DESCRIPTIVE RESULTS

Our sample is initially composed of all companies listed in the CDAX at the end of 2013–2016. We obtain a final sample of 1,086 firm-year observations in our auditor dismissal model (1,065 in the audit outcome models). Details of our sample selection process are provided in Table 1 and in the Online Appendix, Methods and Supplemental Information.

Table 2 provides descriptive information about our sample. We observe a change of the auditor in 6.5 percent of firm-year observations, consistent with previous studies in Germany (Baumann and Ratzinger-Sakel 2020). We report a mean audit report lag of 76.4 days and a modified audit opinion for 8.4 percent of our observations. With respect to shareholder dissatisfaction, on average, 2.0 percent of SRA votes are negative, which is moderately higher than SRA in the United States (Barua et al. 2017; Raghunandan and Rama 2003). The mean value of votes against the ratification of audit committee's acts is 3.2 percent, even including a few instances of overall disapproval.

VI. RESULTS

Tables 3 presents our regression results for subsequent auditor dismissal. For a more direct comparison with prior studies, we report our results both with and without the German-specific variable *VOTEBOARD*.

Column (1) includes our results without considering votes against audit committee's acts, thereby replicating the research design in prior literature. Using this approach, our results appear to be in line with prior research, showing a significant association between votes against auditor ratification and subsequent auditor dismissal ($p = 0.002$).

[4] German companies can opt between two different formats for reporting on SRA, one of which of does not require the company to publish information on votes abstaining from auditor ratification. However, although previous research usually applied two different measures of shareholder dissent, one of which also considered abstaining votes, the authors regularly observe that both measures yield the same results (Tanyi et al. 2020; Barua et al. 2017). Thus, we consider the lack of data to be of no issue.

TABLE 1

Sample Selection

	Dismissal	Outcome
All firm-year observations of companies listed in the CDAX at the end of the years 2013–2016	1,747	1,747
Less: Firm-year observations in financial services industries (SIC 6000–6999)	220	220
Less: Firm-year observations with missing data in Compustat Global database	244	244
Less: Firm-year observations for which data that had to be hand-collected could not be obtained (e.g., no published SRA voting results or no available group financial statements)	123	123
Less: Firm-year observations with short fiscal years	8	8
Less: Firm-year observations with financial statements not prepared on a going concern basis	2	2
Less: No available company data for two consecutive years (e.g., company not listed in the CDAX in both years)	64	0
Less: Firm-year observations with a switch of the audit firm	0	85
Full sample	1,086	1,065

TABLE 2

Descriptive Statistics

Variable	Mean	Median	Std. Dev.	Min	Max
ARL (days)	76.356	74.000	26.474	28.000	357.000
VOTEAUDITOR	2.011	0.231	4.543	0.000	40.439
VOTEBOARD	3.203	0.414	7.419	0.000	67.166
SIZE (000000 €)	7,879.436	312.868	31,698.190	0.761	409,749.000
LEVERAGE	0.590	0.549	0.515	0.026	11.218
ROA	0.009	0.036	0.187	−1.295	2.604
CFO	0.052	0.073	0.159	−1.377	0.463
BTM	0.899	0.521	3.142	−4.717	53.628
SALESGROWTH	0.115	0.039	1.801	−1.000	58.194
NAF	0.252	0.223	0.205	0.000	0.837
INVREC	0.322	0.319	0.168	0.007	0.883
PPEGROWTH	0.088	0.045	0.433	−1.000	5.767
ALTMANZ	2.959	2.655	5.686	−57.412	104.529

Dummy Variables	Mean
SWITCH[a]	0.065
MODOP	0.084
BIG4	0.686
LOSS	0.219
RESTATEMENT	0.015
GCO	0.078
TENURE	0.375
CEOTURN	0.113
CFOTURN	0.103
ISSUANCE	0.296
M&A	0.403
FYEND	0.869
INDEX	0.302

[a] Descriptive statistics based on firm-year observations from 2014 to 2017.
All variables are defined in Appendix A.

TABLE 3

Multivariate Results—Auditor Dismissal ($SWITCH_{t+1}$)

	Excluding Votes against Audit Committee's Acts (1)		Excluding Votes against Auditor Ratification (2)		Including Both Votes (3)	
	Estimate	**p-value**	**Estimate**	**p-value**	**Estimate**	**p-value**
VOTEAUDITOR	0.054***	0.002			0.031	0.107
VOTEBOARD			0.037***	0.001	0.030**	0.018
BIG4	−0.481	0.102	−0.522*	0.081	−0.512*	0.087
SIZE	0.051	0.523	0.066	0.403	0.058	0.473
LOSS	−0.078	0.844	−0.091	0.806	−0.129	0.731
LEVERAGE	−0.271	0.309	−0.338	0.230	−0.314	0.265
ROA	0.908	0.168	1.091	0.138	1.031	0.154
BTM	−0.054	0.394	−0.042	0.405	−0.047	0.424
SALESGROWTH	−0.007	0.815	−0.005	0.867	−0.004	0.893
RESTATEMENT	−0.126	0.915	−0.031	0.979	−0.080	0.945
GCO	0.838	0.121	0.857	0.125	0.827	0.137
TENURE	−0.119	0.700	−0.105	0.736	−0.112	0.720
CEOTURN	−0.092	0.835	−0.126	0.774	−0.112	0.800
CFOTURN	−0.378	0.452	−0.409	0.422	−0.427	0.411
INDEX	−0.829**	0.036	−0.776*	0.052	−0.778*	0.053
Constant	−2.610***	<0.001	−2.616***	<0.001	−2.664***	<0.001
Year effects	Included		Included		Included	
Industry effects	Included		Included		Included	
n	1,086		1,086		1,086	
Pseudo R^2	0.069		0.074		0.078	
p-value	0.020		0.007		0.004	
Difference					0.001	0.968

*, **, *** Represent significance levels of 0.10, 0.05, and 0.01, respectively.
Difference shows the results for the difference test between the coefficients for *VOTEAUDITOR* and *VOTEBOARD*.
All variables are defined in Appendix A.

However, if we also include votes against audit committee's acts (column (3)), we observe that SRA voting results turn insignificant (coefficient = 0.031 and p = 0.107), whereas we observe a significant coefficient (coefficient = 0.030 and p = 0.018) for votes against audit committee's acts. Thus, our results support H1b (and do not support H1a). Notably, we observe that a 1 percent increase in shareholder dissatisfaction with the audit committee is associated with an above 3 percent increase in the likelihood of auditor dismissal, a figure similar to that reported for SRA voting results in the United States (Barua et al. 2017).

With respect to audit report lag, our findings are similar, as reported in Table 4. Even though we observe a positive and (weakly) significant association between SRA voting results and audit report lag in column (1) (p = 0.051), our results change when we also include shareholder dissatisfaction with the audit committee's acts (column (3)). Specifically, we observe a significant coefficient for *VOTEBOARD* (coefficient = 0.005 and p = 0.010), which supports H2b, and an insignificant coefficient for *VOTEAUDITOR* (coefficient = 0.002 and p = 0.501), which does not support H2a. The positive coefficient is in line with the argument that audit committees demand (or otherwise cause) additional audit effort after being targeted by shareholder dissatisfaction.

Finally, as shown in Table 5, we observe a similar pattern (supporting H3b and not supporting H3a) with respect to modified audit opinions. Although we find an insignificant association between SRA voting results and the auditor's propensity to issue a modified audit opinion (coefficient = 0.007 and p = 0.867), a significant association can be observed in case of votes against audit committee's acts (coefficient = 0.034 and p = 0.005). As we observe a positive coefficient, our results are in line with the argument that audit committees respond to shareholder dissatisfaction by demanding additional audit effort and/or independence, both of which could result in modified audit opinions.

TABLE 4

Multivariate Results—Audit Report Lag (*LNARL*)

	Excluding Votes against Audit Committee's Acts (1)		Excluding Votes against Auditor Ratification (2)		Including Both Votes (3)	
	Estimate	**p-value**	**Estimate**	**p-value**	**Estimate**	**p-value**
VOTEAUDITOR	0.005*	0.051			0.002	0.501
VOTEBOARD			0.005***	0.003	0.005**	0.010
BIG4	−0.033	0.307	−0.038	0.238	−0.038	0.242
SIZE	−0.060***	<0.001	−0.059***	<0.001	−0.059***	<0.001
LOSS	0.058**	0.048	0.052*	0.063	0.051*	0.068
LEVERAGE	0.069**	0.026	0.068**	0.017	0.068**	0.017
CFO	−0.030	0.773	−0.030	0.782	−0.029	0.787
BTM	0.005	0.139	0.005	0.114	0.005	0.112
ISSUANCE	0.022	0.289	0.017	0.419	0.017	0.416
NAF	−0.004	0.946	0.001	0.986	−0.003	0.962
M&A	0.036	0.133	0.040*	0.096	0.039	0.105
INVREC	0.083	0.365	0.074	0.407	0.074	0.407
FYEND	0.033	0.420	0.031	0.433	0.030	0.457
INDEX	−0.061*	0.083	−0.057	0.106	−0.058	0.102
Constant	4.549***	<0.001	4.544***	<0.001	4.543***	<0.001
Year effects	Included		Included		Included	
Industry effects	Included		Included		Included	
n	1,065		1,065		1,065	
R^2	0.332		0.343		0.343	
p-value	<0.001		<0.001		<0.001	
Difference					−0.003	0.375

*, **, *** Represent significance levels of 0.10, 0.05, and 0.01, respectively.
Difference shows the results for the difference test between the coefficients for *VOTEAUDITOR* and *VOTEBOARD*.
All variables are defined in Appendix A.

Our correlation matrix and variance inflation factors (untabulated) suggest that our analysis is unlikely to suffer from multicollinearity. Noticeably, the correlation coefficient between *VOTEBOARD* and *VOTEAUDITOR* is around 40 percent, which we consider to be a sufficiently low threshold to assume that these variables capture different dimensions of shareholder dissatisfaction. However, we note that the reported coefficients for *VOTEAUDITOR* and *VOTEBOARD* are not significantly different *from each other* (auditor dismissal: p = 0.968, audit report lag: p = 0.375, modified audit opinions: p = 0.517). Therefore, we refer to our robustness tests in the Online Appendix, Methods and Supplemental Information. Even if we only consider (1) the difference in votes against audit committee's acts and votes against auditor ratification or (2) observations for which both voting results deviate by more than 1 percent, our results continue to hold, implying that both variables do not capture the same construct. Nonetheless, the reported effect sizes should be treated with caution. For comparability, we report our results without *VOTEAUDITOR* in column (2) of Tables 3 to 5.

VII. CONCLUSION AND IMPLICATIONS

In this paper, we examine the impact of shareholder dissatisfaction on both auditor dismissals and observable audit outcomes—audit report lag and modified audit opinions—in Germany, a setting characterized by separate votes on auditor ratification and approval of audit committee's acts. Our study is motivated by the advantage of distinguishing between shareholder dissatisfaction directed at the auditor and the audit committee, which allows us to identify the drivers behind the response to shareholder dissatisfaction.

TABLE 5

Multivariate Results—Modified Opinion (*MODOP*)

	Excluding Votes against Audit Committee's Acts (1)		Excluding Votes against Auditor Ratification (2)		Including Both Votes (3)	
	Estimate	**p-value**	**Estimate**	**p-value**	**Estimate**	**p-value**
VOTEAUDITOR	0.030	0.470			0.007	0.867
VOTEBOARD			0.035**	0.013	0.034***	0.005
BIG4	0.279	0.561	0.275	0.565	0.277	0.565
SIZE	−0.595***	<0.001	−0.616***	<0.001	−0.616***	<0.001
LOSS	2.389***	<0.001	2.381***	<0.001	2.372***	<0.001
LEVERAGE	0.994	0.168	0.851	0.207	0.862	0.206
CFO	−3.640**	0.034	−3.619**	0.032	−3.617**	0.033
BTM	0.020	0.701	0.032	0.512	0.031	0.525
ISSUANCE	0.069	0.872	0.079	0.850	0.079	0.852
INVREC	2.771*	0.068	2.785*	0.067	2.786*	0.068
SALESGROWTH	−0.056***	<0.001	−0.055***	<0.001	−0.055***	0.001
PPEGROWTH	−0.187	0.667	−0.177	0.684	−0.179	0.681
ALTMANZ	−0.051	0.181	−0.051	0.165	−0.051	0.173
Constant	−12.054***	<0.001	−11.185***	<0.001	−11.207***	<0.001
Year effects	Included		Included		Included	
Industry effects	Included		Included		Included	
n	1,065		1,065		1,065	
Pseudo R^2	0.550		0.557		0.557	
p-value	<0.001		<0.001		<0.001	
Difference					−0.027	0.517

*, **, *** Represent significance levels of 0.10, 0.05, and 0.01, respectively.
Difference shows the results for the difference test between the coefficients for *VOTEAUDITOR* and *VOTEBOARD*.
All variables are defined in Appendix A.

Using 1,086 firm-year observations related to companies listed in the CDAX at the end of 2013–2016, we find that votes against audit committees' acts (rather than votes against auditor ratification) are associated with a higher likelihood of subsequent auditor dismissal as well as longer audit report lag and a higher likelihood of a modified audit opinion. Our results suggest that audit committees particularly respond to shareholder dissatisfaction when their own reputation is at stake. Shareholders' disapproval of audit committee's acts seems to increase audit committees' incentive to incur the costs associated with changing the auditor. Presumably, audit committees want to signal increased monitoring activities as a response to shareholder dissatisfaction.

Additionally, subsequent audit outcomes appear to be driven by the audit committee's (rather than the auditor's) reputational concerns. Among others, these audit outcomes could be the result of audit committees requesting more in-depth audit procedures by auditors. Our findings complement prior research and illustrate the audit committee's vital role in responding to shareholder dissatisfaction. Potentially, our results could even indicate that the comparatively lenient German auditor liability regime, to a certain extent, disincentivizes auditors from responding to shareholder dissatisfaction on their own initiative. However, we acknowledge that this claim should be treated with caution given the lack of a significant difference between the coefficients for votes against audit committee's acts and votes against auditor ratification. Nonetheless, regulators could consider whether shareholders should obtain greater insights into the audit (e.g., by providing mandatory information on additional audit characteristics) to appreciate (or sanction) the auditor's response to shareholder dissatisfaction.

Our study is subject to several limitations. Most notably, we highlight the lack of a significant difference between the coefficients of our test variables, even though we use several robustness tests to account for any potential similarity that would weaken our inferences. Further, votes against the acts of the supervisory board do not only relate to the audit committee but are also influenced by other monitoring deficits, such as compliance issues. In addition, Germany is

characterized by several unique features (e.g., liability regime) that hinder the transferability of our results to the U.S. setting. Finally, we acknowledge that the observed audit outcomes could be due to a myriad of factors, for example, increased coordination efforts, as outlined in our hypothesis development. Nonetheless, considering that our findings are consistent across our models and robust to a variety of robustness tests, we are confident that our results provide meaningful insights into the audit committee's role in responding to shareholder dissatisfaction.

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APPENDIX A

Empirical Definitions of Variables

Variable	Empirical Definition	Data
Dependent Variables and Test Variables		
SWITCH	Equal to 1 if the audit engagement is a first-year audit and 0 otherwise.	AR[a]
LNARL	Natural logarithm of the number of days between the client's fiscal year-end and the date of the auditor's report.	AR
MODOP	Equal to 1 if the client has received a modified opinion (i.e., a going concern opinion, qualified opinion, or adverse opinion) and 0 otherwise.	AR
VOTEAUDITOR	Proportion of shareholders voting against auditor ratification.	VR[b]
VOTEBOARD	Proportion of shareholders voting against ratification of the acts of the supervisory board.	VR
Control Variables		
BIG4	Equal to 1 if the auditor is a Big 4 audit firm and 0 otherwise.	AR
SIZE	Natural logarithm of total assets.	CG[c]
LOSS	Equal to 1 if the client has reported negative net income and 0 otherwise.	CG
LEVERAGE	Ratio of year-end total debt to total assets.	CG
ROA	Net income divided by total assets.	CG
CFO	Operating cash flow divided by total assets.	CG
BTM	Ratio of book value of equity to market value of equity.	CG, DB[d]
SALESGROWTH	Percentage of annual growth in total sales.	CG
RESTATEMENT	Equal to 1 if a restatement was announced within the 12-month period before the annual meeting and 0 otherwise.	FG[e]
GCO	Equal to 1 if the client has received a going concern opinion and 0 otherwise.	AR
TENURE	Equal to 1 if audit firm tenure (consecutive number of years that the client has been audited by the same audit firm) exceeds ten years and 0 otherwise.	AA,[f] AR
CEOTURN	Equal to 1 if the client appointed a new CEO and 0 otherwise.	FS[g]
CFOTURN	Equal to 1 if the client appointed a new CFO and 0 otherwise.	FS
ISSUANCE	Equal to 1 if the client has issued equity and 0 otherwise.	CG
NAF	Nonaudit fee ratio (i.e., nonaudit fees divided by total fees).	FS
M&A	Equal to 1 if the client was involved in a merger or acquisition and 0 otherwise.	CG
INVREC	Sum of inventory and receivables divided by total assets.	CG
FYEND	Equal to 1 if the client's fiscal year-end is December 31 and 0 otherwise.	FS
INDEX	Equal to 1 if the client is listed in one of the major German indices (i.e., DAX, MDAX, and TecDAX (= HDAX)) and 0 otherwise.	DB
PPEGROWTH	Percentage of annual growth in property, plant, and equipment.	CG
ALTMANZ	Altman Z-score, calculated in accordance with Altman (1968).	CG, DB

[a] Audit reports.
[b] Companies' published voting results.
[c] Compustat global database.
[d] Deutsche Börse Group.
[e] *German Federal Gazette*.
[f] Audit Analytics.
[g] Companies' financial statements.