Regulatory Transparency and the Alignment of Private and Public Enforcement

Amy Hutton [1*]

Susan Shu [1]

Xin Zheng [2]

ABSTRACT

We propose and find that enhanced regulatory transparency facilitates alignment between private and public enforcement. Utilizing the SEC's 2004 decision to publicly disclose its comment letters, we explore the actions of a public enforcer (the SEC) and a private enforcer (shareholder litigants). The two parties' enforcement targets are more aligned in the post-public-disclosure period. The increased alignment is attributable to two channels. First, SEC's actions are subject to greater public scrutiny, enhancing regulator incentives and reducing regulatory capture. Second, shareholder plaintiffs gain information previously accessible only by regulators, enabling litigants to identify cases with "merit," reducing nuisance suits and earning larger settlements.

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[1]Carroll School of Management, Boston College. [2] Sauder School of Business, University of British Columbia.

*Corresponding author

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1. Introduction

The effectiveness of private and public enforcement mechanisms in constraining managerial misconduct has garnered widespread interest from regulators, practitioners, and academics. Public enforcement involves government entities such as the SEC, while private enforcements are actions taken by private parties such as shareholders, activist investors, and auditors. Conceptually, both forms have limitations. Regulators face resource constraints and can be captured by special interests (Stigler 1971). Private parties, while generally apolitical, have limited enforcement options and restricted information access relative to regulators. Thus, efficient enforcement often involves blended enforcement, with involvement from both private and public mechanisms (Djankov, La Porta, Lopez-de-Silanes, and Shleifer 2003; Shleifer 2005). In this paper, we propose enhanced regulatory transparency as a potential means to remedy regulator's incentive problems and improve the information of private enforcers. As private parties scrutinize regulators' oversight activities, and as private enforcers gain information previously accessible only by regulators, the increased incentive and information alignment likely results in a greater overlap in the enforcement actions by both parties. In this study, we explore the interaction between the SEC, a public enforcement entity, and private shareholder litigants, a private enforcement mechanism, following a recent regulatory change that resulted in the public disclosure of all SEC comment letters as well as corporate filers' responses to the SEC's inquiry.

As the primary regulator of the U.S. financial markets, SEC oversight has been shown to deter managerial misconduct (Jackson and Roe 2009; Kedia and Rajgopal 2011). However, many argue that the SEC is susceptible to political influences (e.g., Correia 2014, Mehta and Zhao, 2020), undermining its enforcement integrity. Additionally, the SEC also faces resource

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constraints, which hinders enforcement effectiveness (Bayless 2000; Jackson and Roe 2009; Kubic 2020). These limitations, however, can be mitigated to some extent with the involvement of private enforcement. To this end, we focus on private securities litigation brought under the U.S. securities laws, as this is a primary means for shareholders to redress damages from managerial misconduct (Schantl and Wagenhofer, 2020). Although the threat of shareholder lawsuits affects various corporate decisions (Skinner 1997; Field, Lowry, and Shu 2005; Hopkins 2018), legal scholars have questioned the effectiveness of private securities litigation. Plaintiff attorneys' incentives to race to the courtroom, combined with their information disadvantage, lead to nuisance lawsuits that cause deadweight welfare loss (see, for example, Rose 2008; Mahoney 2009). Although both the SEC and the securities litigation target corporate wrongdoings (La Porta, Lopez-de-Silanes, and Shleifer 2006; Jackson and Roe 2009), each exhibits biases and inefficiencies.

To explore the interplay between the two enforcement mechanisms, we focus on a policy change that provided a window into regulatory oversight activities. In June of 2004, the SEC announced a shift in policy: starting with corporate reports filed after August 2004, the agency would publicly disclose its comment letters and corporate filers' responses to the SEC inquiries.[1] Before this policy change, comment letters were only accessible to parties who filed a Freedom of Information Act (FOIA) request. This policy change's stated objective was to alleviate both the delay and the selective access to SEC comment letters. In making the comment letters public, the SEC increased the transparency of their oversight activities. We examine whether this

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[1] Mahoney (2009) points out that not all significant changes in private securities litigation in the U.S. have resulted from actual changes in the securities laws per se. Rather, changes in the interpretation of the laws (e.g., Rule 23 in 1967) and more recently, changes in prosecutors' practices (e.g., Spitzer use of the Martin Act in 2002) have resulted in significant changes in the ways securities laws are implemented and enforced. In turn, Mahoney argues that these more subtle changes in practice and procedure explain significant changes in the U.S. capital markets (e.g., U. S. corporate delisting behavior and reduced foreign corporate cross-listing in the U.S.).

increased transparency facilitates the alignment of the public and private enforcers' incentives and information sets, resulting in a greater overlap of enforcement actions.[2]

SEC oversight activities range from the Division of Corporate Finance (DCF)'s review and comment process to the Division of Enforcement (DOE)'s issuance of Accounting and Auditing Enforcement Releases (AAERs). The latter involves the most egregious fraud cases and capture only a small fraction of SEC's overall enforcement. Most accounting and disclosure deficiencies that come to the SEC's attention, in fact, are resolved through the SEC's review and comment process (Heese, Khan, and Ramanna, 2017; Bayless, 2000). Although DCF staff can recommend further action by the DOE, "most often the staff decides that the investment of additional time and resources into the investigation and litigation of the accounting error is unlikely to accomplish significantly more than the comment process achieved already" (Bayless, 2000).

We conjecture that the public disclosure of SEC comment letters likely has two broad consequences. First, public disclosure can mitigate SEC staff's incentive problems (*incentive alignment*). Individual staff members, typical of bureaucrats, may not engage in the costly investigative effort to detect financial reporting problems (Prendergast, 2003; 2007; Schantl and Wagenhofer, 2020) if their oversight activities are hidden from public view. The SEC is also susceptible to political influence (Correia, 2014; Mehta and Zhao, 2020). Both incentive problems are likely curtailed once the SEC comment letters are publicly disclosed, as outsiders can more easily monitor SEC staff members' oversight activities.

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[2] Greater overlap demonstrates the complementarity of public and private enforcement: private mechanisms pick up where the public enforcement stopped because of differences in resource constraints and/or incentives (Bayless 2000).

Second, public disclosure of SEC comment letter correspondence enables private parties to access information previously accessible only by regulators (*information alignment*). The enhanced information likely improves the quality of private securities litigation by facilitating the identification of financial reporting and disclosure issues concerning the SEC, and presumably, investors. Both of these forces, i.e., remedied SEC incentives and expanded information access by private shareholder litigants, likely lead the two enforcement mechanisms to pursue firms with questionable accounting and disclosure practices, which results in a greater alignment in enforcement actions.[3]

We start by examining whether regulatory transparency results in greater alignment of enforcement *targets* by the SEC and private litigants. Our evidence suggests that public enforcement (via SEC comment letters) and private enforcement (via private securities litigation) coincide to a greater extent in the post-public-disclosure period.[4] Additionally, there appears to be an increased alignment in timing: the (absolute) filing lag between private and public enforcement activities declines significantly following the SEC's disclosure policy change. For firms receiving SEC comment letters that are also involved in private securities lawsuits, the lag between the filing dates of the public and private enforcement actions declines in the post-public-disclosure period.

Having documented a greater alignment in enforcement following the public disclosure of SEC comment letters, we turn to the specific factors contributing to the alignment. First, we

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[3] SEC oversight involves a range of activities, from routine filing reviews to enforcement actions. The comment letter (CL) reviews conducted by the Division of Corporate Finance enhance compliance with disclosure and accounting regulation (see the discussion of Bayless 2000 in the next section). Noted often within the first paragraph of an SEC comment letter is its purpose: "Please understand that the purpose of our review process is to assist you in your compliance with the applicable disclosure requirements and to enhance the overall disclosure in your filing."
[4] We define enforcement actions as any willful actions to prevent alleged violations of securities laws and/or to deter future violations alike. SEC enforcement activities take many forms. A stream of literature views the SEC comment letter process as a form of SEC enforcement and oversight (e.g., Heese et al. 2017; Johnston and Petacchi 2017).

consider the SEC's *incentive alignment*: did the SEC increase enforcement efforts post-public-disclosure when their enforcement activities became observable to outsiders and more easily monitored? Focusing on the SEC's tendency to issue comment letters to firms with questionable accounting practices and firms with significant political influences, we find that the SEC steps up its oversight and enforcement activities during the post public disclosure period. Specifically, the SEC is more likely to issue comment letters to firms with questionable accounting practices (i.e., firms that eventually must restate their financials), consistent with SEC staff's increased oversight effort. Compared to pre-2004, there is an increased likelihood (12.9%) that a restatement firm receives an SEC comment letter in the post-2004 period.

In addition to increased enforcement effort, the SEC is also less susceptible to political influence in the post-disclosure period. Previous literature (e.g., Correia 2014) finds that the SEC is less likely to enforce against firms with high PAC contributions, suggesting regulatory capture.[5] We confirm this relationship in the pre-public-disclosure period when private parties could not easily obtain comment letters. In contrast to the negative association between PAC contributions and the likelihood of an SEC comment letter in the pre-disclosure period, we find a *positive* association in the post-disclosure period, consistent with Heese et al. (2016). The conflicting evidence in the two disclosure regimes provides a reconciliation for the somewhat contradictory findings in Correia (2014) and Heese et al. (2016): While the SEC can be captured when its actions are opaque to the public, such incentives are mitigated, even reversed, if the SEC's actions become visible to the public. In sum, the SEC's increased tendency to issue comment letters to restating firms and to politically connected firms suggests that regulatory

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[5] Correia (2014) examines a set of restatement firms and observes whether the SEC files a civil or administrative action against them.

transparency reduces political capture and enhances regulators' incentives to detect financial reporting problems.

Next, we turn to the role of *information alignment* and ask whether the availability of information from SEC's filing reviews affects the "quality" of the private securities litigation. With access to SEC comment letter correspondence, plaintiffs' attorneys can more easily identify and target firms with questionable financial reporting practices, thereby increasing the "merit" of the cases. The increased merit of securities litigation translates to a lower likelihood of case dismissal and larger settlement amounts.

In this analysis, we narrowly focus on the effect of enhanced information access on the merit of cases pursued by securities lawyers. In particular, we examine the outcomes of the suits filed with and without access to the detailed information in concurrent SEC comment letter correspondence. To isolate the effect of the litigants' information access and avoid the confounding effects of changing SEC's incentives across the two disclosure regimes, we focus exclusively on the post-disclosure period. We utilize each SEC comment letter's actual *dissemination date*, relative to the lawsuit filing date, to identify lawsuits filed with access to the relevant correspondence between the SEC and the registrant. Since these correspondences shed light on possible misrepresentations and omissions in corporate filings, access to such information likely helps private shareholder litigants identify higher quality lawsuits, reducing nuisance lawsuits that significantly drain corporate resources. We find that access to comment letters indeed improves the merit of the shareholder litigation: lawsuits filed after the dissemination date of the SEC comment letter correspondence are less likely to be dismissed, and they result in larger settlement amounts than those filed before the dissemination date. The larger settlement can also result from private plaintiffs using comment letters to boost their

claims, "including materiality, scienter, loss causation, and more" (Platt, 2020). Overall, this evidence adds to the existing literature the insight that a transparent SEC review process brings new information to light that lowers private litigants' information-search costs and encourages more effective private enforcement of securities laws (Landis 1938 and La Porta et al 2006).

We face two empirical challenges. First, confounding events could complicate our inferences. Specifically, we focus on the regulatory change surrounding the public disclosure of SEC comment letters in 2004. However, our results could be confounded by an earlier regulatory change, in particular, Section 408 of SOX, which requires the SEC to review each issuers' filings at least once every three years. This SOX requirement likely increased the number of SEC comment letters issued post-2002. However, the increase in SEC comment letters is not necessarily accompanied by parallel private securities litigation, as comment letters were not easily accessible until May 2005 (when comment letters first became available on EDGAR). Nevertheless, to ensure that SOX does not drive the findings, we split the pre-disclosure period into two sub-periods, pre-Sox and post-Sox, and repeat our main analysis. The evidence indicates that SOX did not significantly increase the overlap between SEC comment letters and securities class actions. Instead, the increased alignment between public and private enforcement did not occur until after the SEC changed its disclosure policy. Further evidence suggests that SOX *alone* did not make it more likely for the SEC to issue comment letters to firms with questionable accounting practices, nor did it change the SEC's reluctance to issue comment letters to politically connected firms. SEC's incentives alignment took place only after the change in its disclosure policy post-2004.

Second, the increased alignment between the two enforcement mechanisms could be due to other changes, such as broader shifts within the SEC that altered the regulator's incentives,

and not necessarily due to the public disclosure of comment letters. To address this alternative explanation, we conduct a falsification test by replacing SEC comment letters with SEC investigations. While SEC comment letters began to be publically disclosed in 2005, SEC investigations have remained undisclosed.[6] Interestingly, we find no change in the alignment of private enforcement (class-action lawsuits) and SEC public enforcement post-2004 when we use SEC investigations (instead of SEC comment letters) to measure public enforcement. This evidence suggests that it is indeed the *public disclosure* of SEC comment letters that drove the increased overlap between private and public enforcement.

To our knowledge, we are the first to empirically examine whether increased regulatory transparency affects the interaction between private shareholder litigation and the SEC's public enforcement activities. While prior literature presents mixed findings on whether market-based enforcement is a compliment or substitute for public enforcement, we use a new setting to examine how regulatory transparency changed the incentive and information alignment between private and public enforcement.

2. Institutional Background and Related Literature

2.1. The SEC's Disclosure Review Process

SEC staff members in the Division of Corporation Finance provide issuers with comments on their corporate filings when the staff believes the filing should be improved. They also issue a comment letter when they deem a filing to be materially deficient or require further

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[6] Firms may choose to disclose that they are being investigated by the SEC voluntarily, but the SEC does not disclose which firms it is investigating. Recent research examines which firms choose to voluntarily disclose ongoing SEC investigations (see Blackburne and Quinn 2018).

clarification.[7] Robert A. Bayless, former Chief Accountant, Division of Corporation Finance

(DCF), highlights the important role of the comment letter process:

> *What is commonly overlooked… is that most financial reporting problems are handled by the Commission's full disclosure program, which is administered by the Division of Corporate Finance… Only the most egregious and obvious of these accounting errors lead to action by the Division of Enforcement. In the overwhelming majority of cases, the registrant restates its financial statements quietly after a challenge by the Division of Corporate Finance… [T]he accounting issues underlying the restatement of financial statements in these situations are usually no less important than those that have served as the basis for more dramatic enforcement actions.[8]*

The Division of Corporate Finance's disclosure reviews often involve several rounds of

comments from the staff and responses from the issuer until the issues are resolved.[9] The SEC's

disclosure review process is tied to its stated goal of ensuring that "investors have access to high-

quality disclosure materials that are useful to investment decision making."[10] SOX Section 408

mandates that the SEC review all public companies' disclosures at least once every three years.

Until 2005, the SEC only released staff comment letters and issuer responses selectively

to those who filed FOIA requests. Then on June 24, 2004, the SEC announced a change in policy

regarding the release of comment letters and filer responses:

> *In recent months, an increasing number of our comment letters and filer responses to them are being released publicly through the FOIA process, but only to those persons who make FOIA requests for them. We believe it is appropriate to expand the transparency of the comment process so that this information is available to a broader audience, free of charge... Public access to this correspondence will no longer require a FOIA request.[11]*

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[7] The SEC is careful to highlight that these comment letters set forth staff positions on a particular filing only and do not constitute an official expression of the Commission's views (retrieved on March 26, 2019, https://www.sec.gov/fast-answers/answerscommentlettershtm.html).

[8] Bayless (2000): http://www.sec.gov/news/speech/spch394.htm (accessed on May 31, 2020).

[9] As noted by Bayless in the above quote, the Division of Corporate Finance infrequently recommends the company and issues discussed in its CLs to the Enforcement Division. Rather, our understanding is that a large majority of the Division of Enforcement's activities begin with an anonymous tip. According to the SEC's annual enforcement report, "Commission personnel reviewed more than 16,000 tips, largely from the general public (SEC 2017)."

[10] SEC (2011) Annual Report, p. 77.

[11] See SEC press release: https://www.sec.gov/news/press/2004-89.htm (accessed March 26, 2019).

The SEC announced that it would begin releasing comment letters and response letters relating to disclosure filings made after August 1, 2004. On May 9, 2005, the SEC indicated that the first batch of comment letters would be publicly released on May 12, 2005. After that, the correspondence would be released 45 days after the staff completed its filing review. In January of 2012, the release process was shortened to 20 days after completing the review.[12]

The June 2004 announcement also indicated that the SEC staff "may ask companies to represent in writing that they will not use the SEC's comment process *as a defense* in any securities-related litigation.[13] The SEC's decision to include such language in all initial reviews demonstrates two important points. First, the SEC recognizes the link between information provided, *vis-a-vis* its review process, and private securities litigation. Second, the SEC does not wish for its disclosure review process to undermine the legitimacy of any private shareholder enforcement action.[14]

2.2. Related Literature

While a large literature in comparative economics discusses various mechanisms for public control over economic activity, Segal and Whinston (2006) point out two basic approaches for deterring socially harmful behavior in most countries: private litigation and public enforcement by agencies such as the SEC.[15] Existing empirical work employs

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[12] See SEC announcement: https://www.sec.gov/divisions/corpfin/cfannouncements/edgarcorrespondence.htm (accessed March 26, 2019).

[13] This request is known as a "Tandy letter." Retrieved on March 26, 2019, from https://www.sec.gov/news/press/2004-89.htm The SEC discontinued the Tandy Letter language in October of 2016.

[14] On October 5, 2016, the SEC changed course indicating that companies no longer need to include the Tandy language, and "instead [the SEC would] include the following statement in [its] comment letters: *We remind you that the company and its management are responsible for the accuracy and adequacy of their disclosures, notwithstanding any review, comments, action or absence of action by the staff.*" https://www.sec.gov/corpfin/announcement/cf-announcement---no-more-tandy-language.html (emphasis added).

[15] Segal and Whinston (2006, p. 1) go on to note that "Private litigation is common in the United States and (to a lesser extent) in the United Kingdom and other 'common law' jurisdictions. In contrast, the 'civil law' countries, such as those of continental Europe, have far less private litigation, and rely more on enforcement by public agencies."

international settings to assess which control mechanisms are more beneficial to the capital market, with mixed findings. La Porta et al. (2006) examine the effect of securities laws on stock market development in 49 countries and find little evidence that public enforcement benefits stock markets. Instead, they find that laws mandating disclosure and facilitating private enforcement through liability statutes benefit stock markets. In contrast, Jackson and Roe (2009) employ securities regulators' resources as a proxy for *regulatory intensity* and find public enforcement to be as important as disclosure and more important than private liability standards in explaining financial market outcomes.

Private enforcement of public statues is a highly effective strategy of enforcing good conduct in many situations (Hay, Shleifer, and Vishny 1996; Hay and Shleifer 1998), empirically demonstrated for securities markets by La Porta et al. (2006) and for banking regulation by Barth, Caprio, and Levine (2004). Private securities litigation by shareholders is an example of private enforcement of corporate conduct under the Securities Act of 1933 and 1934. The threat of shareholder lawsuits affects various corporate decisions (Skinner 1997; Field, Lowry, and Shu 2005; Hopkins 2018). However, legal scholars have also questioned the effectiveness of private securities litigation, arguing that shareholders and their attorneys only go after "deep pockets," and the incentives to race to the courtroom lead to many lawsuits without merits and deadweight welfare loss (Mahoney 2009; Rose 2008).

When private enforcement incentives are insufficient, existing research highlights several distinct advantages of a public enforcer, such as the SEC (LaPorta et al. 2006). Public regulators can develop expertise and be motivated to pursue social objectives (Landis 1938; Glaeser, Johnson, and Sheleifer 2001; Pistor and Xu 2002). They have a greater array of enforcement options and enjoy exclusive access to non-public information they can solicit directly from firms.

SEC comment letter correspondence, for example, illustrates the SEC's unique information advantage over private parties. These various advantages make public enforcement in some circumstances more efficacious than private enforcement (Shleifer 2005). On the other hand, public enforcement's primary problem is the risk of lax or biased enforcement by officials captured by special interests (e.g., Shleifer 2005; Correia, 2014).[16]

With public access to SEC comment letters, several recent papers have begun to explore the information and financial reporting consequences of SEC comment letters. Johnston and Petacchi (2017) find that following comment letter resolution, the adverse selection component of the bid-ask spread declines, and earnings response coefficients increase, concluding that SEC's oversight has beneficial informational effects. Using a sample similar to ours, Duro, Heese, and Ormazabal (2019) find evidence that post-public disclosure of comment letters, firms' financial reporting improved, as indicated by lower discretionary accruals, fewer future restatements, and longer narratives. Interestingly, the authors do not find evidence of increased SEC oversight intensity in the post-2004 period, as measured by the length of the comment letter review process or number of rounds of letters.[17]

2.3. Hypotheses Development

While there is extensive literature examining the SEC and shareholder litigants' oversight and enforcement activities, our understanding of how these two enforcement mechanisms interact is limited.[18] In this paper, we attempt to fill this gap by examining whether increased

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[16] Yu and Yu (2011) demonstrate this point by examining the relationship between corporate lobbying and fraud detection. They document that, compared to non-lobbying firms, lobbying firms evade fraud detection by an extra 117 days and are 38% less likely to be detected by regulators (such as the SEC).

[17] These authors analyze the determinants of receiving a CL for the periods before and after the SEC disclosure policy change (Appendix 3 in their study). Based on the low explanatory power of the determinant models both before and after the disclosure policy change, the authors conclude that "by and large, firms are systematically subject to CL reviews."

[18] Two exceptions are LaPorta et al. (2006) and Jackson and Roe (2009). Both use international settings to explore the importance of public and private enforcement in capital markets development at the country level.

transparency of the SEC oversight and enforcement process affects the behavior and the outcomes of private and public enforcement.

We expect the 2004 policy change to enhance the SEC's effectiveness as a public enforcer. Economic theory argues that public enforcers are effective if they are *independent* (not politicized and not captured), *motivated* to pursue social objectives, and if they can *secure information from issuers* that private parties cannot (or at least not as efficiently). Making the SEC enforcement activities more observable enhances the SEC's external monitoring, which in turn, should improve the SEC's *incentives* to be independent (or at least to appear independent). Similarly, greater transparency likely motivates the SEC's staff to step up enforcement activities important to investors (e.g., high profile cases that result in restatements).[19] Moreover, any new information the SEC can secure from issuers via the comment letter review process is revealed to outsiders post-2004, ensuring greater *information alignment* across private and public enforcement.[20] The SEC's incentive alignment and shareholder litigants' information alignment post-public-disclosure should result in both enforcement mechanisms targeting firms with questionable accounting practices. This leads to our three sets of hypotheses:

H1: After the public disclosure of SEC comment letters, there is an increased alignment in enforcement activities between the SEC (via comment letters) and private shareholder litigants.

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[19] Section 408 (b1) of SOX outlines criteria for when the SEC should review an issuer's filings. The outlined criteria include restatements, suggesting that SOX likely leads to an increase in the overlap of reviews and restatement firms. However, a filing review per se does not necessarily indicate that a comment letter will be sent to the issuer. Nevertheless, in our empirical tests, we use sub-sample analyses to estimate the effects of SOX and the SEC's decision to disclose all comment letter correspondence separately.

[20] La Porta et al. (2006) argue that to effectively harness market participants' incentive to enforce securities laws through private litigation, it is necessary to make the private recovery of investors' losses easy (Landis 1938). Such efficiency considerations include lower information and search costs for market participants through *disclosure requirements*, as well as *liability standards* that make it cheaper for investors to recover damages when information is wrong or omitted. We add to these arguments the insight that the SEC's review process, when made public, brings to light new information that lowers private litigants' information and search costs.

H2a (Incentive Alignment): The SEC is more likely to issue comment letters to firms with questionable accounting practices.

H2b (Incentive Alignment): The SEC is less likely to be captured by politically connected firms.

H3 (Information Alignment): Private securities lawsuits filed with access to SEC comment letters have lower dismissal rates and higher settlement amounts than lawsuits filed without such access.

3. Data and Sample Selection

We begin with the *Compustat* database to identify all firm-years in our sample period, 1997 to 2015. We then augment *Compustat* with data on SEC comment letters and shareholder class-action lawsuits. The comment letter (CL) sample comprises all SEC comment letters issued for 10-Ks filed between January 1, 1997, and June 30, 2015.[21] Each comment letter refers to one 10-K filing (i.e., alleged wrongdoing year). The SEC began to publicly disclose all comment letters related to filings made after August 1, 2004. For the post-2004 CL reviews, we gather data from *Audit Analytics*; for the pre-2004 CL reviews, we obtain data through FOIA requests. The SEC provided the recipients of the comment letters (company names) and the first and last correspondence dates.[22]

We next search Stanford's Securities Class Action Clearinghouse for all shareholder lawsuits with alleged Rule 10b-5 violation filed within our sample period, January 1, 1997, through June 30, 2015, and hand-collect detailed lawsuit information (http://securities.stanford.edu/index.html). We focus on lawsuits against public companies and

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[21] We focus on comment letters related to 10-K filings following Dechow et al. (2015). SEC comment letters predominantly relate to annual financial reports (Dechow et al. 2015).

[22] For the pre-2004 period, we do not have access to the text of the comment letters. Nor do we have access to which CLs were disclosed to interested parties in response to a FOIA request. (The SEC's FOIA log is available only post 2006: https://www.sec.gov/foia/docs/foia-logs.htm) Thus, while we confirm alignment of disclosure and accounting topics of the CL and private litigation actions in the post-2004 period, we assume this alignment holds in the pre-2004 period. Additionally, our tests assume that SEC CLs were not disclosed to private litigants in the pre-2004 period, although they might have been via a FOIA request. We note that a violation of these assumptions would weaken the power of our tests, but do not necessarily introduce a bias into our analysis.

exclude lawsuits related to IPO allocation, mutual fund, and analysts, following prior literature

(e.g., Kim and Skinner 2012). Our sample period starts after the Private Securities Litigation

Reform Act (PSLRA, 1996), which ensures consistent legal standards throughout our sample

period. It ends in June 2015 to allow sufficient time for lawsuit resolution.[23]

We first identify firm-year observations whose 10-Ks are associated with SEC comment

letters. We then identify all firm-years associated with securities litigation.[24] To determine the

firm-years subject to both public oversight and private action, we require an overlap between the

lawsuit class period and the CL subject year (from the start of a 10-K fiscal year to its filing

date).[25] This matching criteria likely identifies the comment letters and class-action lawsuits that

target the same wrongdoing years.[26]

Our control variables are motivated by two separate lines of research. First, we include

control variables related to the securities litigation literature (e.g., Kim and Skinner 2012). We

control for high litigation industries (*Litigation_ind*), aggregate abnormal returns in the year

before the 10-K period (*Returns*), stock turnover (*Turnover*), and stock skewness (*Skewness*).

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[23] On average, the median time to settle a class-action suit is about 3.2 years (retrieved from
https://corpgov.law.harvard.edu/2020/03/11/securities-class-action-settlements-2019-review-and-analysis/).
[24] In cases involving misleading statements or omissions, a class period generally starts when a company allegedly
makes an untrue statement or omits material facts. The class period typically ends with the revelation of the "truth"
to the investing public via a 'corrective disclosure.' On average, 2.3 firm years fall into a class period for our sample
of class-action lawsuits. While this average drops to 2 firm years in the post-2004 period, the drop is not statistically
significant.
[25] Because class periods are often longer than one fiscal year, a lawsuit can be matched with more than one fiscal
period (or 10-K) that received a CL. We clustered standard errors by firm to ensure correct inference from our
statistical test. We cannot cluster standard errors by lawsuits, as the majority of our firm-year observations are not
associated with a lawsuit.
[26] To further validate that the matched CLs and legal complaints indeed focus on the same disclosure and accounting
issue(s), we examined all firm years with both a CL and a class-action lawsuit in the post-public disclosure period.
We started with issues identified in comment letters. The SEC staff listed all the issues in bullet points in comment
letters. We then compared them with issues identified in class action complaints. For over 75% of the observations,
the financial reporting issues outlined in the CL and complaint overlap. As an example: 3D Systems Corporation
received a CL on its 2013 10-K. The focus of the SEC's CL review (spanning May 13, 2014 to June 5, 2014) was
the company's method for calculating its *organic growth rate* and questions regarding its disclosure of revenues
from acquired businesses for each period presented. The class-action lawsuit filed on June 12, 2015 highlighted
several corrective disclosures during the class period (October 29, 2013 to May 5, 2015) that also focused on the
company's reported (and lack of reporting of) *organic growth rates*.

Second, we include control variables related to the issuance of SEC comment letters (e.g., Cassell, Dreher, and Myers 2013; Dechow, Lawrence and Ryans 2016; Heese et al. 2017). Specifically, we control for high firm-level stock price volatility (*High_volatility*), firm's market capitalization (*Size*), market-to-book ratio (*M2B*), firm age (*Age*), loss firms (*Loss*), Altman Z-score (*Altman*), changes in sales (*Chg_Sales*), merger activities (*Merger*), restructuring costs (*Restructure*), restatement with non-clerical error in the current or prior years' 10-Ks (*Rstmt (t or t-1))*, amendments to the firm's 10-Ks (*Amend*), natural log of the number of days between fiscal year-end date and 10K filing date (*FilingGap*), financing activities (*Financing*), Big 4 auditors (*Big4*), and auditor tenure (*Tenure*). We use the GAO restatement data and *Audit Analytics* to identify restatements in the pre- and post-period, respectively. We acquire PAC contributions from the Center for Responsive Politics (https://www.opensecrets.org/). Variable definitions are in the Appendix.

We describe the sample selection procedure in Panel A of Table 1. The final sample consists of 25,267 firm-years in the pre-disclosure period and 28,625 firm-years in the post-disclosure period. To assess the impact of SOX, we further split the pre-disclosure period into pre and post-SOX with 18,911 and 6,356 firm-year observations, respectively. While in the pre-disclosure period, 11.9% of the firm-years receive comment letters, it is worth noting that this percentage is lower pre-SOX, 8.9%, and increases to 20.7% with the introduction of SOX's Section 408 requirement that the SEC review all issuers' 10-Ks at least once every three years. Interestingly, the rate of firm-years receiving comment letters rises to 32.2% in the post-disclosure period. Examining the fraction of firm years associated with lawsuits, it is similar between the pre-SOX period (5.9%) and the post-disclosure period (5.3%). Notably, the rate of lawsuits spikes to 7.6% in the post-SOX but pre-disclosure period (between 2002 and 2004). The

question of interest is whether the *overlap* between SEC comment letters and private class-action

lawsuits increases in the post-2004 period. In fact, the frequency of firm-years targeted by both

shareholder litigants and the SEC appears to be quite similar in the pre-disclosure but post-SOX

period (2.3%) and the post-disclosure period (2.5%). Below, we formally test whether there is a

change in the frequency of this overlap in a multivariate setting.

In Panel B of Table 1, we provide descriptive statistics on the CL review process pre- and

post-2004. The filing lag (defined as the number of days between the 10-K filing and the first

comment letter) appears similar pre- and post-2004. However, the number of days between the

start and finish of the review has declined in the post period. The mean number of days for a

review fell from 114 to 71 (median fell from 72 to 49). This decline could result either from

changes in SEC staff behavior or changes in issuers' behavior (Duro et al. 2019). Finally, for

completeness, Panel C of Table 1 provides descriptive statistics for the many control variables

used in our regression analyses.

4. Research Design and Results

4.1. Alignment of Private and Public Enforcement

We use the following logit regression to explore whether the likelihood of a parallel

shareholder lawsuit in concert with SEC action (targeting the same firm years) increases after the

public disclosure of SEC CLs:

$$Prob(Lawsuit) = f\ (CL, CL * Post, controls)$$

The dependent variable, *Lawsuit*, equals one if a portion of the firm year falls within the class

period of a securities class action, and zero otherwise. *CL* equals one if the firm-year received a

comment letter on its 10-K from the SEC, and zero otherwise. *Post* is an indicator variable for

the public-disclosure period (i.e., firm years with 10-K filing dates between August 1, 2004, and June 30, 2015). Observations are at the firm-year level. We include industry and year fixed effects.[27] Standard errors are clustered at the firm level.

Table 2 presents the regression results. We estimate the relation between lawsuits and CLs for the pre-public disclosure period (column 1), the post-disclosure period (column2), and the pooled regression with the interaction term, *CL*Post* (columns 3 and 4). Column 4 includes SEC office-year fixed effects to control for idiosyncratic office and time effects.[28] The findings consistently demonstrate a statistically significant increase in the association between SEC comment letters and private lawsuits from the pre- to the post-2004 period. While the *CL* coefficient is positive and significant in the pre-disclosure period, it is significantly higher in the post-disclosure period. The chi-square test (reported in Panels B) comparing the two *CL* coefficients rejects the equivalence of the coefficients in the pre and post periods. The coefficient on *CL*Post* in columns 3 and 4 is positive and significant, confirming the stronger association between lawsuits and CLs in the post-public disclosure period. Thus, the alignment or overlap of SEC comment letters and private lawsuits increases in the post-2004 public-disclosure period.

As noted above, the SOX Section 408 requires that the SEC review each issuer's filings (including 10-Ks) at least once every three years, possibly contributing to the increase in the SEC comment letters post-disclosure. However, of interest to us is whether the SEC comment letters are accompanied by more parallel private class-action lawsuits in the post-2004 period. To disentangle the effect related to SOX, passed in 2002, we re-run the Table 2 regressions with the

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[27] We use Fama and French 12 industry for our fixed effects.
[28] It is possible that the increase in the frequency of CLs over the sample period is at least partially the result of the SEC ramping up staff/resources to accommodate the new requirements of SOX Section 408. Thus, following Heese et al, (2017), we include SEC office-year fixed effects. Unfortunately, when included, the sample size decreases as some office-years are perfectly co-linear with the dependent variable.

pre-disclosure period split into two sub-periods: (1) Pre-Sox (January 1, 1997, to July 31, 2002) and (2) post-SOX but pre-disclosure (August 1, 2002, through July 31, 2004). Table 3 follows the format of Table 2, except for the additional split around SOX: column 1 Pre-Sox; column 2 post-SOX but pre-disclosure; and columns 3 and 4, the combined regression using only the *post-SOX* but pre-disclosure years (column 2) as our *pre* sample. Importantly, the coefficient on the interaction term *CL*Post* is positive and significant in both columns 3 and 4 (with the year and office-year fixed effects, respectively), suggesting the increased alignment in the post-disclosure period is not driven by the SOX effect.

Moreover, the sub-period analysis is instructive about the time-series changes in the relationship between lawsuits and CLs. Specifically, the coefficient estimate on *CL* in the post-SOX period is comparable to that in the pre-SOX period (confirmed by the Chi-square test in Panel B of Table 3, which fails to reject the null). In contrast, when comparing the coefficient estimate on *CL* in the post-SOX, pre-disclosure period (column 2 of Table 3, 0.253) to that in the post-disclosure period (column 2 of Table 2, 0.564), the coefficient is significantly higher in the post-disclosure period (Chi-square is 4.97, untabulated statistic). These results are consistent with the pooled regression results in columns 3 and 4, Table 3. Thus, while SOX could be responsible for the increase in the number of CLs post-2002, the increased *alignment* between CLs and securities class actions is unlikely driven by SOX. Instead, the increase in the parallel actions takes place only after the public disclosure of the CL correspondence.

4.2.Changes in SEC's Behavior: Incentive Alignment

Our evidence indicates an increased alignment in the enforcement targets of the SEC and private securities litigants post 2004. We explore two reasons for the increased alignment, i.e., SEC's improved incentives and private litigants' enhanced information access. In this section,

we focus on the SEC's behavior changes. With the increased transparency of its filing review process, we expect the SEC to become more vigilant in its enforcement activities and less captured by special interests in the post-disclosure period. Specifically, we test whether the SEC is more likely to issue comment letters to firms that eventually restate their accounts and firms with large PAC contributions in the post-2004 period.

We use the following logit regressions to study the likelihood that the SEC issues comment letters to firms with questionable accounting practices:

$$Prob(Comment\ Letter) = f\ (Rstmt, Post, Rstmt * Post, controls)$$

The dependent variable, *Comment Letter*, equals one if the firm-year received a comment letter on its 10-K from the SEC, and zero otherwise. *Rstmt* equals one if the firm's current or prior year's financials are eventually restated. Note a restated year refers to a wrongdoing year and not the year of the public announcement of the restatement. Existing evidence indicates that it takes one to three years for firms to announce prior earnings management (see, e.g., Dechow, Sloan, and Sweeney 1996). In our restatement sample, the average lag from the end of the wrongdoing period to the restatement announcement date is almost two years (699 days). Thus, issuing a comment letter in the year after or the year of the financial misreporting effectively requires the SEC to spot these misstatements and raise concerns before the accounting irregularity is publicly announced. Another possibility is that the SEC CL process triggered the restatements, in which case the SEC's oversight role is even more salient. If, in the post-2004 period, the SEC is more likely to issue comment letters to firms that eventually restate their financial statements, we expect the coefficient on *Rstmt*Post* to be positive.

Table 4 presents the regression results for the above model. We first present the regression results separately for the pre and post-disclosure period (columns 1 and 2) and then

present the pooled regression results (columns 3 and 4) with the interaction term, *Rstmt * Post*

added. Columns 3 and 4 only differ in the fixed-effect structure (year fixed versus SEC office-

year fixed effects). In the pre-2004 period, the likelihood of an SEC comment letter is not related

to a firm's impending restatements. In contrast, in the post-2004 period, an SEC comment letter

is positively and significantly related to restatements. The chi-square test (reported in Panel B)

comparing columns 1 and 2 rejects the equivalence of the two coefficient estimates on *CL*.

Moreover, the coefficients on *Rstmt * Post* in columns 3 and 4 are positive and significant,

indicating that the SEC steps-up its oversight of firms with questionable accounting practices

after the public disclosure of its comment letters.[29] For economic interpretation, we compute the

marginal effects (untabulated) of the interaction term, *Rstmt * Post*, in column (3). Setting all

other variables at means, the change of *Rstmt * Post* from 0 to 1 corresponds to an increase in the

likelihood of receiving a comment letter by 12.9%.[30]

To ensure that SOX Section 408 (b1) is not driving our results, we re-estimate the above

regressions with the pre-disclosure period split into two sub-sample periods: (1) pre-SOX

(column 1) and (2) post-SOX (column 2). The results are presented in Table 5. The coefficient

on *Rsmt* is insignificant in both pre-disclosure periods. The Chi-square test in Panel B confirms

that the two coefficients are not significantly different from each other. We then run pooled

regression using only the *post-SOX* years as our pre-disclosure sample (columns 3 and 4). The

coefficient on the interaction term *Rstmt*Post* is positive and significant in both columns 3 and

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[29]Here, we implicitly assume that the SEC CL is issued *before* a firm announces the relevant restatement, which is reasonable given the typical time lag between a wrongdoing year and the eventual restatement. To solidify our inference, we conduct an alternative analysis using only the subsample of restatement firms. We find that for firms that eventually restate their statement, the SEC is indeed more likely to issue a CL before the restatement announcement in the post-2004 period, compared to the pre period, confirming our inference in both Table 4 and Table 5 (when we define the pre-disclosure period to include only the post SOX years).

[30] The increased likelihood (of 12.9%) is calculated by setting all other variables to their mean values and changing the interactive variable, *Restate * Post*, from 0 to 1.

4. Thus, even though Section 408 (b1) highlights restatements as a criterion for SEC reviews, it did not lead to more CLs being issued to restating firms; instead, such an increase occurred only after the SEC changed its disclosure policy.[31]

Next, we investigate whether the SEC is less prone to political capture in the post-disclosure period. Specifically, we estimate the following model to investigate the relation between PAC money and SEC comment letters.

$$Prob(Comment\ Letter) = f\ (PAC, Post, PAC * Post, controls)$$

PAC is the natural log of the dollar amount of a firm's PAC contribution during the fiscal year.

As shown in Table 6, in the pre-2004 period, SEC comment letters are significantly *negatively* associated with the PAC amount (column 1). In contrast, post-2004, the relationship is reversed, as the *PAC* coefficient becomes positive and significant (column 2), consistent with the findings in Heese et al., (2017). The Chi-square test (in Panel B) rejects the equivalence of the *PAC* coefficients across the pre and post periods. Moreover, the coefficients on *PAC * Post* are positive and significant in columns 3 and 4. Thus, our findings reconcile existing evidence in Correia (2014) and Heese et al. (2017). While the SEC was likely captured when its actions were opaque to the public, it appears no longer captured after the increased transparency of its filing review process.

Table 7 repeats the above analyses with the pre-disclosure period split into two sub-sample periods: pre-SOX (column 1) and post-SOX (column 2). The *PAC* coefficient is negative in both pre-disclosure sub-periods, and significant in column 2. The chi-square test reported in

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[31] Our findings do not suggest that the SEC failed to comply with SOX Section 408 (b1), as we are not able to observe SEC filing reviews that did not result in comment letters. It is possible that the frequency of SEC filing reviews increased for restatement firms in the post-SOX period. Our findings merely suggest that whatever the increase in the reviews post-SOX, these filing reviews did not increase the likelihood of comment letter being issued to restating firms until after the 2004 change in the disclosure policy.

Panel B indicates that the *PAC* coefficient in column 1 is insignificantly different from that in column 2. Columns 3 and 4 pool the pre-disclosure but *post-SOX* years and post-disclosure years in one regression and include the interaction term, *PAC*Post*. The coefficient on the interaction is positive and significant, suggesting that the tendency to cater to political interests tapers off significantly in the post-disclosure period, compared to pre-disclosure (but post-SOX) period.

4.3.Accessibility to SEC Comment Letters and Litigation Outcomes: Information Alignment

The above analysis suggests that the SEC's incentives have changed due to the increased regulatory transparency of its oversight activities. Another potential reason for the alignment between public and private enforcement is improved information access by shareholder litigants (information alignment). Since CL correspondence sheds light on misrepresentations and omissions in corporate filings, access to such information likely helps private shareholder litigants identify "higher quality" lawsuits, reducing nuisance lawsuits. We conjecture that private litigations with access to comment letters are better able to target lawsuits with "merit."

To draw inference on the effect of litigants' improved *information* access, we need to hold the regulators' incentives constant. Thus, we restrict the following analysis to the post-disclosure period. To hold firm characteristics constant, we further restrict the sample to only those firms facing class-action lawsuits that also received CL from the SEC. Our identification strategy is to exploit the time lag between the SEC comment letter issuance and dissemination, average around 76 days after a comment letter process is closed in our sample.[32] The SEC does not release comment letters in real-time. Thus, private parties are unaware of any ongoing reviews until the SEC publicly disseminates the relevant comment letter correspondence. The

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[32] This is another reason we have to restrict the sample to the post-2004 period: dissemination dates are only available for comment letters issued in the post-disclosure period.

unit of analysis is the individual class-action lawsuit; each lawsuit must have an associated comment letter, so we can compare the lawsuit's filing and CL's dissemination dates. These requirements result in a sample of 382 individual lawsuits with comment letters in the post-disclosure period.

We use the following two regressions to investigate whether litigants' access to SEC comment letters before filing a lawsuit is associated with two observable outcomes: whether the lawsuit is dismissed (not certified) and the settlement amount. If the improved information access helps private litigants target cases with more merit, then we would expect to find that these cases are less likely to be dismissed and will result in larger settlement amounts:

$$Logit(Dismissed) = f\ (AccessBFLawsuit,\ controls)$$

$$Tobit(log(Settlement\ amoun\$ + 1)) = f\ (AccessBFlawsuit, controls)$$

As noted above, we have 382 lawsuits with comment letters in the post-2004 period for the logit regression. For the Tobit regression, the lawsuit must be settled, reducing our sample size further to 136 settled lawsuits. Our variable of interest are *AccessBFLawsuit*, which equals one if the dissemination date of comment letter in the post-2004 period was before the filing date of lawsuits, and 0 otherwise.

We present the findings in Table 8. Once again, the regressions are estimated with year and industry fixed effects.[33] We find that lawsuits filed *after* the dissemination of the SEC comment letters are less likely to be dismissed (column 1). That is, lawsuits informed by the information revealed in SEC comment letter correspondence are more likely to move forward in the legal proceedings and thus appear to have more "merit." In addition, the settlement amounts

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[33] For these tests, our sample size is insufficient to estimate the regressions with SEC-office year fixed effects.

are higher for the cases filed with access to the SEC comment letters (column 2). The evidence

suggests that improved information access helps private enforcement parties target cases with

more merit, resulting in few nuisance lawsuits.

5. Additional Analyses

5.1. Alignment of Private and Public Enforcement - Timing

Having demonstrated greater alignment in the *targets* of enforcement, we next examine

whether private and public enforcement activities have greater alignment in *timing* post-2004. In

particular, we explore whether one party's enforcement action precipitates an enforcement action

by the other. If so, we expect the time lag between public and private enforcement to decrease in

the post-disclosure period, relative to the pre-disclosure period.

We condition our sample to those firms that are subject to both private and public actions.

Our unit of analysis is the individual class-action lawsuit. We compare the 382 lawsuits with CLs

filed after the disclosure policy change to the 253 lawsuits with CLs filed before the 2004 policy

change.[34] Specifically, we estimate the following Tobit regressions to study whether the filing

lag between the private and public enforcement actions changed from the pre to the post-2004

period:

$$Tobit(Log\_AbsFilingLag)) = f \ (Post, controls)$$

where the *Log_AbsFilingLag* is the natural log of the number of days between the two

enforcement actions (the *issuance*, not dissemination, of an SEC comment letter and the filing of

a class-action lawsuit). We present the results in Table 9. Note that the regression analysis

includes all class-action lawsuit observations with SEC comment letters. Consistent with

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[34] Employing unique lawsuits as the level of observation, a comparison of the frequency of lawsuits with CLs increases significantly from the pre to the post-disclosure period. Specifically, 253 out of 823 unique lawsuits or 30.7% have at least one CL pre 2004 versus 382 out of 592 unique lawsuits or 64.5% post-2004 (Chi-square = 159).

expectation, the coefficient on *Post* is negative and significant, suggesting the time lag between the public and private actions has decreased post-disclosure.

5.2. Falsification test

So far, we document an increase in the alignment between public and private enforcement following the 2004 policy change that resulted in public disclosure of SEC comment letters. One concern is that the increased alignment between the two enforcement mechanisms is due to other factors, such as broader shifts within the SEC that altered the regulator's resources and incentives. Including SEC office-year fixed effects partially addresses this concern. To further solidify our inference that the increased alignment is attributable to the *disclosure* of SEC comment letters, we conduct a falsification test. We reexamine the alignment between private and public enforcers but replace the issuance of comment letters with SEC investigations. SEC investigations are not publicly disclosed by the SEC, unlike SEC comment letters that experienced a shift in the disclosure policy. Given the lack of transparency regarding SEC investigations throughout, we would *not* expect to observe increased alignment between private shareholder litigation and SEC investigations. Since the SEC does not publicly disclose which companies it is or has investigated, we acquired the SEC investigations data through the FOIA. The dataset covers the period 1993 to 2018. The SEC provided a unique identifier for each investigation, the name of the targeted company, and the start and end dates of the investigation. The content of an investigation, however, is not available.

Our falsification tests are presented in Table 10. We first present the relationship for the pre and post periods separately (columns 1 and 2), and then we run a pooled regression with the interaction term, *Investigation*Post* (columns 3 and 4). Findings consistently demonstrate no change in the association between SEC investigations and private lawsuits from the pre to the

post-2004 period. The coefficients on *Investigation*Post* in columns 3 and 4 are not statistically significant at the 5% level; the Chi-square test in Panels B fails to reject the equivalence of the coefficients on *CL* in columns 1 and 2. Thus, the overlap between private litigation and another form of public enforcement, SEC investigations, did not change significantly in the post-2004 period. The evidence suggests that increased alignment between shareholder litigation and SEC comment letters is attributable to SEC comment letter disclosure.

6. Conclusion

We find that enhanced regulatory transparency facilitates the alignment between private and public enforcement actions. We study the interaction between a public enforcement entity (the SEC) and a private enforcer mechanism (private securities litigation) before and after a regulatory change that resulted in the SEC publicly disclosing its comment letter correspondence with issuers. We find that after the public disclosure of comment letters, the SEC and the private litigants achieved greater alignment in their respective enforcement targets. Firms that received SEC comment letters are also more likely to be targets of private securities litigation compared to the pre-disclosure period. Importantly, our empirical work indicates that this increase in the overlap between CL and class actions is not driven by the SOX Section 408, which requires that the SEC review issuers' filings at least once every three years. Instead, only after the SEC changed its disclosure policy in August 2004 did the overlap increased significantly.

We hypothesize and find that the increased alignment between public and private enforcement is attributable to two effects. First, the increased visibility of the SEC's actions enhances the SEC's incentives and reduces regulatory capture. We find that the SEC is more likely to issue a comment letter to firms with questionable accounting practices, i.e., firms that eventually must restate their financial reports. This finding suggests that the SEC increased its

oversight in the post-disclosure period. We also find that firms making higher PAC contributions in the post-disclosure period are more likely to receive SEC comment letters, consistent with Heese et al. (2017). This evidence is in sharp contrast to the SEC's behavior in the pre-disclosure period, when the SEC was less likely to issue comment letters to firms with high PAC contributions. Collectively, the results suggest that the SEC stepped up its enforcement efforts and became less sensitive to political pressure once its review process became more observable to the public. These findings should be of interest to regulators, including Congress (the regulator of regulators), as they suggest that greater transparency of regulators' oversight activities leads to greater regulatory effectiveness and independence.

Second, public disclosure of SEC comment letters enhances private litigants' access to information, which in turn helps litigants identify and pursue high-quality cases, limiting nuisance cases. We show that when plaintiffs have access to the comment letter correspondence before they file their cases, the lawsuits have greater merit as the dismissal rate is lower for these cases than for lawsuits filed without access to the relevant SEC correspondence. Moreover, settlement amounts are also larger for lawsuits filed with the knowledge of SEC comment letters. Overall, we contribute to the broad academic debate on the effectiveness of various enforcement actions by providing evidence that enhanced regulatory transparency facilitates greater alignment of public and private enforcement actions, via improved incentives and enhanced information access.

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Appendix: Variable Definition

Variable Name	Definition
Post	An indicator variable equal to 1 if the time period is on and after August 1st, 2004 and before June 30th 2015, and 0 if the time period is between January 1st, 1997 and July 31st, 2004.
CL	An indicator variable equal to 1 if the 10-K filing in year t received a comment letter, and 0 otherwise.
PAC	Natural log of annual PAC contributions plus one. The data is from Center for Responsive Politics (https://www.opensecrets.org/).
Rstmt (t or t-1)	An indicator variable equal to 1 if the current or prior firm-year is eventually restated, and 0 otherwise. Restatement information is from GAO restatement data base and Audit Analytics.
High_volatility	An indicator variable equal to 1 if a firm's stock volatility ranks top 10% in its industry-year, and 0 otherwise.
Size	Natural log of total market capitalization.
M2B	Market to book ratio is calculated as total market capitalization divided by book value.
Age	Firm age is the number of annual observations in Compustat through year t.
Loss	An indicator variable equal to 1 if earnings before extraordinary items is negative in a given year, and 0 otherwise.
Altman	Altman z score is calculated based on Altman (1968) and Defond and Hung (2003) and is equal to 1.2*[net working capital (ACT-LCT)/total assets (AT)] + 1.4*[retained earnings (RE)/total assets] + 3.3*[earnings before interest and taxes (PI - XINT)/total assets]+ 0.6*[market value of equity (CSHO*PRCC_F)/book value of liabilities (LT)]+ 1.0*[sales (SALE)/total assets].
Chg_Sales	Percentage change in sales revenue (REVT in Compustat) from year t-1 to year t.
Merger	An indicator variable equal to 1 for non-zero acquisitions or mergers as reported on a pre-tax basis (AQP) in Compustat in year t and 0 otherwise.
Restructure	An indicator variable equal to 1 for non-zero restructuring costs as reported in Compustat on a pre-tax basis (RCP) in year t and 0 otherwise.
Financing	The sum of equity financing and debt financing scaled by total assets, measured in t + 1, following Ettredge et al., (2011). Equity financing equals the sales of common and preferred stock (SSTK) minus the purchases of common and preferred stock (PRSTKC) minus dividends (DV). Debt financing equals long-term debt issued (DLTIS) minus long-term debt reduction (DLTR) minus the change in current debt (DLCCH).
Litigation_ind	An indicator variable equal to 1 if the company is in a highly litigious industry (four-digit SIC industry codes 2833–2836, 3570–3577, 3600–3674, 5200–5961, 7370–7374, or 8731-8734 following Francis et al., (1994) and Kim and Skinner (2012), and 0 otherwise.
Big4	An indicator variable equal to 1 if the auditor is a Big 4 audit firm, and 0 otherwise.
Tenure	Auditor tenure is the number of years during which the auditor has audited the company.
Returns	Market-adjusted 12-month stock return for year t-1.

Turnover	Natural log of trading volume accumulated over the 12-month period in year t-1 ending with the fiscal year-end scaled by beginning of year t-1 shares outstanding, plus one.
Skewness	Skewness of the firm's 12-month return for year t-1.
Amend	An indicator variable equal to 1 if the firm filed an amended annual filing, and 0 otherwise.
FilingGap	Natural log of the number of days between fiscal year end date and 10-K filing date plus one.
AccessBFLawsuit	An indicator variable equal to one if the dissemination date of comment letter in the post-2004 period was before the filing date of lawsuits, and 0 otherwise.
Log_AbsFilingLag	Natural log of the absolute value of the number of days between the first and second enforcement actions.
Investigate	An indicator variable equal to 1 if the firm-year was investigated by the SEC, and 0 otherwise.

Table 1: Descriptive Statistics

Panel A: Firm-year sample selection

	Pre-period			Post-period
	Pre-period before SOX Jan 1, 1997 - July 31, 2002	*Pre-period after SOX* Aug 1, 2002 - July 31, 2004	*Combined* January 1 1997 to July 30 2004	(August 1 2004 to June 30 2015)
Firm-years in final sample	18,911	6,356	25,267	28,625
Firm-years with CL (%)	1,696 (8.9%)	1,317 (20.7%)	3,013 (11.9%)	9,208 (32.2%)
Firm-years with lawsuits (%)	1,134 (5.9%)	487 (7.6%)	1,621 (6.4%)	1,509 (5.3%)
Firm-years with CL and lawsuits (%)	175 (0.9%)	145 (2.3%)	320 (1.2%)	704 (2.5%)

Panel B: The SEC's filing review process (SEC comment letters)

		Pre-period			Post-period
		Pre-period before SOX Jan 1, 1997 - July 31, 2002	*Pre-period after SOX* Aug 1, 2002 - July 31, 2004	*Combined* January 1 1997 to July 30 2004	(August 1 2004 to June 30 2015)
CL Review Period (in days)	N	1,696	1,317	3,013	9,208
	Mean	125	98	114	71
	Median	77	66	72	49
CL Filing Lag (in days)	Mean	162	128	148	149
	Median	153	111	133	135

*CL filing lag is defined as the number of days between 10K filing date and the first comment letter issued

Panel C: Summary statistics for control variables for the 53,892 firm years used in our sample period, January 1, 1997 to June 30, 2015.

	25%tile	Median	75%tile	Mean	SD
High_volatility	0	0	0	0.105	0.307
Size	4.156	5.736	7.240	5.766	2.137
M2B	1.217	2.022	3.542	3.272	4.255
Age	9	15	29	20.563	15.280
Loss	0	0	1	0.335	0.472
Altman	1.609	3.072	5.212	4.181	6.190
Chg_Sales	-0.028	0.077	0.223	0.172	0.527
Merger	0	0	0	0.102	0.302
Restructure	0	0	0	0.218	0.413
Financing	-0.049	-0.002	0.054	0.031	0.175
Litigation_ind	0	0	1	0.332	0.471
Big4	0	1	1	0.722	0.448
Tenure	4	7	13	9.523	7.944
Returns	-0.314	-0.056	0.235	0.044	0.608
Turnover	11.278	12.803	14.107	12.682	2.010
Skewness	-0.207	0.301	0.867	0.353	0.848
Rstmt (t or t-1)	0	0	0	0.103	0.305
Amend	0.000	0.000	0.000	0.089	0.284
FilingGap	4.143	4.344	4.500	4.345	0.303

Table 2: Alignment of Lawsuits and Comment Letters

Panel A reports the results of logistic regression Pr (*Lawsuit*) = f *(CL*Post, CL*, controls). *CL* is an indicator variable equal to 1 if the 10K filing in year t received a comment letter, and 0 otherwise. *Post* is an indicator variable equal to 1 if the time period is on and after August 1st, 2004 and before June 30th, 2015, and 0 otherwise. All other variables are defined in the Appendix. Column (1) uses the sample from pre-disclosure period; Column (2) uses the sample from post-disclosure period; Columns (3) and (4) include the pooled sample from pre- and post-periods with year fixed-effects and SEC office-year fixed effects, respectively. Continuous variables are winsorized at 1% and 99%. Robust standard errors are reported in the brackets. *, **, and *** denote significance at the 0.1, 0.05, and 0.01 levels, respectively.

Panel A:

	(1) Pre-period	(2) Post-period	(3) Pooled Yr FE	(4) Pooled Office-Yr FE
CL*Post			0.259***	0.258***
			[0.099]	[0.100]
CL	0.181**	0.564***	0.229***	0.228***
	[0.081]	[0.072]	[0.079]	[0.079]
High_volatility	0.195*	0.671***	0.474***	0.470***
	[0.108]	[0.104]	[0.074]	[0.074]
Size	0.026	-0.005	0.011	0.004
	[0.039]	[0.047]	[0.030]	[0.030]
M2B	-0.003	0.007	0.001	0.001
	[0.008]	[0.008]	[0.005]	[0.005]
Age	-0.008*	-0.013***	-0.010***	-0.012***
	[0.004]	[0.004]	[0.003]	[0.003]
Loss	-0.031	-0.022	-0.018	0.014
	[0.086]	[0.090]	[0.062]	[0.062]
Altman	0.001	0.039***	0.017***	0.019***
	[0.005]	[0.006]	[0.004]	[0.004]
Chg_Sales	0.206***	0.123***	0.170***	0.173***
	[0.038]	[0.046]	[0.030]	[0.030]
Merger	0.231	0.110	0.076	0.082
	[0.188]	[0.098]	[0.090]	[0.091]
Restructure	-0.003	-0.044	-0.046	-0.036
	[0.098]	[0.085]	[0.066]	[0.066]
Financing	0.686***	-0.219	0.268**	0.256**
	[0.160]	[0.195]	[0.128]	[0.129]
Litigation_ind	-0.253*	-0.276**	-0.241**	-0.225**
	[0.135]	[0.137]	[0.099]	[0.099]
Big4	-0.114	-0.283**	-0.250***	-0.205***
	[0.098]	[0.124]	[0.077]	[0.077]
Tenure	-0.019***	-0.012	-0.017***	-0.017***
	[0.007]	[0.008]	[0.005]	[0.006]
Returns	-0.133***	-0.500***	-0.260***	-0.261***
	[0.048]	[0.083]	[0.042]	[0.043]
Turnover	0.544***	0.592***	0.548***	0.575***
	[0.045]	[0.053]	[0.034]	[0.035]
Skewness	-0.257***	-0.322***	-0.304***	-0.300***
	[0.042]	[0.039]	[0.028]	[0.029]
Rstmt (t or t-1)	1.595***	0.684***	1.157***	1.171***
	[0.100]	[0.108]	[0.075]	[0.075]

Amend	0.154*	0.410***	0.277***	0.265***
	[0.087]	[0.092]	[0.064]	[0.065]
FilingGap	0.518***	1.522***	0.882***	0.897***
	[0.085]	[0.135]	[0.074]	[0.074]
Constant	-13.081***	-17.129***	-14.688***	-14.616***
	[0.649]	[0.857]	[0.569]	[0.911]
Observations	25,267	28,625	53,892	53,605
Industry FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	No
SEC Office-Year FE	No	No	No	Yes
Cluster by Firm	Yes	Yes	Yes	Yes
Pseudo R2	0.204	0.168	0.172	0.183

Panel B: Test *CL* coefficients in (1) and (2) in Panel A

Chi2(1)=13.46

P-value=<0.001

Table 3: Alignment of Lawsuits and Comment Letters - Controlling for SOX

Panel A reports the results of logistic regression Pr (*Lawsuit*) = f (*CL*Post*, *CL*, controls) by different time periods. *CL* is an indicator variable equal to 1 if the 10K filing in year t received a comment letter, and 0 otherwise. *Post* is an indicator variable equal to 1 if the time period is on and after August 1st, 2004 and before June 30th, 2015, and 0 otherwise. All other variables are defined in the Appendix. Column (1) includes 10-K filings between January 1, 1997 and July 31, 2002. Column (2) includes 10K filings between August 1, 2002 and July 31, 2004. In columns (3) and (4), we pool samples from the pre-disclosure, post SOX and post disclosure period in column (2) of Table 2, and include year fixed effects and SEC office-year fixed effects, respectively. Continuous variables are winsorized at 1% and 99% to mitigate outliers. Robust standard errors are reported in the brackets. *, **, and *** denote significance at the 0.1, 0.05, and 0.01 levels, respectively.

Panel A:

	(1)	(2)	(3)	(4)
	Pre-period		**Pooled:**	**Pooled:**
	Pre-SOX 1/1997-7/2002	**Post-SOX 8/2002-7/2004**	**Pre-period = Post-SOX**	**Pre-period = Post-SOX**
Post*CL			0.357***	0.356***
			[0.133]	[0.134]
CL	0.179*	0.253**	0.196	0.197
	[0.103]	[0.127]	[0.123]	[0.124]
High_volatility	-0.052	0.768***	0.683***	0.687***
	[0.128]	[0.196]	[0.092]	[0.092]
Size	0.026	-0.016	-0.010	-0.013
	[0.044]	[0.070]	[0.040]	[0.041]
M2B	-0.007	0.005	0.006	0.006
	[0.009]	[0.012]	[0.007]	[0.007]
Age	-0.007	-0.007	-0.011***	-0.012***
	[0.005]	[0.006]	[0.004]	[0.004]
Loss	-0.02	-0.16	-0.042	-0.023
	[0.100]	[0.155]	[0.078]	[0.078]
Altman	-0.001	0.017*	0.034***	0.035***
	[0.006]	[0.010]	[0.005]	[0.005]
Chg_Sales	0.214***	0.172*	0.125***	0.125***
	[0.044]	[0.089]	[0.042]	[0.042]
Merger	0.397*	0.065	0.100	0.114
	[0.218]	[0.278]	[0.094]	[0.095]
Restructure	0.013	0.025	-0.017	0.002
	[0.139]	[0.127]	[0.074]	[0.074]
Financing	0.730***	0.631*	-0.046	-0.064
	[0.182]	[0.331]	[0.176]	[0.176]
Litigation_ind	-0.382**	0.069	-0.180	-0.164
	[0.154]	[0.184]	[0.120]	[0.120]
Big4	-0.127	0.229	-0.228**	-0.199*
	[0.106]	[0.247]	[0.114]	[0.114]
Tenure	-0.026***	-0.010	-0.012*	-0.012*
	[0.009]	[0.010]	[0.007]	[0.007]
Returns	-0.083	-0.277***	-0.405***	-0.413***
	[0.054]	[0.093]	[0.064]	[0.065]

Turnover	0.563***	0.544***	0.575***	0.590***
	[0.051]	[0.067]	[0.044]	[0.044]
Skewness	-0.230***	-0.318***	-0.322***	-0.317***
	[0.049]	[0.076]	[0.035]	[0.035]
Rstmt (t or t-1)	1.711***	1.421***	0.866***	0.873***
	[0.119]	[0.139]	[0.092]	[0.092]
Amend	0.195*	0.001	0.311***	0.292***
	[0.105]	[0.156]	[0.082]	[0.083]
FilingGap	0.303***	1.902***	1.525***	1.555***
	[0.090]	[0.298]	[0.124]	[0.125]
Constant	-12.329***	-18.537***	-16.809***	-15.874***
	[0.716]	[1.533]	[0.762]	[0.871]
Observations	18,911	6,356	34,981	34,922
Industry FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	No
SEC Office-Year FE	No	No	No	Yes
Cluster by Firm	Yes	Yes	Yes	Yes
Pseudo R2	0.210	0.214	0.174	0.184

Panel B: Compare *CL* coefficients in (1) and (2)

Chi2(1) = 0.19
P-val=0.663

Table 4: Incentive Alignment: SEC Comment Letters and Restatements

Panel A reports the results of logistic regression Pr (CL) = f (*Rstmt*Post*, *Rstmt*, controls). *Rstmt* is an indicator variable equal to 1 if the current or prior firm-year (t or t-1) is eventually restated, and 0 otherwise. *Post* is an indicator variable equal to 1 if the time period is on and after August 1st, 2004 and before June 30th, 2015, and 0 otherwise. All other variables are defined in the Appendix. Column (1) uses the sample from pre-disclosure period; Column (2) uses the sample from post-disclosure period; Columns (3) and (4) include the pooled sample from pre- and post-periods with year fixed-effects and SEC office-year fixed effects, respectively. Continuous variables are winsorized at 1% and 99%. Robust standard errors are reported in the brackets. *, **, and *** denote significance at the 0.1, 0.05, and 0.01 levels, respectively.

Panel A:

	(1) Pre-period	(2) Post-period	(3) Pooled Yr FE	(4) Pooled Office-Yr FE
*Post*Rstmt*			0.144**	0.160**
			[0.077]	[0.079]
Rstmt	0.048	0.182***	0.039	0.026
	[0.069]	[0.039]	[0.067]	[0.069]
High_volatility	-0.015	-0.028	-0.012	-0.005
	[0.081]	[0.053]	[0.045]	[0.046]
Size	0.092***	0.196***	0.157***	0.166***
	[0.021]	[0.015]	[0.012]	[0.012]
M2B	-0.002	-0.004	-0.003	-0.002
	[0.005]	[0.003]	[0.003]	[0.003]
Age	0.002	-0.002	0.001	-0.001
	[0.002]	[0.001]	[0.001]	[0.001]
Loss	0.093*	0.064*	0.078***	0.086***
	[0.053]	[0.037]	[0.030]	[0.031]
Altman	-0.008**	0.000	-0.002	-0.002
	[0.004]	[0.002]	[0.002]	[0.002]
Chg_Sales	-0.068*	-0.001	-0.024	-0.018
	[0.039]	[0.031]	[0.024]	[0.024]
Merger	0.145	-0.019	-0.010	-0.008
	[0.117]	[0.037]	[0.035]	[0.036]
Restructure	-0.011	0.061**	0.034	0.037
	[0.060]	[0.030]	[0.027]	[0.027]
Financing	0.082	0.008	0.027	0.005
	[0.127]	[0.093]	[0.076]	[0.076]
Litigation_ind	-0.011	-0.034	-0.033	-0.029
	[0.062]	[0.039]	[0.034]	[0.032]
Big4	0.134**	0.001	0.056*	0.055*
	[0.052]	[0.037]	[0.030]	[0.030]
Tenure	0.001	-0.003	-0.002	-0.002
	[0.003]	[0.002]	[0.002]	[0.002]
Returns	-0.010	-0.030	-0.035	-0.039*
	[0.034]	[0.031]	[0.023]	[0.023]
Turnover	0.117***	0.031**	0.057***	0.053***
	[0.020]	[0.012]	[0.011]	[0.011]
Skewness	0.018	-0.031*	-0.011	-0.007
	[0.027]	[0.017]	[0.014]	[0.015]
Amend	1.071***	0.580***	0.814***	0.803***
	[0.055]	[0.050]	[0.038]	[0.039]
FilingGap	-0.673***	-0.259***	-0.429***	-0.443***

	[0.092]	[0.072]	[0.055]	[0.057]
Constant	-1.484***	-1.438***	-2.064***	-1.799***
	[0.470]	[0.380]	[0.306]	[0.496]
Observations	25,267	28,625	53,892	52,662
Industry FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	No
SEC Office-Year FE	No	No	No	Yes
Cluster by Firm	Yes	Yes	Yes	Yes
Pseudo R2	0.105	0.052	0.119	0.123

Panel B: Test *Rstmt* coefficients in (1) and (2) in Panel B

Chi2(1)=4.50

P-value=0.032

Table 5: Incentive Alignment: SEC Comment Letters and Restatements -Controlling for SOX

Panel A reports the results of logistic regression Pr(*CL*) = f (*Rstmt*Post*, *Rstmt*, controls). *Rstmt* is an indicator variable and equals 1 if the current or prior firm-year (t or t-1) is eventually restated, and 0 otherwise. *Post* is an indicator variable and equals 1 if the time period is on and after August 1st, 2004 and before June 30th, 2015, and 0 otherwise. All other variables are defined in the Appendix. Column (1) includes 10-K filings between January 1, 1997 and July 31, 2002. Column (2) includes 10K filings between August 1, 2002 and July 31, 2004. In columns (3) and (4), we pool samples from the pre-disclosure, post SOX and post disclosure period in column (2) of Table 4, and include year fixed effects and SEC office-year fixed effects, respectively. Continuous variables are winsorized at 1% and 99%. Robust standard errors are reported in the brackets. *, **, and *** denote significance at the 0.1, 0.05, and 0.01 levels, respectively.

Panel A:

	(1)	(2)	(3)	(4)
	Pre-period		**Pooled Pre-period= Post-SOX**	**Pooled Pre-period= Post-SOX**
	Pre-SOX 1/1997-7/2002	**Post-SOX 8/2002-7/2004**		
*Rstmt*Post*			0.243**	0.237**
			[0.096]	[0.097]
Rstmt	0.089	-0.023	-0.051	-0.046
	[0.099]	[0.095]	[0.088]	[0.089]
High_volatility	-0.104	0.161	0.015	0.015
	[0.102]	[0.134]	[0.050]	[0.050]
Size	0.083***	0.158***	0.190***	0.191***
	[0.027]	[0.038]	[0.014]	[0.014]
M2B	-0.004	0.002	-0.003	-0.003
	[0.006]	[0.009]	[0.003]	[0.003]
Age	0.003	-0.002	-0.002	-0.002
	[0.003]	[0.003]	[0.001]	[0.001]
Loss	0.204***	-0.012	0.05	0.054
	[0.068]	[0.088]	[0.034]	[0.034]
Altman	-0.011**	-0.008	-0.001	-0.001
	[0.005]	[0.007]	[0.002]	[0.002]
Chg_Sales	-0.049	-0.151*	-0.018	-0.02
	[0.043]	[0.085]	[0.029]	[0.029]
Merger	0.321*	0.073	-0.017	-0.014
	[0.179]	[0.168]	[0.036]	[0.036]
Restructure	0.075	-0.047	0.044	0.047*
	[0.104]	[0.077]	[0.028]	[0.028]
Financing	0.296**	-0.521**	-0.065	-0.071
	[0.147]	[0.251]	[0.086]	[0.087]
Litigation_ind	0.004	0.021	-0.029	-0.027
	[0.083]	[0.096]	[0.037]	[0.037]
Big4	0.089	0.116	0.001	0.006
	[0.061]	[0.113]	[0.035]	[0.035]
Tenure	0.001	0.004	-0.002	-0.002
	[0.005]	[0.005]	[0.002]	[0.002]
Returns	0.016	-0.005	-0.035	-0.033
	[0.043]	[0.056]	[0.027]	[0.027]
Turnover	0.108***	0.099***	0.041***	0.041***
	[0.028]	[0.032]	[0.012]	[0.012]
Skewness	0.041	-0.005	-0.027*	-0.026*

	(1)	(2)	(3)	(4)
	[0.035]	[0.045]	[0.016]	[0.016]
Amend	1.050***	1.141***	0.709***	0.710***
	[0.070]	[0.093]	[0.044]	[0.045]
FilingGap	-0.704***	-0.522***	-0.293***	-0.290***
	[0.110]	[0.179]	[0.067]	[0.067]
Constant	-1.221**	-0.884	-1.133***	-1.363***
	[0.567]	[0.890]	[0.351]	[0.499]
Observations	18,911	6,356	34,981	34,981
Industry FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	No
SEC Office-Year FE	No	No	No	Yes
Cluster by Firm	Yes	Yes	Yes	Yes
Pseudo R2	0.078	0.095	0.063	0.066

Panel B: Compare *Rstmt* coefficients in (1) and (2)

Chi2(1) = 0.70

P-val=0.404

Table 6: Incentive Alignment: SEC Comment Letters and PAC contributions

Panel A reports the results of logistic regression Pr (CL) = f (*PAC*Post*, *PAC,* controls). *PAC* is the natural log of annual PAC contributions in year t. *PAC* data is from Center for Responsive Politics (https://www.opensecrets.org/). *Post* is an indicator variable and equals 1 if the time period is on and after August 1st, 2004 and before June 30th, 2015, and 0 otherwise. All other variables are defined in the Appendix. Column (1) uses the sample from pre-disclosure period; Column (2) uses the sample from post-disclosure period; Columns (3) and (4) include the pooled sample from pre- and post-periods with year fixed-effects and SEC office-year fixed effects, respectively. . Continuous variables are winsorized at 1% and 99%. Robust standard errors are reported in the brackets. *, **, and *** denote significance at the 0.1, 0.05, and 0.01 levels, respectively.

Panel A:

	(1) Pre-period	(2) Post-period	(3) Pooled Yr FE	(4) Pooled Office-Yr FE
PAC*Post			0.028***	0.027***
			[0.006]	[0.007]
PAC	-0.023***	0.008**	-0.021***	-0.020***
	[0.007]	[0.004]	[0.006]	[0.006]
High_volatility	-0.003	-0.033	-0.010	-0.009
	[0.081]	[0.053]	[0.045]	[0.045]
Size	0.099***	0.193***	0.162***	0.164***
	[0.022]	[0.015]	[0.012]	[0.012]
M2B	-0.002	-0.004	-0.003	-0.003
	[0.005]	[0.003]	[0.003]	[0.003]
Age	0.130***	-0.069***	-0.006	-0.008
	[0.039]	[0.026]	[0.022]	[0.022]
Loss	0.105**	0.060	0.079***	0.085***
	[0.053]	[0.037]	[0.030]	[0.030]
Altman	-0.009**	0.001	-0.003	-0.002
	[0.004]	[0.002]	[0.002]	[0.002]
Chg_Sales	-0.06	-0.004	-0.025	-0.026
	[0.039]	[0.031]	[0.024]	[0.024]
Merger	0.149	-0.018	-0.011	-0.008
	[0.117]	[0.037]	[0.035]	[0.035]
Restructure	-0.014	0.063**	0.033	0.036
	[0.060]	[0.030]	[0.027]	[0.027]
Financing	0.086	0.002	0.028	0.021
	[0.127]	[0.093]	[0.076]	[0.076]
Litigation_ind	-0.015	-0.032	-0.033	-0.033
	[0.062]	[0.039]	[0.034]	[0.034]
Big4	0.131**	-0.003	0.046	0.048
	[0.052]	[0.037]	[0.030]	[0.030]
Tenure	-0.002	-0.002	-0.002	-0.002
	[0.003]	[0.002]	[0.002]	[0.002]
Returns	-0.014	-0.027	-0.037	-0.036
	[0.034]	[0.031]	[0.023]	[0.023]
Turnover	0.126***	0.027**	0.056***	0.056***
	[0.020]	[0.012]	[0.011]	[0.011]
Skewness	0.018	-0.031*	-0.013	-0.012
	[0.027]	[0.017]	[0.014]	[0.014]
Rstmt (t or t-1)	0.043	0.184***	0.144***	0.146***

	[0.069]	[0.039]	[0.034]	[0.034]
Amend	1.076***	0.578***	0.816***	0.816***
	[0.055]	[0.050]	[0.038]	[0.039]
FilingGap	-0.687***	-0.261***	-0.411***	-0.412***
	[0.092]	[0.072]	[0.055]	[0.056]
Constant	-1.831***	-1.210***	-2.123***	-1.848***
	[0.482]	[0.391]	[0.311]	[0.494]
Observations	25,267	28,625	53,892	53,848
Industry FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	No
SEC Office-Year FE	No	No	No	Yes
Cluster by Firm	Yes	Yes	Yes	Yes
Pseudo R2	0.106	0.052	0.119	0.122

Panel B: Test *PAC* coefficients in (1) and (2) in Panel A

Chi2(1)=13.90

P-value<0.001

Table 7: Incentive Alignment: SEC Comment Letters and PAC -Controlling for SOX

Panel A reports the results of logistic regression Pr (*CL*) = f (*PAC*Post*, *PAC*, controls). *PAC* is the natural log of annual PAC contributions in year t. PAC data is from Center for Responsive Politics (https://www.opensecrets.org/). *Post* is an indicator variable and equals 1 if the time period is on and after August 1st, 2004 and before June 30th, 2015, and 0 otherwise. All other variables are defined in the Appendix. Column (1) includes 10-K filings between January 1, 1997 and July 31, 2002. Column (2) includes 10K filings between August 1, 2002 and July 31, 2004. In columns (3) and (4), we pool samples from the pre-disclosure, post SOX and post disclosure period in column (2) of Table 6, and include year fixed effects and SEC office-year fixed effects, respectively. Continuous variables are winsorized at 1% and 99%. Robust standard errors are reported in the brackets. *, **, and *** denote significance at the 0.1, 0.05, and 0.01 levels, respectively.

Panel A:

	(1)	(2)	(3)	(4)
	Pre-period		**Pooled Pre-period= Post-SOX**	**Pooled Pre-period= Post-SOX**
	Pre-SOX 1/1997 - 7/2002	**Post-SOX 8/2002 -7/2004**		
PAC*Post			0.028***	0.028***
			[0.009]	[0.009]
PAC	-0.016	-0.026**	-0.022**	-0.022***
	[0.010]	[0.011]	[0.008]	[0.009]
High_volatility	-0.101	0.169	0.015	0.015
	[0.102]	[0.135]	[0.050]	[0.050]
Size	0.092***	0.175***	0.190***	0.191***
	[0.028]	[0.038]	[0.014]	[0.014]
M2B	-0.004	0.002	-0.003	-0.003
	[0.006]	[0.009]	[0.003]	[0.003]
Age	0.005*	-0.001	-0.002	-0.002
	[0.003]	[0.003]	[0.001]	[0.001]
Loss	0.209***	-0.007	0.049	0.053
	[0.068]	[0.088]	[0.034]	[0.034]
Altman	-0.011**	-0.010	-0.001	-0.001
	[0.005]	[0.007]	[0.002]	[0.002]
Chg_Sales	-0.052	-0.155*	-0.017	-0.019
	[0.043]	[0.086]	[0.029]	[0.029]
Merger	0.323*	0.079	-0.017	-0.014
	[0.178]	[0.168]	[0.036]	[0.036]
Restructure	0.071	-0.048	0.044	0.048*
	[0.104]	[0.077]	[0.028]	[0.028]
Financing	0.288*	-0.532**	-0.057	-0.063
	[0.148]	[0.251]	[0.086]	[0.087]
Litigation_ind	-0.001	0.01	-0.029	-0.027
	[0.083]	[0.096]	[0.037]	[0.037]
Big4	0.086	0.102	-0.002	0.002
	[0.061]	[0.113]	[0.035]	[0.035]
Tenure	0.001	0.004	-0.002	-0.002
	[0.005]	[0.005]	[0.002]	[0.002]
Returns	0.013	-0.007	-0.036	-0.035

	[0.043]	[0.057]	[0.027]	[0.027]
Turnover	0.111***	0.103***	0.041***	0.041***
	[0.028]	[0.032]	[0.012]	[0.012]
Skewness	0.041	-0.005	-0.028*	-0.027*
	[0.035]	[0.045]	[0.016]	[0.016]
Restate	0.087	-0.029	0.153***	0.154***
	[0.098]	[0.095]	[0.036]	[0.036]
Amend	1.053***	1.150***	0.708***	0.710***
	[0.070]	[0.093]	[0.044]	[0.045]
FilingGap	-0.710***	-0.557***	-0.279***	-0.277***
	[0.110]	[0.180]	[0.066]	[0.067]
Constant	-1.269**	-0.86	-1.195***	-1.419***
	[0.570]	[0.891]	[0.351]	[0.493]
Observations	18,911	6,356	34,981	34,981
Industry FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	No
SEC Office-Year FE	No	No	No	Yes
Cluster by Firm	Yes	Yes	Yes	Yes
Pseudo R2	0.078	0.096	0.063	0.066

Panel B: Compare *PAC* coefficients in (1) and (2)

Chi2(1) = 0.54

P-val=0.463

Table 8: Information Alignment: Accessibility to Comment Letters and Lawsuit Outcomes

Columns (1) presents the results for the logistic regression of Prob (*Dismissal*) = f (*AccessBFLawsuit*, Controls). *Dismissal* equals 1 if a lawsuit was eventually dismissed, and 0 otherwise. *AccessBFLawsuit* equals 1 if the dissemination date of a comment letter in the post 2004 period was before the filing date of a lawsuit. Columns (2) reports the results for the tobit regression of Tobit (*Log_settlement*) = f *(AccessBFLawsuit,* Controls). *Log_settlement* is the natural log of lawsuit settlement amount plus one. Observations are at lawsuit level. All other variables are defined in the Appendix. The sample includes the 382 lawsuits filed in the post-disclosure period that have at least one CL issued by the SEC during the class period. In column (2) only settled lawsuits are included. Continuous variables are winsorized at 1% and 99%. Robust standard errors are reported in the brackets. *, **, and *** denote significance at the 0.1, 0.05, and 0.01 levels, respectively.

	(1) logit(Dismiss=1)	(2) Tobit(Log_settlement)
AccessBFLawsuit	-0.788***	0.334*
	[0.249]	[0.173]
High_volatility	0.347	0.002
	[0.381]	[0.214]
Size	-0.038	0.444***
	[0.135]	[0.093]
M2B	0.077**	0.044*
	[0.030]	[0.023]
Age	-0.007	-0.011*
	[0.009]	[0.006]
Loss	-0.092	-0.101
	[0.325]	[0.205]
Altman	0.024	0.021
	[0.018]	[0.013]
Chg_Sales	-0.241	-0.023
	[0.292]	[0.129]
Merger	0.036	-0.065
	[0.323]	[0.280]
Financing	-0.469	-0.838*
	[0.719]	[0.427]
Litigation_ind	0.060	0.035
	[0.317]	[0.174]
Big4	0.912**	0.194
	[0.377]	[0.233]
Tenure	0.003	-0.008
	[0.016]	[0.014]
Returns	0.062	0.419***
	[0.247]	[0.120]
Turnover	0.153	0.079
	[0.145]	[0.068]
Skewness	0.116	0.006
	[0.150]	[0.104]
Rstmt (t or t-1)	-0.171	0.552***
	[0.307]	[0.177]
Amend	0.378	0.177
	[0.393]	[0.181]
FilingGap	-0.801	0.041
	[0.720]	[0.305]
Constant	-0.669	11.458***

	[3.966]	[1.725]
Observations	382	136
Industry FE	Yes	Yes
Year FE	Yes	Yes
Cluster by Firm	Yes	Yes
Pseudo R2	0.119	0.267

Table 9: Filing Lags

This table presents the results of the tobit regression of Tobit (*Log_AbsFilingLag*) = f (*Post*, *Controls*) using all lawsuits with comment letters. *Post* is an indicator variable and equals 1 if the time period is on and after August 1st, 2004 and before June 30th, 2015, and 0 otherwise. *Log_AbsFilingLag* is the natural log of the absolute value of the number of days between the first and second enforcement actions. Observations are at lawsuit level. All other variables are defined in the Appendix. The lawsuit sample includes the 382 lawsuits in the post-disclosure period with CLs and 253 lawsuits filed in the pre-disclosure period (January 1, 1997 and July 31, 2004) that also have at least one associated CL issued by the SEC during the class period. Continuous variables are winsorized at 1% and 99%. Robust standard errors are reported in the brackets. *, **, and *** denote significance at the 0.1, 0.05, and 0.01 levels, respectively.

Post	-0.208**
	[0.095]
High_volatility	0.122
	[0.112]
Size	-0.018
	[0.044]
M2B	-0.006
	[0.011]
Age	-0.002
	[0.003]
Loss	-0.004
	[0.106]
Altman	0.001
	[0.006]
Chg_Sales	-0.068
	[0.065]
Merger	-0.110
	[0.129]
Restructure	-0.064
	[0.100]
Financing	-0.316
	[0.232]
Litigation_ind	-0.069
	[0.119]
Big4	-0.117
	[0.108]
Tenure	-0.028
	[0.066]
Returns	0.034
	[0.059]
Turnover	0.066
	[0.044]
Skewness	-0.057
	[0.046]
Restate	0.181*
	[0.097]
Amend	-0.191*
	[0.111]
FilingGap	0.267**
	[0.108]

Constant	3.608***
	[0.740]

Observations	635
Industry FE	Yes
Year FE	No
Cluster by Firm	Yes
Pseudo R2	0.019

Table 10: Falsification Test -- SEC Investigations

Panel A reports the results of logistic regression Pr (*Lawsuit*) = f (*Investigate*Post*, *Investigate*, controls). *Investigate* is an indicator variable equals 1 if a firm in year t was investigated by the SEC, and 0 otherwise. All other variables are defined in the Appendix. Column (1) uses the sample from pre-disclosure period; Column (2) uses the sample from post-disclosure period; Columns (3) and (4) include the pooled sample from pre- and post-periods with year fixed-effects and SEC office-year fixed effects, respectively. Continuous variables are winsorized at 1% and 99%. Robust standard errors are reported in the brackets. *, **, and *** denote significance at the 0.1, 0.05, and 0.01 levels, respectively.

Panel A:

	(1) PrePeriod	(2) PostPeriod	(3) Pooled Yr FE	(4) Pooled Yr FE
Investigate*Post			-0.196 [0.153]	-0.230 [0.153]
Investigate	0.576*** [0.132]	0.424*** [0.098]	0.616*** [0.130]	0.656*** [0.129]
CL	0.181** [0.081]	0.562*** [0.073]	0.390*** [0.055]	0.390*** [0.056]
High_volatility	0.193* [0.107]	0.666*** [0.104]	0.471*** [0.074]	0.467*** [0.074]
Size	0.028 [0.039]	-0.016 [0.047]	0.009 [0.030]	0.002 [0.030]
M2B	-0.004 [0.008]	0.007 [0.008]	0.001 [0.005]	0.001 [0.005]
Age	-0.008** [0.004]	-0.013*** [0.004]	-0.011*** [0.003]	-0.012*** [0.003]
Loss	-0.035 [0.086]	-0.033 [0.090]	-0.029 [0.062]	0.004 [0.062]
Altman	0.001 [0.005]	0.040*** [0.006]	0.017*** [0.004]	0.020*** [0.004]
Chg_Sales	0.212*** [0.038]	0.128*** [0.046]	0.177*** [0.029]	0.181*** [0.030]
Merger	0.229 [0.186]	0.117 [0.098]	0.078 [0.090]	0.084 [0.091]
Restructure	-0.018 [0.098]	-0.054 [0.085]	-0.057 [0.066]	-0.049 [0.066]
Financing	0.716*** [0.161]	-0.188 [0.195]	0.295** [0.128]	0.282** [0.129]
Litigation_ind	-0.253* [0.134]	-0.290** [0.137]	-0.250** [0.099]	-0.235** [0.098]
Big4	-0.12 [0.098]	-0.278** [0.123]	-0.251*** [0.076]	-0.205*** [0.077]
Tenure	-0.019** [0.007]	-0.011 [0.008]	-0.016*** [0.005]	-0.016*** [0.005]
Returns	-0.130*** [0.048]	-0.488*** [0.083]	-0.256*** [0.042]	-0.256*** [0.043]
Turnover	0.530*** [0.044]	0.578*** [0.053]	0.533*** [0.034]	0.559*** [0.035]
Skewness	-0.251*** [0.042]	-0.325*** [0.039]	-0.303*** [0.028]	-0.298*** [0.028]
Rstmt (t or t-1)	1.571*** [0.100]	0.673*** [0.108]	1.141*** [0.075]	1.154*** [0.075]

Amend	0.159*	0.419***	0.273***	0.260***
	[0.087]	[0.093]	[0.064]	[0.064]
FilingGap	0.512***	1.487***	0.870***	0.886***
	[0.085]	[0.134]	[0.074]	[0.073]
Constant	-12.906***	-16.762***	-14.459***	-14.383***
	[0.648]	[0.856]	[0.569]	[0.912]
Observations	25,267	28,625	53,892	53,605
Industry FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	No
SEC Office-Year FE	No	No	No	Yes
Cluster by Firm	Yes	Yes	Yes	Yes
Pseudo R2	0.206	0.17	0.175	0.186

Panel B: Test *Investigate* coefficients in (1) and (2) in Panel A

Chi2(1)=0.93
P-value=0.335