Target Overvaluation in M&A:

Evidence from Valuation-Expert Auditors

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Abstract

Target overvaluation causes many M&A deals to destroy acquirers' value. While acquirers routinely hire external advisors to facilitate transactions, prior research suggests that these advisors generally do not improve M&A performance and may even contribute to target overvaluation. We predict that engagement auditors with valuation expertise have both the incentives and expertise to provide input that mitigates target overvaluation. Auditing standards require auditors to understand clients' major transactions and strategic plans, which can provide auditors with visibility of contemplated acquisitions and opportunities to provide input during the valuation process. Managers have incentives to incorporate this input because their valuations are subsequently subject to audit scrutiny. We test this prediction using Chinese data, which allow us to identify engagement auditors who are licensed Certified Public Valuers and thus possess valuation expertise. Consistent with our prediction, we find that firms with valuation-expert auditors receive higher M&A announcement-period returns. To address endogeneity, we identify two regulatory shocks that improve M&A returns for SOEs and smaller deals, with these improvements concentrated among firms with valuation-expert auditors. Corroborating evidence shows that firms with valuation-expert auditors pay lower takeover premiums, are less likely to report post-acquisition goodwill impairments, and exhibit stronger post-acquisition profitability. The benefits from valuation-expert auditors are stronger when clients lack in-house valuation expertise or M&A experience, when auditors have greater industry expertise or audit more economically important clients, and when targets are more difficult to value. In contrast to prior literature, we identify an outside M&A expert that mitigates target overvaluation and improves acquirers' M&A outcomes.

Keywords: mergers and acquisitions; M&A advisors; M&A performance; engagement auditor; valuation expertise

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1 Introduction

Mergers and acquisitions (M&A) activity equaled $4.5 trillion in 2025 globally, making it one of the largest forms of corporate investments, comparable in magnitude to capital expenditures and R&D (Levingston and Barnes 2025; Mauboussin and Callahan 2025). However, a large proportion of M&A deals destroy shareholder value due to target overvaluation (Moeller et al., 2005; Gu and Lev 2011; Hartford et al., 2012). Because M&A transactions are large and complex, acquirers usually hire external advisors who specialize in M&A, such as investment bankers and lawyers, to facilitate transactions. Prior research, however, finds that these advisors do not improve M&A performance and are even associated with target overvaluation, consistent with incentive misalignment between acquirers and these advisors. In contrast, engagement auditors with valuation expertise possess both the expertise and institutional incentives to provide input that mitigates target overvaluation. We therefore examine whether engagement auditors with valuation expertise improve M&A outcomes.

M&A advisors, such as lawyers and investment bankers, typically receive compensation contingent on deal size and successful completion, providing incentives to close deals despite target overvaluation (McLaughlin 1990, 1992). In contrast, engagement auditors are prohibited from charging fees contingent on deal outcomes (PCAOB Rule 3521, CICPA Code of Ethics No. 4). Further, in contrast to these other external M&A experts, engagement auditors have incentives to prevent their clients from overvaluing target companies. Overvaluation increases the likelihood that auditors will need to propose downward audit adjustments, such as goodwill impairments, during the post-acquisition audit of the consolidated financial statements.[1] These adjustments directly challenge management's valuation judgments, increasing the risk of

[1] This is consistent with the positive association between post-acquisition misstatements and target company overvaluation (Bens et al., 2011).

auditor-client disagreements and auditor dismissal.[2]

Auditing standards require auditors to obtain an understanding of clients' objectives, strategies and related business risks (PCAOB 2022, AS 2110), all of which can be affected by planned M&A activity. Complying with these standards therefore leads auditors to learn about material acquisitions that are under consideration or in process. A deep understanding of clients' M&A plans is particularly important in the auditor's assessment of a client's ability to continue as a going concern, because planned acquisitions can materially affect expected cash flows, financing needs and business risk (Bae et al. 2017).

Auditors obtain information about planned M&A activities during the normal course of the audit through a combination of formal procedures and ongoing interactions with management. These include meetings with senior management, review of board and committee minutes, and, in some cases, attendance at board or audit committee meetings where strategic initiatives are discussed. Auditors also engage in frequent informal conversations with management throughout the audit as part of their broader effort to understand the client's business objectives, strategies, and related risks. Together, these activities enable auditors to gain visibility of contemplated acquisitions, often before transactions are publicly announced or formally executed.

While engagement auditors in the U.S. are prohibited from providing advisory services to their clients, discussions with management about potentially material transactions and the application of accounting standards for complex transactions do not violate auditor independence requirements (PCAOB 2005).[3] Through their ongoing interactions with management, auditors are therefore able to share their perspectives on contemplated M&A transactions before the transactions are finalized. Managers have incentives to incorporate

[2] This is consistent with the increased risk of auditor dismissal following goodwill impairments (Ayres 2019).
[3] PCAOB (2005) states "The auditor's discussing and exchanging views with management does not in itself violate the independence principles... Investors benefit when auditors and management engage in dialogue, including... the appropriate accounting treatment for complex or unusual transactions."

auditor input because their valuation decisions will later be subject to audit scrutiny, which increases the expected cost of overly optimistic valuation assumptions. Managers also have incentives to incorporate auditor input because auditors are viewed as a valuable source of information given their experience across a portfolio of clients. As a result, auditor input can improve the quality of M&A-related decisions by reducing managers' information search costs.

Although auditors have both incentives and opportunities to help managers avoid overvaluing target companies, their success depends on the ability to provide input to help assess the target's underlying fair value. Auditors with valuation expertise have specialized skills in evaluating the target company's financials and integrating them into valuation models. Valuation expertise in M&A is especially important because target companies commonly use their information advantage over acquirers to overstate performance, inflating the acquisition price (Luypaert and Van Caneghem 2014; Chen et al., 2018). Auditors with valuation expertise should also be relatively better at assuring that their clients' internal controls over M&A are adequate, particularly controls over the accurate valuation of target companies. Accordingly, we hypothesize that valuation-expert auditors help mitigate target overvaluation, which is ultimately reflected in higher abnormal announcement-period stock returns.

Several arguments provide tension to our hypothesis. First, because the auditor's primary duties are to audit the financial statements, they may be constrained in the amount of effort devoted to providing input on valuing M&A targets. Second, acquirers may rely more heavily on input from other M&A advisors, whose primary specialty is M&A, than input from valuation-expert engagement auditors, whose primary specialty is auditing. Third, if managers engage in M&A activity to extract private benefits from shareholders through "empire building," (Jensen, 1986; Masulis et al., 2007; Jang and Yehuda, 2021; Gokkaya et al., 2023), they may not value input from external experts, including auditors with valuation expertise.

We use proprietary data from the Chinese Institute of Certified Public Accountants

(CICPA) to identify auditors who are licensed as Certified Public Valuers (CPVs). To qualify for CPV licensure, candidates must pass a rigorous two-day exam with an average pass rate of 11%. They are also required to have two years of work experience in valuation, and must complete 60 class-hours of continuing education each year. Following prior literature, we measure M&A performance as short-term abnormal returns around the acquisition announcement (Asquith et al., 1983; Kale et al., 2003; Cai et al., 2016; Wang et al., 2022). Our sample comprises all M&A deals by Chinese listed companies from 2008 to 2020, consisting of 5,154 firm-year observations for 2,051 unique acquirers.

Consistent with our prediction, we find that acquirers with valuation-expert engagement auditors experience significantly higher abnormal returns around the acquisition announcement date. The effect is also economically meaningful, with abnormal returns that are 0.625 percentage points higher than those without valuation-expert auditors. This equals a 49.5% increase over the unconditional sample mean return of 1.262% around acquisition announcements, representing 9.1 percent of the sample standard deviation of acquisition returns of 6.85%. This is equivalent to an increase of about US$15.78 million in shareholder value for the average acquirer with a market capitalization of US$2.51 billion. Thus, our results reflect economically significant increases in announcement-period returns. To ensure that valuation expertise does not simply capture general auditor ability, we control for auditors' industry expertise, a well-established proxy for auditor competence, and find that industry expertise is not associated with acquisition outcomes. We also perform a falsification test and find that auditors' tax expertise is unrelated to acquisition performance, suggesting that our results are specific to valuation expertise and not driven by auditors' general competence or competence unrelated to valuation.

Because valuation-expert auditors may be endogenously chosen by acquirers, we examine the effects of two regulatory shocks that are expected to exogenously improve M&A

performance for a subset of firms. The first shock streamlined the M&A decision-making process for SOEs in an effort to improve operating performance. We find that SOE acquisition returns increase following the new rule, as intended by the regulation, with the increase concentrated in companies with valuation-expert auditors. The second shock, which simplified the administrative approval and review process for small-deal acquisitions, increased acquisition returns for small-deal acquisitions, with the increase similarly concentrated in companies with valuation-expert auditors. These exogenous policy shocks mitigate endogenous selection issues, strengthening identification. We also show that the main effects are concentrated among longer-tenure auditors and those in place prior to the transaction year, consistent with auditors providing input to valuation decisions before deals are finalized and mitigating concerns about transaction-specific auditor selection.

To further improve identification, we also examine other M&A outcomes to corroborate our inference that valuation-expert auditors reduce target overvaluation. We find that valuation-expert auditors are associated with smaller takeover premiums. We further find that while takeover premiums are positively associated with future goodwill impairments, valuation-expert auditors attenuate this association, consistent with the reduction in takeover premiums resulting from overvaluation. We also find that clients of valuation-expert auditors have better post-acquisition performance as measured by operating profitability. Together, these additional analyses strengthen identification by triangulating the reduction in target overvaluation across alternative M&A outcomes.

We also examine cross-sectional variation in the association between valuation-expert auditors and acquisition returns. We find that this association is concentrated among clients who lack in-house valuation expertise or have less M&A experience. This suggests that our findings are not explained by clients with inherently better M&A abilities hiring auditors with valuation expertise, further strengthening identification. We also find that the association is

stronger for clients that are financially more important to the auditor, and when engagement auditors have industry expertise, consistent with auditors' incentives and competence enhancing the effects of valuation expertise on M&A performance. Finally, we find that the association is stronger when the target is more difficult to value, and when the acquirer and target are in different industries. Collectively, our cross-sectional tests suggest that the effects of valuation-expert auditors on acquisition returns vary predictably with acquirer and auditor characteristics, further alleviating concerns that unobservable acquirer, auditor, or deal characteristics explain our results.

Finally, we find that valuation-expert auditors who help their clients achieve better M&A outcomes are less likely to be dismissed and earn higher audit fees, providing incentives for valuation-expert auditors to help clients improve M&A performance. We also find that valuation-expert auditors have better career outcomes, as indicated by a lower likelihood of leaving the profession, and a higher likelihood of moving to a larger audit firm or being promoted to partner or manager. Collectively, these findings indicate that engagement auditors have incentives to obtain valuation-expert certification.

Our study contributes to the M&A literature by identifying engagement auditors as an external expert that improves M&A performance. This contrasts with prior literature, which generally finds that external experts have no effect on M&A outcomes (Bowers and Miller, 1990; Michel et al., 1991; Servaes and Zenner, 1996; Chang et al. 2016; Allen et al. 2004) and are frequently associated with target overvaluation (Rau 2000; Kisgen et al., 2009; Krishan and Masulis, 2013). Evidence that some external experts can improve M&A performance is only found in limited settings, when the expert has expertise in the target's industry, or when the expert is a top-tier investment banker and the target is publicly-held (Golubov et al., 2012; Wang et al., 2022). Given the incentives of these experts to close deals despite target overvaluation, it is not surprising they are often not associated with positive M&A outcomes.

In contrast, we find that valuation-expert engagement auditors, who have little incentive to close deals or increase deal size, but have incentives and expertise to help clients avoid overvaluing target companies, improve their clients' M&A performance.[4]

We contribute to the auditing literature by examining the engagement auditor's role in providing input that affects clients' M&A performance. This contrasts with prior studies, which primarily examine auditors' assurance role in providing high financial reporting quality (Xie et al. 2013; Kim et al. 2020; Gal-Or et al., 2022), and auditors' informational role in providing private and local information to acquirers (Bae et al., 2017; Cai et al., 2016; Dhaliwal et al. 2016; Louis 2005). In contrast, our findings highlight auditors' role in providing audit-related services and add to the growing literature on auditors' real effects on influencing clients' resource allocation decisions (e.g., DeFond, Qi, Si and Zhang 2025; Chy and Hope 2021; Bae et al. 2017).

We also extend the auditing literature by examining a previously unexplored dimension of auditor expertise. Early auditing research focuses almost exclusively on industry expertise, measured at the audit firm-level. Recent studies examine audit firms' expertise in auditing fair value measures, SOX 404, or multinational clients (Ahn et al., 2020; Anantharaman and Wans, 2019; Gunn and Michas, 2018), and engagement auditors' tax expertise (DeFond et al., 2025). We are the first to examine engagement auditors' valuation expertise and its effect on M&A outcomes.

2 Motivation and Hypothesis Development

2.1 Prior research on M&A experts

Mergers and acquisitions are significant corporate events that can result in substantial capital reallocation (Bonaime et al. 2018), cultivate synergies (Wang and Xie 2009), and affect

[4] While increasing deal size or closing overvalued deals may increase future audit fees, we expect the costs associated with overvaluation to exceed this potential benefit.

many stakeholders (Kim et al. 2020). Nevertheless, the M&A literature generally concludes that a large proportion of acquisitions destroy shareholder value, due to overvaluation of the target company (Moeller et al., 2005; Gu and Lev 2011).[5] Because M&A involves a significant commitment of resources and is highly complex, acquirers routinely seek advice from external advisors, such as investment bankers and lawyers. These experts typically have compensation contracts that increase with deal size and are contingent on deal completion (Rau, 2000). This provides strong incentives for these experts to facilitate deal completion, despite target overvaluations.[6]

Prior studies generally find that an acquirer's use of an external expert has either no effect on M&A performance, or a negative effect. External advisors that have no effect on M&A performance include investment bankers (Servaes and Zenner 1996); prestigious investment bankers (Bowers and Miller 1990; Michel, Shaked, and Lee 1991); investment bankers with expertise in the acquirer's industry (Chang, Shekhar, Tam, and Yao 2016); and commercial banks (Allen et al. 2004). External advisors that adversely affect M&A performance include investment banks with a high market share of the acquisition market (Rau 2000); investment bankers who provide third-party assessment of the fairness of M&A transactions (Kisgen et al. 2009); and leading law firms (Krishnan and Masulis, 2013).[7]

Two studies find evidence that some investment bankers are associated with higher M&A performance in somewhat limited settings. Golubov et al. (2012) find larger acquirer returns when the advisor is a top-tier investment banker, but only when the target is publicly-held.

[5] This is consistent with 47% of the acquisitions in our sample resulting in negative announcement-period returns for the acquirer.

[6] Investment bankers and legal advisors also have incentives to protect their professional reputations and maintain long-term client relationships, which can discourage them from facilitating acquisitions of overvalued targets (Krishnan and Masulis 2013; Golubov 2012; Rau 2000). However, we emphasize that their compensation structure, which is tied to deal completion and transaction size, can, at the margin, reduce their incentives to discourage acquisitions that may result in target overvaluation.

[7] The literature finds negative M&A performance as evidenced in Rau (2000) and Kisgen et al. (2009) by negative announcement-period returns, and in Krishnan and Masulis (2013) by higher takeover premiums.

Wang et al. (2022) find larger acquirer returns when the investment banker has more experience in the target company's industry.[8]

Evidence from Chinese data on the use of external advisors in M&A is limited to one study, which finds conflicting evidence. Wan et al. (2021) find that while investment bankers with better educational credentials improve M&A announcement returns, investment bankers with greater M&A experience have no effect on M&A announcement returns and they reduce subsequent stock returns for poorly governed firms.

In summary, prior studies generally find that external experts either do not improve M&A performance, or harm M&A performance, except in limited settings. We conjecture that this is because the experts examined in this literature benefit from deal closing, even when target companies are overvalued (McLaughlin 1990, 1992). In this study, we examine the effects of engagement auditors, whose professional responsibilities and incentives are more closely aligned with helping clients mitigate target overvaluation.

2.2 Prior research on auditors in M&A

Prior studies on auditors in M&A primarily examine their assurance role in providing high quality financial reporting, or informational role in providing private information to acquirers. This contrasts with our study, which examines the auditor's audit-related role in providing input to management's M&A valuations.

Research on auditors' assurance role finds that auditors provide higher quality monitoring during merger waves, playing a gatekeeping role in M&A (Carnes, 2025), and that acquirers whose auditors have greater office-level M&A experience are less likely to engage in M&A-related earnings management (Gal-Or et al., 2022).[9] In contrast to earnings quality, we examine

[8] While Bao and Edmans (2011) find an association between acquisition returns and investment-banker fixed effects, their findings simply indicate that there is variation across banks in their ability to either improve or impair acquisition returns, and they do not identify the characteristics that explain their results.

[9] Research also finds that target companies who engage Big-4 or PCAOB-inspected auditors have a higher likelihood of receiving M&A bids and are more likely to ultimately be acquired (Xie, Yi, and Zhang 2013; Kim, Su, Zhou, and Zhu 2020).

a real effect of auditors' audit-related role, mitigating target company overvaluation. Another major difference is that Gal-Or (2022) examines auditor *M&A expertise* at the office-level, inferred from M&A experience, while we examine auditor *valuation expertise* at the engagement auditor level, objectively measured using their Certified Public Valuation licensure.[10]

Research on auditors' informational role finds that a common auditor between the acquirer and the target reduces information asymmetry that results in superior M&A performance for acquirers (Cai, Kim, Park, and White 2016; Dhaliwal, Lamoreaux, Litov, and Neyland 2016). Louis (2005) also finds that when acquiring privately-held target companies, acquirers with non-Big N auditors experience better M&A outcomes than acquirers with Big N auditors, and conjectures this is because non-Big N auditors possess superior information about local business conditions. [11]

In contrast to existing research, we are the first to examine the audit-related role of auditors in providing input to management's M&A valuations. We find that better M&A outcomes are associated with a direct measure of the auditor's valuation expertise (i.e., Certified Public Valuation licensure). In addition, while prior research does not control for the endogenous choice of shared auditors or non-Big N auditors, we use exogenous policy shocks to help alleviate concerns about endogeneity.

2.3 Hypothesis

2.3.1 Auditors' role in M&A activity

Auditing standards require auditors to obtain an understanding of their clients' business objectives, strategies and related risks (AICPA 2023, AU-C Section 315; PCAOB 2022, AS

[10] We also note that only 5% of deals result in M&A-related misstatements (Gal-Or, 2022), while more than half of acquisitions are estimated to result in overvaluing the target company (Moeller et al., 2005). Thus, the outcome we examine is more prevalent than the outcome examined in Gal-Or (2022).

[11] In contrast to Louis (2005), untabulated analysis reported in Bae et al. (2017) find that Big N auditors are associated with higher M&A announcement returns. However, Bae et al. (2017) does not provide any details of its untabulated analysis, making it difficult to compare with other studies.

2110). Understanding the client's business objectives and strategies includes considering how the firm intends to grow or expand, including through M&A. In addition, since M&A transactions introduce significant business risk, auditors need to evaluate the impact of the planned M&A activity on estimation uncertainty and financial reporting risk. AS 12 requires auditors to inquire "whether the company has entered into any significant unusual transactions", where significant unusual transactions include those outside the normal course of business or unusual due to size or nature. A full understanding of planned M&A activity is particularly important for the evaluation of the client as a going concern, which requires an assessment of whether the firm is likely to continue as a viable entity based on its expected future performance (Bae et al. 2017; AU-C Section 570; PCAOB AS 2415). Because this evaluation involves assessing future cash flows and sources of uncertainty, it may require auditors to consider management's strategies, including planned acquisitions.

Auditors obtain information about planned M&A activity as a natural consequence of complying with auditing standards. Specifically, Auditing Standards require auditors to obtain management representations on "plans or intentions that may affect the carrying value or classification of assets or liabilities" and confirm "the company has no plans or intentions that may materially affect the carrying value or classification of assets and liabilities" (AS 2805). Auditors can obtain information about planned M&A through their routine information-gathering activities during the audit, including communications with senior management, the examination of board minutes, and participation in audit committee meetings (Dhaliwal et al., 2016). These interactions often occur prior to the completion of a transaction, allowing auditors to become aware of planned M&A activity before key valuation decisions are finalized.

2.3.2 Auditor–management interactions in M&A decisions

Auditors are in frequent contact with client management. While engagement auditors in the U.S. are prohibited from providing "advisory services" to management, the PCAOB states

that "auditors discussing and exchanging views with management does not in itself violate independence principles" (PCAOB 2005). Instead, the PCAOB asserts that "investors benefit when auditors and management engage in dialogue" regarding the "accounting treatment for complex transactions." The SEC further states that as long as management makes the final determination of the accounting used, auditor involvement is appropriate and not a violation of independence requirements (SEC 2005). The rules in China are generally similar, allowing auditors to exchange views with management as long as their independence is not compromised.[12] These permitted interactions provide auditors with opportunities to provide input on M&A activity before transactions are finalized.

Because management's valuation decisions will later be scrutinized during the year-end audit, managers have incentives to take auditors' input into account when making valuation decisions. Audit scrutiny increases the expected personal costs to managers of overly optimistic valuation assumptions, including a higher likelihood of forced CEO turnover following goodwill impairments (Cowan et al. 2023). In addition to this discipline, managers have incentives to incorporate auditor input because it can improve M&A-related decisions. Auditors are a potential source of valuable information for client management due to the knowledge and experience gained from their exposure to a wide variety of clients and business issues. Obtaining input from auditors lowers management's information search costs and can expand the information set they use to make informed decisions (Bae et al., 2017). This input can influence management's valuation assessments before the acquisition is completed, for example by helping ensure that key assumptions and projections regarding target companies are well supported.

[12] Similar to the U.S. framework, the Code of Ethics for Chinese Certified Public Accountants permits auditors to communicate with management and provide technical views on accounting matters as part of the audit process, provided that management makes the final accounting decisions (Articles 136–137). Further, auditors may provide professional opinions, technical advice, or other professional services to audit clients, provided that they ensure management makes all significant judgments and decisions and assumes responsibility (Articles 143).

2.3.3 Auditors' incentives and competence in helping clients avoid target overvaluation

Accurate valuation of the target company is critical to successful acquisitions and a fair purchase price largely depends on the acquirers' understanding and evaluation of the target's financial performance and operations (Field and Mkrtchyan 2017). The nature of M&A transactions subjects acquirers to significant information risk due to information asymmetry about the target's value and the expected future performance of the merged entity (Wangerin 2019). For example, target companies are expected to provide optimistically biased information before the offer price is set, in order to increase the acquisition price (Luypaert and Van Caneghem 2014; Chen et al. 2018).[13] This optimism could increase the tendency for acquirers to overestimate the target's value.

Auditors have strong incentives to discourage managers from overvaluing target companies because they must audit the post-acquisition financial statements. When a target is overvalued, auditors are required to propose write-downs, usually goodwill impairments, to correct overvalued assets. These write-downs reflect poorly on client management, increasing the likelihood of forced CEO turnover (Cowan et al. 2023), giving managers incentives to resist such adjustments. This resistance creates tension between auditors and managers, increasing the risk of auditor dismissal. Consistent with this, prior research finds that clients are more likely to switch auditors following unfavorable reporting outcomes, including goodwill impairments (e.g., DeFond, Zhang and Zhao 2024; Ayres et al. 2019). Taken together, these incentives motivate auditors to provide input that helps managers, *ex-ante*, avoid overvaluing target companies.[14]

Auditors' frequent interactions with management, management's demand for financial

[13] Anecdotal evidence shows that in 2012, HP wrote off $8.8 billion from its acquisition of UK technology company Autonomy (with $11.1 billion acquisition price), due to alleged accounting misrepresentations committed by senior Autonomy management.

[14] In terms of M&A valuation, the SEC does not prohibit audit firms from using their own valuation specialists to review the work done by the audit client, as long as the audit client (or a third-party specialist employed by the audit client) is the source of the financial information subject to review or audit (SEC, 2003)

expertise, and auditors' incentives to prevent target overvaluation, provide both the opportunity and motivation for auditors to provide input to management's valuation of target companies. However, not all auditors possess the specialized expertise required to improve target company valuation. We predict that auditors with expertise in appraising companies, proxied by licensure as a valuation expert, are more effective in providing input that helps their clients avoid overvaluing target companies.

Auditors with valuation expertise can also influence M&A outcomes indirectly through their role in evaluating firms' internal controls. Because M&A transactions expose companies to substantial risk and the potential for significant losses, auditors evaluate the design and implementation of internal controls governing M&A activities (Harp and Barnes 2018). This includes assessing management's valuation of target companies, including the projections, discount rates, and other key assumptions that directly determine the acquisition price. By strengthening these controls, auditors can improve the reliability of valuation inputs and reduce the likelihood of overvaluation, independent of whether they have information about any specific M&A transaction.

These arguments lead to the following hypothesis, in the alternative form:

Hypothesis. Acquirers with valuation-expert engagement auditors experience higher announcement-period stock returns.

Nonetheless, several arguments work against our prediction, adding tension to our hypothesis. First, engagement auditors are not explicitly contracted to advise management on acquisition decisions. Rather, their primary duty is to provide assurance regarding the fair presentation of the audited financials (Dye 1993; O'Reilly et al. 2006). Thus, auditors' input regarding M&A transactions may be limited. Second, acquiring firms may put more weight on advisers who are explicitly M&A experts, such as investment bankers (Kale et al. 2003;

Mattioli 2016).[15] Third, client-shareholder agency conflicts may lead managers to engage in acquisitions even when they result in overvaluing target companies. For example, entrenched managers who engage in "empire building" (Jensen 1986; Masulis et al. 2007; Jang and Yehuda 2021; Gokkaya et al. 2023) would likely ignore value-enhancing advice from auditors. Thus, the effect of auditors' valuation expertise on acquirers' acquisition performance is an empirical question.

3 Sample, Measures, and Descriptive Statistics

3.1 Sample

Our sample consists of M&A deals from the CSMAR database between Jan. 1, 2008, and Dec. 31, 2020 with available information. We require the acquirers to be A-share firms publicly listed on the Shanghai and Shenzhen stock exchanges and remove acquirers that are in financial services or have special treatment.[16] We exclude deals related to divestment, asset replacement, debt restructuring, and repurchase. If acquirers announce multiple deals in a given year, we retain only the first.[17] We limit our sample to firm-years with M&A and our final sample comprises 5,154 acquiring-firm-year observations for 2,051 unique acquirers.[18]

3.2 Measuring auditor valuation expertise

We identify signing auditors using the China Securities Market and Accounting Research database (CSMAR) and obtain auditors' demographic data from the Chinese Institute of Certified Public Accountants (CICPA). We use proprietary data from the CICPA to identify auditors who are Certified Public Valuers (CPVs). CPV licensure is overseen by the China Appraisal Society and is considered essential for professionals working in asset valuation.[19]

[15] China Securities Regulatory Commission (CSRC) requires acquirers to employ a financial advisor when the targets are public listed companies. See "July 31, 2006, Act of Merger and Acquisitions of Listed Companies, 35th CSRC Order".
[16] Chinese Securities laws label listed companies that report accounting losses for two consecutive years as special treatment (ST) firms. Further annual losses result in ST companies being suspended from trading or even delisted.
[17] Our main finding remains if we exclude acquisitions by firms with multiple M&A deals within three months.
[18] The exact number of observations used in the additional analyses varies depending on data availability.
[19] The *Asset Appraisal Law* permits only CPVs to practice asset valuation and requires CPVs to sign legally mandated appraisal reports, underscoring the qualification's central role in the valuation profession.

The requirements for certification include a rigorous two-day exam, two years of practical work experience in valuation, and the completion of 60 class hours of continuing education each year to maintain certification. In 2023, the pass rate of the CPV exam was 10.66%.[20] Audit reports in China have two signatory auditors, a junior engagement auditor primarily responsible for the fieldwork and a lead engagement auditor responsible for review. We define *VAL_EXP* as equal to one if either signatory auditor is a CPV, and zero otherwise.

The junior field auditor is typically more directly involved in the day-to-day execution of the audit, whereas the lead engagement auditor holds a more senior role with overall responsibility for overseeing the engagement. Importantly, the lead auditor's role extends beyond a purely ex post review of completed audit work. They also play a central role in audit planning and risk assessment, and have final authority over key audit judgments. Prior research in the China setting indicates that the lead engagement auditor is involved throughout the course of the audit engagement, including reviewing key working papers and accounting judgments, and providing guidance on complex or contentious issues (e.g., Lennox, Wang, and Wu 2020; Schneider, Church, and Ramsay 2003; Epps and Messier 2007; Chinese Institute of Certified Public Accountants (CICPA) 2006, 2010). In addition to this ongoing oversight, the lead engagement auditor performs a formal final review of the audit file and must approve significant judgments before signing the audit report, bearing joint legal responsibility for the opinion. This combination of senior oversight, continuous supervision, and final approval implies that lead auditors can influence key valuation-related judgments, such as fair value estimates, impairment assessments, and acquisition accounting, both through *ex-ante* guidance during the audit engagement process, and through *ex-post* evaluation. Accordingly, we expect valuation expertise at either the field or lead level to influence how auditors evaluate target valuations, motivating our measure of *VAL_EXP*.

[20] https://www.chinaacc.com/zichanpinggushi/fxzd/li20250115120831.shtml

In our sample, 15.7% of the acquirer-year observations have at least one signing auditor who is a CPV. Among the CPVs, 3.40% are from Big 4 audit firms, 43.88% from domestic Big 10 audit firms, and 52.72% from small domestic audit firms. The engagement auditor's mean (median) age when qualifying as a CPV is 32.91 (32) years, with a 25th and 75th percentile of 29 and 35 years, respectively.

3.3 Measuring M&A performance

Following prior literature, we measure acquisition performance using acquirers' abnormal stock returns around the M&A announcement date (Asquith et al. 1983; Kale et al. 2003; Cai and Sevilir 2012; Cai et al. 2016; Wang et al. 2022). We define *ACQ_CAR* as the market-adjusted cumulative abnormal returns of the acquirer over a three-day event window [-1, 1], centered on the announcement date. The market-model parameters are estimated over a 120 trading-day period, starting from 150 trading days prior to the announcement date, and we use the Shanghai and Shenzhen Stock Exchange value-weighted return as the market return. We first regress the daily returns of acquiring firms on the market returns over the estimation period, and then calculate the daily abnormal return over the event window as the actual return minus the predicted return from the market model. We then cumulate the daily abnormal returns over the three-day window to calculate *ACQ_CAR*.

3.4 Descriptive statistics and univariate analyses

Table 1, Panel A, presents the descriptive statistics for the regression variables. The mean and median values of *ACQ_CAR* are 1.262% and 0.277%, respectively, consistent with values found in other China M&A studies.[21] The mean value of *VAL_EXP* indicates that 15.7% of acquirer-years have auditors who are valuation-experts. Additionally, 5.7% of acquirer-years have Big 4 auditors (*BIG4*), and 54.1% have domestic Big 10 auditors (*LOCAL10*).

[21] For example, Li et al. (2018) report a mean (median) acquirers' CARs of 1.1% (0.4%) around M&A announcements during 2000 to 2012, and Song et al. (2023) report a mean (median) acquirers' CARs of 1.1% (0.2%) around M&A announcements during 2014 to 2021.

Approximately 34.1% of sample observations have related transactions with the target (*RELATED*), and 91.1% are paid in cash (*PAYTYPE*). Less than 1% of target firms (0.5%) are public (*PUB_TAR*). We also note that the statistics for our control variables are similar to those in extant literature (Wan et al. 2021; Chi et al. 2011; Black et al. 2015; Yang et al. 2019).

Table 1, Panel B presents a univariate test of our hypothesis. After partitioning on acquirer-firm-years with and without valuation-expert auditors, the mean three-day *ACQ_CAR* is 1.864% for clients with valuation-expert auditors, compared to 1.150% for clients without valuation-expert auditors. The difference (0.714%) is significant at the 1% level (p=0.0032), representing a 62% increase in return (0.714%/1.150%). Thus, the univariate test supports our hypothesis.

Table 1, Panel C shows the Pearson correlations for the variables of interest. The correlation between *VAL_EXP* and *ACQ_CAR* is 0.038 (p<0.05), providing further univariate support to our hypothesis. Consistent with prior studies, *ACQ_CAR* is also negatively correlated with *SIZE*, *ROE*, *BRDSIZE*, and *PAYTYPE*, positively correlated with *GROWTH*, *TOVER* and *RELATED* (Louis 2005; Chen et al. 2018).

4. Empirical Results

4.1 Auditors' valuation expertise and acquirers' acquisition returns

We use the following OLS model to test whether auditors' valuation expertise improves acquirers' acquisition returns.

$$ACQ\_CAR = \beta_0 + \beta_1 \times VAL\_EXP + \beta_c \times Controls + Year\ FE + ACQ\_Ind\ FE + Region\ FE + \varepsilon. \quad (1)$$

where *ACQ_CAR* is the three-day cumulative abnormal return over the window [-1, 1] around the acquisition announcement. The treatment variable, *VAL_EXP*, equals one when the acquirer's engagement auditor is a CPV, and zero otherwise. Our hypothesis predicts a positive coefficient on *VAL_EXP*.

Based on prior literature, we control for several acquirer and deal characteristics that are known to explain announcement-period abnormal returns. For acquirer characteristics, we

include size (*SIZE*), leverage (*LEV*), profitability (*ROE*), cash holding (*CASH*), operating risk (*BUSRISK*), and sales growth (*GROWTH*), stock turnover (*TOVER*), state-owned enterprises (*SOE*), firm age (*LNMAGE*), boardroom size (*BRDSIZE*), board independence (*INDP*), CEO duality (*DUAL*), and ownership concentration (*TOP1*) (Moeller et al. 2004; Lin et al. 2011; John et al. 2015; Doukas and Zhang 2021; Gong et al. 2008; Zhou et al. 2015; Masulis et al. 2007; Yang et al. 2019). For deal characteristics we include related transactions (*RELATED*), method of payment (*PAYTYPE*) (Chang 1998; Yang et al. 2019), whether the target is public (*PUB_TAR*), whether the acquisition is cross-regional (*CROSSREG*), and the relative ratio of the acquisition price to the acquiring firm's total assets (*RELATIVE*). We also control for auditor characteristics, including Big 4 auditors (*BIG4*), domestic Big 10 auditors (*LOCAL10*), and engagement auditors' industry specialization (*CPAIND*). We also include announcement-year, acquirer industry and region fixed effects, with all continuous variables are winsorized at the 1st and 99th percentiles. The Appendix provides detailed definitions of all variables.

Table 2 presents the results from estimating equation (1). Column (1) regresses *ACQ_CAR* on *VAL_EXP* without control variables but with fixed effects. We find a significantly positive coefficient on *VAL_EXP* of 0.859 (p<0.01). In Column (2), we add the control variables and find a significantly positive coefficient on *VAL_EXP* of 0.625 (p<0.01). Thus, we find that acquirers with valuation-expert auditors experience significantly higher abnormal returns around the announcement date than acquirers without valuation-expert auditors. The effect is economically significant, with clients of valuation-expert auditors experiencing abnormal returns that are 0.625 percentage points higher than those without valuation-expert auditors. This equals a 49.5% increase over the unconditional mean return (0.625/1.262), and represents 9.1 percent of the sample standard deviation of acquisition returns of 6.85%.[22] The increase in

[22] In comparison, Custodio and Metzger (2013) find that when acquirer's CEO has previous experience in the target industry, the acquirer's abnormal announcement-period returns are between 1.2 and 2.0 percentage points higher than otherwise.

ACQ_CAR translates into an abnormal gain of about US$15.87 million in shareholder value for the average acquirer in our sample with a market capitalization of about US$2.51 billion. Overall, the findings in Table 2 support our hypothesis, suggesting that valuation-expert auditors are associated with better acquisition performance, as measured by the abnormal announcement returns.

4.2 Identification strategies

4.2.1 Regulatory shocks

To mitigate endogeneity concerns, we examine two regulatory changes that improve acquisition performance for a subset of firms, and test whether the effects of these exogenous shocks are stronger when acquirers have valuation-expert auditors.

In our first regulatory change, implemented in July 2010, the Chinese General Office of the State Council issued the "Opinions on Further Promoting the Implementation of the 'Three Important and One Large-scale' Decision-Making System in State-Owned Enterprises". This regulation requires that important business decisions, personnel appointments and removals, project management, and large-scale capital operations must be decided collectively by the leadership team, rather than, for example, by the CEO alone. The objective of this rule was to improve the decision-making process and corporate governance of SOEs, with an explicit goal of improving M&A decisions.[23] As a result, we expect SOEs' M&A performance to improve after the rule's implementation.

Importantly, the 2010 regulation improves the M&A decision-making process, but it does not directly improve the quality of the valuation inputs underlying those decisions. Improving the decision-making process increases the demand for high-quality valuation inputs, and the effectiveness of M&A decisions still depends on the quality of information used in the

[23] Important business decisions include decisions related to corporate development strategy, bankruptcy, restructuring, mergers and acquisitions, asset transfers, and foreign investments.

management's deliberations. Engagement auditors with valuation expertise should provide higher quality input that improves the assessment of target value and challenges optimistic assumptions, thereby improving the decision-making process. Consequently, any improvement in SOEs' acquisition performance following the regulation is expected to be greater among SOEs with valuation-expert auditors.

We examine a five-year window centered on 2010, and define *Rule2010* as one for the two years following implementation, and zero otherwise. Panel A of Table 3 reports the results of this analysis. We first verify that this rule improves SOE-acquirers' returns by regressing *ACQ_CAR* on *SOE*, *RULE2010*, and *SOE* × *RULE2010*. Column (1) finds that the coefficient on SOE is significantly negative (p<0.10), suggesting that before 2010, SOEs had worse M&A performance than non-SOEs. However, the coefficient on *SOE* × *RULE2010* is significantly positive (p<0.10), indicating that M&A performance of SOEs improved, relative to non-SOEs, during the two years following the new rule.

In Column (2), we further interact *VAL_EXP* with *SOE* and *RULE2010*. We find that the coefficient on the triple interaction term is significantly positive (p<0.01), while the coefficient on *SOE*×*RULE2010* becomes insignificant. This indicates that the effect of Rule2010 in improving acquisition returns for SOEs is concentrated in SOEs with valuation-expert auditors.

In our second regulatory change, implemented in October 2018, the China Securities Regulatory Commission (CSRC) introduced the 'Small-deal Fast-track' rule to make the M&A review process for small deals easier. Specifically, small deals that do not constitute significant asset restructurings are directly reviewed by the listed companies' Merger and Acquisition Review Committee, simplifying administrative approvals and reducing review time. This rule was designed to streamline the process for small transactions, making them easier and less costly. This review also expanded the range of payment tools for M&A, increasing support for direct financing of M&A deals.

While the 2018 regulation reduces administrative and financing frictions associated with small M&A transactions, it does not directly improve the quality of the underlying valuation analyses. Lowering approval costs and expanding financing options should enable firms to pursue a broader set of transactions, including more marginal deals with greater valuation uncertainty. As a result, the regulation likely has countervailing effects: reduced frictions can improve outcomes, while the inclusion of more difficult-to-value deals can increase the risk of overpayment. For firms without valuation expertise, these effects may offset on average. In contrast, engagement auditors with valuation expertise are better able to evaluate marginal deals. Consequently, any improvement in acquisition performance following the regulation is expected to be greater among firms with valuation-expert auditors.

We examine a five-year window centered around 2018 (from 2016 to 2020). We define an indicator variable, *SMALL,* that equals one if the M&A trading size is in the bottom quintile, and zero otherwise. We define *RULE2018*, which equals one if the M&A was conducted in the two years after implementing the rule, and zero otherwise. Panel B of Table 3 reports the results of this analysis. We first verify the effect of this rule on small-deal acquirers' returns by regressing *ACQ_CAR* on *SMALL*, *RULE2018*, and *SMALL* × *RULE2018*. As expected, column (1) reports that the coefficient on *SMALL* × *RULE2018* is significantly positive (p<0.10), indicating that this rule improves acquisition returns for small deals.

In Column (2), we further interact *VAL_EXP* with *SMALL* and RULE2018. We find that the coefficient on the triple interaction term is significantly positive (p<0.10), while the coefficient on *SMALL*× *RULE2018* is insignificant. This indicates that the effect of Rule2018 in improving small deal acquisition returns is concentrated in small-deal acquirers with valuation-expert auditors.

The analyses in Table 3 find that the exogenous shocks in the analysis only increased acquisition returns for companies with valuation-expert auditors, helping to mitigate

endogeneity concerns. Appendix B reports the parallel trend analysis for the above tests, and finds that the treatment firms and control firms do not differ significantly before the shocks.[24]

4.2.2 Auditor-client tenure

A potential concern is that valuation-expert auditors are appointed after the acquisition offer is made, and hence too late to influence valuation-related decisions, or are selected in response to anticipated M&A activity. In the former case, the observed association may not reflect a plausible causal channel due to limited auditor involvement, while in the latter case it may reflect endogenous auditor selection rather than auditors affecting deal outcomes. Thus, we examine auditor tenure because longer-tenure auditors are more likely to be involved early enough in the acquisition process to influence valuation decisions, and less likely to be selectively chosen.

To address this, we conduct two tests. First, we partition *VAL_EXP* based on whether the valuation-expert auditor's tenure with the client is above or below the sample median (two years). Second, we define *VAL_EXP* only if the auditor has been with the client at least two years. This specification excludes observations in which the valuation-expert auditor is newly appointed during the transaction year.

The results are reported in Table 3, Panels C and D. In Panel C, the coefficient on *VAL_EXP* is significantly larger for longer-tenure value-expert auditors, while the coefficient for shorter-tenure value-expert auditors is insignificant. In Panel D, the results are similar when we require the valuation-expert auditor to be present in the prior year.

Overall, these findings are consistent with valuation-expert auditors requiring sufficient tenure to be involved early enough in the acquisition process to influence valuation-related

[24] For RULE2018, we find a significantly positive increase in acquisition returns for treatment firms during each of the two years following adoption, and a positive but insignificant increase during the third year following adoption. For RULE2010, we find a significantly positive increase in acquisition returns for treatment firms during the first year following adoption, and a positive but insignificant increase during the second- and third-year following adoption. Together, this suggests that these policies were initially effective in improving M&A performance, but that their effects decayed over time.

decisions. They also mitigate concerns that our results are driven by transaction-specific auditor selection, since the effects are stronger when auditors have longer tenure and are in place prior to the transaction year.

4.3 Corroborating evidence

4.3.1 Takeover premiums and goodwill impairments

Our primary findings are consistent with valuation-expert auditors helping acquirers avoid overvaluing target companies. Thus, we also expect acquirers with valuation-expert auditors to pay lower takeover premiums, and the lower takeover premiums to reduce the likelihood of post-acquisition goodwill impairments. We test these predictions in this section.

We measure the takeover premium (*PREMIUM*) as the purchase price minus the book value of the target, scaled by the book value of the target. The sample size in this analysis is reduced because nearly all target companies are privately-held, limiting data availability. Column (1) of Table 4, Panel A replaces *ACQ_CAR* as the dependent variable in our primary analysis with *PREMIUM* and finds that the coefficient on *VAL_EXP* is significantly negative (p<0.05), indicating that acquirers with valuation-expert auditors pay lower takeover premiums than their counterparts. In Column (2), the sample is restricted to companies with goodwill, and the dependent variable (*IMPAIRMENT*) equals one if the company reports a goodwill impairment within the three years following the acquisition, and zero otherwise. This analysis finds a significantly positive coefficient on *PREMIUM* (p<0.01), consistent with higher takeover premiums being associated with a higher likelihood of future goodwill impairment. We also find that the coefficient on *VAL_EXP* ×*PREMIUM* is significantly negative (p<0.01), indicating that valuation-expert auditors attenuate the positive association between takeover premiums and future goodwill impairments. Together, these tests provide evidence that valuation-expert auditors help acquirers avoid overpayment, particularly overpayment that leads to future goodwill impairment.

4.3.2 Post-acquisition operating performance

If valuation-expert auditors help managers avoid overvaluing target companies, it should improve the acquirers' post-acquisition performance. This is because overvaluing the target increases the likelihood of overvaluing the target's depreciable and amortizable assets and undervaluing its liabilities, which reduce future operating performance. We measure operating performance as the change in industry-adjusted returns on equity (*ΔROE_ADJ*) from the pre-acquisition year to one and two years after the deal, labelled as *ΔROE_ADJ_1* and *ΔROE_ADJ_2*, respectively. We test this using the following model:

$$Performance = \beta_0 + \beta_1 \times VAL\_EXP + \beta_c \times Controls_{Performance} + Year/ACQ\_Ind/Region\ FE + \varepsilon. \quad (2)$$

We include controls for the acquirer's firm size (*SIZE*), leverage (*LEV*), profitability (*ROE*), cash holding (*CASH*), operating risk (*BUSRISK*), sales growth (*GROWTH*), stock turnover (*TOVER*), firm age (*FIRMAGE*), state-owned enterprise indicators (*SOE*), corporate governance factors (*BRDSIZE*, *INDP*, *DUAL*, *TOP1*), deal characteristics (*RELATED*, *PAYTYPE*), and auditor characteristics (*BIG4*, *LOCAL10*), all measured during the year of deal announcement. We also include acquirer industry, announcement-year and region fixed effects. Standard errors are adjusted for heteroskedasticity and clustered at the acquirer level.

Table 4 Panel B presents the results from estimating model (2). Column (1) uses *ΔROE_ADJ_1* as the dependent variable and finds that the coefficient on *VAL_EXP* is significantly positive (p<0.05). Column (2) uses *ΔROE_ADJ_2* as the dependent variable and finds that the coefficient on *VAL_EXP* is also significantly positive (p<0.05). This suggests that acquirers with valuation-expert auditors report better post-acquisition operating performance than acquirers without valuation-expert auditors.

Taken together, Table 4 finds lower takeover premiums, a lower likelihood of future goodwill impairment, and better post-acquisition operating performance, providing triangulating evidence that valuation-expert auditors help mitigate target overvaluation and

improve acquirers' acquisition performance. Examining these additional outcome variables further helps mitigate the concern that unobservable acquirer and deal characteristics drive our main finding.

4.4 Moderating variables

We explore three groups of cross-sectional variables that we expect to moderate the effect of valuation-expert auditors on acquirers' announcement-period returns: (1) the acquirer's M&A experience and expertise, (2) the client's financial importance and auditors' industry expertise, and (3) the difficulty in valuing the target.

4.4.1 Acquirers' M&A expertise and experience

The benefits from hiring a valuation-expert auditor are likely to be higher when the acquirer's executives lack M&A expertise and experience (Cai and Sevilir 2012; Graham and Harvey 2001; Aktas et al. 2021). We test this by separately examining the association between announcement-period returns and valuation-expert auditors, partitioned on three measures of executive expertise and experience. Our first measure captures executives with a background in finance. We partition our sample into two groups, *FBACK*=1 if the CEO or CFO has previous experience in a financial institution or the finance industry and *FBACK=0* otherwise (Aktas et al., 2021). Panel A of Table 5, Column (1) finds that the coefficient on *VAL_EXP* is significantly positive when *FBACK*=0 (p<0.01), while Column (2) finds that the coefficient on *VAL_EXP* is insignificant when *FBACK*=1. Further, the difference between the coefficients is significant (p<0.01). This is consistent with benefits from valuation-expert auditors being larger when the acquirer's executives lack finance experience.

Our second measure captures the effects of directors with larger networks. Prior research finds that better connected independent directors are associated with more favorable M&A outcomes for acquirers (Fogel et al. 2021; Cai and Sevilir 2012). Thus, the auditor's valuation expertise should be less valuable for acquirers with better connected directors. We partition the

sample into two groups: *DIRNW*=1 if the number of interlocked independent directors on the acquirer's board is above the median, and *DIRNW*=0 otherwise. Column (3) of Table 5, Panel A finds that the coefficient on *VAL_EXP* is significantly positive (p<0.05) when *DIRNW*=0, and Column (4) finds that the coefficient on *VAL_EXP* is insignificant when *DIRNW*=1 and that the difference between the coefficients is significant (p<0.05). This is consistent with the benefits from valuation-expert auditors being larger when the acquirer's directors are not well-connected.

Lastly, we examine the acquirer's past experience in M&A. We obtain the number of M&A activities conducted by each acquirer in the past three years and partition the sample into *ACQEXP*=1 if this number is above the sample median, and *ACQEXP*=0 otherwise. Column (5) of Table 5, Panel A finds that the coefficient on *VAL_EXP* is significantly positive (p<0.01) when *ACQEXP*=0, and Column (6) finds that the coefficient on *VAL_EXP* is insignificant when *ACQEXP*=1. Further, the difference in the two coefficients is significant (p<0.01). This is consistent with benefits from valuation-expert auditors being larger when the acquirer's management is less experienced in M&A.

Collectively, the above tests find that valuation-expert auditors improve their clients' M&A outcomes only when their clients lack M&A expertise or experience. This helps with identification by suggesting that our findings are not explained by clients with better M&A skills hiring auditors with valuation expertise. On the contrary, we find that auditors with valuation expertise do not improve M&A performance among clients with greater M&A skills and experience.

4.4.2 Client financial importance and auditors' industry expertise

Engagement auditors have stronger incentives to exert audit effort on financially important clients, because audit failures are relatively more costly for larger clients (DeAngelo, 1981). We calculate *IMPORTANCE* as total assets of a client divided by the sum of the total

assets of clients audited by the auditing firm. We then partition the sample into two groups: *IMP*=1 if *IMPORTANCE* is above the median, and *IMP*=0 otherwise. Column (1) of Table 5, Panel B finds that the coefficient on *VAL_EXP* is significantly positive when *IMP*=1 (p<0.01), Column (2) finds that the coefficient on *VAL_EXP* is insignificant when *IMP*=0, and the difference between the coefficients is significant (p<0.01). This is consistent with the effects of valuation-expert auditors being larger when the client is more important to the audit firm.

We also expect the industry expertise of engagement auditors to complement their valuation expertise and thereby improve their ability to improve the client's M&A performance. While our multivariate analysis in Table 2 finds that auditors' industry expertise (*CPAIND*) is not associated with acquisition-period returns, industry expertise should help valuation-expert auditors better understand their client's business and thus provide better valuation advice. *CPAIND* is the average industry specialization of the acquirers' two engagement auditors, where industry specialization equals the auditor's market share of clients in a specific industry, based on all clients in that industry across the country. We then partition the sample into two groups: *INDSPE*=1 if *CPAIND* is above the sample median, and zero otherwise. Column (3) of Table 5, Panel B finds that the coefficient on *VAL_EXP* is significantly positive (p<0.01) when *INDSPE*=1, Column (4) finds that the coefficient on *VAL_EXP* is insignificant when *INDSPE*=0, and the difference between the coefficients is significant (p<0.05). This suggests that the positive effect of valuation-expert auditors on acquisition performance is stronger when the engagement auditor is also an industry specialist.

4.4.3 Difficulty in valuing the target

Valuation-expert auditors should have a larger effect when acquirers face greater difficulties in assessing the target's value. This is consistent with Cai et al. (2016), which finds that common auditors have a greater improvement on announcement period returns for targets with higher uncertainty. We use two sample partitions to capture the difficulty in valuing the

target. Our first partition uses the economic policy uncertainty (*EPU*) index for China developed in Baker, Bloom and Davis (2016). The EPU index for China equals the frequency of keywords related to policy uncertainty that appear in the South China Morning Post over the six months prior to the deal announcement.[25] We partition the sample into two groups: *H_EPU*=1 if *EPU* is above the median, and zero otherwise. Column (1) of Table 5, Panel C finds that the coefficient on *VAL_EXP* is significantly positive when *H_EPU*=1 (p<0.01), Column (2) finds that the coefficient on *VAL_EXP* is insignificant when *H_EPU* =0, and the difference between the coefficients is significant (p<0.01). This suggests that the positive effect of valuation-expert auditors on acquisition performance is stronger when the economic uncertainty is higher and thus the valuation is more difficult.

Our second partition is based on industry differences, where *Diverse*=1 if the acquirer and target are in different industries, and zero otherwise. We expect acquirers that are in different industries to be more difficult for acquirers to value since they have less in-house expertise in the target's industry. Consistent with our expectation, Column (3) of Table 5 Panel C finds that the coefficient on *VAL_EXP* is significantly positive (p<0.01) when *Diverse*=1, Column (4) finds that the coefficient on *VAL_EXP* is insignificant when *Diverse* =0, and the difference between the coefficients is significant (p<0.10). Because data on private-company targets is unavailable, the sample size in Columns (3) and (4) is significantly reduced.[26] These results further suggest that the positive effect of valuation-expert auditors on acquisition performance is stronger when the M&A is more difficult to value.

Taken together, the cross-sectional analyses in Table 5 indicate that the effects of valuation-expert auditors on acquisition returns vary predictably with acquirer, auditor, and deal characteristics, which helps alleviate concerns that unobservable acquirer, auditor, or deal

[25] See Appendix A in Baker et al. (2016) for a list of the words and word combinations used to measure the economic policy uncertainty index for China.

[26] Because the Wind database provides industry information for a limited number of private targets, the number of companies in the partitions in Columns (3) and (4) exceeds the number of public companies in our sample.

characteristics explain our results.

4.5 Additional Analyses

4.5.1 Auditor incentives to provide audit-related M&A input to their clients

This section examines auditors' incentives to play an advisory role in M&As. We conjecture that valuation-expert auditors, who provide audit-related M&A input to clients that results in superior M&A performance, are less likely to be dismissed and more likely to receive higher audit fees.

We test auditor dismissals using *SWITCH*, which equals one for clients that change audit firms during the year, and zero otherwise. We assume that when the clients of valuation-expert auditors experience superior M&A performance, it is partially due to the audit-related M&A input they receive from their auditor. We measure superior M&A performance using *SUP_OUTCOME*, which equals one if *ACQ_CAR* is above the median, and zero otherwise. We then construct our variable of interest, which is the interaction term, *VAL_EXP* × *SUP_OUTCOME*. Table 6, Column (1) reports the results from this analysis. We find that the coefficient on *VAL_EXP* × *SUP_OUTCOME* is significantly negative (p<0.05), suggesting that acquirers are less likely to dismiss their valuation-expert auditors during M&A years in which they experience superior M&A performance.

The fee test, in Column (2), uses the dependent variable *AB_FEE*, which equals abnormal audit fees as the residual from a fee regression as described in the Appendix. The results find a significantly positive coefficient (p<0.10) on *VAL_EXP* × *SUP_OUTCOME*, which indicates that acquirers pay higher audit fees to valuation-expert auditors that provide input that results in superior M&A performance.[27]

[27] The bottom of Table 6 also shows that the sum of the coefficient on the interaction term plus the coefficient on *SUP_OUTCOME* is significantly negative for auditor switches and significantly positive for audit fees (p<0.05). These main effects suggest that engagement auditors with valuation expertise receive economic benefits from providing M&A input to their clients.

In summary, the analysis in Table 6 indicates that valuation-expert auditors who help their clients achieve better M&A outcomes are less likely to be dismissed and are more likely to receive higher audit fees. This is expected to provide incentives for valuation-expert auditors to provide their clients with M&A input that helps them improve M&A performance.

4.5.2 Engagement auditors' incentives to become a valuation-expert

Because of its large population, job market competition in China is intense, providing incentives for job market participants to pursue additional certifications to improve their career outcomes. Thus, we conjecture that engagement auditors have incentives to become CPVs to increase job security and improve their chances for promotion. We test this using manually collected data on auditors' job changes. Our sample for this test comprises of 40,448 auditor-year observations from 2008 to 2020. Table 7, Panel A reports the results of regressing engagement auditors' job prospects on their valuation expertise (*VAL_EXP*) after controlling for their other personal traits (including gender, age, degree, major, university level and education cohort). The dependent variable in Column (1) is *QUIT*, which equals one if the auditor departs the auditing profession, and zero otherwise. We find that the coefficient on *VAL_EXP* is significantly negative (p<0.10), indicating that valuation-expert engagement auditors are less likely to depart the profession.

The dependent variable in Column (2) is *UPGRADE*, which equals one if the engagement auditor moves from a non-Big 10 auditing firm to a domestic Big 10 auditing firm, or if the auditor moves from a domestic Big 10 auditing firm to a Big 4 auditing firm, and zero otherwise. In this analysis, we exclude auditors who work for Big 4 auditing firms at the beginning of our sample period, which yields 36,674 auditor-year observations. We find that the coefficient on *VAL_EXP* is significantly positive (p<0.01), indicating that valuation-expert engagement auditors are more likely to move from a non-Big 10 auditing firm to a domestic Big 10 auditing firm, or from a domestic Big 10 auditing firm to a Big 4 auditing firm.

Finally, the dependent variable in Column (3) is *PROMOTION*, which equals one if the auditor is promoted to partner or/and a manager in their current auditing firm, and zero otherwise. In this analysis, we exclude auditors who are partners or managers at the beginning of our sample period, which yields 23,376 auditor-year observations (due to data restrictions, the sample period of promotion analysis is 2010-2020). We find that the coefficient on *VAL_EXP* is significantly positive (p<0.01), indicating that valuation-expert auditors are more likely to be promoted to a partner or a manager position in their current auditing firm.

In Panel B of Table 7 we use a Cox proportional hazard model to examine the effect of valuation expertise on auditors' career outcomes. The "failure events" are auditors' quitting, upgrading to a more prestigious audit firm, or being promoted. We report hazard ratios and z-values instead of regression coefficients and t-values. An estimate of hazard ratio above (below) one implies that the explanatory variable shifts the hazard function upward (downward) thus increasing (decreasing) the probability of "failure events". These findings are consistent with our results in Table 7, Panel A.

In summary, the analysis in Table 7 indicates that engagement auditors with valuation expertise have better career outcomes as compared with auditors who do not have valuation expertise. This is consistent with an improvement in career outcomes providing an incentive for engagement auditors to obtain valuation-expert certification.

5. Additional Analysis and Robustness checks

5.1 Matched sample analyses

To alleviate the concern that our results could be driven by observable differences between acquirers with and without valuation-expertise, we perform a matched-sample analysis using entropy-balanced matching, PSM matching, and exact matching. The results are reported in Table 8, Panel A. First, we form a matched sample using the entropy balancing technique. Entropy balancing reweights each acquirer-year without valuation-expert auditors to ensure

that the mean value, variance, and skewness of all control variables are not statistically different between the treatment group with valuation-expert auditors and the control group without such auditors. The results of the analysis using the entropy balanced sample are reported in Column (1) and find that the coefficient on *VAL_EXP* is significantly positive (p<0.01).

For the PSM matching, we employ a logit model that includes all control variables in the first-stage regression to estimate the likelihood of an acquirer-year having valuation-expert auditors. We then match each acquirer-year with valuation-expert auditors to one observation without such auditors, in the same year and industry, based on the closest propensity score, using a maximum caliper width of 0.05. The matching procedure yields 725 acquirer-year pairs.[28] We repeat our analysis in Table 2 using this PSM-matched sample and report the results in Column (2) of Table 8. We find that the coefficient on *VAL_EXP* remains positive and significant (p<0.01).

Finally, we use exact matching, based on size, industry, year, and audit firm. Specifically, we match each observation without a valuation-expert auditor to the closest observation with a valuation-expert auditor based on client size, in the same industry, year, and audit firm. This matching procedure produces a sample of 564 acquirer-year observations. As shown in Column (3), the coefficient on *VAL_EXP* is significantly positive (p<0.01). Overall, the results from our matched sample tests indicate that our main findings are unlikely to be explained by differences in observable firm characteristics.

5.2 Alternative model specifications

Our primary analysis in equation (1) includes announcement year, acquirer industry, and region fixed-effects. As a robustness check, we also examine the following fixed-effects structures: (1) year/industry/region fixed effects paired with audit firm fixed effects; (2)

[28] Untabulated results indicate that all post-matched control variables are statistically indistinguishable between the treatment and control groups, except for *INDP*.

industry-year and region fixed effects only. Panel B of Table 8 reports that our main results continue to hold in all specifications.

5.3 A falsification test (untabulated)

A potential concern is that valuation-expertise certification may simply be an indication that these auditors possess higher general skills that make them superior auditors, and it is this higher skill level, rather than valuation expertise, which explains our results. We note that in Table 2, auditors' industry expertise is insignificant in explaining acquisition returns. Since auditors' industry expertise is a well-established proxy for auditor competence, this finding suggests that valuation expertise does not simply capture general auditor ability. We also perform a falsification test to investigate this by including a variable that captures the effects of auditors' tax expertise on acquisition performance. We capture auditors' tax expertise using their qualification of Certified Tax Agent(s) (CTAs). In untabulated analysis, we find that there is no association between auditors with tax expertise and acquirer announcement-period returns, suggesting that valuation expertise does not simply capture competence unrelated to valuation.

5.4 Field auditor versus review auditor (untabulated)

Two engagement auditors sign audit reports in China, a junior field auditor primarily responsible for the fieldwork and a lead auditor responsible for review. In our baseline specification, we define *VAL_EXP* as equal to one if either auditor is a CPV. As a robustness test, we disaggregate *VAL_EXP* based on the signatory auditor's primary role. We find that valuation expertise is positively associated with acquisition announcement returns for both field and lead auditors and that the effects of each are insignificantly different. This is consistent with the institutional setting described in Section 3.2. While field auditors can provide valuation inputs during their fieldwork, lead auditors can influence valuation-related judgments both through *ex ante* guidance during the audit and through *ex post* evaluation and approval of significant accounting decisions. Overall, these findings reinforce our measure of valuation

expertise and suggest that both engagement auditors contribute to mitigating target overvaluation.

5.5 Due diligence auditor choice (untabulated)

All acquirers must perform due diligence on target companies prior to completing an acquisition, consisting of a structured investigation of the target's financial information. Firms may use their incumbent auditor or an outside auditor to conduct due diligence. If valuation-expert auditors improve M&A outcomes primarily through the due diligence process, our results could be sensitive to the choice of due diligence provider.

To examine this, we hand-collect data on the identity of the due diligence auditor for all transactions with available data (920 out of 5,154 total deals). Among these deals, 69% use the incumbent auditor to conduct due diligence. We perform two tests: (1) whether the association between valuation-expert auditors and acquisition returns differs by due diligence provider, and (2) whether the use of an outside due diligence auditor is associated with acquisition returns. In both tests, we find no evidence that the choice of due diligence auditor affects our inferences.

However, a formal power test finds that these tests are underpowered. The subsample represents less than 20% of our full sample, and within this sample we are unable to reliably detect even our main effect. Thus, we do not rely on these tests for identification.

Importantly, however, we do not expect the choice of due diligence auditor to affect our main results. Regardless of who performs the due diligence, the engagement auditor remains responsible for understanding significant transactions, risks, and sources of estimation uncertainty as part of the audit (PCAOB AS 2110). This implies that incumbent auditors obtain and evaluate due diligence information, even when performed by an outside provider. While interactions may be mediated through management, engagement auditors are expected to access the final due diligence reports and critically assess key assumptions. Thus, due diligence information should be incorporated into the auditor's assessment irrespective of provider.

Taken together, these findings and institutional considerations suggest that the choice of due diligence auditor is unlikely to affect our results.

5. Conclusion

We investigate whether engagement auditors with valuation expertise improve acquirers' M&A outcomes. Using proprietary Chinese data and a comprehensive sample of acquisitions by Chinese listed firms from 2008 to 2020, we find that acquirers with valuation-expert engagement auditors are associated with higher acquisition announcement-period abnormal returns. Consistent with a causal relation, we find that while a regulatory shock in 2010 improves SOEs' acquisition performance relative to non-SOEs, the increase in SOEs' acquisition return is concentrated among valuation-expert auditors. Similarly, while another regulatory shock in 2018 increases small deals' acquisition return, the increase in small deals' acquisition return is also concentrated among valuation-expert auditors.

In additional analyses, we find that valuation-expert auditors are associated with lower takeover premiums, a lower likelihood of future goodwill impairment, and higher post-acquisition operating performance, providing triangulating evidence to our main finding. We also find that the effect of valuation-expert auditors is stronger when acquirers lack in-house M&A expertise and experience, auditors have stronger incentives and competence as captured by client importance and auditors' industry expertise, and targets are more difficult to value.

Our study is the first to examine the auditor's audit-related role in M&A and find that valuation-expert auditors improve acquirers' M&A performance. We contribute to the M&A literature by identifying engagement auditors as an external expert that improves M&A performance. Our study also contributes to the auditing literature by finding that engagement auditors' valuation expertise has real effects by helping clients mitigate target overvaluation in M&A. We also extend the auditing literature by examining a previously unexplored dimension of auditor expertise.

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Appendix A. Variable definitions

Dependent Variables

ACQ_CAR	Acquirer three-day (-1, 1) cumulative abnormal return (in percentage points) calculated using the market model. The market-model parameters are estimated over a 120 trading-day period, starting from 150 trading days prior to the initial announcement date, with the Shanghai and Shenzhen Stock Exchange value-weighted market return serving as the market return.
PREMIUM	The difference between trading value and book value of the targets scaled by the book value of the targets.
IMPAIRMENT	An indicator equal to one if the acquirer records goodwill impairments in the post-acquisition three-year period, and zero otherwise.
ΔROE_ADJ	Changes in industry-adjusted return on equity from the pre-acquisition year to one year or two years after the deals, labelled as *ΔROE_ADJ_1* and *ΔROE_ADJ_2*, respectively.

Variable of Interest

VAL_EXP	Dummy variable, which equals to one if any of the signatory auditors of the acquirer possesses valuation expertise, and zero otherwise. A signatory auditor who has Certified Public Valuer certificate is identified as having valuation expertise.

Control Variables (all measured at the year-end prior to the deal announcement, except for deal characteristics)

SIZE	The natural logarithm of total assets.
LEV	The ratio of total debt to total assets.
ROE	Net income divided by average shareholders' equity.
CASH	Sum of cash and cash equivalents divided by current liabilities.
BUSRISK	Operating leverage.
GROWTH	Sales growth rate.
TOVER	Annual average of daily stock turnover rate.
SOE	Dummy variable, which equals to one if the firm is owned by state, and zero otherwise.
LNAGE	The natural logarithm of firm age.
TOP1	Proportion of shares owned by the largest shareholder.
BRDSIZE	Natural log of the number of directors serving on the boardroom.
INDP	The number of independent directors divided by the total number of directors.
DUAL	Dummy variable, which equals to one if the CEO is also the chair of the boardroom, and zero otherwise.
CPAIND	Average industry specialization of the signatory auditors of the acquirer. A signatory auditor's industry specialization is the market share (based on clients' total assets) within a specific industry.
BIG4	Dummy variable, which equals to one if the firm is audited by international Big 4 auditing firms, and zero otherwise.
LOCAL10	Dummy variable, which equals to one if the firm is audited by Chinese domestic Big 10 auditing firms, and zero otherwise.
RELATED	Dummy variable, which equals to one if the deal is related transaction, and zero otherwise.
PAYTYPE	Dummy variable, which equals to one if the acquirer's payment for the targets consists of only cash, and zero otherwise.
PUB_TAR	Dummy variable, which equals to one if the target is public listed firm, and zero otherwise.
CROSSREG	Dummy variable, which equals to one if the acquisition is cross-regional transactions, and zero otherwise.
RELATIVE	The ratio of the acquisition trading value to acquiring firm's total assets.

Cross-sectional Variables

FBACK	Dummy variable, which equals to one if top executives of the acquirer have prior work experience in finance, and zero otherwise.
DIRNW	Dummy variable, which equals to one if the number of interlocked independent directors on the acquirer's board is above the median, and zero otherwise.
ACQEXP	Dummy variable, which equals to one if the number of M&A activities conducted

	over the past three years of an acquirer is higher than the median, and zero otherwise.
IMP	Dummy variable, which equals to one if *IMPORTANCE* is above the median, and zero otherwise. *IMPORTANCE* is calculated as total assets of the client divided by the sum of the total assets of clients audited by the auditing firm.
INDSPE	Dummy variable, which equals to one if *CPAIND* is above the median, and zero otherwise.
H_EPU	Dummy variable, which equals to one if *EPU* is above the median, and zero otherwise. *EPU* is the average of EPU index over a period of 6 months prior to the deal announcement. EPU index is constructed based on the frequency count of keywords related to policy uncertainty that appear in the SCMP.
DIVERSE	Dummy variable, which equals to one for diversifying acquisitions, namely, acquisitions in which acquirers and targets belong to different industries, and zero otherwise.
Other Variables	
RULE2010	Dummy variable, which equals one after year 2010, and zero otherwise.
RULE2018	Dummy variable, which equals one after year 2018, and zero otherwise.
SMALL	Dummy variable, which equals one if the M&A trading value is in the bottom quintile, and zero otherwise.
SWITCH	Dummy variable, which equals one if the acquirer changes auditing firm, and zero otherwise.
AB_FEE	The residual from the following audit fee regression: $LNFEE = \alpha_0 + \alpha_1 \times SIZE + \alpha_2 \times ARINV + \alpha_3 \times CR + \alpha_4 \times ROA + \alpha_5 \times LOSS + \alpha_6 \times LEV + \alpha_7 \times STAFF + \alpha_8 \times DELAY + \alpha_9 \times AUD\_CHG + \alpha_{10} \times AUD\_SIZE + \alpha_{11} \times BIG4 + \alpha_{12} \times LOCAL10 + Industry/Year\ FEs + \varepsilon.$ *LNFEE* is the natural logarithm of audit fees; *ARINV* is the sum of accounts receivable and inventory divided by total assets; *CR* is the current ratio; *ROA* is net income divided by total assets; *LOSS* is an indicator equal to one if net income is negative for two consecutive years, and zero otherwise; *STAFF* is the square root of the number of employees; *DELAY* is the audit report lag; *AUD_CHG* is an indicator equal to one if the firm's auditing firm changes compared to the prior year, and zero otherwise; *AUD_SIZE* is the sum of the total assets of clients audited by the auditing firm.
SUP_OUTCOME	Dummy variable, which equals one if *ACQ_CAR* is above the median, and zero otherwise
QUIT	Dummy variable, which equals one if the auditor departs the auditing profession, and zero otherwise.
UPGRADE	Dummy variable, which equals one if the auditor moves from a non-Big 10 auditing firm to a domestic Big 10 auditing firm, or if the auditor moves from a domestic Big 10 auditing firm to a Big 4 auditing firm, and zero otherwise.
PROMOTION	Dummy variable, which equals one if the auditor is promoted to partner or/and a manager in their current auditing firm, and zero otherwise.

Appendix B Parallel trends analysis

Panel A. Parallel trends analysis for Table 3 Panel A (Rule to optimize decision process of SOEs in 2010). *PRE2* is a dummy variable capturing two years prior to the rule. *PRE1* is used as the benchmark year. *POST1* and *POST2* are dummy variables capturing one and two years after the rule, respectively.

	DV = *ACQ_CAR*
	(1)
SOE	0.087
	(0.11)
RULE2010	1.377
	(1.09)
SOE × RULE2010_PRE2	**-1.592**
	(-1.63)
SOE × RULE2010_CURRENT	-0.586
	(-0.59)
SOE × RULE2010_POST1	-0.106
	(-0.11)
SOE × RULE2010_POST2	-0.655
	(-0.68)
VAL_EXP	3.102***
	(2.64)
VAL_EXP × SOE	-2.022
	(-1.20)
VAL_EXP × RULE2010_PRE2	**-2.678**
	(-1.53)
VAL_EXP × RULE2010_CURRENT	-4.950***
	(-2.91)
VAL_EXP × RULE2010_POST1	-4.685***
	(-2.72)
VAL_EXP × RULE2010_POST2	-3.316**
	(-2.09)
VAL_EXP × SOE × RULE2010_PRE2	**1.279**
	(0.51)
VAL_EXP × SOE × RULE2010_CURRENT	8.887***
	(3.69)
VAL_EXP × SOE × RULE2010_POST1	2.577
	(1.08)
VAL_EXP × SOE × RULE2010_POST2	3.539
	(1.54)
Control variables	Yes
Year/Industry/Region FEs	Yes
Obs.	1876
R^2	0.155

Panel B. Parallel trends analysis for Table 3 Panel B (Rule to simplify approval and enhancing financing of small deals in 2018). *PRE2* is a dummy variable capturing two years prior to the rule. *PRE1* is used as the benchmark year. *POST1* and *POST2* are dummy variables capturing one and two years after the rule, respectively.

	DV = *ACQ_CAR*
	(1)
SMALL	0.137
	(0.26)
RULE2018	1.481***
	(3.02)
SMALL* × *RULE2018_PRE2	**0.113**
	(0.13)
SMALL × RULE2018_CURRENT	-0.800
	(-0.86)
SMALL × RULE2018_POST1	-0.470
	(-0.60)
SMALL × RULE2018_POST2	1.694**
	(2.06)
VAL_EXP	1.701***
	(2.61)
VAL_EXP × SMALL	-3.313**
	(-2.09)
VAL_EXP* × *RULE2018_PRE2	**-0.783**
	(-0.72)
VAL_EXP × RULE2018_CURRENT	-1.551
	(-1.54)
VAL_EXP × RULE2018_POST1	-1.640
	(-1.10)
VAL_EXP × RULE2018_POST2	0.698
	(0.53)
VAL_EXP* × *SMALL* × *RULE2018_PRE2	**2.464**
	(1.13)
VAL_EXP × SMALL × RULE2018_CURRENT	5.733**
	(2.43)
VAL_EXP × SMALL × RULE2018_POST1	5.367**
	(2.10)
VAL_EXP × SMALL × RULE2018_POST2	2.463
	(0.72)
Control variables	Yes
Year/Industry/Region FEs	Yes
Obs.	2047
R^2	0.083

Table 1. Summary statistics

Panel A. Descriptive statistics

Variable	Obs.	Mean	SD	P25	Median	P75
ACQ_CAR	5,154	1.262	6.854	-2.130	0.277	3.176
VAL_EXP	5,154	0.157	0.364	0	0	0
SIZE	5,154	22.253	1.256	21.354	22.091	22.992
LEV	5,154	0.457	0.202	0.301	0.459	0.617
ROE	5,154	0.111	0.079	0.055	0.096	0.149
CASH	5,154	0.762	1.207	0.195	0.364	0.748
BUSRISK	5,154	1.480	0.548	1.161	1.321	1.581
GROWTH	5,154	0.208	0.380	0.016	0.139	0.307
TOVER	5,154	2.456	1.834	1.131	1.932	3.275
SOE	5,154	0.451	0.498	0	0	1
LNAGE	5,154	2.748	0.391	2.485	2.833	3.045
TOP1	5,154	0.201	0.182	0.039	0.150	0.336
BRDSIZE	5,154	2.160	0.197	2.079	2.197	2.197
INDP	5,154	0.370	0.051	0.333	0.333	0.400
DUAL	5,154	0.224	0.417	0	0	0
CPAIND	5,154	0.020	0.038	0.003	0.007	0.018
BIG4	5,154	0.057	0.233	0	0	0
LOCAL10	5,154	0.541	0.498	0	1	1
RELATED	5,154	0.341	0.474	0	0	1
PAYTYPE	5,154	0.911	0.285	1	1	1
PUB_TAR	5,154	0.050	0.219	0	0	0
CROSSREG	5,154	0.212	0.409	0	0	0
RELATIVE	5,154	0.078	0.237	0.002	0.014	0.050
FBACK	5,154	0.221	0.415	0	0	0
DIRNW	5,026	0.517	0.500	0	1	1
ACQEXP	5,154	0.529	0.499	0	1	1
IMPORTANCE	5,154	0.427	0.379	0.076	0.294	0.838
EPU	5,154	302.661	239.862	121.918	225.891	388.422
H_EPU	5,154	0.502	0.500	0	1	1
DIVERSE	352	0.648	0.478	0	1	0
RULE2010	1,876	0.661	0.474	0	1	1
RULE2018	2,047	0.634	0.482	0	1	1
SMALL	2,047	0.201	0.401	0	0	0
TENURE	5,154	2.045	0.927	1.5	2	2.5
PREMIUM	2,196	3.297	10.316	0.040	0.660	2.390
IMPAIRMENT	1,405	0.483	0.500	0	0	1
ΔROE_ADJ_1	4,933	-0.034	0.238	-0.058	-0.012	0.025
ΔROE_ADJ_2	4,518	-0.039	0.197	-0.065	-0.016	0.024
SWITCH	5,154	0.128	0.334	0	0	0
AB_FEE	4,550	-0.039	0.337	-0.260	-0.020	0.203
SUP_OUTCOME	5,154	0.500	0.500	0	0	1
QUIT	40,448	0.051	0.219	0	0	0
UPGRADE	36,674	0.054	0.226	0	0	0
PROMOTION	23,376	0.098	0.297	0	0	0

Panel B. *ACQ_CAR* means by auditors' valuation expertise

	VAL_EXP =1 (Obs. = 809)	*VAL_EXP* =0 (Obs. =4,345)	Diff	p-value
ACQ_CAR	1.864	1.150	0.714	0.0032

Panel C. Correlation matrix: (1) – (11)

	(1) *ACQ_CAR*	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
(2) *VAL_EXP*	**0.038**										
(3) *SIZE*	**-0.063**	-0.024									
(4) *LEV*	-0.007	0.015	**0.510**								
(5) *ROE*	**-0.030**	**-0.028**	**0.073**	0.022							
(6) *CASH*	-0.013	-0.006	**-0.278**	**-0.572**	**0.036**						
(7) *BUSRISK*	0.025	0.023	0.000	**0.058**	**-0.476**	**-0.102**					
(8) *GROWTH*	**0.040**	-0.014	**-0.068**	0.005	-0.005	**0.031**	-0.004				
(9) *TOVER*	**0.088**	-0.008	**-0.402**	**-0.144**	**-0.068**	**0.082**	**0.035**	**0.053**			
(10) *SOE*	-0.016	0.014	**0.308**	**0.252**	**-0.033**	**-0.123**	**0.112**	-0.022	**-0.174**		
(11) *LNAGE*	0.019	0.020	**0.259**	**0.162**	**-0.080**	**-0.170**	**0.064**	**-0.074**	**-0.141**	**0.133**	
(12) *TOP1*	-0.005	0.000	**0.363**	**0.200**	**-0.077**	**-0.157**	**0.070**	**-0.089**	**-0.428**	**0.252**	**0.261**
(13) *BRDSIZE*	**-0.029**	-0.017	**0.209**	**0.117**	**0.045**	**-0.045**	**0.048**	-0.026	**-0.113**	**0.247**	**-0.030**
(14) *INDP*	0.003	0.021	**0.044**	0.012	**-0.031**	-0.017	-0.018	0.003	0.005	**-0.047**	**0.044**
(15) *DUAL*	0.008	-0.005	**-0.128**	**-0.147**	-0.024	**0.087**	-0.020	0.009	**0.097**	**-0.235**	**-0.070**
(16) *CPAIND*	-0.013	-0.008	**0.361**	**0.144**	**0.056**	**-0.062**	0.016	-0.022	**-0.138**	**0.076**	**-0.046**
(17) *BIG4*	-0.015	**-0.045**	**0.336**	**0.087**	**0.066**	**-0.059**	0.025	-0.027	**-0.134**	**0.143**	0.021
(18) *LOCAL10*	-0.019	**-0.082**	0.021	**-0.055**	**-0.054**	0.016	0.027	-0.024	-0.003	**-0.065**	**0.105**
(19) *RELATED*	**0.065**	0.003	**0.118**	**0.088**	**-0.052**	**-0.086**	**0.096**	-0.025	**-0.067**	**0.154**	**0.072**
(20) *PAYTYPE*	**-0.319**	-0.013	**0.066**	-0.023	**0.079**	0.025	**-0.076**	-0.026	**-0.060**	-0.025	-0.011
(21) *PUB_TAR*	-0.005	0.003	**0.074**	**-0.032**	-0.000	-0.001	-0.004	-0.002	**-0.036**	0.021	**0.061**
(22) *CROSSREG*	**0.039**	0.005	-0.012	-0.027	-0.018	0.008	0.013	0.027	0.022	**-0.097**	0.016
(23) *RELATIVE*	**0.305**	**0.054**	**-0.190**	**-0.085**	**-0.046**	**0.046**	**0.041**	**0.073**	**0.090**	-0.025	0.018

Panel D. Correlation matrix: (12) – (23)

	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)	(20)	(21)	(22)
(13) *BRDSIZE*	**0.044**										
(14) *INDP*	**0.037**	**-0.448**									
(15) *DUAL*	**-0.105**	**-0.174**	**0.106**								
(16) *CPAIND*	**0.083**	**0.098**	**0.033**	**-0.042**							
(17) *BIG4*	**0.121**	**0.109**	**0.029**	**-0.043**	**0.258**						
(18) *LOCAL10*	**0.064**	**-0.061**	0.016	**0.047**	**-0.075**	**-0.268**					
(19) *RELATED*	**0.126**	**0.070**	-0.012	**-0.130**	**0.062**	**0.046**	-0.015				
(20) *PAYTYPE*	0.004	0.026	0.012	0.022	0.027	**0.027**	**0.040**	**-0.221**			
(21) *PUB_TAR*	0.007	-0.002	0.013	**0.029**	0.012	0.027	0.013	**-0.033**	-0.012		
(22) *CROSSREG*	**-0.029**	**-0.045**	0.024	0.026	0.013	0.025	0.010	**-0.039**	**-0.085**	**0.093**	
(23) *RELATIVE*	**-0.038**	**-0.065**	0.006	0.002	**-0.066**	**-0.040**	-0.017	**0.153**	**-0.522**	0.015	**0.071**

Table 1, Panel A presents the descriptive statistics (Obs. = 5,154). Panel B presents the univariate comparison of *ACQ_CAR* between the two subsamples, one with valuation-expert auditor and another without. Panels C and D presents the Pearson correlation coefficients for regression variables. Correlations significant at the 0.05 level are shown in boldface. See Appendix A for variable definitions.

Table 2. Auditors' valuation expertise and acquirer returns

Dependent Variable	*ACQ_CAR*	
	(1)	(2)
VAL_EXP	**0.859*****	**0.625****
	(2.82)	**(2.26)**
SIZE		-0.048
		(-0.37)
LEV		0.263
		(0.35)
ROE		-0.250
		(-0.15)
CASH		-0.057
		(-0.63)
BUSRISK		-0.142
		(-0.63)
GROWTH		0.462
		(1.61)
TOVER		0.127*
		(1.72)
SOE		-0.041
		(-0.20)
LNAGE		0.392
		(1.43)
TOP1		0.654
		(1.09)
BRDSIZE		-0.193
		(-0.34)
INDP		-0.021
		(-0.01)
DUAL		0.186
		(0.80)
CPAIND		0.438
		(0.20)
BIG4		0.217
		(0.57)
LOCAL10		-0.196
		(-0.99)
RELATED		-0.138
		(-0.72)
PAYTYPE		-4.989***
		(-7.67)
PUB_TAR		-0.233
		(-0.56)
CROSSREG		0.012
		(0.05)
RELATIVE		5.286***
		(6.81)
Constant	1.127***	5.443*
	(11.01)	(1.82)
Year/Industry/Region FEs	Yes	Yes
Obs.	5,154	5,154
R^2	0.049	0.163

Table 2 reports the results of regressing acquirer abnormal returns on auditors' valuation expertise. T-values in parentheses are based on standard errors that are adjusted for heteroscedasticity and clustered at the acquirer firm level. *, **, and *** indicate significance at the 0.10, 0.05, and 0.01 levels, respectively. See Appendix A for variable definitions.

Table 3. Mitigating endogeneity concerns

Panel A. Rule to optimize decision process of SOEs in 2010

Dependent Variable	*ACQ_CAR*	
	(1)	(2)
SOE	-1.018*	-0.683
	(-1.94)	(-1.18)
RULE2010	0.118	0.806
	(0.10)	(0.67)
SOE × RULE2010	**1.081***	0.306
	(1.75)	(0.45)
VAL_EXP		1.995**
		(2.16)
VAL_EXP × SOE		-1.469
		(-1.15)
VAL_EXP × RULE2010		-3.096***
		(-2.69)
VAL_EXP × SOE × RULE2010		**4.179*****
		(2.63)
Control variables	Yes	Yes
Year/Industry/Region FEs	Yes	Yes
Obs.	1,876	1,876
R^2	0.138	0.144

Panel B. Rule to simplify approval and enhancing financing of small deals in 2018

Dependent Variable	*ACQ_CAR*	
	(1)	(2)
SMALL	-0.417	0.181
	(-1.04)	(0.42)
RULE2018	0.863**	1.209***
	(2.07)	(2.73)
SMALL × RULE2018	**1.113****	0.089
	(2.03)	(0.15)
VAL_EXP		1.313**
		(2.26)
VAL_EXP × SMALL		-2.002*
		(-1.78)
VAL_EXP × RULE2018		-0.493
		(-0.57)
VAL_EXP × SMALL × RULE2018		**3.153***
		(1.83)
Control variables	Yes	Yes
Year/Industry/Region FEs	Yes	Yes
Obs.	2,047	2,047
R^2	0.073	0.078

Panel C Long vs. short tenure of the valuation-expert auditors

Dependent Variable	*ACQ_CAR*
	(1)
VAL_EXP $_{Long\ Tenure}$	**0.792***
	(1.94)
VAL_EXP $_{Short\ Tenure}$	0.475
	(1.42)
Control variables	Yes
Year/Industry/Region FEs	Yes
Obs.	5,154
R^2	0.163

Panel D Excluding valuation-expert auditors that have short tenure

Dependent Variable	*ACQ_CAR*
	(1)
VAL_EXP $_{two\ years}$	**0.621***
	(1.91)
Control variables	Yes
Year/Industry/Region FEs	Yes
Obs.	5,154
R^2	0.163

Table 3 reports the results of tests mitigating endogeneity concerns. In Panel A, we examine a 2010 rule that optimizes the decision process of SOEs. The sample is limited to a five-year period centered around 2010 (from 2008 to 2012). *RULE2010* is a dummy variable equal to one if the M&A is conducted after the rule, and zero otherwise. In Panel B, we examine a 2018 rule that simplifies the approval process and expanded the financing tools of small deals. The sample is limited to a five-year period centered around 2018 (from 2016 to 2020). *SMALL* is a dummy variable equal to one if the M&A trading value is in the bottom quintile, and zero otherwise. *RULE2018* is a dummy variable equal to one if the M&A is conducted after the rule, and zero otherwise. In Panel C, we partition *VAL_EXP* based on whether the valuation-expert signing auditor's tenure with the client is above or below the sample median (two years). Tenure is the average tenure of the two signing auditors of the acquirer. *VAL_EXP* $_{Long\ Tenure}$ is a dummy variable equal to one if any of the signing auditors of the acquirer possesses valuation expertise and the valuation-expert signing auditor's tenure is above the median, and zero otherwise. *VAL_EXP* $_{Short\ Tenure}$ is a dummy variable equal to one if any of the signing auditors of the acquirer possesses valuation expertise and the valuation-expert signing auditor's tenure is below the median, and zero otherwise. In panel D, we define *VAL_EXP* only if the auditor has been with the client at least two years to excludes observations in which the valuation-expert auditor is newly appointed during the transaction year. *VAL_EXP* $_{two\ years}$ is a dummy variable equal to one if any of the signing auditors of the acquirer possesses valuation expertise, and the valuation-expert auditor is also one of the signing auditors of the acquirer in the prior year, and zero otherwise. T-values in parentheses are based on standard errors that are adjusted for heteroscedasticity and clustered at the acquirer firm level. *, **, and *** indicate significance at the 0.10, 0.05, and 0.01 levels, respectively. See Appendix A for variable definitions.

Table 4. Corroborating evidence

Panel A. Takeover premium and future goodwill impairment

Dependent Variable	*PREMIUM*	*IMPAIRMENT*
	(1)	(2)
VAL_EXP	**-1.306*****	0.005
	(-2.64)	(0.12)
VAL_EXP ×PREMIUM		**-0.008*****
		(-2.72)
PREMIUM		0.003***
		(2.95)
Control variables	Yes	Yes
Year/Industry/Region FEs	Yes	Yes
Obs.	2,196	1,405
R^2	0.084	0.193

Panel B. Post-acquisition operating and performance

Dependent Variable	*ΔROE_ADJ_1*	*ΔROE_ADJ_2*
	(1)	(2)
VAL_EXP	**0.015****	**0.014****
	(2.08)	**(2.09)**
Control variables	Yes	Yes
Year/Industry/Region FEs	Yes	Yes
Obs.	4,933	4,518
R^2	0.025	0.038

Table 4 reports the results testing the mechanisms of value creation. Panels A examines the effect of auditors' valuation expertise on takeover premiums and future goodwill impairment. Panel B examines the association between auditors' valuation expertise and acquirers' post-acquisition operating and market-based performance. Different numbers of observations result from missing values. The T-values in parentheses are based on standard errors that are adjusted for heteroscedasticity and clustered at the acquirer firm level. *, **, and *** indicate significance at the 0.10, 0.05, and 0.01 levels, respectively. See Appendix A for variable definitions.

Table 5. Cross-sectional analyses

Panel A. Acquirers' M&A expertise and experience

Dependent Variable	*ACQ_CAR*					
	FBACK=0	*FBACK*=1	*DIRNW*=0	*DIRNW*=1	*ACQEXP*=0	*ACQEXP*=1
	(1)	(2)	(3)	(4)	(5)	(6)
VAL_EXP	**0.790****	0.117	**0.842****	0.357	**0.832****	0.391
	(2.43)	(0.22)	**(2.09)**	(0.95)	**(2.18)**	(1.05)
Control variables	Yes	Yes	Yes	Yes	Yes	Yes
Year/IND/Region FEs	Yes	Yes	Yes	Yes	Yes	Yes
Coef Test: |diff|	0.674***		0.486**		0.441*	
p-value	<0.001		0.046		0.061	
Obs.	4,015	1,139	2,597	2,429	2,729	2,425
R^2	0.167	0.217	0.179	0.166	0.202	0.152

Panel B. Clients' importance and auditors' industry expertise

Dependent Variable	*ACQ_CAR*			
	IMP=1	*IMP*=0	*INDSPE*=1	*INDSPE*=0
	(1)	(2)	(3)	(4)
VAL_EXP	**0.953****	0.321	**0.869****	0.419
	(2.56)	(0.78)	**(2.51)**	(0.97)
Control variables	Yes	Yes	Yes	Yes
Year/IND/Region FEs	Yes	Yes	Yes	Yes
Coef Test: |diff|	0.632**		0.450*	
p-value	0.010		0.057	
Obs.	2,574	2,580	2,580	2,574
R^2	0.160	0.192	0.151	0.197

Panel C. Difficulty in valuing the target

Dependent Variable	*ACQ_CAR*			
	H_EPU=1	*H_EPU*=0	*DIVERSE*=1	*DIVERSE*=0
	(1)	(2)	(3)	(4)
VAL_EXP	**1.347*****	-0.218	**6.514*****	1.512
	(3.42)	(-0.61)	**(2.94)**	(0.90)
Control variables	Yes	Yes	Yes	Yes
Year/IND/Region FEs	Yes	Yes	Yes	Yes
Coef Test: |diff|	1.565***		5.003*	
p-value	<0.001		0.056	
Obs.	2,587	2,567	228	124
R^2	0.174	0.199	0.504	0.723

Table 5 reports the results of cross-sectional analyses. *FBACK*, *DIRNW*, and *ACQEXP* measure acquirer firms' demand for valuation expertise. *IMP* is a dummy variable based on whether the acquirer is economically important to the auditor. *INDSPE* is a dummy variable based on the engagement auditors' industry expertise. *H_EPU* is a dummy variable based on economic policy uncertainty surrounding acquisition announcements. *INTAN* is a dummy variable based on the ratio of acquirers' intangible assets to total assets. *Diverse* is a dummy variable based on whether the acquirer and target belong to different industries. The T-values in parentheses are based on standard errors that are adjusted for heteroscedasticity and clustered at the acquirer firm level. *, **, and *** indicate significance at the 0.10, 0.05, and 0.01 levels, respectively. See Appendix A for variable definitions.

Table 6. Client response to auditors' valuation expertise

Dependent Variable	*SWITCH* $_t$	*AB_FEE*
	(1)	(2)
VAL_EXP	0.028	-0.003
	(1.53)	(-0.18)
VAL_EXP* × *SUP_OUTCOME	**-0.041***	**0.046***
	(-1.65)	**(1.75)**
SUP_OUTCOME	0.001	0.004
	(0.13)	(0.41)
$\beta_{[VAL\ EXP \times SUP\ OUTCOME]} + \beta_{[SUP\ OUTCOME]}$	-0.040*	0.051**
p-value	0.082	0.038
Control variables	Yes	Yes
Year/Industry/Region FEs	Yes	Yes
Obs.	5,154	4,550
R^2	0.079	0.115

Table 6 reports the results testing auditors' incentives. *SUP_OUTCOME* is a dummy variable equal to one if *ACQ_CAR* is above the median, and zero otherwise. Different numbers of observations result from missing values. The T-values in parentheses are based on standard errors that are adjusted for heteroscedasticity and clustered at the acquirer firm level. *, **, and *** indicate significance at the 0.10, 0.05, and 0.01 levels, respectively. See Appendix A for variable definitions.

Table 7. Auditors' incentive to become a valuation expert

Panel A. OLS model

Dependent Variable	*QUIT*	*UPGRADE*	*PROMOTION*
	(1)	(2)	(3)
VAL_EXP	**-0.008***	**0.050*****	**0.084*****
	(-1.89)	**(7.27)**	**(4.99)**
GENDER	0.014***	0.007***	-0.004
	(5.95)	(2.67)	(-0.95)
AGE	0.006	0.159***	0.053***
	(0.79)	(21.93)	(4.44)
EDUCATION	0.005	0.005	0.004
	(1.47)	(1.26)	(0.69)
MAJOR	-0.001	0.019***	0.080***
	(-0.49)	(8.19)	(18.60)
SCHOOL	0.004	0.016***	-0.000
	(1.02)	(3.31)	(-0.03)
WORKLOAD	-0.009***	0.002	0.023***
	(-6.08)	(1.22)	(5.08)
REVENUE	0.002***	0.002***	0.001**
	(7.70)	(9.91)	(2.28)
CLIENTMAO	0.011*	0.008	-0.044**
	(1.72)	(1.06)	(-2.53)
CLIENTABSDA	-0.011	-0.050***	0.067*
	(-0.74)	(-3.25)	(1.83)
Auditing firm/Year FEs	Yes	Yes	Yes
Obs.	40,448	36,674	23,376
R^2	0.044	0.103	0.070

Panel B. Cox proportional hazard model

Dependent Variable	*QUIT*	*UPGRADE*	*PROMOTION*
	(1)	(2)	(3)
VAL_EXP	**0.751****	**1.851*****	**1.594***
	(-2.53)	**(2.95)**	**(1.77)**
GENDER	1.312***	1.098	0.974
	(6.03)	(0.81)	(-0.30)
AGE	0.207***	2.237**	0.562**
	(-7.88)	(2.17)	(-1.99)
EDUCATION	1.092	1.170	1.006
	(1.27)	(1.00)	(0.04)
MAJOR	0.919*	1.265**	2.044***
	(-1.90)	(2.18)	(7.75)
SCHOOL	1.082	1.094	1.068
	(1.04)	(0.52)	(0.40)
WORKLOAD	0.730***	0.578***	0.915
	(-8.00)	(-5.92)	(-0.82)
REVENUE	1.131***	1.073***	1.017
	(24.87)	(5.87)	(1.32)
CLIENTMAO	1.375**	0.874	0.200*
	(2.07)	(-0.46)	(-1.94)
CLIENTABSDA	0.910	1.031	2.642
	(-0.34)	(0.04)	(1.57)
Auditing firm/Year FEs	Yes	Yes	Yes
Obs.	40,448	35,082	21,600

Table 7 reports the results testing how valuation expertise affects signatory auditors' career development. Panel A uses OLS model, while Panel B uses Cox proportional hazard model. *, **, and *** indicate significance at the 0.10, 0.05, and 0.01 levels, respectively. See Appendix A for variable definitions.

Table 8. Robustness tests

Panel A. Matched samples

Dependent Variable	*ACQ_CAR*		
Matching technique	Entropy balanced sample	PSM sample	Same year-industry-auditing firm sample
	(1)	(2)	(3)
VAL_EXP	**0.662****	**1.092*****	**1.516****
	(2.34)	**(2.76)**	**(2.58)**
Control variables	Yes	Yes	Yes
Year/Industry/Region FEs	Yes	Yes	Yes
Obs.	5,154	1,420	564
R^2	0.217	0.210	0.342

Panel B. Alternative model specifications

Dependent Variable		*ACQ_CAR*	
	(1)	(2)	(3)
VAL_EXP	**0.625****	**0.551***	**0.699****
	(2.26)	**(1.93)**	**(2.54)**
Control variables	Yes	Yes	Yes
Year/Industry/Region FEs	Yes	Yes	No
Auditing firm FEs	No	Yes	No
Industry-year/Region FEs	No	No	Yes
Variation absorbed by fixed effects	**4.21%**	**12.42%**	**4.46%**
VIF for *VAL_EXP*	**1.07**	**1.18**	**1.10**
Obs.	5,154	5,154	5,154
R^2	0.163	0.184	0.193

Table 8 reports the results of several robustness checks. Panel A shows the results for three matched samples that ensure balance between observations with and without valuation-expert auditors. Panel B shows the results for alternative model specifications. The T-values in parentheses are based on standard errors that are adjusted for heteroscedasticity and clustered at the acquirer firm level. *, **, and *** indicate significance at the 0.10, 0.05, and 0.01 levels, respectively. See Appendix A for variable definitions.