

Hometown Bias in Auditing

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Abstract

- Investigates whether **audit partners exhibit hometown bias** and how it affects audit quality and financial reporting integrity, emphasizing the importance of maintaining objective and consistent auditing practices
- Data was collected on audit partners across the U.S., including Big 4 and Non-Big 4 firms across all 50 states. Information from truepeoplesearch.com was compiled into spreadsheets containing demographics, education, and professional affiliations
- Analyses examined relationships between auditors' hometowns and client outcomes, including earnings management, restatements, going concern opinions, and internal control weaknesses
- Firms audited by hometown partners are **more likely to just meet or slightly beat earnings forecasts**, with coefficients of 0.295–0.383 suggesting possible leniency; Negative restatement coefficients indicate these firms are less likely to later correct financial statements
- Going concern opinions show minimal effects, likely due to strong oversight, while internal control weakness results are mixed but stronger in Non-Big 4 firms, suggesting oversight limits bias
- Geographically, California (148) and New York (119) represent ~23% of the 1,160-firm sample, indicating concentration in major financial hubs; Overall, results show **hometown bias can influence earnings judgments and restatement likelihood**, highlighting the need for careful audit partner assignments and continued research on maintaining audit objectivity

Introduction

Existing Factors:

- Existing research displays that hometown bias is a phenomenon, an **individual tends to favor firms/people/ decisions that are connected to home/education**
- Studies have shown this bias amongst analyst and CEOs
- However, auditors must operate under strict ethical and professional standards that mandate objectivity and independence, which should limit bias

Shortcomings:

- Although hometown bias is noted in other professions, there is **little existing research on whether it exists among auditors**
- Current research places focus on interpersonal/social connections but doesn't effectively measure whether attachment to a place affects professional judgment
- In this study, a direct measure of whether auditors with a connection to the same state as their client exhibit leniency in reporting/weaker constraints

Purpose/Hypothesis: Determine whether auditors show more favorable behavior toward clients located in a state they are connected to and if this affects auditing. There are two main hypotheses:

- H1: No association exists between home-state auditors and leniency in audit reporting.
- H2: No association exists between home-state auditors and leniency in constraining opportunistic client reporting.

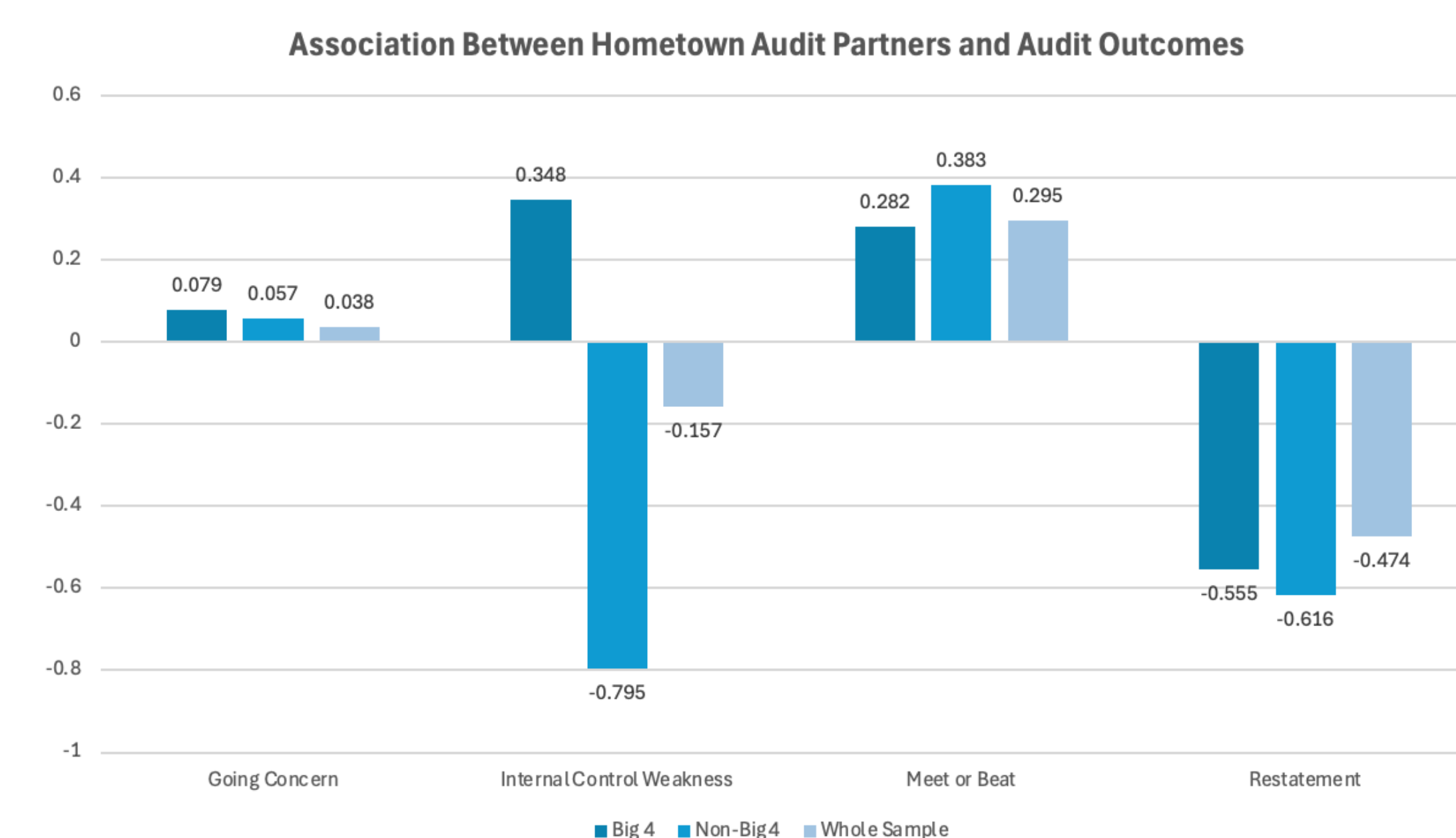
Ultimately, the goal of the study is to **clarify whether attachment to a place can have an impact** on professional judgment even in a regulated environment like auditing

Methods

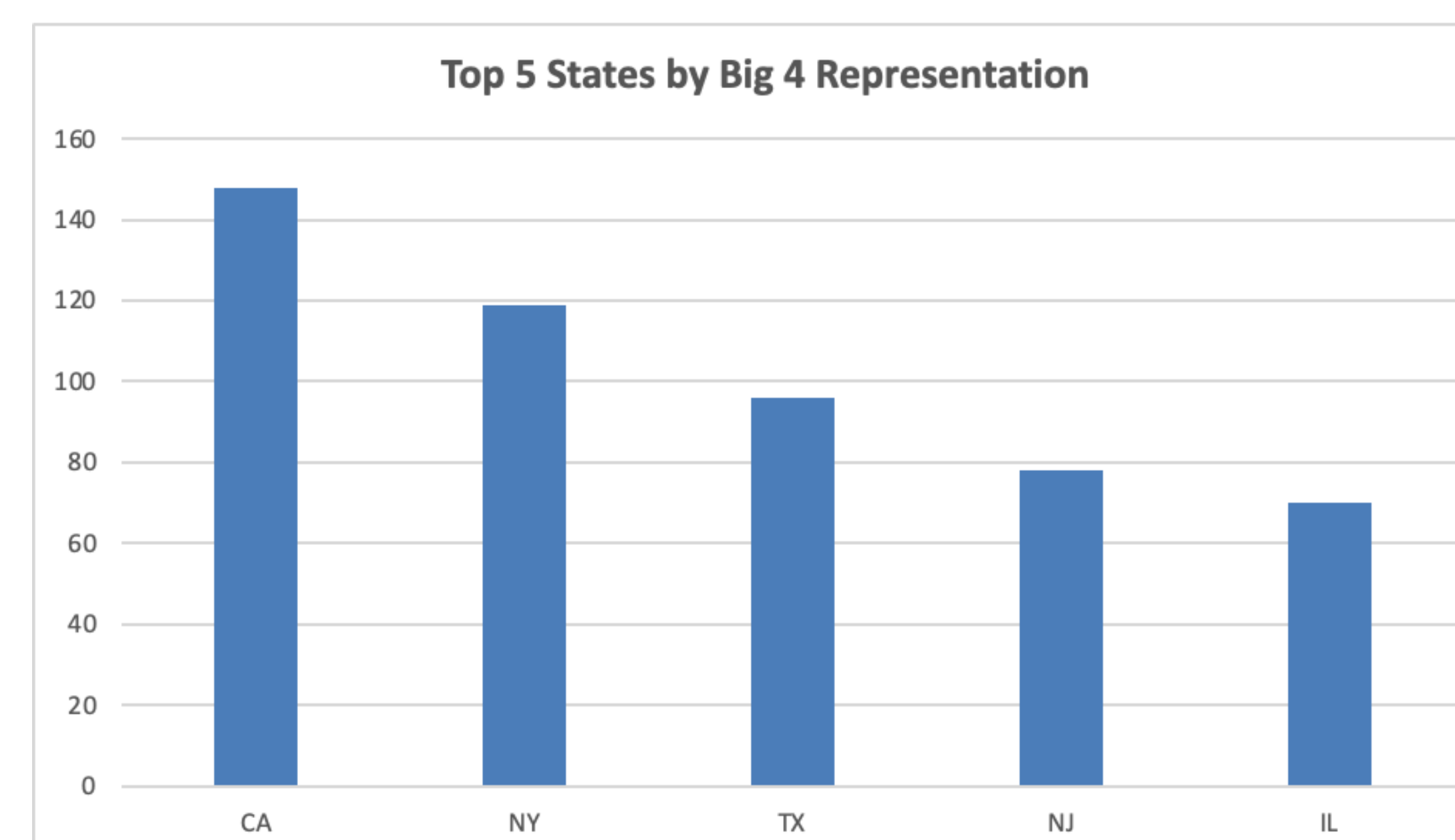
Research project focused on:

- The **careers and hometowns of accounting professionals**
- Collection process was done on TruepeopleSearch.com and provided researchers with:
- All the necessary background information on particular partners
- Data was logged and analyzed in Excel and analysis of factors was completed including:
- Age, Gender, Ethnicity
 - Education/Hometown**
- Researchers interested in the data on:
- Partners' hometowns (used website to determine partner's address during childhood)

Data Analysis



- Meet/Beat (MBE): The company reports earnings that **just meet or slightly beat** analysts' forecasts
- Restatement: The company later corrects its financial statements, showing reporting problems
- Going Concern: Auditor warns the company may not survive financially
- Internal Control Weakness (ICW): Auditor reports **problems in the company's internal controls**



The graph displays the **most common states of auditors** in Big 4 Accounting Firms

Results

- Positive coefficients for "Meet or Beat" (0.295–0.383) indicate that firms audited by hometown partners are more likely just to meet or slightly beat earnings forecasts, suggesting **potential leniency in earnings-related judgments**
- Conversely, negative coefficients for restatements (-0.474 to -0.616) imply that such firms are **less likely to later correct their financial statements**
- Coefficients for going concern opinions (-0.04–0.08) are near zero, showing no meaningful effect, likely due to the **high scrutiny** and oversight of these judgments.
- Results for internal control weaknesses are mixed, with stronger effects observed in Non-Big 4 firms, indicating that oversight structure may influence the extent of hometown bias
- Geographically, California (148) and New York (119) significantly outperform other states, together representing ~23% of the 1,160-firm sample. This highlights a strong clustering of Big 4 professionals in **major financial and business hubs**, suggesting that hometown effects may be most pronounced in these concentrated regions

Conclusion

- This research covers a broad range of audit partner backgrounds across all 50 states, with over 3,000 partners included, making the results widely applicable. The strengths include the **depth and diversity of the data and many resulting patterns**, which were identified and analyzed. The limitations of the research include the focus solely on auditing rather than other accounting practices, along with ongoing efforts to automate data collection, which will improve efficiency and lead to further expansion of the dataset
- Overall, the evidence points to a nuanced pattern: **hometown audit partners appear to allow softer judgments**—such as meeting earnings forecasts—while maintaining rigor in heavily monitored areas like going concern assessments. Restatement patterns suggest a modest protective effect, whereas internal control outcomes highlight differences between Big 4 and Non-Big 4 firms. These findings suggest that **hometown bias exists in areas with discretionary judgment but is constrained where regulatory and internal oversight is stronger**

References

