Internal Human Capital Allocations within Audit Firms: Evidence from Peer Office Growth

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Abstract

This paper examines internal human capital allocations across offices within the same audit firm and the resulting effects on audit quality. We find that the number of audit staff in a focal office is negatively related to the past growth of peer offices in the same audit firm, suggesting that audit firms shift human capital to offices with increased capacity constraints. This relation is more pronounced for peer offices located in areas with greater external labor market competition and when the focal office has low growth and small size. The result is robust to an instrumental variable design exploiting plausibly exogenous office growth due to clients engaging in mergers and acquisitions. Additional tests suggest that direct transfer of audit staff and allocation of recruiting capacity are the two channels through which the internal labor market is at play. This internal human capital shifting mitigates the negative effect of office growth on audit quality documented in prior literature.