

Big 4 Office Political Connections and Client Restatements*

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ABSTRACT

Using a new dataset of Big 4 employee political contributions to members of committees responsible for auditor regulation and oversight, I investigate the relation between auditor political connectedness and client restatement frequency at the *audit office* level. I report that clients of politically connected offices are less likely to restate their earnings. However, the negative relation between audit office political connectedness and client restatement frequency reverses for politically connected clients. I further provide evidence that, during the restatement manipulation years, politically connected clients of connected offices were associated with lower audit fees compared to their non-politically connected clients. Audit fees during the restatement manipulation years increase again and restatement frequency drops for connected clients only in the presence of political ties to the same members of auditor-related committees as the local engagement office. That is, when the common auditor-client political activity is more likely to be scrutinized.

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1. Introduction

Auditors utilize their political connections in order to influence regulators or legislators for their own benefit as well as for the benefit of their clients (e.g., Puro [1984], Watts and Zimmerman [1982]). It is not clear, however, what are the audit quality consequences of the political connections of auditors. Prior literature suggests that politically connected firms are protected and supported by their affiliated politicians, that they exhibit lower accounting quality, and that they are less likely to be targeted by disciplinary agencies (e.g., Chaney, Faccio, and Parsley [2011], Correia [2014], Yu and Yu [2011]). These findings, however, may not necessarily generalize to the audit industry, which is heavily scrutinized by regulatory authorities and market participants because reputation and litigation considerations strongly govern auditor behavior. In the audit literature, few studies provide evidence on how the political connections of auditors or those of their clients could affect auditor behavior. These studies do not investigate directly the relation between auditor political connectedness and audit quality, they are typically based on countries with weak demand for high quality audits and pervasive government intervention, and their findings only apply to specific and unique settings. For example, Gul [2006] finds that, auditors in Malaysia exerted greater effort to their politically connected clients when they were considered to have lost political support during the Asian Financial crisis¹ and Yang [2013] suggests that the involvement of politically connected auditors in the IPO screening process in China could yield benefits to their clients in the form of lower IPO rejection rates. Therefore, the relation between *auditor* political connections and *audit quality* as well as the extent to which this relation differs for clients that are politically connected themselves remains an open empirical question.

¹ Gul [2006] makes no distinction between politically connected and non-politically connected auditors in his study. Only audit clients are classified based on the degree of their political connectedness.

Examining the relation between auditor political connectedness and audit quality is particularly relevant in the US, where the Big 4 accounting firms devote significant amounts of funds to establishing political connections. Reuters, for example, reports that Deloitte, Ernst & Young, KPMG, and PricewaterhouseCoopers spent a combined \$9.4 million on in-house and outside lobbyists in 2011. Moreover, political action committees (PACs) funded mainly by the firms' employees contributed more to congressional campaigns in the 2010 election cycle than they had in at least a decade.² Reuters further reports that, in addition to Big 4's corporate PAC contributions to politicians, "... the four firms' *employees* are targeting campaign money *directly* to members of the Senate and the House of Representatives committees that oversee the industry". Reuters identifies these committees as the Senate committee on Banking, Housing, and Urban Affairs and the House of Representatives committee on Financial Services.

The lack of evidence in the US on the relation between auditor political connectedness and audit quality can be partly attributed to the lack of detailed data that allow for sufficient cross-sectional variation because prior US-based studies have typically used politically connectedness data at the national level.³ In this paper, I investigate the relation between Big 4 *auditor-specific* political connections and audit quality at the *audit office* level. I specifically focus on the frequency of accounting restatements as it constitutes a more direct measure of low-quality audits compared to accrual-based measures (e.g., Francis, Michas, and Yu [2013]) and strongly suggestive that the original audit of the misstated financial statement was of low quality (e.g., Francis, Michas, and Yu [2013], Kinney, Palmrose, and Scholz [2004], Palmrose and Scholz [2004]). To construct my office-level measures of

² <http://www.reuters.com/article/2012/03/13/us-usa-accounting-big-idUSBRE82C0JQ20120313>

³ Burnett, Chen, and Gunny [2016] provide a recent exception: They examine the link between auditor lobbying on behalf of their own clients and audit quality using as their political connectedness measure the percentage of overlap of the politicians that the auditor and the client donate to, through their national PAC contributions. However, they do not find evidence of audit quality compromise.

auditor political connections, I manually retrieve the campaign PAC contributions⁴ of all Big 4 employees in the US targeting members of committees responsible for auditor regulation and oversight, i.e., the Senate committee on Banking, Housing, and Urban Affairs and the House of Representatives committee on Financial Services. Through this procedure, I create a sample of office-specific, long-term political connections that spans from 2003 to 2012. To my knowledge, this is the first paper to investigate the audit quality consequences of the political connections of auditors at the audit office level.

By focusing on auditor political connectedness at the office level my study allows for greater cross-sectional variation within the Big 4 accounting firms, which is necessary in making meaningful inferences. The use of auditor political connectedness measures at the audit office level has the additional benefit of taking into account the political relations developed between auditors and their local members of audit-related committees because one would expect that the spatial proximity between auditors and local politicians favors the creation of political ties through PAC contributions. This observation is important, because committee assignments are aimed at achieving relative geographical balance and diversity (e.g., Frisch and Kelly [2006], Masters [1961]).⁵ Therefore, the audit office emerges as the natural unit to use in this study since both auditors and clients are assigned to geographically dispersed audit offices that match the geographic dispersion of the members of auditor-related committees.⁶

⁴ Consistent with prior research (e.g., Correia [2014]), I focus on campaign PAC contributions, as opposed to other forms of PAC financing, such as Super PACs or Leadership PACs. I do this because campaign PACs are used to support politicians' own election campaigns and they are therefore considered to be direct contributions to politicians. In contrast, Leadership PACs and Super PACs are not allowed to coordinate directly with the candidates that set them up. In other words, Leadership PACs and Super PACs cannot be used to support candidates' own campaigns.

⁵ For example, the Senate committee on Banking, Housing, and Urban Affairs during the 112 Congress, consisted of 22 members who were representing the following 22 distinct states: Alabama, Colorado, Hawaii, Idaho, Illinois, Kansas, Louisiana, Massachusetts, Montana, North Carolina, Nebraska, New Jersey, New York, Ohio, Oregon, Pennsylvania, Rhode Island, South Carolina, South Dakota, Tennessee, Virginia, and Wisconsin.

⁶ One may argue that auditor political connectedness would only take place at the national office of the audit firm. There are reasons, however, as to why auditor political connectedness may not be restricted to Big 4's national offices. First, Reuters reports that, apart from the Big 4's national (corporate) PACs, the Big 4

Political science suggests that interest groups utilize their political connections in order to influence regulators to their benefit. Regulators, however, also stand to benefit from establishing political connections by gaining access to information related to the political as well as policy consequences of their regulatory plans and actions. Regulators therefore place great emphasis on the credibility and reputation of the source (e.g., Heinz et al. [1993], Hillman and Hitt [1999], Hull [1993]). One could therefore argue that, politically connected auditors have increased reputation and litigation considerations that could incentivize them to deliver superior audit quality. This is due to the fact that an audit failure could adversely affect their trustworthiness and, consequently, put their relations with their affiliated politicians at risk. This argument is consistent with Ramanna and Roychowdhury [2010] who argue that politically connected firms take actions to protect their affiliated politicians from political embarrassment.

Political connections yield informational advantages to auditors as well. Social capital theory predicts that, economic agents who are part of a network, gain informational advantages from their network connections and position (e.g., Burt [1992], Cohen, Frazzini, and Malloy [2010], Coleman [1988], Horton and Serafeim [2012], Horton, Tuna, and Wood [2014]). Politically connected auditors are part of a network that includes regulators as well as other auditors who are also politically connected. Furthermore, politically connected auditors are deeply involved in the standard-setting procedure and engage in discussions with

accounting firms also establish political connections to members of auditor-relevant committees through their employees' individual contributions. In the current study, I provide evidence consistent with this latter conjecture and show that, in more than half of each Big 4's engagement offices, Big 4 employees politically connect to members of the auditor-related committees that Reuters reports in its article. Second, the Big 4 may have incentives to decentralize their political connectedness to politicians that hold positions in auditor-specific committees because evidence from the political science literature suggests that interest groups with decentralized organizational structures are better able to monitor, enforce, and punish individual legislators in a district than interest groups with centralized organizational structures (e.g., Naoi and Krauss [2009]). Therefore, due to their proximity with their local politicians, politically connected auditors would be better able to influence politicians as well as monitor their actions. Furthermore, politicians are also more likely to benefit from establishing political connections with their local auditors by having more direct communication with those local professionals whose expertise is important in assessing the policy consequences of their actions and by establishing closer relationships with the electoral body of their electoral district.

regulators about issues that relate to audit practice (e.g., Puro [1984], Roberts, Dwyer, and Sweeney [2003], Thornburg and Roberts [2008], Watts and Zimmerman [1978], Watts and Zimmerman [1982]). They therefore could also be more successful in understanding and applying accounting standards as well as identifying areas that need attention early on. This conjecture is consistent with the “institutional knowledge argument” of Yang [2013] who purports that politically connected auditors could use the institutional knowledge acquired through their position to help their clients better comply with the regulatory requirements applicable to them. It is additionally consistent with Christensen et al. [2017] who argue that politically connections yield benefits to brokers by giving them access to policy-related information.

In line with these predictions, I find that clients of politically connected offices are less likely to restate their financial statements. The results are highly statistically significant and robust across three alternative measures of audit office political connectedness. Furthermore, the negative relation between office-level political connectedness and restatement frequency is distinct from the relation between firm-specific political connectedness and restatement frequency. Overall, these findings suggest that, auditor-specific political connections accrue audit quality benefits to clients of politically connected offices.

One might argue that, for audit engagements with clients that are politically connected themselves, auditor reputation and litigation considerations may not be sufficient to deter audit quality impairment. To the extent that politically connected firms are more likely than non-politically connected firms to engage in activities that aim at bending or circumventing existing rules (e.g., Amore and Bennedsen [2013], Correia [2014], Harstad and Svensson [2011], Yu and Yu [2011]), it is possible that politically connected firms are also more likely to exercise pressure to their auditors to be subject to lower scrutiny when they wish to remain opaque. Because politically connected firms enjoy protection and support by their affiliated

politicians (e.g., Chaney, Faccio, and Parsley [2011], Gul [2006]), politically connected auditors could perceive these clients as being of lower risk and cater their desire to remain opaque. I argue this because, due to their own political connectedness, politically connected auditors could be better able to understand and assess the extent to which their clients may benefit from their political connections in the form of enjoying political support or preferential treatment by regulatory agencies.⁷ Under this scenario, politically connected offices would be less likely to scrutinize politically connected clients, unless the nature of the auditor-client political connectedness is such that instead elevates their reputation and litigation considerations.⁸ Since the detection of accounting misstatements can originate from various sources (e.g., Dyck et al. [2015], Keune and Johnstone [2012], Srinivasan, Wahid, and Yu [2014]), some of these irregularities may be eventually revealed. It follows that politically connected clients of connected auditors would then be more likely to restate their earnings later on. Consistent with this argument, I find that the relation between audit office political connectedness and restatement frequency is less negative for politically connected clients. Furthermore, when limiting my sample only to politically connected clients, I provide evidence of a *positive* relation between audit office political connectedness and client restatement frequency. That is, the audit quality benefits that result from the political connections of auditors do not appear to hold for politically connected clients.

To further examine whether variation in auditor scrutiny indeed accounts for the increased restatement frequency of politically connected clients, I turn to the analysis of audit

⁷ In contrast, non-politically auditors may have incentives to exert higher effort for politically connected clients. This argument gains particular weight to the extent that politically connected firms are characterized by low earning quality (e.g., Chaney, Faccio, and Parsley [2011]).

⁸ As explained later in the paper, when there is an overlap of interests between auditors and clients (e.g., Puro [1984]), it is likely that both auditors and clients establish common political connections (i.e., they establish political connections to the same Senate or House of Representatives committee members). Under this scenario, the common auditor-client political connectedness could heighten the reputation and litigation considerations of politically connected auditors because one might expect that this type of joint political activity is more visible and more likely to attract the scrutiny of market participants and regulatory authorities. This type of auditor-client political connectedness that reflects an overlap of interests between auditors and clients (i.e., in the spirit of Puro [1984]) is different from the argument of auditor lobbying on behalf of her own clients (i.e., when auditors act as advocates of their clients as in Burnett, Chen, and Gunny [2016]).

fees. My findings indicate that, during the non-manipulation period, clients of politically connected offices are, in general, associated with higher audit fees and that this relation is stronger for politically connected clients. However, the positive link between audit office political connectedness and audit fees weakens significantly during the restatement manipulation period, when the importance of high quality auditing is greater. In particular, I provide evidence that, politically connected clients of connected offices were associated with significantly lower audit fees compared to non-politically connected clients during the restatement manipulation period.

Variation in restatement frequency may not always reflect variation in audit quality. While the lower rate of restatements can represent absence of errors or irregularities, it could also be the result of lower enforcement (e.g., Srinivasan, Wahid, and Yu [2014]). To mitigate concerns that lower enforcement accounts for my results, I first examine whether the relation between internal control material weaknesses (ICWs) and the rate of restatements is conditional on the level of the political connections of auditors. Following Srinivasan, Wahid, and Yu [2014], I expect variation in this relation to reflect variation in the quality of detection and disclosure. I find no evidence that the relation between ICWs and restatement frequency varies with auditors' political connections for non-politically connected firms. Interestingly, however, I do provide evidence that this relation is less positive for politically connected clients. That is, for politically connected clients, not only is the frequency of restatements greater, but the association of the rate of restatements with ICWs is weaker as well, which means that some misstatements may remain undetected or undisclosed.

In a second step, I examine the relation between audit office political connectedness and audit quality using as my measure of audit quality the propensity to issue a going concern opinion. Consistent with the argument that politically connected auditors have increased reputation and litigation considerations and deliver superior audit quality, I provide evidence

of a positive relation between audit office political connectedness and the propensity to issue a going concern opinion. Moreover, in line with the argument of lower perceived client riskiness or impaired auditor independence for connected clients of connected offices, I show that the positive relation between audit office political connectedness and the propensity to issue a going concern opinion is significantly weakened during the restatement manipulation period for connected clients of connected offices.

Finally, I test whether the positive relation between auditor political connectedness and client restatement frequency differs for those clients that share at least one common political connection with their local office. That is, when both auditors and clients are more likely to establish common political connections to pursue mutual or overlapping lobbying interests (e.g., Puro [1984]). I find that client restatement frequency falls again with the level of audit office political connectedness and that the drop in audit fees during the restatement manipulation years wanes for those politically connected clients that have established political ties with the same auditor-related congressional committee members as their local office. These findings therefore suggest that auditors are less likely to reduce the audit quality of their political connected clients when the auditor-client political activity is more likely to attract the scrutiny of regulators and market participants.

This paper makes several contributions to the literature. Prior empirical research has mainly focused on the consequences of the political connections of firms (e.g., Blau, Brough, and Thomas [2013], Chaney, Faccio, and Parsley [2011], Correia [2014], Faccio [2006], Faccio [2010], Guedhami, Pittman, and Saffar [2014], Leuz and Oberholzer-Gee [2006], Skaife, Veenman, and Werner [2013], Tahoun [2014], Yu and Yu [2011]). To my knowledge, this is one of the few empirical studies to investigate the audit quality consequences of the political connections of auditors and the first to examine the relation between auditor political connections and audit quality at the audit office level.

Second, by providing evidence of a negative relation between auditor political connections and client restatement frequency, I show that the political connections of auditors accrue audit quality benefits to their clients, whereas prior research seems to suggest that politically connected firms are associated with lower earnings quality (e.g., Chaney, Faccio, and Parsley [2011]). Moreover, the relation between audit office political connectedness and restatement frequency is distinct from the relation between client political connectedness and restatement frequency.

Third, the current study contributes to the literature on the determinants of audit quality at the audit office level. Francis and Yu [2009], Choi et al. [2010], and Francis, Michas, and Yu [2013] reason that audit office size is a determinant of superior audit quality. Furthermore, Reichelt and Wang [2010] find that there is a positive link between audit office industry expertise and audit quality. I argue that politically connected audit offices are more likely to deliver superior audit quality and this effect is incremental to that of previously defined office-level characteristics.

Finally, this paper contributes to the literature that investigates threats to auditor independence. For example, prior research has identified the joint provision of audit and non-audit services as potential threats to auditor independence (e.g., DeFond, Raghunandan, and Subramanyam [2002], Ferguson, Seow, and Young [2004], Frankel, Johnson, and Nelson [2002], Hope and Langli [2010]). My findings suggest that politically connected clients are more likely to restate their financial statements when they are being audited by politically connected offices unless they share common political ties. I therefore argue that the threat of audit quality compromise could be greater when both clients and auditors are politically connected since, from an auditor's perspective, the perceived cost of an audit failure is lower.

The remainder of this paper is organized as follows. In section 2, I review the related literature and develop the hypotheses. Section 3 presents the empirical models. In section 4, I

describe the sample selection process and offer descriptive statistics, while in section 5, I present the empirical results and additional robustness tests. Section 6 concludes.

2. Background and Hypothesis Development

Research in political science generally concludes that firms use PAC contributions to buy access to influential politicians and political favors (e.g., Kroszner and Stratmann [1998], Milyo, Primo, and Groseclose [2000], Snyder [1990], Snyder [1992], Snyder [1993]). This argument represents the main principle of *exchange theories* (e.g., Hall and Deardorff [2006], Hillman and Hitt [1999], Lowi [1969], McConnell [1966], Morton and Cameron [1992]) which interpret lobbying as an exchange of money and votes for political favors. Stigler [1971]'s *capture theory* draws upon exchange theories and purports that interest groups capture regulators in their attempt to shape law and regulations to their own favor.⁹

Auditors use their political connections to lobby for their own interests as well for the interests of their clients. Through their political connections, auditors exercise influence on regulators and shape the standard-setting process to their own benefit. For example, Watts and Zimmerman [1978], Watts and Zimmerman [1982], and Puro [1984] argue that auditors lobby standard-setting agencies, such as the Financial Accounting Standards Board, for the introduction of new standards or the amendment of existing standards. Other studies show how audit firms use PAC contributions to gain access to politicians and influence regulatory changes regarding audit practice, such as the Private Securities Litigation Reform Act of 1995 and the Sarbanes-Oxley Act of 2002 (e.g., Dwyer and Roberts [2004], Roberts, Dwyer, and Sweeney [2003], Thornburg and Roberts [2008]). Two congressional committees are mainly

⁹ Recent evidence in accounting and finance seems to confirm capture theory. For example, Yu and Yu [2011] find that politically connected firms are more likely to avoid fraud detection. Moreover, Correia [2014] finds that politically connected firms are less likely to be targeted by the SEC and conditional on being targeted, they pay lower penalties. In addition, politically connected firms exhibit lower accounting quality (e.g., Chaney, Faccio, and Parsley [2011]). These findings gain additional support in the argument that the SEC is resource-constrained and conducts investigations based on preferences and political influence (e.g., Correia [2014], Kedia and Rajgopal [2011]).

responsible for auditor regulation and oversight by the SEC and the PCAOB: The Senate Banking, Housing, and Urban Affairs Committee and the House of Representatives Committee on Financial Services. Using PAC contributions, Big 4 auditors have strongly supported members from both committees over the past years.

While exchange theories view lobbying as an exchange of money and votes for political favors, *persuasion theories* focus on the information value of interest groups to regulators. These theories draw upon the information asymmetry between legislators and interest groups to justify the existence of lobbying (e.g., Austen-Smith [1993], Austen-Smith [1995], Austen-Smith and Wright [1994], Hansen [1991], Holyoke [2009], Naoi and Krauss [2009]). Regulators have limited resources in terms of time, labor, and information to address all issues on which they want to be involved (e.g., Hall and Deardorff [2006]). Since interest groups are specialists in their area, regulators rely on them to acquire specialized information and assess the political and policy consequences of their actions (e.g., Aplin and Hegarty [1980], Austen-Smith and Wright [1992], Gilligan and Krehbiel [1989], Hall and Deardorff [2006], Hillman and Hitt [1999]). Therefore, the creditworthiness of the agent of the interest group is of great importance to legislators (e.g., Heinz et al. [1993], Hillman and Hitt [1999], Hull [1993]). Such reputation is built through repeated dealing and shapes the long-term nature of the interest group-legislator relation. There is little guarantee that either party will not renege on its promises as fee-for-service agreements would be considered bribery (e.g., Kroszner and Stratmann [2000]). In the absence of formal, enforceable contracts, the demand for reputable and credible agents is amplified by the implicit non-enforceable nature of the agreements on which interest groups and regulators rely. An audit failure could severely impair the creditworthiness and status of the involved auditors and thus threaten the continuation of their relations with political authorities. Such a breach would undermine the ability of the associated accounting firm to influence political authorities and standard setting

agencies and thus incur an even greater reputation loss and status downgrade to the involved auditors. Following these arguments, I reason that politically connected auditors have increased reputation and litigation considerations because an audit quality failure could compromise their relations with political authorities and incur consequences for both the auditor and the associated accounting firm. Consistent with this argument, Ramanna and Roychowdhury [2010] show that politically connected firms are concerned about the preservation of their relation with their affiliated politicians and take actions to protect them against political embarrassment.

The consequences of a potential breach in the political connections of auditors are probably even greater when considering the informational benefits that flow from politicians to auditors. These benefits allow politically connected auditors to improve their audit-related skills and knowledge. They therefore enhance the reputation and litigation considerations of politically connected auditors because they increase the value of political connections to them. Politically connected auditors are part of a wide network of regulators, standard setters, and other politically connected auditors. Through their interaction with these individuals, they become further involved in the issues that concern their profession. That is, politically connected auditors have access to peers and regulators with whom they can consult and therefore they have more opportunities to enhance their competencies, knowledge, and skills. Francis and Yu [2009] for instance argue that, one of the reasons why auditors in large offices offer superior audit quality is the fact that large offices have greater in-house networking and consultation opportunities. These arguments are consistent with the premises of social capital theory which predicts that network connections accrue informational advantages to members of the network (e.g., Burt [1992], Cohen, Frazzini, and Malloy [2010], Coleman [1988], Horton and Serafeim [2012], Horton, Tuna, and Wood [2014]). Network studies have repeatedly shown that there is a positive link between social capital and

performance. For example, Horton, Millo, and Serafeim [2012] find that firms with better connected directors have better future performance. Moreover, Horton and Serafeim [2012] argue that analysts with more connections issue more accurate and timely forecasts, while Horton, Tuna, and Wood [2014] provide evidence that better connected audit partners provide higher quality audits.

One could further argue that politically connected auditors benefit from their position in their network (which encompasses other connected auditors as well as standard setters and regulators) particularly when it comes to interpreting and correctly applying accounting standards in accordance with GAAP. Politically connected auditors are heavily involved in the standard-setting procedure (e.g., Dwyer and Roberts [2004], Puro [1984], Roberts, Dwyer, and Sweeney [2003], Thornburg and Roberts [2008], Watts and Zimmerman [1978], Watts and Zimmerman [1982]). Legislators discuss with auditors about issues that pertain to audit practice, the correct application of GAAP, as well as to ways on how to improve existing standards. Therefore, compared to non-connected auditors, politically connected auditors may be more likely to be informed about potential ambiguities surrounding provisions of the current standards that require judgement. Furthermore, to the extent that audit firms lobby for the introduction of new standards or the amendment of existing standards, politically connected auditors may be more likely to have a better understanding of the letter and spirit of the new or amended standard due to their participation in the deliberations regarding the standard. The conjecture that politically connected auditors have better knowledge of accounting standards is in line with the “institutional knowledge argument” of Yang [2013] who finds that politically connected auditors in China that participate in the IPO selection process have superior knowledge of the related regulatory procedure and use this knowledge to help their clients lower their IPO rejection rates. On a

related note, Christensen et al. [2017] argue that politically connected brokers have access to policy-related information that allows them issue more profitable stock recommendations.

In this paper, I investigate the relation between Big 4 *auditor-specific* political connections and audit quality at the audit office level. I define as *auditor-specific*, those political connections that auditors establish with members of committees responsible for auditor regulation and oversight. That is, the Senate committee on Banking, Housing, and Urban Affairs and the House of Representatives committee on Financial Services. I measure audit quality as the frequency of accounting restatements because the material restatement of originally audited financial statements is strongly suggestive that the original audit of those financial statements was of low quality (e.g., Francis and Michas [2013], Francis, Michas, and Yu [2013], Kinney, Palmrose, and Scholz [2004], Palmrose and Scholz [2004]). Moreover, the SEC describes restatements as “the most visible indicator of improper accounting and source of new investigations” Schroeder [2001]. Restatements can have severe consequences for auditors. They trigger SEC disciplinary actions (e.g., Dechow et al. [2011], Dechow, Sloan, and Sweeney [1995]), lawsuits against auditors (e.g., Palmrose and Scholz [2004]) and may even result in auditor resignation or dismissal (e.g., Hennes, Leone, and Miller [2014]). Due to their visibility and significant reputation-damaging effects, I expect that a restatement would severely affect the connections of the auditor responsible for the audit with her affiliated politicians. Politically connected auditors have therefore strong incentives to avoid being involved in a restatement. Furthermore, drawing upon Plumlee and Yohn [2010] who find that 37% of all restatements are due to lack of clarity in accounting standards or due to the use of judgement in applying the standards, I argue that the frequency of accounting misstatements is a suitable measure to capture to what extent clients of politically connected auditors may benefit from their auditors’ knowledge on how to correctly apply accounting standards.

Based on these arguments, I formulate my first hypothesis (in alternative format) as follows:

H1: Clients of politically connected offices are less likely to restate their earnings.

Even if, on average, politically connected auditors deliver superior audit quality, there might still be settings in which auditor political connections account for a decrease in audit quality. Audit engagements with politically connected clients probably constitute one such setting. Politically connected firms have often been assumed to capture regulatory authorities or to use opaque means in an effort to change or circumvent existing rules (e.g., Amore and Bennedsen [2013], Correia [2014], Harstad and Svensson [2011], Yu and Yu [2011]). One could therefore argue, that, compared to non-connected firms, politically connected firms are more likely to also exercise pressure to their auditor so that they are subject to lower auditor scrutiny when they wish to remain opaque.¹⁰ To the extent that politically connected clients are protected by their affiliated politicians (e.g., Chaney, Faccio, and Parsley [2011], Correia [2014], Gul [2006], Yu and Yu [2011]), politically connected auditors may perceive these clients as being less risky and cater their desire to remain opaque. That is, politically connected auditors might be more likely to allow their politically connected clients contract for lower audit fees and be subject to lower auditor scrutiny, when they wish to remain opaque.¹¹ Politically connected auditors may be more likely to lower their scrutiny on politically connected clients because, due to their own political connectedness, they are

¹⁰ The case of Enron is a notable example. Enron was heavily involved in lobbying activities. John Dean, a former Counsel to President Richard Nixon, argued that Enron's lobbying activities and campaign contributions "may have helped slow detection of its troubles, and helped the company fly under the radar for as long as was possible given what now appear to be some egregious accounting and business practices" (Yu and Yu [2011]). William Lerach, the lead plaintiff's attorney in the case against Enron said that "The Enron fraud is the story of synergistic corruption. There are supposed to be checks and balances in the system. The lawyers were supposed to say no, the accountants were supposed to say no, the bankers were supposed to say no, but no one who was supposed to say no, said no." Therefore Enron's practices aimed at bending the system and circumventing existing rules extended well beyond capturing governmental agencies and regulatory authorities.

¹¹ This argument, however, does not necessarily imply that connected auditors have prior knowledge of their clients' intended misreporting and knowingly allow for such manipulation activities to take place.

probably more likely to understand that the nature of their clients' connections allows them to enjoy political support.¹² Therefore, to the extent that their clients are supported by their politicians, connected auditors might be more likely to assume that their connected clients are less likely to fail or have lower incentives to misreport. This argument is consistent with Gul [2006] who shows that, during the Asian financial crisis, auditors in Malaysia, while not necessarily politically connected themselves, increased their effort on politically connected firms when were considered to have lost political support. However, they reduced their effort when their clients' political connections were re-established, thus lowering the likelihood of a business failure as well as the incentives of politically connected firms to misreport.¹³ Alternatively, connected auditors could be less reluctant to allow their clients contract for lower audit fees, when they wish to remain opaque, if they discount the negative consequences of a possible audit quality failure. That is, if they assume that, even if an accounting irregularity takes place while their connected clients are subject to lower auditor scrutiny, and the irregularity is later detected and subject to regulatory scrutiny, the auditor is less likely to be held liable. This scenario is plausible to the extent that, due to their own network position and institutional knowledge, connected auditors may have a better

¹² One may argue that an alternative threat of audit quality compromise could exist when auditors utilize their political connections to explicitly lobby on behalf of certain clients. Auditor lobbying is permissible in the US. However, SOX prohibits auditors from serving as advocates of audit clients as such activity could impair their independence and objectivity. Therefore, it may be reasonable to expect that the likelihood of auditors serving as lobbying advocates of their clients is very limited. The case of Ernst & Young is a notable exception: In March 2012, Reuters questioned Ernst & Young's independence in providing audit services citing the lobbying contracts that the auditing firm had with a number of its clients. The SEC investigation which was initiated following the article resulted in Ernst & Young receiving a fine of \$4 million in July 2014 for violating auditor independence rules in lobbying activities. While the likelihood of auditor lobbying on behalf of certain clients may be limited, the possibility that both auditors and clients have overlapping lobbying objectives is not unlikely (e.g., Puro [1984]).

¹³ While Gul [2006] makes no distinction between (politically) connected and non-connected auditors in his paper, he argues that "anecdotal evidence and numerous press reports suggest that capital controls were introduced by the Malaysian government in September 1998 so that some "strong politicians" could support PCON firms". In other words, it appears that the introduction of capital controls during the Asian crisis was a widely publicized event and that it was common knowledge that its main purpose was to support politically connected firms. Therefore, it is reasonable to argue that, irrespective of their own level of political connectedness, auditors in Malaysia had a very good understanding that the political links of their previously connected firms had been re-established. In the current paper I argue that, in the US setting, Big 4 auditors' own level of political connectedness gives them an insider knowledge or better understanding of the benefits and protection that their clients may enjoy by being politically connected themselves.

understanding of the type of audit failures for which they are more likely to be held liable by regulatory authorities. Therefore, they may also be less likely to restrict those irregularities for which their liability is more difficult to be proven in the court of law.^{14,15} Under these alternative scenarios connected auditors might be willing to allow for lower levels of client scrutiny because they can still cater the needs of their connected clients to remain opaque, without running the risk of experiencing severe consequences, even if their clients' irregularities are eventually revealed. I argue this because an accounting misstatement may be detected from sources other than the auditor herself (e.g., Dyck et al. [2015], Keune and Johnstone [2012], Srinivasan, Wahid, and Yu [2014]). Therefore, when connected clients of connected offices are less scrutinized by their auditors, some of these irregularities may eventually be revealed, whereas others may not. This argument implies that, a) it is less likely that clients of politically connected auditors will be associated with lower restatement frequency when they are politically connected themselves, and b) some accounting irregularities may still remain undetected unless other market participants are successful in detecting all undetected misstatements. Alternatively, to the extent that auditor reputation and litigation considerations are sufficient to deter any incidence of audit quality compromise or the nature of the common auditor-client political activity is such that instead elevates their reputation and litigation considerations, connected auditors may not deliver suboptimal audit quality to connected clients. Non-connected auditors on the other hand, probably have valid

¹⁴ This conjecture is also line with the “institutional knowledge argument” of Yang [2013], in that good knowledge of the regulatory process could allow politically connected auditors formally comply with the prevailing regulatory requirements without necessarily delivering superior audit quality (in the sense that auditors may allow their clients engage in activities for which auditor negligence cannot be easily established or proven). It is additionally consistent with Correia [2014] who argues that the lower likelihood of regulatory enforcement and penalties for connected firms can be attributed to lobbyists' better knowledge of regulatory process.

¹⁵ While one might argue that connected auditors could also allow non-connected clients engage in the type of accounting irregularities for which auditors are less likely to be held liable, I purport that it is the possible pressure by politically connected clients to their connected auditors to lower their scrutiny on them, the protection of connected clients by their affiliated politicians, as well as connected auditors' superior knowledge of the institutional environment that may weaken the incentives of connected auditors to restrict the type of irregularities for which auditors are less likely to be held accountable.

reasons to consistently exert greater effort and hence consistently charge higher fees to connected clients to the extent that politically connected clients have lower earnings quality and are more opaque (e.g., Chaney, Faccio, and Parsley [2011]).

Based on these arguments, I state my next two hypotheses (in alternative format) as follows:

Hypothesis 2a: The relation between the frequency of restatements and audit office political connectedness is less negative for politically connected clients.

Hypothesis 2b: Audit fees are lower for politically connected clients of politically connected offices during the restatement manipulation period.

3. Methodology

3.1 *Audit Office Political Connectedness Measures*

Because interest groups develop long-term relations with affiliated politicians (e.g., Bernhagen [2013], Berry [1999], Mccarty and Rothenberg [1996], Snyder [1992]), I focus on long-term measures of audit office political connectedness to capture the relation between restatement frequency and audit office political connectedness. Following Cooper, Gulen, and Ovtchinnikov [2010] and Correia [2014], I define my first measure as the 5-year dollar amount of PACs targeting auditor-relevant politicians. I calculate this variable at the audit firm-audit office level:

$$\mathbf{Measure\ 1} = \sum_{p=1}^P \mathbf{PAC}_{t-4,t}^p$$

where $p=1, \dots, P$ is the politician index and $\sum_{p=1}^P \mathbf{PAC}_{t-4,t}^p$ is the dollar amount of PAC contributions to auditor-relevant committee members made by all employees of each audit firm-office over the previous five years.

My second measure is the 5-year sum of distinct per year auditor-relevant politicians supported by each audit firm-office:

$$\mathbf{Measure\ 2} = \sum_{t=4}^t \sum_{p=1}^P \mathbf{1},$$

where $p=1, \dots, P$ is the politician index and $\sum_{p=1}^P \mathbf{1}$ is the total number of politicians supported per audit firm-office-fiscal year.

My last measure is the 5-year sum of distinct per year contributors for each audit firm-office:

$$\mathbf{Measure\ 3} = \sum_{t=4}^t \sum_{e=1}^E \mathbf{1},$$

where $e=1, \dots, E$ is the politically connected employee index and $\sum_{e=1}^E \mathbf{1}$ is total number of employees making PAC contributions per audit firm-office-fiscal year.

Because my office-level measures of auditor political connectedness are strongly positively correlated with the size of the engagement office which has been identified as a determinant of superior audit quality by prior literature (e.g., Choi et al. [2010], Francis, Michas, and Yu [2013], Francis and Yu [2009]), I regress the natural logarithm of one plus each of these measures on the size of the audit office. My final measures of auditor political connectedness are the residuals of each of these regressions.¹⁶

3.2 Empirical Models

To test hypothesis 1, I use the following probit model:

$$\mathbf{Restate}_{i,t} = \mathbf{a_0} + \mathbf{a_1 Measure_Res} + \mathbf{Controls} + \mathbf{Year\ FE} + \mathbf{Industry\ FE} \\ + \mathbf{Audit\ Office\ FE} + \boldsymbol{\varepsilon}_{i,t} \quad (1),$$

¹⁶ Results are generally qualitatively similar when using the original audit office political connectedness measures.

where $Restate_{i,t}$ is an indicator variable that takes the value 1 if a firm-year is subsequently restated, and 0 otherwise, whereas $Measure_Res$ is the corresponding orthogonalized auditor political connectedness measure. Following Francis, Michas, and Yu [2013], I use heteroscedasticity and autocorrelation robust standard errors, clustered at the office-year-audit firm level.¹⁷

Control Variables

I control for firm-specific long-term political connectedness (Pol_Client), which I calculate as the natural logarithm of one plus the 5-year sum of the distinct per year politicians supported by firm i . Following Francis, Michas, and Yu [2013], Choi et al. [2010], and Francis, Michas, and Yu [2013], I control for the size of the engagement office ($Office\ Size$). I define this variable as the natural logarithm of the audit fees of all clients of the office minus the audit fees of the corresponding client.¹⁸ I control for firm size ($Total\ Assets$) calculated as the natural logarithm of total assets although most prior studies find no relation between size and restatements (e.g., Cao, Myers, and Omer [2012]). I include market-to-book ratio ($Market-to-Book$) as a control for firm growth. I control for leverage ($Leverage$) motivated by the debt covenant hypothesis (e.g., Watts and Zimmerman [1986]). I calculate this variable as the ratio of long-term debt divided by total assets. I control for profitability (ROA) and firms that report losses ($Loss$) to capture the link between firm performance and misstatement frequency. I further control for firm complexity by including the natural logarithm of one plus the number of business ($Num.\ of\ Business\ Segments$) and geographic segments ($Num.\ of\ Geographic\ Segments$). Moreover, I include an indicator variable for mergers and acquisitions ($Merger$), as well as for new financing activities ($Financing$) following prior literature (e.g., Dechow [1996], Palmrose and Scholz [2004]). I additionally

¹⁷ Results are generally qualitatively similar if I cluster at the firm level.

¹⁸ I follow prior literature and calculate office size prior to merging with Compustat.

control for the proportion of assets in receivables and inventory (*Receivables & Inventory*) (e.g., Feroz, Park, and Pastena [1991], Summers and Sweeney [1998]), the standard deviation of ROA (*Std ROA*) to control for operational volatility (e.g., Cao, Myers, and Omer [2012]), as well as indicators for industry expertise at the city and national level (*City Leader*, *National Leader*) following Francis, Michas, and Yu [2013]. In both specifications, I include industry, year, and audit firm fixed effects. I estimate industry fixed effects using 2-digit SIC codes. Finally, I winsorize all continuous, non-logarithmic variables at the 1% and 99% levels. Detailed definitions of all variables can be found in the Appendix.

To test hypothesis 2a, I use an indicator variable that takes the value 1 if the client has made PAC contributions over the past five years, and zero otherwise (*Pol_Client_D*). I subsequently estimate the following probit model:

$$\begin{aligned}
 \mathbf{Restate}_{i,t} = & \mathbf{a}_0 + \mathbf{a}_1 \mathbf{Measure_Res} + \mathbf{a}_2 \mathbf{Measure_Res} \times \mathbf{Pol_Client_D}_{i,t} \\
 & + \mathbf{a}_3 \mathbf{Pol_Client_D}_{i,t} + \mathbf{Controls} + \mathbf{Year\ FE} + \mathbf{Industry\ FE} \\
 & + \mathbf{Audit\ Office\ FE} + \boldsymbol{\varepsilon}_{i,t} \quad (2)
 \end{aligned}$$

Controls are defined as previously. Moreover, due to the difficulties in interpreting interaction terms in probit specifications (e.g., Ai and Norton [2003], Becker and Milbourn [2011], Christensen et al. [2017], Cornelli, Kominek, and Ljungqvist [2013]), in untabulated tests, I also estimate all probit specifications that include interaction terms using OLS estimation techniques.

To test hypothesis 2a and investigate the degree to which audit fees were lower for politically connected clients of politically connected offices during the restatement manipulation period, I use the following OLS specification:

$$\begin{aligned}
Fees_{i,t} = & a_0 + a_1 Measure_Res + a_2 Measure_Res \times Pol_Client_D_{i,t} \\
& + a_3 Measure_Res \times Pol_Client_D_{i,t} \times Restate_{i,t} \\
& + a_4 Measure_Res \times Restate_{i,t} + a_5 Pol_Client_D_{i,t} \times Restate_{i,t} \\
& + a_6 Pol_Client_D_{i,t} + a_7 Restate_{i,t} + Controls + Year\ FE \\
& + Industry\ FE + Audit\ Office\ FE + \varepsilon_{i,t} \quad (3),
\end{aligned}$$

where $Fees_{i,t}$ is the natural logarithm of audit fees of firm i in year t . The control variables include all controls of the main specification. In addition, following Francis, Reichelt, and Wang [2005], I control for the propensity to issue a going concern opinion.

4. Data and Descriptive Statistics

4.1 Audit Office Political Connections Data

To construct my office-level measures of political connectedness, I obtain PAC contribution data originating from individuals from the Center for Responsive Politics (CRP) for the period 1999-2012.¹⁹ In particular, I use the “Individual Contributions” file from the Campaign Finance Database and manually match the name of each Big 4 audit firm to the corresponding employer field.²⁰ I additionally retrieve location information including the city, address, and zip code of all contributors and use this data to match each contributor to the corresponding local engagement office. My source of data for the list of all local Big 4 audit engagement offices is Audit Analytics. If the city of the contributor cannot be matched, I use the available zip code and require a maximum distance of 10 miles from the closest local office. I further filter out those PAC contributions that do not directly target individual candidates and use Charles Stewart's Congressional Data Page to identify those PACs

¹⁹ <http://www.opensecrets.org/>

²⁰ Manually matching is required by the fact that the CRP provides no single standardized name for the employment firm of individual contributors. Instead, multiple alternative names correspond to each employment firm.

supporting auditor-relevant politicians.²¹ That is, I focus on PACs to members of the Senate Committee on Banking, Housing, and Urban Affairs and the House of Representatives Committee on Financial Services. Through this procedure, I am able to identify 189 unique Big 4 offices with at least one PAC contribution to auditor-relevant politicians during the period 1999-2012. I present descriptive statistics of this sample in Table 1 before merging with Compustat and imposing further data restrictions.

Table 1, Panel A shows the number of politically connected offices per audit firm for the years 1999-2012. I classify an office as politically connected if at least one employee of that office makes an auditor-relevant PAC contribution during this period. KPMG has the largest number of politically connected offices with 51 distinct offices that have supported at least one auditor-relevant politician during the sample period. PwC has the fewest politically connected offices (44), whereas Deloitte and Ernst & Young have 45 and 49 connected offices respectively. These numbers do not seem to indicate significant absolute differences among audit firms. When comparing the number of politically connected offices with the total number of all offices reported in Audit Analytics for the same period (1999-2012), these differences remain comparatively small.²² In relative terms, 50 to 55 per cent of all Big 4 offices can be classified as politically connected.

Panel B presents aggregate values of three alternative measures of audit firm employee political connectedness calculated at the audit firm level over the period 1999-2012: the dollar amount of PACs, the number of supported auditor-relevant politicians, and the number of politically connected employees. Upon initial review, this panel seems to indicate that there are important differences in the degree of audit employee political connectedness among Big 4 audit firms. For example, Deloitte ranks first in two out of three measures and second in the third with 432 politically connected employees and more than \$547 thousand

²¹ http://web.mit.edu/17.251/www/data_page.html#2

²² This comparison is based on the number of Big 4 audit offices reported in Audit Analytics with at least one firm that can be matched with Compustat.

spent on 96 auditor-relevant politicians. KPMG on the other hand, ranks last in all measures: From 1999 to 2012, 220 KPMG employees supported 65 distinct politicians with PAC contributions that amount to roughly \$207 thousand. Furthermore, both Ernst & Young and PwC are significantly different from each other, as well as from the other two Big 4 audit firms, in terms of total amount spent on PACs, number of supported politicians, and number of connected employees. To investigate whether these differences are driven by differences in the total number of employees among the Big 4, I retrieve data on the total number of employees of the Big 4 accounting firms from www.statista.com and present this data in Table 1, Panel C.²³ Indeed, Panel C shows that the differences in Panel B are largely mitigated when considering the differences in the number of total employees among the Big 4 accounting firms. Politically connected employees in Deloitte represent 0.71% of the total number of employees, whereas the corresponding percentages for KPMG and PwC are 0.89% and 0.79% respectively. Ernst & Young exhibits the greatest percentage of politically connected to total number of employees (1.21%).

4.2 Main Sample Data

I define my sample period from 2003 to 2012 and thus I allow enough office-year observations to construct my 5-year auditor political connectedness measures. I retrieve auditor and restatement data from Audit Analytics. I drop restatements that occur due to clerical errors, quarterly restatements, as well restatements with positive impact on earnings. Moreover, I restrict my sample to clients which are headquartered and incorporated in the US and are audited by US Big 4 practice offices. I additionally drop firm-year observations when an auditor switch occurs during the fiscal year. I merge this database with Compustat as well as with the audit office political connectedness dataset from the previous step. To identify

²³ I use audit firm employee data from www.statista.com for the year 2013, since there are no earlier records of this type of data readily available.

firms that have made PAC contributions in the past, I use firm PAC data from the CRP. I follow Correia [2014] and match this database to Compustat manually by name. Finally, I drop observations with missing values in the variables of interest. These restrictions result in a sample of 17,374 firm-year observations and 3,275 firms.²⁴ Restated firm-years amount to roughly 13% of the sample. Table 2 presents political connectedness descriptive statistics at the office-year level as well descriptive statistics of all regression inputs for the full model.

5. Results

5.1 Auditor Political Connections

Table 3 presents the probit estimations of the regression of restatement frequency on each of the three alternative office-specific, long-term measures of political connectedness after controlling only for industry, year, and audit firm fixed effects. This specification results in a sample of 24,694 firm-year observations and 4,341 firms. In the second column of each measure I additionally include the related firm-specific control. Table 3 shows that all three measures are negative and statistically significant at the 5% and 1% levels. The coefficients of each measure for the specifications without including control variables are -0.0077, -0.0440, and -0.0318 respectively.

The inclusion of control variables reduces the sample size to 17,330 firm-year observations. The negative relation between audit office political connections and rate of restatements holds after the inclusion of control variables. In particular, the related coefficients are statistically significant at the 5% level. There is a negative relation between long-term firm political connections and the likelihood of accounting restatements and this effect is significant at the 1% level across all three alternative measures. The negative relation between firm-specific political connections and the likelihood of accounting restatements

²⁴ The sample size of probit specifications amounts to 17,330 observations for the main analysis due to a number observations dropping with the inclusion of fixed effects.

seems to contradict prior research showing that politically connected firms are associated with lower financial reporting quality (e.g., Chaney, Faccio, and Parsley [2011]). It is possible, however, that, to the extent that politically connected firms are more opaque, on average, auditors exert greater effort and lower the frequency of restatements for these clients.²⁵ This scenario is plausible, since misstatements constitute a very direct and egregious measure of audit quality, whereas audit quality is not the only component of financial reporting quality (e.g., Defond and Zhang [2014]). All other statistically significant control variables have the predicted sign. Overall, these findings seem to suggest that politically connected offices deliver superior audit quality in terms of the restatement frequency of their clients.

5.2 Auditor-Client Political Connections

In Table 4, I present the results of regression (2) in which I test hypothesis 2a. Consistent with expectations, I find that the relation between audit office political connections and restatement frequency is less negative for clients that have made PAC contributions to politicians over the past 5 years. In particular, the coefficient of the interaction term between Measure 1 and the firm political connectedness indicator is equal to 0.0370 (p-value<0.001). For the second and third measures, the interaction term coefficients are 0.1407 (p-value 0.003) and 0.1166 (p-value 0.001). These findings indicate 1% significance levels for the related interaction terms. Moreover, both main effects retain their sign compared to the model of Table 3 and are also significant at the 1% level. These findings are in line with the argument that politically connected auditors deliver lower audit quality to connected clients.

²⁵ Consistent with the argument that the negative link between client political connectedness and restatement frequency is the result of greater auditor effort and superior audit quality, the results of Tables 4 and 5 suggest that, when the appointed auditor is not connected herself, client political connectedness is associated with lower frequency of restatement and higher audit effort (proxied by the amount of audit fees). In contrast, connected clients of connected offices are more likely to restate their earnings and are associated with lower audit effort during the restatement manipulation period.

In the second column of each measure, I repeat regression (1) for the subsample of politically connected firms. This analysis results in 2,887 firm-year observations. The results show that all three measures are positive and statistically significant at the 1% level. This analysis provides evidence that the negative relation between audit office political connectedness and client restatement frequency reverses for politically connected clients.

In untabulated tests, I repeat regression (2) using OLS estimation techniques. Results are qualitative identical to original findings. In particular, I continue to find a negative and significant at the 1% level coefficient on all three audit office political connectedness measures. Moreover, the interaction term between all audit office political connectedness and client political connectedness remains positive and significant at the 1% level, whereas the main effect of the client political connectedness measure is negative and significant at the 1% level.

5.3 *Audit Fee Analysis*

To test hypothesis 2b and further examine whether politically connected offices are less likely to scrutinize politically connected firms, I turn to the analysis of audit fees. In particular, I investigate the degree to which politically connected offices scrutinize their politically connected clients as well as whether auditor scrutiny was significantly weaker during the restatement manipulation period. To the extent that audit fees capture variation in audit effort, lower audit fees when politically connected firms were engaging in earnings manipulation activities could indicate that politically connected auditors were less likely to scrutinize politically connected clients precisely when delivering high quality audits was more important. Such finding could therefore explain the increased occurrence of restatements for politically connected clients, even if auditor scrutiny is nevertheless strong during the non-manipulation period for connected clients of connected auditors. Moreover, to the extent that the lower frequency of restatements for non-connected clients of connected

auditors is the result of greater auditor effort, then one would expect that audit fees are greater for non-connected clients of connected auditors.

Consistent with the argument that politically connected offices generally deliver superior audit quality as indicated in Table 3, the first column of Table 5 shows that politically connected offices charge higher fees. In particular, the coefficients on all three measures of audit office political connectedness are positive and significant at the 5% level or better. Furthermore, the second column of each measure in Table 5 shows that the relation between audit office political connectedness and audit fees is stronger for politically connected clients during the non-manipulation period. In particular, the main effect coefficients of the office political connectedness measures are statistically significant at the 5% and 10% levels for Measures 2 and 3, respectively. The coefficient of Measure 1 is positive but insignificant. Moreover, the interaction of each political connectedness measure with the client political connectedness indicator is positive at the 5%, 10%, and 1% levels for Measures 1, 2, and 3, respectively. The positive two-way interaction terms seem to initially contradict the findings of Table 4, which indicate that politically connected clients are more likely to restate their earnings when audited by politically connected firms. However, the three-way interaction term *Meas_Res X Pol_Client_D X Restate*, which examines whether this positive relation was significantly different during the restatement manipulation period is negative and significant at 5% level across the three alternative office political connectedness measures. This finding holds when focusing on the restatement period only, thus limiting the sample to 2,329 firm-year observations. These results suggest that politically connected clients were associated with lower audit fees compared to non-politically connected clients during the restatement manipulation period only when audited by politically connected offices. Therefore, they were less likely to be scrutinized by their auditors precisely when the earnings manipulation activities were taking place.

It is interesting to note that the coefficient on client-specific political connectedness (*Pol_Client_D*) in the second column of each measure, which captures the relation between client political connectedness and audit fees when these clients are *not* audited by connected offices is consistently positive and significant at the 1% level. This finding is in line with the argument that the negative link between client political connectedness and restatement frequency documented in Table 4 is the result of greater scrutiny on connected clients by their non-connected auditors.

5.4 *Restatement Frequency and Competing Explanations*

Lower frequency of restatements may not always represent fewer errors and irregularities. It could also be the result of lack of detection and disclosure of these errors and irregularities (e.g., Srinivasan, Wahid, and Yu [2014]). This argument is consistent with prior research showing that politically connected firms are less likely to be involved in SEC enforcement actions and that they are less likely to be detected for fraud, despite having lower accounting quality (e.g., Chaney, Faccio, and Parsley [2011], Correia [2014], Yu and Yu [2011]). Therefore, one could argue that the negative relation between audit office political connections and the rate of restatements reflects low enforcement rather than superior audit quality. This is a plausible scenario to the extent the auditor political connections capture regulatory authorities and therefore allow them to enjoy preferential treatment from disciplinary agencies, consistent with Stigler's capture theory. The positive interaction term of Table 4 provides some initial comfort that my results are most likely not driven by lower enforcement. If politically connected auditors as well as their clients were less scrutinized by regulatory authorities, then one would expect that the negative relation between auditor political connections and the rate of restatements is even stronger for politically connected clients. This is not the case as the results of Table 4 indicate. Moreover, the audit fee analysis of Table 5 offers further support to the argument that the negative link

between audit office political connectedness and client restatement frequency is the result of greater auditor effort. The results of Table 5 are additionally important, because they show that variation in auditor effort for connected clients of connected auditors is associated in a predictable way with variation in the relation between audit office political connectedness and client restatement frequency. Nevertheless, to further mitigate concerns that my measures of audit office political connections capture variation in audit quality rather than variation in enforcement, I conduct two additional tests.

5.4.1 Restatement Sensitivity to Internal Control Material Weaknesses

I first test the extent to which the relation between internal control material weaknesses (ICWs) and restatement frequency varies with the level of audit office political connectedness. Prior research has shown that there is a positive link between the quality of firms' internal controls over financial reporting and the rate of restatements (e.g., DeFond and Jiambalvo [1991], Hammersley, Myers, and Shakespeare [2008], Plumlee and Yohn [2010]). Srinivasan, Wahid, and Yu [2014] argue that variation in this relation could reflect variation in the quality of detection and disclosure because if firms conceal their restatements, the positive link between restatements and ICWs should be weaker. Therefore, to the extent that the negative relation between the rate of restatements and audit office political connectedness reflects lower levels of detection and disclosure rather than better audit quality, I expect the relation between ICW and restatement frequency to be less positive for politically connected offices. To test this prediction I run the following probit model:

$$\begin{aligned}
\mathbf{Restate}_{i,t} = & \mathbf{a}_0 + \mathbf{a}_1 \mathbf{Measure_Res}_{i,t} + \mathbf{a}_2 \mathbf{Measure_Res} \times \mathbf{Pol_Client_D}_{i,t} \\
& + \mathbf{a}_3 \mathbf{Measure_Res} \times \mathbf{Pol_Client_D}_{i,t} \times \mathbf{ICW}_{i,t} \\
& + \mathbf{a}_4 \mathbf{Measure_Res} \times \mathbf{ICW}_{i,t} + \mathbf{a}_5 \mathbf{Pol_Client_D}_{i,t} \times \mathbf{ICW}_{i,t} \\
& + \mathbf{a}_6 \mathbf{Pol_Client_D}_{i,t} + \mathbf{a}_7 \mathbf{ICW}_{i,t} + \mathbf{Controls} + \mathbf{Year\ FE} + \mathbf{Industry\ FE} \\
& + \mathbf{Audit\ Office\ FE} + \boldsymbol{\varepsilon}_{i,t} \quad (4),
\end{aligned}$$

where $ICW_{i,t}$ is an indicator variable that takes the value 1 if a firm reported an internal control material weakness (SOX 404), and 0 otherwise. The coefficients of interest in this regression are coefficients α_4 and α_3 . Coefficient α_4 captures the extent to which the positive link between ICW and the frequency of accounting restatements varies with the level of audit office political connectedness, whereas coefficient α_3 captures the extent to which whether this relation is statistically significantly different between politically connected and non-politically connected firms. Following Srinivasan, Wahid, and Yu [2014], I use the original ICWs and do not include those ICWs that were issued due to the restatement itself. Furthermore, because auditor's assessment of internal controls for US accelerated filers became mandatory in November 2004, I restrict my sample to fiscal years starting from 2005. This procedure results in a sample of 11,902 firm-year observations for the full model. I present the results of this analysis in Table 6.

Consistent with expectations, Table 6 documents a strong positive relation between ICW and the frequency of accounting restatements (the respective coefficient is positive and significant at the 1% level under all alternative specifications). Moreover, there is no evidence that the relation between ICW and restatement frequency varies with the level of the political connections of auditors for non-politically connected firms. In particular, the interaction term of the respective audit office political connectedness measure with the ICW indicator ($Measure_Res \times ICW$) is not statistically different from zero across all three measures. This finding suggests that, for non-politically connected firms, the level of political

connectedness of the auditor does not appear to moderate the positive relation between ICW and client restatement frequency. This finding therefore further mitigates concerns that the negative relation between auditor political connections and the rate of restatements could reflect lack of detection or disclosure rather than better audit quality. Interestingly, however, this result does not appear to hold for politically connected firms. Table 6 shows that the three-way interaction term of the corresponding audit office political connectedness measure, the firm political connectedness indicator, and the ICW indicator (*Measure_Res X Pol_Client_D X ICW*), is negative and statistically significant (at the 5% level or better) in all three specifications. This finding indicates that, not only are politically connected firms more likely to restate their earnings when they are being audited by politically connected auditors, but the positive relation between ICW and restatement frequency is weaker as well for these clients. Therefore, to the extent that connected auditors are less likely to scrutinize their connected clients as indicated in Table 5, the results of Tables 5 and 6 are consistent with each other.

Due to the problems in interpreting three-way interaction terms, I regress the frequency of accounting restatements on each measure of audit office political connectedness, its interaction with the ICW indicator, and the controls of Table 6 for the subsample of politically connected clients only and present the results in the second column of each measure. I continue to find a negative and statistically significant ICW interaction term for all three measures. In particular, the corresponding coefficients are significant at the 1% and 5% levels.

In untabulated analyses, I repeat regression (4) using OLS estimation techniques. Results are again qualitatively very similar to original findings. In particular, the three-way interaction term *Measure_Res X Pol_Client_D X ICW* (two-way interaction term *Measure_Res X ICW* in the specification that is limited to connected clients only) is negative

and significant at the 5% level or better across the three measures of audit office political connectedness.

5.4.2 The Propensity to Issue a Going Concern Opinion

I next examine the relation between audit office political connectedness and audit quality using as my measure of audit quality the propensity to issue a going concern opinion. The use of the propensity to issue a going concern opinion as an alternative audit quality measure offers several advantages in my setting: First, like the frequency of restatements, the propensity to issue a going concern opinion constitutes a direct measure of audit quality (e.g., DeFond and Zhang [2014]). Second, prior research seems to suggest that auditor litigation and reputation considerations affect the propensity to issue a going concern opinion because issuing a going concern opinion protects auditors from negligence allegations (e.g., Carcello and Palmrose [1994], Kaplan and Williams [2013]). In line with this argument, Geiger, Raghunandan, and Rama [2006] report that the likelihood of issuing a going-concern opinion decreased significantly following the enactment of the Private Securities Litigation Reform Act (PSLRA) in 1995, which significantly reduced the litigation considerations of accounting firms in the US. Francis and Krishnan [2002] reach similar conclusions regarding the change in the propensity to issue a going concern opinion before and after the PSLRA. Third, audit literature suggests that “the auditor’s propensity to issue a going concern opinion is positively correlated with the auditor’s level of independence” (DeFond, Raghunandan, and Subramanyam [2002]). Consistent with this conjecture, the propensity to issue a going concern opinion has been used in studies that investigate whether auditor independence has been compromised (e.g., DeFond, Raghunandan, and Subramanyam [2002], Hope and Langli [2010]).

I argue that, to the extent that the negative relation between auditor political connectedness and restatement frequency that I document is the result of lower enforcement

by regulatory authorities and/or the result of regulatory capture, politically connected auditors should have lower reputation and litigation considerations. Under this scenario, my audit office political connectedness measures should be associated with a decreased propensity to issue a going concern opinion. In contrast, to the extent the negative relation between audit office political connectedness and client restatement frequency represents higher auditor reputation and litigation considerations and superior audit quality, one should expect a positive relation between audit office political connectedness and the propensity to issue a going concern opinion. Moreover, to the degree that the increased frequency of restatements that I document for connected clients of connected auditors is the result of lower auditor scrutiny during the restatement manipulation period as a result of lower perceived client riskiness and/or auditor independence compromise, one could expect that the propensity to issue a going concern opinion is significantly weakened during the restatement manipulation period for connected clients of connected auditors. To further investigate these conjectures, I estimate the following probit regression model:

$$\begin{aligned}
\mathbf{Going\ Concern}_{i,t} = & \\
& \mathbf{a}_0 + \mathbf{a}_1 \mathbf{Measure_Res} + \mathbf{a}_2 \mathbf{Measure_Res} \times \mathbf{Pol_Client_D}_{i,t} + \\
& \mathbf{a}_3 \mathbf{Measure_Res} \times \mathbf{Pol_Client_D}_{i,t} \times \mathbf{Restate}_{i,t} + \mathbf{a}_4 \mathbf{Measure_Res} \times \mathbf{Restate}_{i,t} + \\
& \mathbf{a}_5 \mathbf{Pol_Client_D}_{i,t} \times \mathbf{Restate}_{i,t} + \mathbf{a}_6 \mathbf{Pol_Client_D}_{i,t} + \mathbf{a}_7 \mathbf{Restate}_{i,t} + \mathbf{Controls} + \\
& \mathbf{Year\ FE} + \mathbf{Industry\ FE} + \mathbf{Audit\ Office\ FE} + \boldsymbol{\varepsilon}_{i,t} \quad (5),
\end{aligned}$$

where $\mathbf{Going\ Concern}_{i,t}$ is an indicator variable that takes the value 1 if a firm has received a going concern opinion, and 0 otherwise. The control variables include all controls of the main specification. In addition, following DeFond, Raghunandan, and Subramanyam [2002], I include a lagged loss indicator ($\mathbf{L_Loss}$). I present the results of this analysis in Table 7.

The first column of each audit office political connectedness measure presents the results of the regression of the propensity to issue a going concern opinion on the respective audit office political connectedness measure and controls. In line with the argument that politically connected offices deliver superior audit quality, my findings suggest that audit office political connectedness is positively associated with the propensity to issue a going concern opinion. In particular, the related coefficients are positive and significant at the 1% level across the three audit office political connectedness measures. However, in the specification in which I examine whether connected auditors were less likely to scrutinize their connected clients during the restatement manipulation period (second column of each measure), I find consistent evidence of a significantly weaker relation between audit office political connectedness and the propensity to issue a going concern opinion. In particular, the respective 3-way interaction terms (*Measure_Res X Pol_Client_D X Restate*) are all negative and significant at the 10% level or better. Moreover, when limiting my sample to the restatement manipulation period (third column of each measure), I find strong evidence that connected auditors are more likely to issue a going concern opinion but this relation is significantly weakened for their connected clients. In particular, the related 2-way interaction terms (*Measure_Res X Pol_Client_D*) are all negative and significant at the 1% level.²⁶ These findings are consistent with the argument that connected auditors have heightened reputation and litigation considerations but they were less likely to scrutinize their connected clients precisely when they were engaging in earnings manipulation activities. Furthermore, the findings of Table 7 seem to suggest that connected clients of non-connected offices are consistently associated with a higher propensity of receiving a going concern opinion. These findings are therefore in line with the results of Tables 4 and 5 that show that connected

²⁶ In untabulated tests, I repeat regression (5) using OLS estimation techniques. Results are robust to this alternative specification. In particular, I find that the related 3-way (2-way) interaction terms remain negative and significant at the 10% (5%) level or better.

clients of non-connected offices are associated with lower frequency of restatements and greater audit fees.

5.5 Auditor-Client Common Political Connectedness

The findings of Table 4 suggest that politically connected clients are more likely to restate their earnings when audited by politically connected firms. In this section I investigate the extent to which the positive relation between audit office political connectedness and client restatement frequency is different for those politically connected clients that share at least one common political link with their local office. While connected auditors are less likely to scrutinize connected clients, the presence of common political ties between auditors and clients could heighten the reputation and litigation considerations of auditors. One could argue that the auditor-client common political activity would attract heightened scrutiny by regulatory agencies and market participants that closely monitor accounting firms for evidence of compromise in auditor independence. Therefore, it is very likely that, in the presence of common political ties with their clients, politically connected auditors would be less likely to reduce their scrutiny on politically connected clients. In a related study, Burnett, Chen, and Gunny [2016] investigate the extent to which auditors are likely to compromise their independence for clients with whom they share the same political connections as the audit firm. Using auditor PAC data at the national level, they find that the presence of auditor-client common political ties is associated with lower restatement frequency and better audit quality.²⁷

²⁷ Burnett, Chen, and Gunny [2016] argue that the existence of common political ties between auditors and clients could be suggestive of auditor lobbying on behalf of the client. Given that auditors are not allowed to act as advocates of their clients one may argue that the occurrence of explicit auditor lobbying on behalf of her clients is very limited. However, the existence of common political ties between the auditor and her client when auditors and clients have overlapping lobbying interests or objectives, as Puro [1984] suggests, seems to be a plausible alternative scenario. Under this hypothesis, it may be reasonable to expect that the common auditor-client political activity in pursue of mutual or overlapping lobbying objectives could increase the visibility of the involved parties and attract the scrutiny of regulators and market participants, thus increasing the reputation and litigation considerations of auditors.

To investigate whether the positive relation between audit office political connectedness and client restatement frequency that I document for politically connected clients differs when these clients have common political ties with their audit offices and therefore reconcile my findings with those of Burnett, Chen, and Gunny [2016], I use an indicator variable that takes the value 1 if the client and the local engagement office have shared at least one joint political connection with an auditor-specific congressional committee member over the past five years, and zero otherwise (*Pol_Client_J*). I then estimate the following probit model for the subsample of politically connected firms, while retaining the controls of regression (1):

$$\begin{aligned}
 \mathbf{Restate}_{i,t} = & \mathbf{a}_0 + \mathbf{a}_1 \mathbf{Measure_Res} + \mathbf{a}_2 \mathbf{Measure_Res} \times \mathbf{Pol_Client_J}_{i,t} \\
 & + \mathbf{a}_3 \mathbf{Pol_Client_J}_{i,t} + \mathbf{Controls} + \mathbf{Year\ FE} + \mathbf{Industry\ FE} \\
 & + \mathbf{Audit\ Office\ FE} + \boldsymbol{\varepsilon}_{i,t} \quad (6)
 \end{aligned}$$

I present the results of this analysis in Table 8. Table 8 shows that the positive relation between the political connections of auditors and the restatement frequency of their clients is mitigated for those clients that have common political ties with their local offices. The related interaction terms are negative and significant at the 1% and 5% levels across the three alternative audit office political connectedness measures.²⁸ In the second column of each measure, I separately present the regressions of the restatement likelihood on audit office political connectedness for the subsample of the political connected clients that have joint political connections with their auditors only (329 firm-year observations). The results of these regressions suggest that, for those clients, the relation between audit office political connectedness and restatement frequency becomes negative again and that the respective coefficients are significant across all three measures at the 1% and 5% levels.

²⁸ In untabulated tests, I repeat regression (6) using OLS estimation techniques. The related interaction terms remain negative and significant at the 10% level for first political connectedness measure and at the 5% level for the remaining two political connectedness measures.

To further investigate whether the drop in restatement frequency for clients with joint political connections is associated with increased auditor scrutiny relative to the other politically connected clients, particularly when those clients are engaging in earnings manipulation activities, I perform the following audit fee model for the subsample of politically connected clients while retaining the control variables of regression (3):

$$\begin{aligned}
Fees_{i,t} = & a_0 + a_1 Measure_Res + a_2 Measure_Res \times Pol_Client_J_{i,t} \\
& + a_3 Measure_Res \times Pol_Client_J_{i,t} \times Restate_{i,t} \\
& + a_4 Measure_Res \times Restate_{i,t} + a_5 Pol_Client_J_{i,t} \times Restate_{i,t} \\
& + a_6 Pol_Client_J_{i,t} + a_7 Restate_{i,t} + Controls + Year\ FE \\
& + Industry\ FE + Audit\ Office\ FE + \varepsilon_{i,t} \quad (7)
\end{aligned}$$

Table 9 presents the results of this analysis. The findings suggest that the drop in audit fees during the restatement manipulation period does not persist for politically connected clients with whom politically connected offices share common political connections. The three-way interaction term *Meas_Res X Pol_Client_J X Restate* is positive and significant at the 1% level across the three alternative office political connectedness measures. Due to the difficulties in interpreting three-way interaction terms, I limit the sample to the restatement manipulation period and present the results in the second column of each measure. The results are very similar and indicate that, during the restatement manipulation period, the drop in audit fees for connected clients of connected offices is mitigated in the presence of common political connections with the local office.

Taken together, the results of Tables 8 and 9 are consistent with the argument that politically connected auditors are less likely to deliver suboptimal audit quality to their connected clients when they share common political connections. These results therefore reconcile my main findings with those of Burnett, Chen, and Gunny [2016], who argue that

the existence of common political links between auditors and clients are associated with the provision of superior audit quality. They are additionally important because they lend further support to the argument that it is indeed variation in auditor scrutiny that accounts for the variation in the frequency of accounting restatements that I report in my main findings.

5.6 Propensity Score Matching

One might argue that clients are not randomly allocated to connected offices and therefore the relations that I document in my main findings are driven by differences in the risk profiles of clients of connected offices rather than the level of audit office political connectedness. There are two main reasons as to why this is probably less likely to be the case. First, the use of an extensive set of control variables reduces the likelihood of an omitted risk-related determinant of audit effort and audit quality. Second, self-selection bias is probably less likely to explain the results that indicate that connected offices were less likely to scrutinize connected clients during the restatement manipulation period.²⁹ Nevertheless, to mitigate residual concerns that my results are affected by self-selection, I employ propensity-score matching techniques. In particular, I create an indicator variable (*Pol_Off_D*) that takes the value of 1 if an office has been identified as politically connected following the procedure explained in section 3.1, and zero otherwise. I next estimate a first-stage probit model in which I regress the audit office political connectedness indicator on the control variables of respective specification (restatement or audit fee) as well as industry, year, and audit firm fixed effects. I subsequently match, without replacement, a client audited by a politically connected auditor with a client audited by a non-politically connected auditor

²⁹ Even if one argues that self-selection accounts for differences in client riskiness among connected offices it is hard to explain how these differences could account for lower auditor scrutiny only during the restatement manipulation period and only for connected clients of connected auditors. Furthermore, if anything, the conjecture that connected clients self-select to offices in which they would be less likely to be scrutinized when they engage in earnings manipulation activities makes the audit quality compromise argument for connected clients even stronger because it implies that auditors knowingly allow their clients engage in earnings manipulation activities.

that has the closest predicted value from the respective first-stage probit model while allowing a maximum caliper distance of 1%. I present the results of the first-stage probit model that corresponds to the regression specification estimated in Table 3 in Table 10, panel A. Furthermore, I present the propensity-score matched specifications of regression models (1), (2), and (3) in panels B and C of Table 10.³⁰

Table 10, panel A shows that politically connected clients are more likely to be audited by politically connected offices. Moreover, larger offices are more likely to be politically connected. Clients with lower market-to-book ratios and greater levels of leverage are more likely to be audited by connected offices. Finally, auditors that are identified as nation-wide industry leaders are more likely to be politically connected.

Table 10, panels B and C present the results of regression models (1), (2), and (3) that are estimated on the respective propensity-score matched samples. Results are qualitative almost identical to original findings. That is, clients of connected offices are less likely to restate their earnings; however, this relation reverses for connected clients (the related coefficients are significant at the 5% level or better).³¹ Moreover, connected offices charge higher audit fees and this relation is even stronger for connected clients (the related coefficients are significant at the 5% and 10% level, respectively). However, the positive relation between audit office political connectedness and audit fees weakens significantly for connected clients of connected offices during the restatement manipulation period (the corresponding coefficient is negative and significant at the 5% level). These results therefore suggest that self-selection considerations are less likely to affect my findings.

5.7 Further Considerations

³⁰ The propensity-score matched specifications presented in panels B and C of Table 10 are estimated each time based on the corresponding first-stage probit model that is estimated every time for the purposes of each distinct regression specification.

³¹ The OLS regression of the second specification of Table 10, panel B yields coefficients that retain their original signs as well as level of statistical significance (at the 1% level) in the variables of interest (*Pol_Off_D*, *Pol_Off_D X Pol_Client_D*, and *Pol_Client_D*).

5.7.1 Self-Motivated Auditor Political Connectedness

The audit office political connectedness measures used in the current study are constructed based on the PAC contributions of audit firm employees. One could therefore argue that auditors politically connect to serve self-motivated objectives rather than pursue the lobbying objectives of the audit firm in which they are employed. While the exact motivation behind the PAC contribution of audit firm employees may be hard to track, my audit office political connectedness measures are only limited to PAC contributions that are relevant to the audit profession. By computing my audit office political connectedness measures using PAC contributions targeting members of committees responsible for auditor regulation and oversight, my study is, by design, less likely to take into account the PAC contributions of audit firm employees that may be self-motivated. This is because, it seems reasonable to assume that auditors would make PAC contributions to members of committees that are relevant to the audit profession to serve primarily professional objectives rather than personal objectives. In its article, Reuters suggests that audit firm employees indeed directly target members of committees that are relevant to the audit profession to serve the lobbying objectives of their audit firms.³² Even, however, if one discredits the argument that auditors politically connect to serve the lobbying objectives of their audit firms as Reuters suggests, the political links of auditors with members of auditor-related committees are still valid. By virtue of this, one could argue that the political activities of these auditors would increase their visibility and their own litigation and reputation considerations because their involvement in an audit failure could still negatively affect their credibility and put their political connections at risk. The reputation and litigation risk argument is therefore a stand-alone argument that applies irrespective of the motivation behind the contributions made by

³² While auditor political connectedness to auditor-relevant committees is more likely to serve professional objectives, the possibility that the drop in auditor scrutiny for connected clients is motivated by audit firm employee self-interest cannot be ruled out particularly when considering evidence suggesting that legal corruption may be present even in least corrupt countries (e.g., Amore and Bennedsen [2013]).

connected auditors (corporate or personal, lobbying or not). The reputation and litigation risk argument is also consistent with the argument of lower auditor scrutiny on connected clients, to the extent these clients are considered to be less risky due to connected clients' political protection. It is additionally consistent with the finding that audit fees during the restatement manipulation years increase again and restatement frequency drops in the presence of political ties to the same members of auditor-related committees as the local engagement office. This is because the common auditor-client political activity by itself is likely to attract the scrutiny of market participants and regulatory authorities irrespective of the true motivation behind it, if it creates the perception that it might be motivated by the pursuance of mutual lobbying objectives or if it raises concerns that it represents a case of auditor lobbying on behalf of her clients.³³ However, these findings are also consistent with Ramanna and Roychowdhury [2010] who argue that politically connected firms take actions to protect their affiliated politicians when they are more likely to be scrutinized.

5.7.2 Auditor Skill Unrelated to Political Connections

An additional consideration is whether the positive relation between audit office political connectedness and audit quality is driven by auditor skill and is not the result of their political connections. In other words, one may argue that better skilled auditors are more likely to be politically connected and since it may be reasonable to expect that there is a positive relation between auditor skill and audit quality, my audit office political connectedness measures could in fact proxy for auditor skill and not the level of auditor political connectedness. Whereas it is hard for any research design to completely eliminate this possibility, there are reasons to believe that this scenario may be less plausible in the

³³ This observation gains particular importance in the light of growing concerns about auditors serving as lobbying advocates of their clients. For example, according to Reuters, Douglas Carmichael, former chief auditor for the PCAOB has expressed concerns that "Lobbying members of Congress on behalf of audit clients would make the auditor an advocate for the client".

current study. First, my current research design controls for audit quality determinants that are highly correlated with auditor skill, such as audit office size and national-specific and city-specific industry expertise. Second, the argument that my measures of audit office political connectedness are spuriously correlated with auditor skill unrelated to auditors' political connections is hard to reconcile with the extensive cross-sectional tests that consistently provide evidence that connected offices are less likely to scrutinize their connected clients. That is, if my audit office political connectedness measures indeed capture auditor skill and not auditor political connectedness, then it is hard to explain why better skilled auditors would be less likely to scrutinize connected clients, when one would expect exactly the opposite to be the case. In other words, the argument that my measures of audit office political connectedness capture auditor skill and not the effects of auditors' political connectedness on their reputation and litigation considerations and/or their information acquisition advantages is very hard to reconcile with the results of Tables 4, 5, 6, 7, 8, and 9. These findings therefore provide confidence that it is indeed auditors' political connections rather than alternative explanations that drive my results.

6. Conclusion

The political connections of firms have garnered considerable research attention the past few years. Until now, accounting literature has mainly focused on the accounting quality consequences of politically connected firms, reviving Stigler's theory of regulatory capture in an accounting context. Yet, despite growing public focus on the lobbying activities of audit firms, there is still little and inconclusive evidence regarding the audit quality consequences of the political connections of auditors. In this paper, I attempt to close this gap in the literature and investigate the relation between auditor political connections and client restatement frequency at the audit office level. To this end, I retrieve all Big 4 employee PAC

contributions to members of committees directly responsible for auditor regulation and oversight and create a dataset that spans from 2003 to 2012. I argue that politically connected auditors are more likely to offer high quality audits due to stronger reputation and litigation considerations as well as network-related information and knowledge acquisition benefits. My results are consistent with these arguments. Clients of politically connected offices are less likely to restate their earnings. However, the negative relation between the rate of restatements and audit office political connectedness does not appear to persist for politically connected firms, unless clients and auditors share common political connections.

This paper contributes to the literature by being the first to investigate the audit quality consequences of the political activities of auditors at the audit office level. My results indicate that there is a positive relation between the political connections of auditors and audit quality and therefore, on average, auditor-and firm-specific political connections affect accounting quality in opposite directions. This is true, however, only for non-politically connected clients or those politically connected clients that share common political ties with their auditors and they therefore are more likely to attract the scrutiny of regulators and market participants. This latter finding suggests that, to the extent that connected auditors lower their scrutiny on those politically connected clients for which the auditor-client political activity is less likely to attract regulatory scrutiny, regulatory authorities may need to consider whether auditor political connections merit heightened oversight. Future research can explore other settings in which the political connections of auditors are likely to have an effect on audit quality as well as how the political connections of the local engagement office affect auditor choice.

Appendix

Panel A: Dependent and Test Variables

<i>Restate</i>	An indicator variable that takes the value 1 if the firm-year is subsequently misstated, and zero otherwise.
<i>Measure 1</i>	The 5-year sum of dollar PACs targeting auditor-relevant politicians per Big 4 audit firm-office-fiscal year.
<i>Measure 2</i>	The 5-year sum of distinct per year auditor-relevant politicians targeted per Big 4 audit firm-office-fiscal year.
<i>Measure 3</i>	The 5-year sum of distinct per year employees making PAC contributions to auditor-relevant politicians per Big 4 audit firm-office -fiscal year.
<i>Measure_Res</i>	The residuals from the regression of the logarithmic transformation of each political connectedness measure on office size.
<i>Fees</i>	The natural logarithm of audit fees paid.

Panel B: Control Variables

<i>Pol_Client</i>	The natural logarithm of one plus the 5-year sum of distinct per year politicians supported by a particular client.
<i>Pol_Client_D</i>	An indicator variable that takes the value of 1 if a client has supported at least one politician over the last 5 years, and zero otherwise.

<i>Pol_Client_J</i>	An indicator variable that takes the value of 1 if a client and the corresponding local engagement office have shared at least one common political connection to the same auditor-specific congressional committee member(s) over the last 5 years, and zero otherwise.
<i>Going Concern</i>	An indicator variable that takes the value of 1 if a firm receives a qualified auditor opinion on a specific year, and zero otherwise.
<i>Office Size</i>	The natural logarithm of the audit fees of all clients of the office.
<i>Total Assets</i>	The natural logarithm of total assets.
<i>Market-to-Book</i>	The ratio of market value of equity to book value of equity.
<i>Leverage</i>	The ratio of long-term debt to lagged total assets.
<i>ROA</i>	The ratio of net income to lagged total assets.
<i>Loss</i>	An indicator variable that equals 1 if the firm reports negative net income, and zero otherwise.
<i>L_Loss</i>	The lagged by one year <i>Loss</i> indicator.
<i>Num. of Business Segments</i>	The natural logarithm of one plus the number of business segments.
<i>Num. of Geographic Segments</i>	The natural logarithm of one plus the number of geographic segments.
<i>Merger</i>	An indicator variable that takes the value 1 if a firm has engaged in a merger or acquisition in the corresponding fiscal year, and zero otherwise.
<i>Financing</i>	An indicator variable that takes the value 1 if Merger is equal to zero and number of shares outstanding increased

by at least 10% or long-term debt increased by at least 20%, and zero otherwise.

Receivables & Inventory

The ratio of receivables plus inventory to lagged total assets.

Std ROA

The 5-year standard deviation of ROA.

City Leader

An indicator variable that takes the value 1 if an office is the number one auditor in terms of aggregated client audit fees in an industry within that city in a specific fiscal year, and zero otherwise.

National Leader

An indicator variable that takes the value 1 if an auditor is the number one auditor in an industry in terms of aggregated audit fees in a specific fiscal year, and zero otherwise.

ICW

An indicator variable that takes the value 1 if a firm reported an internal control material weakness (SOX 404) prior to identifying the need to restate earnings, and zero otherwise.

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TABLE 1*Panel A: Number of Politically Connected Offices per Big 4 Audit Firm*

Audit Firm	Number of Politically Connected Offices	Total Number of Offices in Audit Analytics	% Politically Connected Offices
Ernst & Young	49	96	51.04%
Deloitte	45	85	52.94%
KPMG	51	92	55.43%
PwC	44	87	50.57%

Panel B: Aggregate Measures of Audit Firm Employee Political Connectedness

Audit Firm	Aggregate \$ PACs	Number of Supported Politicians	Number of Politically Connected Employees
Ernst & Young	428,294	111	374
Deloitte	547,498	96	432
KPMG	206,931	65	220
PwC	322,280	79	310

Panel C: Percentage of Connected Employees to the Number of Total Employees per Big 4 Audit Firm

Audit Firm	Number of Politically Connected Employees	Number of Total Employees (2013)	% Politically Connected Employees
Ernst & Young	374	30,900	1.21%
Deloitte	432	60,951	0.71%
KPMG	220	24,618	0.89%
PwC	310	39,158	0.79%

This table presents the Big 4 employee-political connectedness descriptive statistics at the audit firm level for the period 1999-2012. Panel A shows the number of politically connected offices per audit firm in absolute numbers as well as as a percentage of the total number of engagement offices for each audit firm. An engagement office is classified as politically connected if at least one employee of that office makes PAC contributions to support auditor- relevant politicians during the period 1999-2012. Panel B presents three aggregate measures of audit firm employee political connectedness: the sum of dollar PACs targeting auditor- relevant politicians, the number of distinct auditor- relevant politicians supported, as well as the number of distinct employees identified as PAC contributors over the same 14-year period. Panel C offers descriptive statistics regarding the percentage of politically connected employees to the number of total employees for each audit firm. The number of total employees is obtained from www.statista.com and corresponds to US employees of Big 4 audit firms in year 2013.

TABLE 2*Panel A: Office-Year Descriptive Statistics of Current-Year PAC Contributions Only*

Variable	N	Mean	SD	P25	Median	P75
\$ PACs	392	2,472	3,619	500	1,000	2,604
Number of Politicians	392	1.52	1.4	1	1	2
Number of Contributors	392	2.96	3.96	1	1	3
Number of Unique Offices	140					

Panel B: Office-Year Descriptive Statistics of Long-Term Political Connectedness Measures

Variable	N	Mean	SD	P25	Median	P75
\$ PACs	959	4,836	8,510	750	1,951	5,100
Number of Politicians	959	3.05	3.95	1	2	3
Number of Contributors	959	5.92	9.82	1	2	6
Number of Unique Offices	170					

Panel C: Full Model Descriptive Statistics

Variable	N	Mean	SD	P25	Median	P75
Restate	17,374	0.13	0.34	0	0	0
Measure 1_Res	17,374	0	3.59	-3.34	0.73	2.99
Measure 2_Res	17,374	0	0.70	-0.52	-0.13	0.44
Measure 3_Res	17,374	0	0.91	-0.66	-0.16	0.54
Pol_Off_D	17,374	0.53	0.50	0	1	1
Pol_Client	17,374	0.72	1.68	0	0	0
Pol_Client_D	17,374	0.18	0.38	0	0	0
Pol_Client_J	3,072	0.14	0.35	0	0	0
Fees	17,374	13.99	1.10	13.28	13.95	14.67
Going Concern	17,374	0.02	0.15	0	0	0
Office Size	17,374	17.36	1.88	16.66	17.65	18.38
Total Assets	17,374	6.59	1.78	5.39	6.57	7.75
Market- to- Book	17,374	2.73	3.95	1.28	2.04	3.36
Leverage	17,374	0.20	0.25	0	0.14	0.31
ROA	17,374	0.01	0.19	-0.01	0.04	0.09
Loss	17,374	0.29	0.45	0	0	1
Num. of Bus. Segments	17,374	0.76	0.75	0	0.69	1.39
Num. of Geog. Segments	17,374	0.91	0.73	0	0.69	1.39
Merger	17,374	0.47	0.50	0	0	1
Financing	17,374	0.24	0.43	0	0	0
Receivables & Inventory	17,374	0.28	0.20	0.13	0.25	0.39
Std ROA	17,374	0.12	0.23	0.02	0.05	0.11
City Leader	17,374	0.66	0.47	0	1	1
National Leader	17,374	0.30	0.46	0	0	1
ICW	13,306	0.06	0.23	0	0	0

This table presents descriptive statistics for the period 2003-2012. Panel A shows current-year only office-level political connectedness descriptive statistics. Panel B presents office-year statistics of the long-term political connectedness measures in raw format. Panel C reports firm-year statistics of all regression inputs for the sample period. See Appendix for variable definitions.

TABLE 3
Regression of Restatements on Audit Office Political Connectedness

Variables	Dependent Variable: Likelihood of Accounting Restatements					
	Measure 1_Res		Measure 2_Res		Measure 3_Res	
Measure_Res	-0.0077** (0.013)	-0.0092** (0.014)	-0.0440*** (0.006)	-0.0503** (0.011)	-0.0318** (0.012)	-0.0359** (0.019)
Pol_Client	-	-0.0476*** (0.000)	-	-0.0478*** (0.000)	-	-0.0477*** (0.000)
Office Size	-	-0.0357*** (0.003)	-	-0.0356*** (0.003)	-	-0.0358*** (0.003)
Total Assets	-	0.0278** (0.012)	-	0.0280** (0.011)	-	0.0279** (0.011)
Market-to- Book	-	-0.0027 (0.430)	-	-0.0026 (0.438)	-	-0.0026 (0.439)
Leverage	-	0.0924* (0.099)	-	0.0937* (0.095)	-	0.0937* (0.095)
ROA	-	-0.0475 (0.604)	-	-0.0477 (0.602)	-	-0.0481 (0.599)
Loss	-	0.1193*** (0.001)	-	0.1187*** (0.001)	-	0.1188*** (0.001)
Num. of Bus. Seg.	-	0.0671*** (0.001)	-	0.0675*** (0.001)	-	0.0675*** (0.001)
Num. of Geog. Seg.	-	0.0633*** (0.003)	-	0.0628*** (0.003)	-	0.0631*** (0.003)
Merger	-	0.0362 (0.285)	-	0.0362 (0.284)	-	0.0367 (0.278)
Financing	-	0.0714** (0.037)	-	0.0714** (0.037)	-	0.0717** (0.036)
Rec. & Inv.	-	0.1526* (0.065)	-	0.1528* (0.064)	-	0.1520* (0.065)
Std ROA	-	0.0094 (0.867)	-	0.0093 (0.869)	-	0.0083 (0.883)
City Leader	-	0.0016 (0.957)	-	0.0017 (0.954)	-	0.0017 (0.955)
National Leader	-	0.0407 (0.150)	-	0.0415 (0.143)	-	0.0406 (0.152)
Constant	-1.1539*** (0.000)	-0.7828*** (0.009)	-1.1483*** (0.000)	-0.7813*** (0.010)	-1.1511*** (0.000)	-0.7801*** (0.010)
Industry, Year, and Audit Firm FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	24,694	17,330	24,694	17,330	24,694	17,330
Pseudo R-Squared	0.0541	0.0666	0.0542	0.0666	0.0542	0.0666

This table presents the probit regression results of restatement frequency on the three alternative measures of audit office political connectedness for the period 2003-2012 without and with controls. P-values are in parentheses. *, **, and *** indicate significance at the two-tailed 10%, 5%, and 1% levels, respectively.

TABLE 4
Regression of Restatements on Audit Office Political Connectedness and Interaction Term

Variables	Dependent Variable: Likelihood of Accounting Restatements					
	Measure 1_Res		Measure 2_Res		Measure 3_Res	
Measure_Res	-0.0152***	0.0342***	-0.0737***	0.1281***	-0.0566***	0.0987***
	(0.000)	(0.000)	(0.001)	(0.003)	(0.001)	(0.002)
Measure_Res X Pol_Client_D	0.0370***	-	0.1407***	-	0.1166***	-
	(0.000)		(0.003)		(0.001)	
Pol_Client_D	-0.1557***	-	-0.1529***	-	-0.1543***	-
	(0.000)		(0.000)		(0.000)	
Office Size	-0.0363***	0.0271	-0.0359***	0.0280	-0.0361***	0.0283
	(0.003)	(0.381)	(0.003)	(0.364)	(0.003)	(0.358)
Total Assets	0.0183*	-0.0918***	0.0187*	-0.0894***	0.0187*	-0.0892***
	(0.088)	(0.003)	(0.082)	(0.003)	(0.082)	(0.004)
Market-to- Book	-0.0028	-0.0143*	-0.0027	-0.0141*	-0.0028	-0.0144*
	(0.403)	(0.087)	(0.417)	(0.091)	(0.410)	(0.087)
Leverage	0.1037*	0.1395	0.1061*	0.1495	0.1056*	0.1426
	(0.065)	(0.399)	(0.059)	(0.366)	(0.060)	(0.390)
ROA	-0.0340	0.0214	-0.0339	0.0285	-0.0342	0.0396
	(0.709)	(0.959)	(0.711)	(0.946)	(0.709)	(0.925)
Loss	0.1186***	0.0994	0.1188***	0.1039	0.1190***	0.1061
	(0.001)	(0.383)	(0.001)	(0.362)	(0.001)	(0.352)
Num. of Bus. Seg.	0.0659***	-0.0132	0.0663***	-0.0117	0.0659***	-0.0142
	(0.001)	(0.812)	(0.001)	(0.834)	(0.001)	(0.798)
Num. of Geog. Seg.	0.0643***	0.0074	0.0638***	0.0071	0.0638***	0.0064
	(0.002)	(0.900)	(0.003)	(0.903)	(0.003)	(0.913)
Merger	0.0368	0.0602	0.0375	0.0638	0.0376	0.0622
	(0.277)	(0.522)	(0.268)	(0.496)	(0.266)	(0.507)
Financing	0.0732**	0.1601	0.0735**	0.1595	0.0737**	0.1578
	(0.032)	(0.121)	(0.032)	(0.122)	(0.031)	(0.126)

Rec. & Inv.	0.1450*	0.0584	0.1461*	0.0920	0.1457*	0.0949
	(0.079)	(0.837)	(0.077)	(0.744)	(0.078)	(0.736)
Std ROA	0.0040	0.1652	0.0051	0.1819	0.0040	0.2038
	(0.943)	(0.627)	(0.927)	(0.598)	(0.944)	(0.554)
City Leader	-0.0008	0.0961	-0.0002	0.0954	-0.0001	0.0966
	(0.978)	(0.269)	(0.995)	(0.272)	(0.998)	(0.266)
National Leader	0.0420	0.0644	0.0415	0.0615	0.0408	0.0652
	(0.139)	(0.394)	(0.143)	(0.413)	(0.151)	(0.387)
Constant	-0.7068**	-0.7547	-0.7199**	-0.8200	-0.7169**	-0.8269
	(0.019)	(0.300)	(0.017)	(0.258)	(0.018)	(0.254)
Industry, Year, and Audit Firm FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	17,330	2,887	17,330	2,887	17,330	2,887
Pseudo R-Squared	0.0668	0.127	0.0664	0.125	0.0664	0.125

This table presents the probit regression results of restatement frequency on the three alternative measures of audit office political connectedness and their interaction with politically connected firms for the period 2003-2012. The second specification of each measure presents the results of restatement frequency on auditor political connections for politically connected clients only. See Appendix for variable definitions. P-values are in parentheses. *, **, and *** indicate significance at the two-tailed 10%, 5%, and 1% levels, respectively.

TABLE 5

Regressions of Audit Fees on Audit Office Political Connectedness

Variables	Dependent Variable: Audit Fees								
	<i>Measure 1_Res</i>			<i>Measure 2_Res</i>			<i>Measure 3_Res</i>		
Measure_Res	0.0036** (0.018)	0.0028 (0.113)	0.0041 (0.320)	0.0222*** (0.004)	0.0187** (0.035)	0.0261 (0.223)	0.0183*** (0.002)	0.0128* (0.055)	0.0245 (0.151)
Measure_Res X Pol_Client_D	-	0.0068** (0.020)	-0.0221** (0.030)	-	0.0257* (0.083)	-0.1311** (0.013)	-	0.0319*** (0.003)	-0.1011*** (0.010)
Measure_Res X Pol_Client_D X Restate	-	-0.0238** (0.016)	-	-	-0.1161** (0.028)	-	-	-0.0970** (0.012)	-
Measure_Res X Restate	-	0.0031 (0.412)	-	-	0.0169 (0.382)	-	-	0.0181 (0.239)	-
Pol_Client_D X Restate	-	-0.0044 (0.895)	-	-	-0.0055 (0.866)	-	-	-0.0049 (0.881)	-
Pol_Client_D	-	0.0794*** (0.000)	0.0872** (0.015)	-	0.0796*** (0.000)	0.0869** (0.015)	-	0.0782*** (0.000)	0.0873** (0.014)
Restate	-	0.0678*** (0.000)	-	-	0.0677*** (0.000)	-	-	0.0679*** (0.000)	-
Pol_Client	0.0275*** (0.000)	-	-	0.0276*** (0.000)	-	-	0.0275*** (0.000)	-	-
Office Size	0.0879*** (0.000)	0.0876*** (0.000)	0.0824*** (0.000)	0.0879*** (0.000)	0.0876*** (0.000)	0.0826*** (0.000)	0.0879*** (0.000)	0.0875*** (0.000)	0.0825*** (0.000)
Total Assets	0.4726*** (0.000)	0.4791*** (0.000)	0.4913*** (0.000)	0.4724*** (0.000)	0.4790*** (0.000)	0.4914*** (0.000)	0.4724*** (0.000)	0.4790*** (0.000)	0.4913*** (0.000)
Market-to- Book	-0.0001 (0.907)	-0.0000 (0.996)	-0.0051* (0.081)	-0.0001 (0.892)	0.0000 (0.997)	-0.0051* (0.080)	-0.0001 (0.882)	-0.0000 (0.981)	-0.0051* (0.084)
Leverage	-0.0279 (0.148)	-0.0373* (0.053)	-0.1641*** (0.002)	-0.0287 (0.136)	-0.0382** (0.047)	-0.1652*** (0.002)	-0.0290 (0.131)	-0.0385** (0.045)	-0.1655*** (0.002)

ROA	-0.3255*** (0.000)	-0.3333*** (0.000)	-0.5153*** (0.000)	-0.3254*** (0.000)	-0.3332*** (0.000)	-0.5154*** (0.000)	-0.3253*** (0.000)	-0.3328*** (0.000)	-0.5158*** (0.000)
Loss	0.1572*** (0.000)	0.1558*** (0.000)	0.1884*** (0.000)	0.1575*** (0.000)	0.1560*** (0.000)	0.1875*** (0.000)	0.1576*** (0.000)	0.1561*** (0.000)	0.1872*** (0.000)
Num. of Bus. Seg.	0.1161*** (0.000)	0.1158*** (0.000)	0.1214*** (0.000)	0.1158*** (0.000)	0.1156*** (0.000)	0.1212*** (0.000)	0.1155*** (0.000)	0.1153*** (0.000)	0.1218*** (0.000)
Num. of Geog. Seg.	0.1874*** (0.000)	0.1860*** (0.000)	0.1558*** (0.000)	0.1876*** (0.000)	0.1862*** (0.000)	0.1561*** (0.000)	0.1877*** (0.000)	0.1863*** (0.000)	0.1566*** (0.000)
Merger	0.0532*** (0.000)	0.0515*** (0.000)	0.0221 (0.483)	0.0533*** (0.000)	0.0514*** (0.000)	0.0209 (0.506)	0.0532*** (0.000)	0.0513*** (0.000)	0.0215 (0.496)
Financing	-0.0016 (0.879)	-0.0035 (0.732)	0.0049 (0.881)	-0.0014 (0.894)	-0.0033 (0.746)	0.0045 (0.892)	-0.0014 (0.892)	-0.0034 (0.741)	0.0041 (0.900)
Rec. & Inv.	0.4969*** (0.000)	0.4987*** (0.000)	0.5653*** (0.000)	0.4963*** (0.000)	0.4980*** (0.000)	0.5629*** (0.000)	0.4965*** (0.000)	0.4974*** (0.000)	0.5594*** (0.000)
Std ROA	0.1669*** (0.000)	0.1689*** (0.000)	0.2139*** (0.000)	0.1672*** (0.000)	0.1693*** (0.000)	0.2128*** (0.000)	0.1681*** (0.000)	0.1700*** (0.000)	0.2133*** (0.000)
City Leader	0.1184*** (0.000)	0.1190*** (0.000)	0.1402*** (0.000)	0.1185*** (0.000)	0.1192*** (0.000)	0.1409*** (0.000)	0.1187*** (0.000)	0.1192*** (0.000)	0.1407*** (0.000)
National Leader	0.0223** (0.013)	0.0223** (0.013)	0.0107 (0.696)	0.0218** (0.015)	0.0218** (0.015)	0.0122 (0.654)	0.0220** (0.014)	0.0221** (0.013)	0.0116 (0.668)
Going Concern	0.2150*** (0.000)	0.2175*** (0.000)	0.1740* (0.091)	0.2147*** (0.000)	0.2173*** (0.000)	0.1722* (0.093)	0.2146*** (0.000)	0.2172*** (0.000)	0.1695* (0.100)
Constant	7.9793*** (0.000)	7.9440*** (0.000)	8.1365*** (0.000)	7.9778*** (0.000)	7.9401*** (0.000)	8.1325*** (0.000)	7.9784*** (0.000)	7.9449*** (0.000)	8.1370*** (0.000)
Industry, Year, and Audit Firm FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	17,374	17,374	2,329	17,374	17,374	2,329	17,374	17,374	2,329
R-Squared	0.8042	0.8041	0.7475	0.8043	0.8041	0.7477	0.8043	0.8042	0.7478

This table presents the OLS regression results of audit fees on the three alternative measures of audit office political connectedness and the respective two-way and three-way interaction terms with politically connected clients and the restatement manipulation period. The third specification of each measure presents the results of audit fees on auditor political connections and the corresponding interaction with politically connected clients during the restatement manipulation period only. This analysis covers the period 2003-2012. See Appendix for variable definitions. P-values are in parentheses. *, **, and *** indicate significance at the two-tailed 10%, 5%, and 1% levels, respectively.

TABLE 6*Sensitivity of Restatement Frequency to ICW Conditional on Audit Office Political Connectednes*

Variables	Dependent Variable: Likelihood of Accounting Restatements					
	<i>Measure 1_Res</i>		<i>Measure 2_Res</i>		<i>Measure 3_Res</i>	
Measure_Res	-0.0189*** (0.001)	0.0330*** (0.003)	-0.1206*** (0.000)	0.1366*** (0.009)	-0.0963*** (0.000)	0.0936** (0.014)
Measure_Res X Pol_Client_D	0.0422*** (0.000)	-	0.2060*** (0.001)	-	0.1604*** (0.000)	-
Measure_Res X Pol_Client_D X ICW	-0.1103** (0.031)	-	-0.6892*** (0.004)	-	-0.4047** (0.017)	-
Measure_Res X ICW	-0.0075 (0.690)	-0.1247** (0.012)	0.0265 (0.779)	-0.7495*** (0.001)	0.0231 (0.758)	-0.4173*** (0.007)
Pol_Client_D X ICW	0.4112** (0.024)	-	0.4331** (0.019)	-	0.4122** (0.023)	-
Pol_Client_D	-0.1207** (0.017)	-	-0.1174** (0.020)	-	-0.1176** (0.020)	-
ICW	0.9313*** (0.000)	1.2255*** (0.000)	0.9358*** (0.000)	1.2657*** (0.000)	0.9362*** (0.000)	1.2415*** (0.000)
Office Size	-0.0614*** (0.000)	0.0136 (0.713)	-0.0634*** (0.000)	0.0139 (0.705)	-0.0638*** (0.000)	0.0152 (0.679)
Total Assets	-0.0063 (0.685)	-0.1375*** (0.000)	-0.0047 (0.759)	-0.1349*** (0.000)	-0.0050 (0.746)	-0.1355*** (0.000)
Market-to- Book	-0.0002 (0.962)	-0.0142 (0.223)	-0.0001 (0.990)	-0.0142 (0.223)	-0.0000 (0.994)	-0.0141 (0.230)
Leverage	0.0775 (0.255)	0.1205 (0.547)	0.0831 (0.223)	0.1374 (0.491)	0.0826 (0.226)	0.1437 (0.471)
ROA	-0.2429* (0.079)	-0.7291 (0.223)	-0.2483* (0.074)	-0.8232 (0.172)	-0.2423* (0.081)	-0.7559 (0.210)
Loss	0.0484 (0.329)	-0.0613 (0.690)	0.0474 (0.340)	-0.0759 (0.623)	0.0482 (0.332)	-0.0662 (0.668)

Num. of Bus. Seg.	0.0566** (0.028)	-0.0101 (0.886)	0.0584** (0.024)	-0.0082 (0.907)	0.0584** (0.024)	-0.0087 (0.901)
Num. of Geog. Seg.	0.0135 (0.621)	0.0215 (0.761)	0.0127 (0.640)	0.0264 (0.709)	0.0119 (0.661)	0.0224 (0.752)
Merger	0.1078** (0.017)	0.2566** (0.022)	0.1075** (0.017)	0.2497** (0.025)	0.1084** (0.016)	0.2539** (0.023)
Financing	0.0616 (0.216)	0.1806 (0.187)	0.0611 (0.220)	0.1756 (0.200)	0.0620 (0.213)	0.1824 (0.182)
Rec. & Inv.	-0.0111 (0.922)	-0.2253 (0.531)	-0.0098 (0.931)	-0.2096 (0.556)	-0.0122 (0.915)	-0.2179 (0.541)
Std ROA	0.0511 (0.640)	-0.1511 (0.813)	0.0542 (0.620)	-0.1316 (0.839)	0.0519 (0.636)	-0.1444 (0.824)
City Leader	-0.0197 (0.600)	0.0986 (0.342)	-0.0206 (0.581)	0.0896 (0.385)	-0.0218 (0.560)	0.0877 (0.396)
National Leader	0.0690* (0.054)	0.0008 (0.993)	0.0705** (0.049)	0.0026 (0.977)	0.0679* (0.058)	-0.0010 (0.992)
Industry, Year, and Audit Firm FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	11,902	2,251	11,902	2,251	11,902	2,251
Pseudo R-Squared	0.0844	0.160	0.0849	0.161	0.0848	0.159

This table presents the results of probit specifications of the sensitivity of restatement frequency to the effectiveness of internal control systems for the period 2005-2012. This analysis is based on the original ICW that were issued prior to identifying the need to restate earnings. The second specification of each measure is restricted to politically connected clients only. Controls are not presented for brevity. See Appendix for variable definitions. P-values are in parentheses. *, **, and *** indicate significance at the two-tailed 10%, 5%, and 1% levels, respectively.

TABLE 7

Regressions of the Propensity to Issue a Going Concern Opinion on Audit Office Political Connectedness

Variables	Dependent Variable: Going Concern Opinion								
	Measure 1_Res			Measure 2_Res			Measure 3_Res		
Measure_Res	0.0349*** (0.000)	0.0315*** (0.000)	0.0899*** (0.002)	0.1908*** (0.000)	0.1672*** (0.000)	0.4494*** (0.001)	0.1315*** (0.000)	0.1082*** (0.001)	0.3906*** (0.000)
Measure_Res X Pol_Client_D	-	0.0009 (0.967)	-0.2474*** (0.000)	-	-0.0064 (0.956)	-1.2106*** (0.001)	-	0.0124 (0.883)	-1.0438*** (0.001)
Measure_Res X Pol_Client_D X Restate	-	-0.1775** (0.016)	-	-	-0.8359* (0.063)	-	-	-0.7970** (0.011)	-
Measure_Res X Restate	-	0.0460* (0.083)	-	-	0.2543** (0.045)	-	-	0.2133** (0.023)	-
Pol_Client_D X Restate	-	0.0978 (0.721)	-	-	0.0976 (0.724)	-	-	0.0680 (0.812)	-
Pol_Client_D	-	0.2426** (0.016)	0.4106 (0.248)	-	0.2441** (0.015)	0.3386 (0.343)	-	0.2368** (0.018)	0.2899 (0.436)
Restate	-	-0.0215 (0.826)	-	-	-0.0300 (0.757)	-	-	-0.0390 (0.691)	-
Pol_Client	0.0487** (0.040)	-	-	0.0495** (0.035)	-	-	0.0481** (0.042)	-	-
Office Size	0.0529** (0.038)	0.0530** (0.038)	0.2365** (0.012)	0.0497** (0.047)	0.0482* (0.053)	0.1994** (0.031)	0.0496** (0.047)	0.0476* (0.055)	0.1899** (0.034)
Total Assets	-0.1160*** (0.000)	-0.1180*** (0.000)	-0.0587 (0.534)	-0.1164*** (0.000)	-0.1189*** (0.000)	-0.0593 (0.524)	-0.1150*** (0.000)	-0.1173*** (0.000)	-0.0584 (0.536)
Market-to- Book	-0.0355*** (0.000)	-0.0357*** (0.000)	-0.0504*** (0.003)	-0.0362*** (0.000)	-0.0363*** (0.000)	-0.0490*** (0.002)	-0.0360*** (0.000)	-0.0360*** (0.000)	-0.0474*** (0.004)
Leverage	-0.3810*** (0.009)	-0.3807*** (0.009)	-1.3820*** (0.001)	-0.3953*** (0.007)	-0.3954*** (0.007)	-1.3649*** (0.002)	-0.3949*** (0.007)	-0.3928*** (0.007)	-1.3270*** (0.002)

ROA	-1.4327*** (0.000)	-1.4399*** (0.000)	-2.8055*** (0.000)	-1.4356*** (0.000)	-1.4410*** (0.000)	-2.7393*** (0.000)	-1.4318*** (0.000)	-1.4376*** (0.000)	-2.7289*** (0.000)
Loss	0.6923*** (0.000)	0.6924*** (0.000)	0.6610*** (0.008)	0.6974*** (0.000)	0.6961*** (0.000)	0.6739*** (0.007)	0.6937*** (0.000)	0.6923*** (0.000)	0.6731*** (0.007)
L_Loss	0.4655*** (0.000)	0.4711*** (0.000)	-0.0657 (0.722)	0.4712*** (0.000)	0.4766*** (0.000)	-0.0597 (0.753)	0.4688*** (0.000)	0.4746*** (0.000)	-0.0473 (0.800)
Num. of Bus. Seg.	0.0576 (0.188)	0.0537 (0.228)	0.0621 (0.660)	0.0543 (0.216)	0.0509 (0.253)	0.0599 (0.674)	0.0521 (0.235)	0.0490 (0.272)	0.0345 (0.811)
Num. of Geog. Seg.	0.1193*** (0.005)	0.1242*** (0.004)	0.0235 (0.878)	0.1214*** (0.005)	0.1285*** (0.003)	0.0526 (0.729)	0.1211*** (0.005)	0.1287*** (0.003)	0.0612 (0.686)
Merger	-0.2547*** (0.001)	-0.2552*** (0.001)	-0.2257 (0.254)	-0.2521*** (0.001)	-0.2551*** (0.001)	-0.2322 (0.251)	-0.2539*** (0.001)	-0.2588*** (0.000)	-0.2585 (0.202)
Financing	-0.3514*** (0.000)	-0.3528*** (0.000)	-0.2178 (0.365)	-0.3469*** (0.000)	-0.3495*** (0.000)	-0.2282 (0.345)	-0.3454*** (0.000)	-0.3498*** (0.000)	-0.2374 (0.330)
Rec. & Inv.	-0.1443 (0.456)	-0.1561 (0.418)	0.1435 (0.760)	-0.1291 (0.504)	-0.1374 (0.475)	0.1958 (0.676)	-0.1244 (0.519)	-0.1315 (0.494)	0.1839 (0.691)
Std ROA	0.1383 (0.138)	0.1399 (0.133)	0.5596** (0.018)	0.1414 (0.129)	0.1444 (0.121)	0.5686** (0.012)	0.1422 (0.127)	0.1459 (0.116)	0.5968*** (0.009)
City Leader	0.1204* (0.050)	0.1203* (0.051)	-0.0964 (0.590)	0.1193* (0.051)	0.1206** (0.049)	-0.0710 (0.694)	0.1150* (0.059)	0.1166* (0.056)	-0.0749 (0.680)
National Leader	0.0217 (0.738)	0.0195 (0.763)	0.0887 (0.621)	0.0145 (0.824)	0.0158 (0.807)	0.1133 (0.524)	0.0164 (0.801)	0.0169 (0.794)	0.0667 (0.715)
Constant	-6.3342*** (0.000)	-6.3831*** (0.000)	-10.1857*** (0.000)	-6.3359*** (0.000)	-6.2985*** (0.000)	-9.6473*** (0.000)	-6.3039*** (0.000)	-6.2679*** (0.000)	-9.5330*** (0.000)
Industry, Year, and Audit Firm FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	16,579	16,579	1,524	16,579	16,579	1,524	16,579	16,579	1,524
Pseudo R-Squared	0.365	0.368	0.440	0.366	0.368	0.438	0.365	0.368	0.446

This table presents the probit regression results of the propensity to issue a going concern opinion on the three alternative measures of audit office political connectedness and the respective two-way and three-way interaction terms with politically connected clients and the restatement manipulation period. The third specification of each measure presents the results of the propensity to issue a going concern opinion on auditor political connections and the corresponding interaction with politically connected clients during the restatement manipulation period only. This analysis covers the period 2003-2012. See Appendix for variable definitions. P-values are in parentheses. *, **, and *** indicate significance at the two-tailed 10%, 5%, and 1% levels, respectively.

TABLE 8
Auditor-Client Joint Political Connection: Restatement Frequency Specification

Variables	Dependent Variable: Likelihood of Accounting Restatements					
	<i>Measure 1_Res</i>		<i>Measure 2_Res</i>		<i>Measure 3_Res</i>	
Measure_Res	0.0373*** (0.000)	-0.1744** (0.021)	0.1733*** (0.001)	-0.6903*** (0.000)	0.1310*** (0.001)	-0.3901*** (0.003)
Measure_Res X Pol_Client_J	-0.0967** (0.048)	-	-0.4082*** (0.008)	-	-0.2578** (0.023)	-
Pol_Client_J	0.3735* (0.072)	-	0.3442** (0.032)	-	0.2944* (0.067)	-
Office Size	0.0147 (0.644)	-0.1951 (0.114)	0.0234 (0.453)	-0.0515 (0.626)	0.0262 (0.400)	-0.0466 (0.659)
Total Assets	-0.0947*** (0.002)	-0.0302 (0.766)	-0.0905*** (0.003)	-0.0331 (0.746)	-0.0926*** (0.003)	-0.0459 (0.663)
Market-to- Book	-0.0143* (0.088)	-0.1632*** (0.009)	-0.0143* (0.088)	-0.1649** (0.011)	-0.0142* (0.091)	-0.1525** (0.012)
Leverage	0.1397 (0.398)	-0.1477 (0.795)	0.1292 (0.438)	-0.2959 (0.601)	0.1345 (0.419)	-0.1491 (0.792)
ROA	-0.0122 (0.977)	-2.2139 (0.211)	-0.0127 (0.976)	-2.3772 (0.179)	0.0018 (0.997)	-2.3676 (0.186)
Loss	0.0921 (0.419)	0.4635 (0.332)	0.0993 (0.384)	0.5007 (0.297)	0.1009 (0.376)	0.4757 (0.332)
Num. of Bus. Seg.	-0.0115 (0.836)	0.1278 (0.603)	-0.0065 (0.907)	0.2169 (0.385)	-0.0093 (0.867)	0.1786 (0.470)
Num. of Geog. Seg.	0.0058 (0.921)	0.3561* (0.093)	0.0044 (0.940)	0.3315 (0.122)	0.0066 (0.910)	0.3952* (0.057)
Merger	0.0673 (0.475)	0.2327 (0.550)	0.0652 (0.488)	0.2439 (0.542)	0.0663 (0.481)	0.2470 (0.534)
Financing	0.1723* (0.097)	0.6069 (0.185)	0.1724* (0.096)	0.6919 (0.140)	0.1684 (0.104)	0.6556 (0.159)

Rec. & Inv.	0.0451 (0.874)	-0.0336 (0.971)	0.0846 (0.765)	0.1447 (0.873)	0.0699 (0.805)	-0.1073 (0.906)
Std ROA	0.1620 (0.636)	-1.0295 (0.283)	0.1620 (0.640)	-1.1450 (0.230)	0.1794 (0.607)	-1.1750 (0.217)
City Leader	0.0857 (0.326)	-0.2621 (0.319)	0.0853 (0.328)	-0.2911 (0.255)	0.0901 (0.302)	-0.3144 (0.223)
National Leader	0.0671 (0.377)	-0.0376 (0.886)	0.0711 (0.346)	0.0748 (0.782)	0.0712 (0.347)	-0.0192 (0.943)
Constant	-0.5145 (0.488)	5.5298* (0.054)	-0.7424 (0.311)	2.5699 (0.265)	-0.7643 (0.296)	2.8402 (0.212)
Industry, Year, and Audit Firm FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	2,887	329	2,887	329	2,887	329
Pseudo R-Squared	0.129	0.269	0.128	0.289	0.128	0.277

This table presents the probit regression results of restatement frequency on the three alternative measures of audit office political connectedness and their interaction with politically connected firms that have shared at least one common political connection with their local office over the last five years. This analysis covers the period 2003-2012 and is based on the sample of all politically connected clients. The second specification of each measure presents the results of restatement frequency on auditor political connections for politically connected clients with joint political connections only. See Appendix for variable definitions. P-values are in parentheses. *, **, and *** indicate significance at the two-tailed 10%, 5%, and 1% levels, respectively.

TABLE 9
Auditor-Client Joint Political Connections: Audit Fee Specification

Variables	Dependent Variable: Audit Fees					
	<i>Measure 1_Res</i>		<i>Measure 2_Res</i>		<i>Measure 3_Res</i>	
Measure_Res	0.0064**	-0.0183*	0.0248	-0.1353**	0.0251**	-0.0906**
	(0.023)	(0.074)	(0.123)	(0.018)	(0.035)	(0.021)
Measure_Res X Pol_Client_J	-0.0038	0.1838***	0.0318	0.2443**	0.0382	0.1656**
	(0.751)	(0.003)	(0.449)	(0.046)	(0.216)	(0.023)
Measure_Res X Pol_Client_J X Restate	0.2172***	-	0.2139*	-	0.1552**	-
	(0.000)		(0.079)		(0.032)	
Measure_Res X Restate	-0.0295***	-	-0.1431***	-	-0.1142***	-
	(0.001)		(0.003)		(0.001)	
Pol_Client_J X Restate	-0.7734***	-	-0.1549	-	-0.1437	-
	(0.000)		(0.168)		(0.216)	
Pol_Client_J	0.0367	-0.5647**	-0.0062	-0.0636	-0.0324	-0.0627
	(0.478)	(0.011)	(0.894)	(0.598)	(0.504)	(0.603)
Restate	0.0446	-	0.0391	-	0.0403	-
	(0.132)		(0.187)		(0.174)	
Office Size	0.0590***	0.0074	0.0577***	-0.0167	0.0572***	-0.0221
	(0.000)	(0.848)	(0.000)	(0.660)	(0.000)	(0.558)
Total Assets	0.5446***	0.5145***	0.5442***	0.4976***	0.5446***	0.5002***
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Market-to- Book	-0.0025	-0.0016	-0.0025	-0.0033	-0.0026	-0.0039
	(0.216)	(0.887)	(0.230)	(0.762)	(0.212)	(0.723)
Leverage	0.0436	0.0732	0.0453	0.0947	0.0418	0.0977
	(0.394)	(0.727)	(0.375)	(0.645)	(0.413)	(0.641)
ROA	-0.3970***	-1.0441*	-0.3837***	-1.0795*	-0.3785**	-1.0537*
	(0.007)	(0.056)	(0.009)	(0.055)	(0.010)	(0.057)
Loss	0.0980***	0.0702	0.0966***	0.0577	0.0979***	0.0595

	(0.002)	(0.451)	(0.002)	(0.533)	(0.002)	(0.520)
Num. of Bus. Seg.	0.1435***	0.2094***	0.1431***	0.2006***	0.1427***	0.2027***
	(0.000)	(0.001)	(0.000)	(0.001)	(0.000)	(0.001)
Num. of Geog. Seg.	0.1524***	0.0323	0.1528***	0.0344	0.1531***	0.0325
	(0.000)	(0.558)	(0.000)	(0.543)	(0.000)	(0.566)
Merger	0.0063	-0.0043	0.0060	0.0178	0.0058	0.0204
	(0.791)	(0.960)	(0.801)	(0.838)	(0.809)	(0.817)
Financing	-0.0456*	0.0186	-0.0444	0.0362	-0.0454*	0.0383
	(0.096)	(0.845)	(0.107)	(0.709)	(0.099)	(0.696)
Rec. & Inv.	0.5952***	0.4152*	0.5894***	0.3407	0.5900***	0.3653
	(0.000)	(0.096)	(0.000)	(0.176)	(0.000)	(0.156)
Std ROA	0.3914***	0.4303	0.3991***	0.4361	0.4016***	0.4186
	(0.003)	(0.252)	(0.003)	(0.265)	(0.003)	(0.287)
City Leader	0.1537***	0.2035***	0.1543***	0.1986***	0.1548***	0.1835**
	(0.000)	(0.008)	(0.000)	(0.010)	(0.000)	(0.014)
National Leader	0.0266	0.0045	0.0266	0.0221	0.0264	0.0159
	(0.167)	(0.950)	(0.169)	(0.765)	(0.171)	(0.823)
Going Concern	0.3196***	0.6905***	0.3252***	0.6778***	0.3241***	0.6881***
	(0.001)	(0.000)	(0.001)	(0.000)	(0.001)	(0.000)
Constant	8.3837***	9.7018***	8.4119***	10.2684***	8.4164***	10.3587***
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Industry, Year, and Audit Firm FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	3,072	330	3,072	330	3,072	330
R-Squared	0.8300	0.8598	0.8290	0.8565	0.8294	0.8563

This table presents the OLS regression results of audit fees on the three alternative measures of audit office political connectedness and the respective two-way and three-way interaction terms with connected clients with whom they have joint political connections, as well as with the restatement manipulation period. This analysis covers the period 2003-2012 and is based on the sample of all politically connected clients. The second specification of each measure presents the results of audit fees on auditor political connections and the corresponding interaction with politically connected clients with joint political connections during the restatement manipulation period only. See Appendix for variable definitions. P-values are in parentheses. *, **, and *** indicate significance at the two-tailed 10%, 5%, and 1% levels, respectively.

TABLE 10*Panel A: Determinants of Audit Office Political Connectedness*

Variables	Dependent Variable: Pol_Office_D
Pol_Client	0.0275*** (0.000)
Office Size	0.5380*** (0.000)
Total Assets	-0.0023 (0.837)
Market-to- Book	-0.0047* (0.065)
Leverage	0.1161** (0.022)
ROA	0.0953 (0.217)
Loss	-0.0321 (0.315)
Num. of Bus. Seg.	0.0446** (0.039)
Num. of Geog. Seg.	-0.0438** (0.034)
Merger	-0.0664** (0.015)
Financing	-0.0721** (0.016)
Rec. & Inv.	0.1544* (0.061)
Std ROA	-0.1876*** (0.010)
City Leader	-0.1521*** (0.003)
National Leader	0.1287*** (0.000)
Constant	-8.8303*** (0.000)
Industry, Year, and Audit Firm FE	Yes
Observations	17,352
Pseudo R-Squared	0.166

Panel B: Likelihood of Accounting Restatements Propensity-Score-Matched Sample

Variables	Dependent Variable:		
	Likelihood of Accounting Restatements		
Pol_Off_D	-0.0676** (0.044)	-0.1153*** (0.002)	0.3135*** (0.001)
Pol_Off_D X Pol_Client_D	-	0.3060*** (0.000)	-
Pol_Client_D	-	-0.3264*** (0.000)	-
Pol_Client	-0.0586*** (0.000)	-	0.0315 (0.513)
Office Size	-0.0166 (0.381)	-0.0163 (0.391)	0.0856 (0.167)
Total Assets	0.0290** (0.046)	0.0170 (0.234)	-0.1920*** (0.000)
Market-to- Book	-0.0047 (0.296)	-0.0050 (0.268)	-0.0350*** (0.003)
Leverage	0.1308* (0.075)	0.1470** (0.045)	0.0769 (0.743)
ROA	0.0333 (0.763)	0.0459 (0.677)	0.6412 (0.227)
Loss	0.1394*** (0.003)	0.1390*** (0.003)	0.3275** (0.047)
Num. of Bus. Seg.	0.0791*** (0.003)	0.0780*** (0.004)	0.0535 (0.529)
Num. of Geog. Seg.	0.0622** (0.021)	0.0639** (0.017)	0.0201 (0.810)
Merger	0.0441 (0.329)	0.0435 (0.335)	0.2942** (0.044)
Financing	0.1263*** (0.004)	0.1275*** (0.004)	0.3958** (0.012)
Rec. & Inv.	-0.0057 (0.957)	-0.0179 (0.867)	-0.0142 (0.974)
Std ROA	-0.0288 (0.710)	-0.0333 (0.666)	0.3071 (0.462)
City Leader	-0.0129 (0.735)	-0.0153 (0.691)	0.2581* (0.053)
National Leader	0.0771** (0.041)	0.0797** (0.035)	0.0750 (0.499)
Constant	-1.2603*** (0.004)	-1.1664*** (0.008)	-5.7846*** (0.000)
Industry, Year, and Audit Firm FE	Yes	Yes	Yes
Observations	10,338	10,338	1,419
Pseudo R-Squared	0.0667	0.0667	0.170

Panel C: Audit Fees Propensity-Score-Matched Sample

Variables	Dependent Variable: Audit Fees		
Pol_Off_D	0.0356*** (0.006)	0.0299** (0.043)	0.0247 (0.506)
Pol_Off_D X Pol_Client_D	-	0.0471* (0.070)	-0.2098** (0.038)
Pol_Off_D X Pol_Client_D X Restate	-	-0.1648** (0.041)	-
Pol_Off_D X Restate	-	0.0156 (0.656)	-
Pol_Client_D X Restate	-	0.1408** (0.018)	-
Pol_Client_D	-	0.0542*** (0.005)	0.2429*** (0.001)
Restate	-	0.0563** (0.019)	-
Pol_Client	0.0274*** (0.000)	-	-
Office Size	0.0901*** (0.000)	0.0892*** (0.000)	0.0761*** (0.000)
Total Assets	0.4651*** (0.000)	0.4714*** (0.000)	0.4742*** (0.000)
Market-to- Book	0.0006 (0.640)	0.0007 (0.541)	-0.0012 (0.796)
Leverage	-0.0265 (0.280)	-0.0371 (0.132)	-0.2330*** (0.003)
ROA	-0.3059*** (0.000)	-0.3137*** (0.000)	-0.5146*** (0.000)
Loss	0.1549*** (0.000)	0.1531*** (0.000)	0.2110*** (0.000)
Num. of Bus. Seg.	0.1156*** (0.000)	0.1158*** (0.000)	0.0999*** (0.000)
Num. of Geog. Seg.	0.1704*** (0.000)	0.1687*** (0.000)	0.1113*** (0.000)
Merger	0.0617*** (0.000)	0.0596*** (0.000)	0.0521 (0.285)
Financing	0.0042 (0.762)	0.0028 (0.839)	0.0160 (0.751)
Rec. & Inv.	0.4709*** (0.000)	0.4737*** (0.000)	0.5976*** (0.000)
Std ROA	0.1520*** (0.000)	0.1545*** (0.000)	0.1660** (0.049)
City Leader	0.1160*** (0.000)	0.1168*** (0.000)	0.1234*** (0.002)

National Leader	0.0141 (0.223)	0.0135 (0.244)	-0.0163 (0.680)
Going Concern	0.2543*** (0.000)	0.2580*** (0.000)	0.1483 (0.271)
Constant	8.0772*** (0.000)	8.0543*** (0.000)	8.8995*** (0.000)
Industry, Year, and Audit Firm FE	Yes	Yes	Yes
Observations	10,338	10,338	1,196
R-Squared	0.7976	0.7976	0.7141

Table 10, Panel A presents the first-stage probit specification of the determinants of audit office political connectedness. Panel B (Panel C) presents the probit (OLS) regression of restatement frequency (audit fees) on audit office political connectedness that is performed on the respective propensity-score-matched sample. The third column of Panel B presents the results of the regression of client restatement frequency on audit office political connectedness for the subsample of political connected clients only. The third column of Panel C presents the results of the regression of audit fees on audit office political connectedness and the corresponding interaction with politically connected clients during the restatement manipulation period only. This analysis covers the period 2003-2012. See Appendix for variable definitions. P-values are in parentheses. *, **, and *** indicate significance at the two-tailed 10%, 5%, and 1% levels, respectively.