

Government Preferences, SEC's Enforcement Actions and Firms' Accounting Violations

Jonas Heese

Maastricht University School of Business and Economics

Department of Accounting & Information Management

PO Box 616, 6200 MD Maastricht

j.heese@maastrichtuniversity.nl

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ABSTRACT

I posit that the SEC's enforcement actions are influenced by government's preferences for firms that contribute to the government's policy of fostering employment conditions. Using a large sample of listed US firms for the period 1982 to 2012, I investigate whether the resource-constrained SEC reduces its enforcement actions for labor-intense firms, a proxy for a firm's contribution to employment conditions. I find that labor-intense firms are less likely to face an SEC enforcement action. Next, I also show that labor-intense firms are even less likely to face an SEC enforcement action in election years. All of these results hold after controlling for firms' accounting quality and two alternative explanations for firms' favorable treatment by the SEC, i.e., firms' location and firms' lobbying activities. Consistent with my hypotheses, these findings indicate that government preferences affect the SEC's enforcement actions. Finally, I find some evidence that labor-intense firms exploit this favorable treatment by engaging in more aggressive accounting choices. My results suggest that firms that contribute to government policies are rewarded by reduced SEC enforcement actions.

Keywords: Government preferences, SEC enforcement actions, accounting violations

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1. Introduction

Research in accounting and finance traditionally assumes that the Securities and Exchange Commission (SEC) is a neutral regulatory agency that allocates scarce resources to investigate those firms that are most likely to violate Generally Accepted Accounting Principles (GAAP), and uniformly enforces firms' compliance with those accounting standards (Dechow et al. 2011; Dechow et al. 1995, 1996). A number of recent studies, however, indicate that the SEC is significantly resource-constrained and prone to political pressure, and therefore undertakes investigations based on preferences (Correia 2009; Kedia and Rajgopal 2011; Yu and Yu 2011). For instance, Correia (2009) and Yu and Yu (2011) show that firms with political connections or that engage in lobbying are less likely to be convicted by the SEC. Kedia and Rajgopal (2011) find evidence consistent with the so called 'constrained cop' hypothesis. They show that the resource-constrained SEC is more likely to investigate firms located closer to its offices and interpret their findings as an indication that the SEC minimizes costs associated with its investigations.

While the above mentioned studies argue that the SEC's preferences are based on firms' attempts to influence the SEC or underlying conditions for the investigation, they do not take into account possible systematic preferences of the SEC based on operational characteristics of the firm. Yet, economists such as Stigler (1971) and Peltzman (1976) have long argued that regulations and regulators are influenced by the government. As the government decides on the resource allocations to regulatory agencies in the first place (Bealing 1994; Weingast 1984), the SEC, as a regulatory agency, is dependent on the government's budget decisions. In light of the

recent evidence that the SEC is significantly resource-constrained (Kedia and Rajgopal 2011; Thomsen 2009), this dependency is potentially even stronger.

Following this argumentation, I investigate whether the government's preferences are likely to reflect in the SEC's decisions as to which firms to investigate. In particular, I study whether the SEC's enforcement actions are influenced by government's preferences for firms that contribute to government's policies. As the government's goal is to maximize political support, which comes in the form of votes, it responds to both constituent and special interest pressure by adjusting its political decisions and measures accordingly (Stigler 1971). Given that employment conditions are proven to systematically affect future electoral outcomes (Hibbs 2006; Kau et al. 1982; MacRae 1977; Wolfers 2002), the government has long favored a policy to promote these conditions by supporting not only large employers in absolute terms, but also smaller, labor-intensive firms that contribute to future employment (Adams and Brock 1987b; Audretsch 2003; Caves 1976). Therefore, in this study, I use firm's labor intensity as a proxy to identify firms that contribute to government's policies and investigate whether the resource-constrained SEC reduces its enforcement actions for labor-intensive firms.¹

SEC enforcement actions can be devastating for firms. In particular, sanctions directed by the SEC in combination with negative market reactions result in huge reputational and financial costs for both the firm and manager, and can ultimately lead to bankruptcy of the convicted firm (Feroz et al. 1991; Karpoff et al. 2008a, 2008b). As job losses are a direct consequence of bankruptcy, SEC enforcement actions do not only affect the economic wealth of government's

¹ Governments pursue various policies such as environmental, health care or educational policies. While the importance of these policies is likely to vary across time and is likely to be dependent on the government's partisanship, the policy of promoting employment is likely to be most important to every government as it is proven to systematically affect electoral outcomes (Hibbs 2006; MacRae 1977). Consequently, the government promotes this policy more than other policies, making it a powerful proxy for government's preferences.

constituents, e.g., a firm's employees, but also take down firms that are important for the government's policy of promoting employment. Avoiding bankruptcies of firms that employ a relatively larger number of people is thus beneficial for the government as it reduces signs of government's failure to foster employment.² Therefore, the SEC and its Commissioners are likely to face political pressure from the government to spare labor-intense firms from enforcement actions.

Furthermore, as labor-intense firms represent the preferences of the government itself this political pressure is likely to be independent of firms' lobbying for their special interests (Adams and Brock 1987b; Correia 2009; Yu and Yu 2011). Thus, I argue that the SEC, which is constrained in terms of time, effort and enforcement budgets (Kedia and Rajgopal 2011; Thomsen 2009) implicitly incorporates this government influence in its decision processes as to which firms to investigate. As a consequence, the SEC is less likely to investigate labor-intense firms whose prosecution might ultimately increase prosecution costs or negatively impact future budget decisions due to the political pressure. This lower likelihood of investigation lowers regulatory enforcement and thus makes it less likely that labor-intense firms get convicted for a violation of GAAP.

To test whether the SEC reduces its enforcement actions for labor-intense firms, I use a sample of firms for the time period 1982 to 2012 that have been sanctioned by the SEC for violating GAAP as reported in Accounting and Auditing Enforcement Releases (AAERs) and all

² An SEC enforcement action is not necessarily the reason for a firm's bankruptcy as firms that are subject to such actions might already have been on the verge of bankruptcy. In these instances an SEC enforcement action is not necessarily the cause of a firm's bankruptcy, but it is likely to accelerate the process that leads to a firm's bankruptcy. Delaying such failure, however, might also benefit the government as it can avoid negative news about the current employment conditions (Brown and Dinç 2005). In addition, distressed firms that gain additional time by not being subject to an SEC enforcement action might use this time to avoid failure after all.

other public firms that did not receive an AAER over this period. Using a firm's labor intensity as a proxy for the firm's contribution to the government's policies, I investigate whether labor-intensive firms face fewer SEC enforcement actions. I also include firms' lobbying efforts (Yu and Yu 2011) and distance to an SEC office (Kedia and Rajgopal 2011) in my model in order to control for the impact of these circumstances on the SEC's enforcement preferences.

Consistent with my hypothesis, I find evidence that labor-intensive firms are less likely to be subject to an AAER. This finding indicates that firms that contribute to the government's policy of promoting employment face lower enforcement by the SEC. These results hold after controlling for a firm's accounting quality, location, and lobbying efforts, which provides evidence that these preferences are not driven by firms' lobbying activities, but instead are systematically based on firms' characteristics that support government's policies.

To test the robustness of these results, I further examine whether variations in government's sensitivity to constituents' interests result in variations of SEC enforcement actions against labor-intensive firms. Prior research in political economy especially highlights the role of upcoming elections as a period in which the government is likely to take measures to ensure political support in the upcoming election (Brown and Dinç 2005; Kramer 1971). Thus, I argue that this higher sensitivity results in more political pressure on the SEC, resulting in even fewer enforcement actions against labor-intensive firms. In line with this hypothesis, I find that the lower likelihood of SEC enforcement actions against labor-intensive firms is even more pronounced in election years. Consequently, this finding provides further evidence that the government's preferences for firms that support government's policies reflect directly in SEC's enforcement actions.

One could argue, however, that labor-intense firms, which might be more important for the economy and are therefore under more scrutiny, have a higher accounting quality because of higher following by investors and analysts. Such a higher accounting quality would explain lower SEC investigations and convictions. Even though I include a firm's F-score (Dechow et al. 2011)³ as a control variable in all of my earlier tests to control for a firm's accounting quality, I run several additional regressions to investigate whether labor-intense firms have a better accounting quality and thus fewer SEC enforcement actions. Next to using all three specifications of the F-score as developed by Dechow et al. (2011), I also calculate discretionary accruals using the modified Jones model as in Dechow et al. (2011) and the Dechow and Dichev (2002) model. I find consistent evidence across all models that labor-intense firms have a lower accounting quality than their less labor-intense peers. This finding suggests that fewer SEC enforcement actions against labor-intense firms cannot be explained by these firms having a higher accounting quality. Instead, my results indicate that labor-intense firms exploit this preferential treatment by the SEC by engaging in more aggressive accounting choices.

Finally, I run several robustness tests to address potential concerns of my research design. First, I apply propensity score matching to better address the differences in the distribution of firm characteristics between AAER and non-AAER firms. My results are robust to this alternative research design. Second, I also investigate whether labor-intense firms are less likely to receive a comment letter from the SEC. As comment letters are a potential trigger event for an SEC enforcement action, examining whether labor-intense firms are less likely to receive such letters can provide indications at which stage of the SEC investigation process the SEC adjusts its

³ The F-score developed by Dechow et al. (2011) is a scaled probability that can be used as a red flag or signal of the likelihood of earnings management or misstatement. Dechow et al. (2011) developed the F-score by systematically investigating financial characteristics of firms that have been subject to an AAER.

enforcement actions in accordance with government's policy to foster employment. I find that labor-intense firms are less likely to receive a comment letter, suggesting that the SEC allocates fewer resources to reviews of labor-intense firms, which might lead to fewer enforcement actions against these firms.

I contribute to the accounting literature in the following ways. First, in line with a growing body of research (Correia 2009; Kedia and Rajgopal 2011; Yu and Yu 2011), I show that the SEC is not neutral in its enforcement actions. Thus, contrary to the dominant assumption in archival accounting research, my study shows that firms in the same industry are not exposed to similar levels of enforcement (Kedia and Rajgopal 2011). Second, I find that the SEC's enforcement actions are systematically influenced by government's preferences. Accounting research has hitherto not examined whether preferences of the government drive SEC's enforcement efforts, although economists have long argued that regulations and regulators are influenced by the government (Stigler 1971). Instead, a small set of studies has focused on firms' attempts to impact SEC's enforcement actions via lobbying and political connections (Yu and Yu 2011). My study, however, shows that, in addition to such active attempts, the government itself imposes pressure on the SEC to ensure that this agency acts in accordance with government's political priorities. Third, by showing that firms adjust their accounting choices as a result of SEC's enforcement actions, my study sheds light on potentially adverse impacts that SEC's enforcement actions can have on firms' accounting quality. Finally, my study also contributes to the need expressed by accounting researchers for studies that enhance our understanding of the complex dynamics surrounding regulation and enforcement of these regulations (Bozanic et al. 2012; Canning and O'Dwyer 2013).

The remainder of the paper is organized as follows. Section 2 discusses prior research on political pressure on governmental agencies and develops the hypotheses. Section 3 presents the data and research method while Section 4 provides the empirical results and additional robustness checks. Section 5 concludes.

2. Hypothesis Development

2.1. Government Preferences for Labor-Intense Firms

Since the seminal studies of Stigler (1971) and Peltzman (1976), research in economics argues that politicians in general and the government in particular seek to maximize political support, which comes in the form of votes, and thus ensure that their actions promote this goal. In line with this theory, a pervasive body of research has since shown that the government indeed represents its constituents' interests to increase political support (Hibbs 2006; Kalt and Zupan 1984; Mian et al. 2010; Peltzman 1984, 1985, 1992; Potrafke 2012). Consequently, the government considers the economic interests of voters and interest groups in its actions. Hibbs (2006) and MacRae (1977) argue that constituents' support is to a large degree influenced by economic variables such as employment, inflation or the growth rate of private consumption. Furthermore, as empirical studies show that employment conditions significantly influence voters when deciding whether to re-appoint an incumbent government, employment has generally been a core interest of the government (Bertrand et al. 2007; Conover et al. 1986, 1987; Hibbs 2006; Holbrook 1991; Kau et al. 1982; MacKuen et al. 1992; MacRae 1977; Wolfers 2002). For instance, Holbrook (1991), who investigates presidential election outcomes for the years 1960 to 1984, finds that for every percentage point of unemployment, the president's party loses 1.2 percent of the vote.

As the employment conditions significantly affect future electoral outcomes, the government has the incentive to foster employment conditions in order to ensure political support (Caves 1976). Indeed, a huge body of research indicates that governments, independent of their partisanship (Nordhaus 1975; Potrafke 2012), promote employment. For instance, governments of both partisanship established policies to promote small businesses as these businesses are often more labor-intense than larger firms (Brock and Evans 1989) and are perceived to have the ability to generate jobs (Audretsch 2003; Davis et al. 1996). In particular, small businesses have been supported by government programs such as the Small Business Innovation Research (SBIR) program in the early 1980s in order to contribute to the employment conditions.⁴ More recently, the Jumpstart Our Business Startups Act or JOBS Act, which is also intended to support small US businesses, has been passed with bipartisan support (VanRoekel 2012). In addition, the government also promotes employment by supporting specific firms that contribute significantly to the overall employment conditions. In particular, firms that are perceived as being too big to fail receive government support in various forms such as import protection, regulatory delays, and subsidies in the form of tax favors and bailouts (Adams and Brock 1986, 1987a, 1987b, 2004). Chrysler, for instance, has been bailed out by the government to prevent huge job losses and destabilization of the entire manufacturing sector at the end of the 1970s and 2000s (Adams and Brock 1987b; Barnes 2009).

Therefore, the government has long favored a policy to promote employment conditions by supporting not only large employers in absolute terms, but also smaller businesses that employ a large number of people in relative terms and contribute to future employment. As a consequence,

⁴ The SBIR was an offshoot of the Small Business Investment Company (SBIC) program, which provided more than \$3 billion to young firms between 1958 and 1969 (Audretsch 2003).

the government has preferences not just for large firms but also for smaller, labor-intense firms as they contribute to the overall employment conditions (Adams and Brock 1986, 1987a, 1987b, 2004; Audretsch 2003; Caves 1976; Hillman et al. 1987). As job losses are a direct consequence of bankruptcy, bankruptcy of labor-intense firms will result in relatively more job losses than bankruptcy of firms that are less labor-intense. Consequently, the government has incentives to protect labor-intense firms from events such as failure or bankruptcy that can interfere with the government's policy of promoting employment.

2. 2. SEC Behavior under Government Preferences

As outlined above, the government seeks to promote employment conditions to maximize political support and ensures that its actions promote this goal. To promote employment the government can choose to adjust regulations or induce pressure on regulators (Peltzman 1976; Stigler 1971). Therefore, the government is likely to impose pressure on regulators whose enforcement actions have a significant impact on employment conditions. SEC enforcement actions, for instance, have the potential to significantly interfere with the employment conditions the government aims to provide to its voters. Karpoff et al. (2008b), for instance, find that, in addition to the direct penalties, SEC's enforcement actions can lead to huge reputational penalties imposed by the market.⁵ As a result, about 34 percent of the firms do not survive the enforcement process and thus file bankruptcy.⁶ On the other hand, firms that survive face a mean dollar loss of \$591.75 million from the SEC enforcement action (Karpoff et al. 2008b). Thus, an SEC

⁵ In particular, the reputational penalties, i.e., the expected losses in the present value of future cash flows due to lower sales and higher contracting and financing costs, are over 7.5 times the sum of all penalties imposed through the legal and regulatory system (Karpoff et al. 2008b).

⁶ An SEC enforcement action is not necessarily the reason for a firm's bankruptcy as firms that are subject to an AAER might already have been on the verge of bankruptcy. In these instances an SEC enforcement action is not necessarily the cause of a firm's bankruptcy, but it is likely to accelerate the process that leads to a firm's bankruptcy.

enforcement action, whether or not it results in the firm's bankruptcy, can significantly interfere with the government's goal to promote employment, resulting in incentives for the government to impose pressure on the SEC.

The reason why the government's preferences are likely to reflect in the SEC's decisions as to which firms to investigate is the combination of SEC's resource constraints (Kedia and Rajgopal 2011; Thomsen 2009) and the fact that the government decides on the resource allocations to the SEC in the first place (Bealing 1994; Weingast 1984). Thus, the SEC, as a regulatory agency, is dependent on the government's budget decisions. Kedia and Rajgopal (2011), for instance, show that the SEC budget between 1995 and 2009 is less than one percent of total stock market capitalization, indicating that the SEC is significantly resource-constrained. Next to government's control over the SEC's budget, the government has several additional instruments at its disposal that can potentially create incentives for regulators to act in accordance with the government's goal, i.e., the maximization of political support. First, as described by Arthur Levitt, former Chairman of the SEC (Levitt and Dwyer 2003), members of the government can actively intervene with an SEC investigation. Second, the government, i.e., the president with the advice and consent of the Senate, appoints SEC Commissioners and can thus impact which political views are represented in the SEC (Noll 1971; SEC 2013a; Weingast 1984). Finally, the government can sanction the SEC and its employees. For instance, the careers of SEC Commissioners and other key employees might depend on their political support. As a result, the SEC is likely to act in accordance with government's policy to foster employment and thus exercises judgment as to which firms to investigate.

This judgment can potentially occur at several steps of the SEC investigation process, which consists of several distinct stages and can ultimately lead to an AAER.⁷ The investigation process typically starts with a firm's conspicuous announcement, called trigger event, which can lead to an informal and confidential investigation by the SEC. If questionable activity is suspected, a formal investigation is initiated after which the Commission decides how the investigation proceeds. The process ends with an enforcement action such as an AAER.⁸ An SEC that is likely to adjust its enforcement actions in accordance with government's policy to foster employment has several possibilities to exercise judgment as to which firms to investigate during this process. For instance, the SEC can allocate less resources to general reviews⁹ or informal and confidential investigations of labor-intense firms. In addition, if another source puts forward claims against labor-intense firms, the SEC can pursue these claims less severely. In all of these instances, such a behavior of the SEC potentially reduces the likelihood that the SEC detects misbehavior of labor-intense firms. If the SEC starts a formal investigation of a labor-intense firm, the SEC Commissioners, as they decide how the investigation proceeds, can still overrule the recommendation of the SEC staff and thus reduce or even prevent enforcement actions against these firms.

In summary, the government has both the incentive and the means to impact the investigation process of the SEC. Therefore, I argue that the government's preference for labor-

⁷ For a more detailed description of the SEC enforcement process see Karpoff et al. (2008b) and Kedia and Rajgopal (2011).

⁸ During the investigation period, the targeted firm may issue a press release indicating that it is the target of an SEC informal inquiry or formal investigation. However, usually the firm does not voluntarily disclose this information (Karpoff et al. 2008b; Kedia and Rajgopal 2011).

⁹ General reviews of company filings are conducted by the SEC's Division of Corporation Finance and may result in a comment letter if the Division believes that disclosure can be improved. According to Robert Sack, the former Chief Accountant of the Enforcement Division, these reviews are an important trigger event of an enforcement action as the SEC obtains about 50% of the leads from these reviews (Feroz et al. 1991).

intense firms, to promote employment conditions, reflects in lower likelihood of SEC enforcement actions against these firms. This argumentation can be summarized in the following hypothesis:

Hypothesis 1: Labor-intense firms are less likely to be subject to an AAER.

2.3. Government's Pressure on SEC during Election Years

Prior research in political economy especially highlights the role of upcoming elections as a period in which the government is likely to respond even more to the needs of its constituents to ensure political support in the upcoming election (Brown and Dinç 2005; Hibbing and Alford 1981; Kramer 1971). As Kinder and Kiewiet (1979, 1981) have emphasized, voters often use the current health of the economy as a signal of the incumbent's economic competence that will influence the voter's economic prosperity in the future. Therefore, it is of particular importance for the government to foster the employment conditions prior to elections. In line with that argument, a large literature on political business cycles, starting with Nordhaus (1975), has highlighted that the incumbent government is indeed willing to engage in potentially costly activities prior to elections to enhance the current employment conditions or avoid negative news with regard to these conditions. For instance, Alesina et al. (2000), Borjas (1986) and Shleifer and Vishny (1994) show that the government prior to elections can induce pressure on state-owned firms to engage in excess employment and pay above-market wages in order to gain greater political support. Furthermore, studies by Cole (2009) and Dinç (2005) provide evidence that prior to elections the government provides subsidies via government-owned banks to the private sector as an additional mechanism to improve employment.

Next to inducing pressure on government-owned firms, studies have also shown that the government induces pressure on regulators to delay politically costly regulatory actions until after

elections. For instance, Brown and Dinç (2005) investigate bank failures of the ten largest banks in 21 emerging market countries and find that failures are clustered after government elections. They interpret their findings as evidence that the government induces pressure on regulatory agencies to avoid politically costly regulatory interventions before elections. In a similar manner, Imai (2009) examines bank failures in Japan and finds that regulators delay declarations of insolvency in prefectures that support senior politicians of the ruling party.

Therefore, both political economy theory and empirical evidence indicate that the government is likely to place more pressure on the regulator prior to elections. Based on this, I argue that the SEC also faces more political pressure from the government prior to elections. This increased pressure, consequently, leads to even fewer enforcement actions against labor-intensive firms prior to elections. Thus, I state the following hypothesis:

Hypothesis 2: Labor-intensive firms are less likely to be subject to an AAER in election years.

3. Data and Research Method

3.1. SEC Enforcement Data

To investigate the SEC's enforcement actions I use a sample of firms that have been subject to enforcement actions by the SEC for allegedly misstating their financial statements as reported in Accounting and Auditing Enforcement Releases (AAERs). Using the SEC's AAERs as a sample of misstatement firms has several advantages relative to other potential samples. First, the use of AAERs as a proxy for manipulation is a straightforward and consistent methodology. This methodology avoids potential biases induced in samples based on researchers' individual classification schemes and can be easily replicated by other researchers (Dechow et al. 2011). Second, in contrast to the Government Accountability Office (GAO) Financial Statement

Restatement Database, AAERs span a larger time period, state the reporting periods that were misstated and are likely to only include events that occurred as a consequence of intentional misstatements rather than misinterpreting accounting rules (Dechow et al. 2011; Plumlee and Yohn 2010). Finally, using the SEC's AAERs also allows me to use the F-score, which is a potentially powerful proxy for a firm's accounting quality in this specific setting, as the F-score has been developed to predict AAERs (Dechow et al. 2011). Despite the advantages of using AAERs to identify accounting misstatements, there is one main disadvantage, which is common to many studies that also consider additional enforcement actions (e.g., Kedia and Rajgopal 2011). In particular, AAERs as well as other enforcement actions represent the end product of investigations as opposed to the initial investigations themselves. To test whether the government's preferences impact SEC's enforcement actions I would ideally like to study all investigations undertaken by the SEC. However, data on informal investigations that did not eventually convert into formal enforcement actions are not publicly available (Kedia and Rajgopal 2011). As a consequence, I cannot investigate at which stages of the enforcement process government's preferences for firms that contribute to its policies actually affect this very process.¹⁰

I obtain the data on AAERs from Dechow et al. (2011). The SEC investigation process that results in issuing an AAER against a firm typically starts with a conspicuous announcement, referred to as the trigger event, related to the firm that draws the SEC's scrutiny and can arise

¹⁰ As a robustness test, I use SEC's comment letters, which might result from a general SEC review, and investigate whether labor-intensive are less likely to receive such comment letters. As these letters might trigger an enforcement action, investigating the likelihood of receiving these letters provides some insights at which stage of the SEC investigation process the SEC adjusts its enforcement actions in accordance with government's policy to foster employment.

from a variety of sources (Karpoff et al. 2008b).¹¹ The SEC can subsequently conduct an informal but confidential investigation of the target firm that may develop into a formal and public investigation if questionable activity is suspected; otherwise the SEC may drop the case. If a formal investigation is initiated the staff reviews books, trading data, witness testimony and other relevant information. The staff then makes an enforcement recommendation to the Commission, which decides how the SEC investigation proceeds. The SEC investigation can proceed in one of three ways based on the gravity of the perceived irregularity. If the SEC feels that the culpable firm or the individual has committed a criminal offence, the SEC turns the investigation over to the Department of Justice. If the SEC chooses to handle the disciplinary action itself, the SEC pursues the investigation through administrative or civil actions. A civil action is filed in federal court and an administrative action is the documentation of a discrepancy with a firm's accounting policy that does not warrant a civil suit action. All of these proceedings that involve an accountant or an auditor are designated as an Accounting and Auditing Enforcement Release (AAER) by the SEC, which is my measure of the SEC's enforcement actions.

The SEC has issued AAERs during or at the conclusion of an investigation since 1982. Therefore, the dataset I use in this study spans the time period 1982 to 2012 and consists of 3,403 AAERs; resulting in 1,297 firm misstatement events. After excluding AAERs that are unrelated to earnings misstatements or occur in financial industries, i.e., two-digit SIC codes 60-69, and

¹¹ For instance, self-disclosures of malfeasance, restatements, auditor departures, unusual trading, investigations by other federal agencies such as the Department of Defense and Environmental Protection Agency, along with delayed SEC filings, management departures, whistleblower charges, and reviews by the SEC can all be potential sources of trigger events (Karpoff et al. 2008b). According to Robert Sack, the former Chief Accountant of the Enforcement Division, reviews by the SEC are an important trigger event as the SEC obtains about 50% of the leads from these reviews (Feroz et al. 1991). Overall, however, there is no unambiguous information available which event has triggered a specific SEC enforcement action.

matching the remaining misstatement events to firms' publicly available data in Compustat and the Center for Research in Security Prices (CRSP), I have a remaining sample of 694 firm-year observations with available data, representing AAERs against 306 distinct firms. Including my large sample of control firms, i.e., all non-AAER firms with available data, for the same time period, I arrive at an overall sample of 93,207 firm-year observations, representing 11,400 distinct firms.

3.2. Methodology

To test whether labor-intense firms are indeed less likely to receive an AAER I examine the likelihood of receiving an AAER using the following logistic regression model where subscript i represents the firm and t the year:

$$\begin{aligned}
 AAER\ Dummy_{it} &= \beta_0 + \beta_1 Labor\ Intensity_{it} + \beta_2 F - score\ X_{it} + \beta_3 Proximate\ 100_{it} \\
 &+ \beta_4 Lobbying_{it} + \beta_5 ROA_{it} + \beta_6 Big\ 4_{it} + \beta_7 Market - to - Book_{it} + \beta_8 Leverage_{it} \\
 &+ \beta_9 Log\ Firm\ Age_{it} + \beta_{10} Log\ Assets_{it} + \delta_{11} Industry\ Dummies \\
 &+ \delta_{12} Year\ Dummies + e_{it}
 \end{aligned} \tag{1}$$

The *AAER DUMMY* is an indicator variable that is equal to one in the years a firm has been convicted for allegedly misstating its financial statements as reported in Accounting and Auditing Enforcement Releases, and zero otherwise. This data has been obtained from Dechow et al. (2011), who collected the data from the Accounting and Auditing Enforcement Releases published by the Securities and Exchange Commission. This dataset allows me to identify the exact period in which the firm misstated its financial statements and the release year of each AAER.

To test my first hypothesis, I use firm's labor intensity to proxy for a firm's contribution to government's policy of promoting employment. In particular, I measure *LABOR INTENSITY* as the ratio of the firm's total employees (Compustat item: EMP) scaled by current year's total average assets.¹² To control for industry effects, I adjust this measure by subtracting the two-digit SIC code median-industry labor intensity to arrive at my final measure of a firm's *LABOR INTENSITY*.¹³ The higher this share, the more labor-intense a firm is relative to other firms. Thus, a firm with a higher *LABOR INTENSITY* contributes more to the government's policy of promoting employment. H1 predicts a negative coefficient on β_1 , i.e., a higher labor intensity will be associated with a lower likelihood of receiving an AAER.

To test hypothesis 2 whether labor-intense firms are indeed even less likely to receive an AAER prior to elections, I adjust the logistic regression model for testing H1 in the following way:

$$\begin{aligned}
 & \text{AAER Release Dummy}_{it} \\
 &= \beta_0 + \beta_1 \text{Labor Intensity}_{it} + \beta_2 \text{Election Year}_t + \beta_3 \text{Labor Intensity}_{it} \\
 & * \text{Election Year}_t + \beta_k \text{Control Variables}_{it} + \delta_l \text{Industry Dummies} \\
 & + \delta_m \text{Year Dummies} + e_{it} \tag{2}
 \end{aligned}$$

ELECTION YEAR is a dummy variable that is one in all presidential election years during the time period 1982-2012 (i.e., 1984, 1988, 1992, 1996, 2000, 2004, 2008 and 2012), and zero otherwise. As presidential elections coincide with Congressional elections, these years represent

¹² Average total assets equals the sum of beginning and end of year total assets, i.e., (Compustat item: AT), divided by two.

¹³ I use several alternative measures of labor intensity to control for the robustness of my results. In particular, I scale the number of employees by total book value of equity (Compustat item: CEQ) and by total market value of equity (Compustat item: CSHO x Compustat item: PRCC), respectively. Furthermore, I also rerun my models without adjusting these measures by industry-medians. My results are unaffected by applying these different measures.

higher scrutiny of voters towards its government. Thus, I use these years as my proxy for government's sensitivity towards its constituents' interests prior to elections. I interact this dummy variable with my firm-specific measure of *LABOR INTENSITY*. The underlying argument of H2 is that the government is willing to increase its pressure on the SEC to enhance the current employment conditions or avoid negative news with regard to these conditions as voters often use the current health of the economy as a signal of the government's competence to foster future employment. Thus, for testing H2 the timing of the release of an AAER against labor-intense firms, instead of receiving an AAER *per se*, is important as the government can potentially benefit from a delay of releasing an AAER against these firms until after elections. Consequently, I change my dependent variable, denoted *AAER RELEASE DUMMY*. In particular, the *AAER RELEASE DUMMY* is one in the year an AAER has been released, instead of the year the misstatement has occurred. H2 predicts a negative coefficient on β_3 , i.e., labor intensity has greater impact on lowering the likelihood of receiving an AAER in an election year compared to a non-election year.

Firms that engage in less aggressive accounting choices are less likely to be subject to an AAER. To control for a firm's accounting quality, I use the F-score developed by Dechow et al. (2011).¹⁴ Dechow et al. (2011) investigate financial characteristics of misstating firms and develop a model to predict misstatements, i.e., AAERs. The output of this analysis is a scaled probability (F-score) that can be used as a red flag or signal of the likelihood of earnings management or misstatement (Dechow et al. 2011). In particular, Dechow et al. (2011) develop

¹⁴ It is possible that the F-score does not only capture firm's accounting quality but also partly SEC's selection criteria (Dechow et al. 2011). From a firm's perspective, however, being subject to an SEC enforcement action is very costly (Karpoff et al. 2008b), making it beneficial for firms to avoid these characteristics. Therefore, the F-score is likely to mainly capture characteristics of firms that are more likely to misstate their financial statements as opposed to the SEC's selection criteria (Dechow et al. 2011).

three different F-scores that include (1) only financial statement variables such as accruals, changes in ROA or changes in receivables (*F-SCORE 1*), (2) financial statement variables and off-balance sheet as well as nonfinancial variables such as the existence of operating leases (*F-SCORE 2*), and (3) financial statement variables, off-balance sheet as well as nonfinancial variables and stock market-based variables such as market-adjusted stock return (*F-SCORE 3*). Thus, *F-SCORE X* in my model either represents *F-SCORE 1*, *F-SCORE 2* or *F-SCORE 3*. The higher the resulting F-score, the higher is the likelihood of earnings misstatement.¹⁵

As Kedia and Rajgopal (2011) show that the SEC is more likely to investigate firms located closer to its offices, I also control for the distance between the county of a firm's headquarters and SEC offices in Washington, DC, New York City, NY, Miami, FL, Chicago, IL, Denver, CO, and Los Angeles, CA. I follow Kedia and Rajgopal (2011) and estimate the distance between the county of a firm's headquarters and SEC offices using the latitude and longitude of both counties and SEC offices obtained from the US Census Bureau Gazetteer.¹⁶ Based on these distances I create a dummy, *PROXIMATE 100*, that is equal to one for all firms that are located within 100 km of the SEC office.

In addition, several studies find that firms that engage in lobbying or are politically connected can enjoy a favorable treatment by the SEC (Correia 2009; Yu and Yu 2011). I argue, however, that cross-sectional differences in SEC's enforcement actions are driven by government preferences instead of firms' active attempts to influence the SEC. To rule out that my results are

¹⁵ For a detailed explanation of the development of the F-score see Dechow et al. (2011).

¹⁶ In particular, I use the Haversine formula to calculate the distance between counties and SEC offices (Kedia and Rajgopal 2011). In 2007 the SEC elevated its district offices located in Boston, MA, Philadelphia, PA, Atlanta, GA, Fort Worth, TX, Salt Lake City, UT, and San Francisco, CA to regional offices and gave them responsibilities similar to their existing regional offices (Kedia and Rajgopal 2011). In order to increase the comparability of my results to those of Kedia and Rajgopal (2011) I consider only a firm's distance to the original regional offices. Considering these additional regional offices does, however, not affect my results.

driven by such attempts, I obtain data on firms' lobbying expenditures from the Center for Responsive Politics (CRP) (Blau et al. 2013; Correia 2009; CRP 2013). The CRP compiles this data from 1998 onwards using quarterly lobbying disclosure reports filed with the Secretary of the Senate's Office of Public Records and includes lobbying expenditures for each firm.¹⁷ Based on this data I scale firm's lobbying expenditures by total average assets, denoted *LOBBYING EXP*, to control for a firm's lobbying activities relative to its size. I also create an indicator variable, *LOBBY DUMMY*, that is one if the lobbying expenditures are larger than zero, and zero otherwise. Thus, *LOBBYING* in my model either represents *LOBBYING EXP* or *LOBBY DUMMY*.

In accordance with prior studies that investigate determinants of firms' misstatements (Brazel et al. 2009; Ettredge et al. 2008), I also include several variables that control for the characteristics of a firm. First, I include a firm's two-digit SIC code median-adjusted return on assets, denoted *ROA*, to control for a firm's performance. Above average financial performance may indicate that the firm is achieving abnormally high performance through fraudulent reporting, or that the firm may have incentives to commit fraud in order to sustain their performance (Brazel et al. 2009). Next, I construct a dummy variable, denoted *BIG 4*, that is one for all firms audited by a Big 4 firm, and zero otherwise. As Big 4 auditors are of higher quality than non-Big 4 auditors (Defond 1992; Palmrose 1988), clients of the Big 4 are less likely to commit fraud. Consequently, employing a Big 4 auditor may lead to higher audit quality and reduce a firm's opportunity to engage in fraud (Brazel et al. 2009).

Furthermore, I use the *MARKET-TO-BOOK* ratio to control for a firm's growth expectations since Dechow et al. (1996), for instance, find that firms with higher growth

¹⁷ Therefore, all analyses that include lobbying expenditures as control variables are limited to the period 1998-2012.

opportunities are more likely to engage in earnings manipulation. A firm's *LEVERAGE* is also included to control for a firm's financial distress (Brazel et al. 2009; Dechow et al. 1996). Financially distressed firms may have a greater incentive to commit fraud than those that are not distressed. The natural logarithm of a firm's age, denoted as *LOG FIRM AGE*, controls for the fact that fraud firms tend to be younger (Beneish 1997), which may be due to a greater incentive to commit fraud as a result of an initial public offering or other newly issued stock. Finally, to control for size I include the natural logarithm of a firm's total assets, *LOG ASSETS*. Table 1 provides an overview of my variables.

[Insert Table 1 about here]

3.3. Descriptive Statistics

Table 2 reports descriptive statistics of my sample, a comparison between more and less labor-intense firms, and a comparison of the AAER vs. non-AAER firms to better understand the differences between these different types of firms.

As reported in Table 2, Panel A the mean (median) firm in my sample has total average assets of \$1,808 million (\$141 million), 6,823 (837) employees, leverage of .179 (.119), a market-to-book ratio of 2.8 (1.8) and is 15 (10) years old. The skewness of these distributions suggests that my sample includes proportionately more small and younger firms. The majority of firms is audited by a Big 4 auditor (81.4%) and 31.3% of the firms are located within 100 km distance to a major SEC office. Furthermore, during the time period 1998-2012 16.2% of the firms engage in lobbying, spending on average \$71,621.

Table 2, Panel B reports the differences between more and less labor-intense firms. I split the sample at the median value of labor intensity into two groups. The descriptives indicate that

more labor-intense firms are significantly smaller, older, more profitable, employ a larger number of people and have less leverage. Labor-intense firms also engage in less lobbying, i.e., a smaller share of labor-intense firms engages in lobbying at all and the absolute lobbying amounts are lower. Furthermore, more labor-intense firms have significantly higher F-scores, a larger share of them is located further away from an SEC office and does not have a Big 4 auditor; suggesting that labor-intense firms potentially engage in more aggressive accounting choices.

Table 2, Panel C shows the differences between the firms that received an AAER and firms that did not. In particular, I find that firms that received an AAER differ significantly from firms that did not receive an AAER in all variables except for leverage. For instance, AAER firms have a higher F-score, are located closer to an SEC office, are more profitable, are more likely to be audited by a Big 4 auditor, have higher growth expectations as measured by the market-to-book ratio, are younger and larger. This is consistent with the perception that the SEC is more likely to target large firms and firms located closer to its offices (Kedia and Rajgopal 2011). I also find that a larger share of AAER firms engages in lobbying and that the absolute lobbying amounts are larger. In contrast, AAER firms' lobbying amounts relative to firm size are smaller. The descriptives also show that AAER firms employ more people as they are much bigger in size. However, AAER firms are significantly less labor-intense than their non-AAER peers. This finding provides preliminary support for H1.

[Insert Table 2 about here]

4. Results

4.1. Test of H1

Table 3, Panel A shows the results of estimating equation 1, which examines the likelihood of being subject to an AAER. Consistent with H1, the negative and significant coefficient on the labor intensity (β_l) in all of the models indicates that more labor-intense firms are less likely to receive an AAER. The coefficient estimate is not only statistically significant but also points to economic significance as reported in Table 3, Panel B. In particular, the likelihood of an SEC enforcement action for a firm in the bottom quartile of labor intensity in contrast to a firm in the top quartile increases by 11%. These results indicate that the SEC is less likely to prosecute firms that contribute to the government's policy of promoting employment. This finding is robust to controlling for firms' lobbying activities, accounting quality and distance to an SEC office.

The control variables are largely in line with prior research. In particular, the positive and significant coefficients on all three types of F-score, i.e., model (1), (5) and (6), indicate that firms with a higher F-score are more likely to have misstated their financial statements and thus are more likely to receive an AAER (Dechow et al. 2011). I find for the majority of my models, i.e., all models except for model (2) and (3), a positive and significant coefficient on the *PROXIMATE 100* dummy. Therefore, consistent with Kedia and Rajgopal (2011), I show that firms located closer to SEC's main offices are more likely to be investigated and thus receive an AAER. However, in the models (2) and (3), which include control variables for a firm's lobbying activities, the coefficient on the distance dummy is not significant. The negative but insignificant coefficient on the *LOBBY DUMMY* suggests that engaging in lobbying *per se* does not reduce the likelihood of being subject to an AAER. However, firms with higher lobbying expenditures relative to their size are less likely to be subject to an AAER, as indicated by the negative and significant coefficient on *LOBBYING EXP*. I also find, in line with prior research (Brazel et al. 2009), a negative and significant coefficient on the Big 4 dummy in four out of the eight models,

suggesting that clients of the Big 4 are less likely to commit fraud. Finally, I also find that larger and younger firms and firms with a larger growth potential are more likely to be subject to an AAER.

[Insert Table 3 about here]

4.2. Test of H2

Table 4, Panel A presents the results of estimating the probability of receiving an AAER in an election year to test H2. The results show a negative and significant coefficient on β_1 , i.e., a firm's labor intensity, and β_3 , i.e., the interaction term between the election year dummy and a firm's labor intensity, in four out of my five models. The coefficient estimates are not only statistically significant but also economically significant, as reported in Table 4, Panel B. In particular, the likelihood of an SEC enforcement action for a firm in the bottom quartile of labor intensity in contrast to a firm in the top quartile increases by 21% (9%) in an election (non-election) year.¹⁸ These results thus indicate that labor-intense firms are even less likely to receive an AAER in an election year. As the coefficient on labor intensity stays significant in four out of five models the results suggest that labor-intense firms enjoy in general a favorable treatment by the SEC; and not just in election years. Moreover, the election year dummy is positive and significant all models, suggesting that the SEC releases more AAERs during election than non-election years. Overall, these findings provide more robust evidence that labor-intense firms face less SEC enforcement actions in response to government preferences. These results are thus consistent with H2 and indicate that labor-intense firms are even less likely to receive an AAER in election years.

¹⁸ Marginal effects for this interaction term are calculated by holding all variables except for a firm's labor intensity and the election year indicator at their mean (Greene 2010).

The results for the control variables remain largely unchanged to the results reported in Table 3, Panel A and are thus not discussed in detail.

[Insert Table 4 about here]

4.3. *Robustness and alternative tests*

Accounting quality as alternative explanation for reduced SEC’s enforcement actions against labor-intense firms

A potential alternative explanation for fewer enforcement actions against labor-intense firms is that these firms have a higher accounting quality than less labor-intense firms. In addition to controlling for firms’ accounting quality in my main models, I therefore run the following ordinary least squares regression model where subscript i represents the firm and t the year:

$$\begin{aligned}
 & \text{Accounting Quality}_{it} \\
 &= \beta_0 + \beta_1 \text{Labor Intensity}_{it} + \beta_2 \text{ROA}_{it} + \beta_3 \text{Big 4}_{it} + \beta_4 \text{Market-to-Book}_{it} \\
 &+ \beta_5 \text{Leverage}_{it} + \beta_6 \text{Log Firm Age}_{it} + \beta_7 \text{Log Assets}_{it} + \delta_8 \text{Industry Dummies} \\
 &+ \delta_9 \text{Year Dummies} + e_{it} \tag{3}
 \end{aligned}$$

ACCOUNTING QUALITY is measured using five different proxies. In particular, in three of the five models I use the three different types of F-scores as developed by Dechow et al. (2011). Recall that the F-score can be used as a red flag or signal of the likelihood of earnings management or misstatement (Dechow et al. 2011). In addition, I use two discretionary accruals models that have been widely used in prior literature. In particular, I use the modified Jones model (Dechow et al. 1995) and the Dechow and Dichev (2002) discretionary accrual model to measure accounting quality. Discretionary accruals are the difference between firms’ actual accruals and the normal level of accruals. To determine the discretionary accruals, I first estimate

the following modified Jones model (1991) cross-sectionally as in Dechow et al. (2011) for every two-digit industry-year t with at least ten observations per industry-year:

$$\Delta WC_t = \beta_0 + \beta_1 (1/A_{t-1}) + \beta_2 \frac{\Delta S_t - \Delta Rec_t}{A_{t-1}} + \beta_3 \frac{\Delta PPE_t}{A_{t-1}} + e_t \quad (4)$$

where $\Delta WC_t = \Delta AR_t + \Delta Inventory_t - \Delta AP_t - \Delta TP_t + \Delta Other Assets (net)_t$. AR_t is accounts receivable, AP_t is accounts payable, TP_t is taxes payable. S_t is sales, Rec_t accounts receivables, A_{t-1} beginning of the year assets and PPE_t is property, plant and equipment. The estimated unsigned residuals are my proxy for discretionary accruals, denoted *MOD. JONES DIS. ACC.*

To determine the discretionary accruals according to Dechow and Dichev (2002), I estimate the following ordinary least squares model cross-sectionally for every two-digit industry-year t with at least ten observations per industry-year:

$$\Delta WC_t = \beta_0 + \beta_1 (1/A_{t-1}) + \beta_2 CFO_{t-1} + \beta_3 CFO_t + \beta_4 CFO_{t+1} + e_t \quad (5)$$

where ΔWC_t is defined as above and CFO is cash flow from operations. The estimated unsigned residuals are my proxy for discretionary accruals, denoted *DD DIS. ACC.*

Table 2, Panel A-C provides descriptive statistics on the discretionary accruals measures. In particular, Panel B shows that labor-intense firms have significantly higher levels of discretionary accruals, suggesting a lower accounting quality of these firms. More evidence in line with this preliminary evidence is presented in Table 5. The coefficient on labor intensity is positive and significant in all five models, consistently suggesting that the level of labor intensity is negatively associated with a firm's accounting quality. While each of the accounting quality measures has its drawbacks (Dechow et al. 2011; Price III et al. 2011), in sum, these findings consistently suggest that labor-intense firms do not have a higher accounting quality which might explain fewer enforcement actions against these firms. Instead, the results consistently suggest that labor-

intense firms exploit their preferential treatment by the SEC and engage in more aggressive accounting choices.

The coefficients on the control variables are similar to prior research. In particular, firms audited by a Big 4 auditor and older firms have a higher accounting quality; growth firms a lower accounting quality.

Additional tests

As an additional test of my two hypotheses, I apply a research design that better addresses the differences between AAER and non-AAER firms. In particular, the distribution of the variables is likely to differ significantly between the AAER and non-AAER firms. To better address these differences, I employ a propensity-score matched pair research design to match AAER observations with non-AAER observations that are similar along a comprehensive set of firm characteristics that affect the likelihood of receiving an AAER (Dehejia and Wahba 2002). In particular, I calculate each non-AAER firm's propensity score to receive an AAER from the following probit regression model, where subscript i represents the firm and t the year:

$$\begin{aligned}
 & AAER\ Release\ Dummy_{it} \\
 & = \beta_0 + \beta_1 F - score\ 1_{it} + \beta_2 Proximate\ 100_{it} + \beta_3 ROA_{it} + \beta_4 Big\ 4_{it} \\
 & + \beta_5 Market - to - Book_{it} + \beta_6 Leverage_{it} + \beta_7 Log\ Firm\ Age_{it} + \beta_8 Log\ Assets_{it} \\
 & + \delta_9 Industry\ Dummies + \delta_{10} Year\ Dummies + e_{it} \tag{6}
 \end{aligned}$$

This regression includes the same variables as model (1) in Table 4, Panel A, except for the firm's labor intensity and the election year dummy, which are my variables of interest. All variables are defined as before and as described in Table 1. The results of this probit model are shown in Table 6, Panel A and are comparable to the results reported in Table 4. Matched pairs

are formed by selecting an observation that received the treatment, i.e., an AAER, and selecting another observation with the closest propensity score that did not receive the treatment. This matching process is done without replacement, indicating that AAER observations do not have the same non-AAER observation as a pair. As reported in Table 6, Panel B the results of the mean comparisons of matched pairs indicate that the matching procedure successfully finds non-AAER firms that are similar to the AAER firms. In particular, there are no significant differences between my 676 matched pairs of AAER and non-AAER firms in any of the observable variables used in my matching procedure. To test H1 with this alternative research design, I measure the difference in labor intensity between firms that received an AAER and the matched non-AAER firm. The results of this comparison are shown in Table 6, Panel C and indicate that the matched non-AAER firms are more labor-intense than the matched AAER firms. Thus, the propensity score matching provides additional evidence in favor of H1.

To further test H2 with this alternative research design, I run the following logistic regression on the matched sample of 676 matched pairs of AAER and non-AAER firms:

$$\begin{aligned}
 \text{AAER Release Dummy}_{it} = & \\
 & \beta_0 + \beta_1 \text{Labor Intensity}_{it} + \beta_2 \text{Election Year}_t + \beta_3 \text{Labor Intensity}_{it} * \text{Election Year}_t + \\
 & e_{it}
 \end{aligned} \tag{7}$$

This regression includes my two variables of interest, i.e., a firm's labor intensity and the election year dummy, and the interaction between these variables. The results of this regression are shown in Table 6, Panel D. I find a negative and significant coefficient on β_1 , i.e., a firm's labor intensity, and β_3 , i.e., the interaction term between the election year dummy and a firm's labor intensity. These results thus indicate that labor-intense firms are even less likely to receive an AAER in an election year. As the coefficient on labor intensity stays significant, the results

also suggest that labor-intense firms enjoy in general a favorable treatment by the SEC; and not just in election years. Thus, the propensity score matching provides also additional evidence in favor of H2.

Finally, I conduct an additional test to provide more insights at what stages of the enforcement process government preferences are likely to influence SEC's enforcement actions. While my main tests use AAERs, which are the end product of investigations as opposed to the initial investigations themselves, I also run an additional test using SEC comment letters. The SEC's Division of Corporation Finance reviews company filings and sends comment letters to firms if it believes that these filings can be improved (SEC 2013b). The Division of Corporation Finance typically begins with a preliminary review of a firm's filings.¹⁹ Based on this preliminary review, the Division may decide to undertake a further review, which may result in a comment letter if the staff believes that disclosure can be improved. The company will typically respond by sending a letter to the SEC and there may be several rounds of correspondence until the SEC advises the company that the review of the filing is complete (Correia 2009). As the Division of Corporation Finance may refer cases to the Division of Enforcement, comment letters may trigger an enforcement action. Feroz et al. (1991) refer to a speech by Robert Sack, the former Chief Accountant of the Enforcement Division, who indicated that, in his opinion, the SEC obtains 50% of the leads from reviews of financial statements and securities offerings, suggesting that these reviews are an important trigger event of SEC's enforcement actions. A resource-constrained SEC that is likely to adjust its enforcement actions in accordance with government's policy to foster employment might also allocate fewer resources to reviews of labor-intense

¹⁹ The selection criteria for this preliminary review are not publicly disclosed. However, since the passage of the Sarbanes Oxley Act the SEC is required to undertake some level of review of a firm's filings at least once every three years (Kedia and Rajgopal 2011).

firms. As a consequence, labor-intense firms are less likely to receive a comment letter. In order to test whether labor-intense firms are indeed less likely to receive a comment and receive a lower number of comment letters, respectively, I use the following regression model where subscript i represents the firm and t the year:

Comment Letter _{it}

$$\begin{aligned}
 &= \beta_0 + \beta_1 \text{Labor Intensity}_{it} + \beta_2 \text{F-score } 1_{it} + \beta_3 \text{Proximate } 100_{it} \\
 &+ \beta_4 \text{Lobbying Exp}_{it} + \beta_5 \text{ROA}_{it} + \beta_6 \text{Big } 4_{it} + \beta_7 \text{Market-to-Book}_{it} \\
 &+ \beta_8 \text{Leverage}_{it} + \beta_9 \text{Log Firm Age}_{it} + \beta_{10} \text{Log Assets}_{it} + \delta_{11} \text{Industry Dummies} \\
 &+ \delta_{12} \text{Year Dummies} + e_{it} \tag{8}
 \end{aligned}$$

COMMENT LETTER is either the number of letters exchanged between a company and the SEC or an indicator variable that is one in the years a firm received a comment letter from the SEC, and zero otherwise. The time period for this analysis is limited to the period 2004-2010 as comment and response letters are only publicly available from 2004 onwards. All other variables are defined as before.

The results of this additional test are shown in Table 7. I find that labor-intense firms are less likely to receive a comment letter and the total number of letters exchanged between the SEC and a labor-intense firm is also lower. This result suggests that the SEC allocates fewer resources to reviews of firms that contribute to government's policies. To the extent that these reviews are an important trigger event of an enforcement action, allocating fewer resources to reviews of labor-intense firms results in fewer investigations and enforcement actions by the Division of Enforcement. In contrast, firms that have a higher F-score and thus potentially a lower accounting quality, firms that are located further away from the SEC office, and firms that engage in more lobbying are more likely to receive a comment letter and have a more extensive correspondence

with the SEC. These latter findings suggest that the SEC is in general more likely to conduct reviews of firms that have a higher likelihood of misstating their financial statements.

5. Conclusions

The traditional assumption in accounting and finance is that the SEC is a neutral regulatory agency that investigates those firms that are most likely to violate GAAP. Yet, economists have long argued that regulators such as the SEC are influenced by the government. As the government's goal is to maximize political support, which is largely affected by the employment conditions, it is likely to have preferences for firms that contribute to the government's policy of promoting employment. Thus, I investigate whether the SEC, as a consequence of government pressure, reduces its enforcement actions for labor-intense firms, a proxy for a firm's contribution to employment conditions. My results indicate that labor-intense firms are less likely to face an SEC enforcement action, after controlling for firms' accounting quality, location and lobbying efforts. I further exploit the variation in government's sensitivity to voters' interests in election years to provide more robust evidence that labor-intense firms face less SEC enforcement actions due to government preferences for these firms. I find that labor-intense firms are even less likely to receive an AAER in election years, after controlling for two alternative explanations for firms' favorable treatment by the SEC, i.e., firms' location and lobbying activities.

I also investigate whether labor-intense firms' lower likelihood of being subject to an AAER can be explained by the accounting quality of these firms. A higher accounting quality would explain lower SEC investigations and convictions. I find, however, evidence that labor-intense firms have a lower accounting quality than their less labor-intense peers, suggesting that fewer SEC enforcement actions against labor-intense firms cannot be explained by those firms'

higher accounting quality. Instead my results indicate that labor-intense firms exploit this preferential treatment by the SEC by engaging in even more aggressive accounting choices.

My study has several limitations. First, AAERs only represent the end product of SEC's enforcement actions as opposed to the initial investigations themselves. Thus, I can only describe at which stages of the SEC enforcement process government's preferences can affect the outcome of this process, i.e., receipt of an AAER, but cannot conclusively state at which stage exactly such preferences impact the enforcement process. However, by investigating the likelihood of receiving an SEC comment letter as an additional test, I find evidence that labor-intense firms are less likely to receive a comment letter, suggesting that the resource-constrained SEC allocates fewer resources to reviews of firms that contribute to government's policies. Second, my study ignores that also the terms of SEC Commissioners are limited to five years and thus SEC Commissioners themselves might have incentives to impact the enforcement preferences of the SEC around the end of their terms. Future research could explore whether Commissioner's incentives affect the enforcement preferences. Finally, my measures of accounting quality have limitations. For instance, it can be argued that higher discretionary accruals do not reflect fraudulent misstatements that might eventually lead to an AAER, but simply an exploitation of leeway in accounting standards. However, given the consistency of my results across several noisy accounting quality measures, I provide some evidence that labor-intense firms have on average a lower accounting quality than their less labor-intense peers.

Overall, my results indicate that the SEC is not a neutral regulatory agency, but systematically incorporates the government's preferences in its enforcement actions, regardless of firms' active lobbying activities. To the extent that these firms exploit this preferential treatment by engaging in more aggressive accounting choices, my study sheds light on a problematic

consequence of government's pressure on the SEC. Future research could explore other types of firms that the government has preferences for and the costs and benefits arising out of this preferential treatment in greater detail.

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Table 1: Overview of Variables

Variable	Definition
Dependent Variables	
AAER Dummy	1 in the years a firm has been convicted for allegedly misstating its financial statements as reported in Accounting and Auditing Enforcement Releases, and zero otherwise.
AAER Release Dummy	1 in the years a firm has received an AAER for allegedly misstating its financial statements, and zero otherwise.
Number of Comment Letters	Number of comment letters a firm has either received or sent to the SEC.
Comment Letter Dummy	1 in the years a firm has received a comment letter from the SEC, and zero otherwise.
Variables of interest	
Labor Intensity	Firm's total employees (Compustat item: EMP) scaled by firm's total average assets (Compustat item: AT; sum of beginning and end of year total assets divided by two); adjusted by subtracting the two-digit SIC code median-industry labor intensity to arrive at my final measure of labor intensity.
Election Year	1 in all presidential election years (i.e., 1984, 1988, 1992, 1996, 2000, 2004, 2008 and 2012), and zero otherwise.
Control Variables	
F-score 1	Predicted value = $-7.893 + 0.79 * RSST \text{ accruals} + 2.518 * \text{Change in receivables} + 1.191 * \text{Change in inventory} + 1.979 * \% \text{ Soft assets} + 0.171 * \text{Change in cash sales} + 0.932 * \text{Change in ROA} + 1.029 * \text{Actual issuance}$. Based on this predicted value the probability is calculated as $e^{(\text{predicted value})} / (1 + e^{(\text{predicted value})})$. To arrive at the F-score the probability is divided by the unconditional probability, i.e., $\text{misstating firm-years} / (\text{non-misstating firm-years} + \text{misstating firm-years})$. For more details see Dechow et al. (2011).
F-score 2	Predicted value = $-8.252 + 0.665 * RSST \text{ accruals} + 2.457 * \text{Change in receivables} + 1.393 * \text{Change in inventory} + 2.011 * \% \text{ Soft assets} + 0.159 * \text{Change in cash sales} + 1.029 * \text{Change in ROA} + 0.983 * \text{Actual issuance} - 0.15 * \text{Abnormal change in employees} + 0.419 * \text{Existence of operating leases}$. Based on this predicted value the probability is calculated as $e^{(\text{predicted value})} / (1 + e^{(\text{predicted value})})$. To arrive at the F-score the probability is divided by the unconditional probability, i.e., $\text{misstating firm-years} / (\text{non-misstating firm-years} + \text{misstating firm-years})$. For more details see Dechow et al. (2011).
F-score 3	Predicted value = $-7.966 + 0.909 * RSST \text{ accruals} + 1.731 * \text{Change in receivables} + 1.447 * \text{Change in inventory} + 2.265 * \% \text{ Soft assets} + 0.160 * \text{Change in cash sales} + 1.455 * \text{Change in ROA} + 0.651 * \text{Actual issuance} - 0.121 * \text{Abnormal change in employees} + 0.345 * \text{Existence of operating leases} + 0.082 * \text{Market-adjusted stock return} + 0.098 * \text{lagged market-adjusted stock return}$. Based on this predicted value the probability is calculated as $e^{(\text{predicted value})} / (1 + e^{(\text{predicted value})})$. To arrive at the F-score the probability is divided by the unconditional probability, i.e., $\text{misstating firm-years} / (\text{non-misstating firm-years} + \text{misstating firm-years})$. For more details see Dechow et al. (2011).
Mod. Jones Dis. Acc.	Discretionary accruals using the following modified Jones model as in Dechow et al. (2011): $\Delta WC_t = \beta_0 + \beta_1 (1/A_{t-1}) + \beta_2 \frac{\Delta S_t - \Delta Rec_t}{A_{t-1}} + \beta_3 \frac{\Delta PPE_t}{A_{t-1}} + e_t$ where $\Delta WC_t = \Delta AR_t + \Delta Inventory_t - \Delta AP_t - \Delta TP_t + \Delta Other \text{ Assets (net)}_t$. AR is accounts receivable, AP is accounts payable, TP is taxes payable. S is sales, Rec accounts receivables, A_{t-1} beginning of the year assets and PPE is property, plant and equipment. The unsigned estimated residuals are my proxy for discretionary accruals.
DD Dis. Acc.	Discretionary accruals according to Dechow and Dichev (2002), using the following OLS model: $\Delta WC_t = \beta_0 + \beta_1 (1/A_{t-1}) + \beta_2 CFO_{t-1} + \beta_3 CFO_t + \beta_4 CFO_{t+1} + e_t$ where ΔWC_t is defined the same as for the modified Jones model and CFO is cash flow from operations. The unsigned estimated residuals are my proxy for discretionary accruals.
Proximate 100	1 if a firm's headquarters is located within 100 km distance to the SEC office, i.e., SEC offices in Washington, DC, New York City, NY, Miami, FL, Chicago, IL, Denver, CO, and Los Angeles, CA, and zero otherwise. For more details see Kedia and Rajgopal (2011).
Lobby Dummy	1 if the lobbying expenditures are larger than zero as reported in the CRP dataset, zero otherwise.
Lobbying Exp	A firm's lobbying expenditures as reported in the CRP dataset scaled by total average assets.
ROA	Two-digit SIC code median-adjusted return on assets, i.e., Compustat item: IB / Total average assets.
Big 4	1 if a firm's auditor is a Big 4 auditor, zero otherwise.
Market-to-book	Firm's market value scaled by firm's book value, i.e., (Compustat item: CSHO * Compustat item: PRCC) / Compustat item: CEQ.
Leverage	Firm's long-term debt scaled by firm's total average assets, i.e., Compustat item: DLTT / Total average assets.
Log Firm Age	Natural logarithm of a firm's age; based on first time appearance in Compustat.
Log Assets	Natural logarithm of a firm's total assets, i.e., Compustat item: AT.

Table 2: Descriptive Statistics**Panel A: Summary Statistics for years 1982 to 2012^a**

Variable	N	Mean	Std.	Min	1st	Median	3rd	Max
Labor Intensity	93,207	0.002	.008	-.011	-.001	0	.004	.052
Employees	93,207	6.823	18.524	.003	.179	.837	3.992	127.5
F-score 1	93,207	1	.727	.120	.484	.819	1.284	4.287
F-score 2	93,207	1	.758	.107	.464	.810	1.230	4.419
F-score 3	93,207	1	.809	.130	.480	.847	1.387	4.624
DD Dis. Acc.	93,207	0.062	0.070	0	0.016	0.038	0.079	0.334
Mod. Jones Dis. Acc.	93,207	0.056	0.061	0	0.014	0.035	0.074	0.292
Proximate 100	93,207	.313	.464	0	0	0	1	1
Lobby Dummy	55,913	.162	.368	0	0	0	0	1
Lobbying Exp	55,913	31.196	128.405	0	0	0	0	811.219
Lobbying Amount	55,913	71,621	284,129	0	0	0	0	1,740,000
ROA	93,207	-.057	.228	-1.16	-.074	0	.052	.284
Big 4	93,207	.814	.389	0	1	1	1	1
Market-to-Book	93,207	2.804	4.544	-12.751	1.069	1.825	3.261	29.268
Leverage	93,207	.179	.199	0	.003	.119	.292	.898
Firm Age	93,207	14.92	14.08	2	5	10	20	71
Assets	93,207	1,808	5,790	2.12	32.79	140.98	738.16	41,959

Notes to Table 2, Panel A:

^a The table displays the summary statistics of the full sample for all variables over the period 1982-2012. See Table 1 for variable definitions.

Panel B: Statistics for more vs. less labor-intense firms^b

Variable	N	Higher labor intensity (1)	Lower labor intensity (2)	Difference (1) - (2)
Labor Intensity	93,207	.007	-0.002	.009***
Employees	93,207	7.030	6.615	0.415***
F-score 1	93,207	1.07	.923	.147***
F-score 2	93,207	1.07	.927	.143***
F-score 3	93,207	1.13	.984	.146***
DD Dis. Acc.	93,207	0.065	0.059	0.006***
Mod. Jones Dis. Acc.	93,207	0.059	0.053	0.006***
Proximate 100	93,207	.308	.318	-.01***
Lobby Dummy	55,913	.124	.197	-0.073***
Lobbying Exp	55,913	31.33	31.07	0.26
Lobbying Amount	55,913	40,486	100,746	-60,260***
ROA	93,207	-.048	-.067	.019***
Big 4	93,207	.785	.844	-.059***
Market-to-Book	93,207	2.82	2.79	.03
Leverage	93,207	.174	.184	-.010***
Firm Age	93,207	15.02	14.83	.19**
Assets	93,207	987	2,629	-1,642***

Notes to Table 2, Panel B:

^b The table displays average values of the variables over the period 1982-2012 for two groups of firms: (i) more labor-intense firms; and (ii) less labor-intense firms. I constructed these groups by splitting the sample at the median value of the variable labor intensity. The table also displays the differences between the means of these variables. ***, **, and * indicate the significance at the 1%, 5% and 10% level, respectively, of the difference between the means of the more labor-intense firms sample as compared to the less labor-intense firms sample. See Table 1 for variable definitions.

Panel C: Statistics for AAER vs. non-AAER sample^c

Variable	N	AAER sample (1)	N	Non-AAER sample (2)	Difference (1) - (2)
Labor Intensity	694	.0008	92,513	0.0024	-.0016***
Employees	694	12.35	92,513	6.783	5.567***
F-score 1	694	1.47	92,513	1	.47***
F-score 2	694	1.51	92,513	1	.51***
F-score 3	694	1.61	92,513	1.06	.55***
DD Dis. Acc.	694	0.077	92,513	0.062	0.015***
Mod. Jones Dis. Acc.	694	0.067	92,513	0.056	0.011***
Proximate 100	694	.369	92,513	.312	.057***
Lobby Dummy	509	.202	55,404	.162	0.04**
Lobbying Exp	509	16.45	55,404	31.33	-14.88***
Lobbying Amount	509	113,658	55,404	71,235	42,423***
ROA	694	-.029	92,513	-.058	.029***
Big 4	694	.859	92,513	.814	.044***
Market-to-Book	694	3.75	92,513	2.80	.954***
Leverage	694	.188	92,513	.179	.009
Firm Age	694	13.87	92,513	14.93	-1.06**
Assets	694	3,243	92,513	1,798	1,445***

Notes to Table 2, Panel C:

^c The table displays average values of the variables over the period 1982–2012 for two groups of firms: (i) the AAER sample, i.e., firms that received an AAER; and (ii) the non-AAER sample, i.e., firms that did not receive an AAER; and the differences between the means of these variables. ***, **, and * indicate the significance at the 1%, 5% and 10% level, respectively, of the difference between the means of the AAER sample as compared to the non-AAER sample. See Table 1 for variable definitions.

Table 3: Test of Hypothesis 1

Panel A: Logistic Regression Estimation of the Probability of being subject to an AAER^a

Variables	(1) AAER Dummy	(2) AAER Dummy	(3) AAER Dummy	(4) AAER Dummy	(5) AAER Dummy	(6) AAER Dummy
Labor Intensity	-23.900** (0.01)	-38.807*** (0.00)	-38.383*** (0.00)	-23.761** (0.05)	-23.723** (0.02)	-29.714*** (0.01)
F-score 1	0.469*** (0.00)	0.472*** (0.00)	0.473*** (0.00)	0.557*** (0.00)		
F-score 2					0.445*** (0.00)	
F-score 3						0.421*** (0.00)
Proximate 100	0.298* (0.07)	0.112 (0.58)	0.111 (0.59)	0.232* (0.09)	0.304* (0.07)	0.295* (0.10)
Lobby Dummy		-0.181 (0.40)				
Lobbying Exp			-0.001* (0.08)			
ROA	0.111 (0.68)	0.396 (0.30)	0.412 (0.28)	0.150 (0.64)	0.200 (0.47)	0.436 (0.16)
Big 4	-0.482** (0.02)	-0.055 (0.87)	-0.039 (0.91)	-0.371** (0.04)	-0.438** (0.05)	-0.442* (0.05)
Market-to-Book	0.031*** (0.00)	0.027** (0.02)	0.027** (0.02)	0.035*** (0.00)	0.032*** (0.00)	0.026** (0.01)
Leverage	0.001 (1.00)	-0.065 (0.86)	-0.053 (0.89)	-0.631** (0.05)	0.011 (0.97)	0.018 (0.96)
Log Firm Age	-0.245*** (0.00)	-0.107 (0.28)	-0.113 (0.26)	-0.274*** (0.00)	-0.248*** (0.00)	-0.287*** (0.00)
Log Assets	0.345*** (0.00)	0.367*** (0.00)	0.353*** (0.00)	0.308*** (0.00)	0.346*** (0.00)	0.354*** (0.00)
Constant	-10.149*** (0.00)	-10.975*** (0.00)	-10.870*** (0.00)	-9.465*** (0.00)	-10.155*** (0.00)	-10.071*** (0.00)
Industry Dummies	Yes	Yes	Yes	No	Yes	Yes
Year Dummies	Yes	Yes	Yes	Yes	Yes	Yes
Clustered by	Firm	Firm	Firm	Firm and Industry	Firm	Firm
Observations	79,814	38,693	38,693	85,386	78,815	72,696
Pseudo R-squared	0.121	0.142	0.142	0.095	0.123	0.134

Notes to Table 3, Panel A:

^a The dependent variable for all the models presented here is an indicator variable that is equal to one in the years a firm has been convicted for allegedly misstating its financial statements as reported in Accounting and Auditing Enforcement Releases, and zero otherwise for the period 1982–2012. The results reported are from a logistic regression estimation. The models differ in the variables included and sample composition. In particular, model 1, 5 and 6 differ in the F-score control variable. Model 2 and 3, in contrast to model 1, also include control variables for a firm’s lobbying efforts. As the data on lobbying expenditures is only available from 1998 onwards, these models are limited to the period 1998–2012. Model 4 includes the same variables as model 1. However, I exclude industry dummies and cluster by both year and industry instead. This approach increases the sample size. *P*-values are displayed in parentheses below the coefficient estimate. *, **, *** represent significance at the 10, 5, and 1 percent level (two-tailed), respectively; variables are winsorized at 1% and 99% levels. See Table 1 for variable definitions.

Panel B: Marginal Effects^b

Variables	Marginal Effect
Probability of Labor Intensity at Upper Quartile	.00413
Probability of Labor Intensity at Lower Quartile	.00465
Interquartile Marginal Change	-.00052
Interquartile Marginal Change in %	-11.18%

Notes to Table 3, Panel B:

^b The marginal effect presented here is calculated based on model 1, Table 3, Panel A. All variables except for labor intensity are at their mean values to calculate the probabilities at the upper and lower quartile of labor intensity.

Table 4: Test of Hypothesis 2

Panel A: Logistic Regression Estimation of the Probability of receiving an AAER in an Election Year^a

Variables	(1) AAER Release Dummy	(2) AAER Release Dummy	(3) AAER Release Dummy	(4) AAER Release Dummy
Labor Intensity	-16.564* (0.08)	-36.687*** (0.01)	-36.290*** (0.01)	-15.566 (0.14)
Election Year	1.540* (0.08)	1.547* (0.08)	1.545* (0.08)	1.538* (0.08)
Labor Intensity * Election Year	-27.575* (0.07)	-21.559* (0.10)	-21.475* (0.10)	-30.015** (0.01)
F-score 1	0.433*** (0.00)	0.439*** (0.00)	0.440*** (0.00)	0.530*** (0.00)
Proximate 100	0.296* (0.08)	0.121 (0.55)	0.120 (0.56)	0.233* (0.07)
Lobby Dummy		-0.157 (0.47)		
Lobbying Exp			-0.001* (0.08)	
ROA	0.012 (0.96)	0.415 (0.29)	0.427 (0.27)	0.047 (0.91)
Big 4	-0.526** (0.01)	-0.166 (0.62)	-0.152 (0.65)	-0.409** (0.01)
Market-to-Book	0.024*** (0.01)	0.022* (0.06)	0.022* (0.05)	0.029*** (0.01)
Leverage	-0.030 (0.92)	-0.119 (0.76)	-0.109 (0.78)	-0.674* (0.06)
Log Firm Age	-0.223*** (0.01)	-0.087 (0.39)	-0.091 (0.37)	-0.256*** (0.00)
Log Assets	0.354*** (0.00)	0.373*** (0.00)	0.361*** (0.00)	0.313*** (0.00)
Constant	-10.128*** (0.00)	-10.898*** (0.00)	-10.801*** (0.00)	-9.473*** (0.00)
Industry Dummies	Yes	Yes	Yes	No
Year Dummies	Yes	Yes	Yes	Yes
Clustered by	Firm	Firm	Firm	Firm and Industry
Observations	79,684	38,693	38,693	85,696
Pseudo R-squared	0.118	0.139	0.139	0.092

Notes to Table 4, Panel A:

^a The dependent variable for all the models presented here is an indicator variable that is equal to one in the years a firm has received an AAER for allegedly misstating its financial statements, and zero otherwise for the period 1982–2012. The results reported are from a logistic regression estimation. The models differ in the variables included and sample composition. In particular, model 2 and 3, in contrast to model 1, also include control variables for a firm’s lobbying efforts. As the data on lobbying expenditures is only available from 1998 onwards, these models are limited to the period 1998-2012. Model 4 includes the same variables as model 1. However, I exclude industry dummies and cluster by both year and industry instead. This approach increases the sample size. *P*-values are displayed in parentheses below the coefficient estimate. *, **, *** represent significance at the 10, 5, and 1 percent level (two-tailed), respectively; variables are winsorized at 1% and 99% levels. See Table 1 for variable definitions.

Panel B: Marginal Effects^b

Variables	Marginal Effect in Election Year	Marginal Effect in Non-Election Year
Probability of Labor Intensity at Upper Quartile	.0095	.003
Probability of Labor Intensity at Lower Quartile	.012	.0033
Interquartile Marginal Change	-.0025	-.0003
Interquartile Marginal Change in %	-20.83%	-9.09%

Notes to Table 4, Panel B:

^b The marginal effects presented here are calculated based on model 1, Table 4, Panel A. All variables except for labor intensity and election year are at their mean values to calculate the probabilities at the upper and lower quartile of labor intensity.

Table 5: OLS Regression Estimation of Accounting Quality on Labor Intensity^a

Variables	(1) F-score 1	(2) F-score 2	(3) F-score 3	(4) Mod. Jones Dis. Acc.	(5) DD Dis. Acc.
Labor Intensity	8.455*** (0.00)	8.562*** (0.00)	8.575*** (0.00)	0.091*** (0.01)	0.085* (0.05)
ROA	0.187*** (0.00)	0.139*** (0.00)	0.176*** (0.00)	-0.043*** (0.00)	-0.036*** (0.00)
Big 4	-0.104*** (0.00)	-0.099*** (0.00)	-0.111*** (0.00)	-0.005*** (0.00)	-0.006*** (0.00)
Market-to-Book	0.007*** (0.00)	0.007*** (0.00)	0.008*** (0.00)	0.000*** (0.00)	0.001*** (0.00)
Leverage	0.336*** (0.00)	0.397*** (0.00)	0.376*** (0.00)	-0.007*** (0.00)	0.016*** (0.00)
Log Firm Age	-0.089*** (0.00)	-0.096*** (0.00)	-0.077*** (0.00)	-0.003*** (0.00)	-0.005*** (0.00)
Log Assets	0.037*** (0.00)	0.042*** (0.00)	0.039*** (0.00)	-0.006*** (0.00)	-0.004*** (0.00)
Constant	0.759*** (0.00)	0.680*** (0.00)	0.721*** (0.01)	0.119*** (0.00)	0.034*** (0.00)
Industry Dummies	Yes	Yes	Yes	Yes	Yes
Year Dummies	Yes	Yes	Yes	Yes	Yes
Clustered by	Firm	Firm	Firm	Firm	Firm
Observations	93,207	91,953	85,215	91,870	72,954
Adj. R-squared	0.174	0.183	0.186	0.177	0.134

Notes to Table 5:

^a The dependent variable for all the models presented here is a different proxy for a firm's accounting quality for the period 1982-2012. The first three models use all three types of F-scores as defined by Dechow et al. (2011). The dependent variables in model 4 and model 5, respectively, are unsigned discretionary accruals estimated from a modified Jones model as in Dechow et al. (2011) and estimated according to Dechow and Dichev (2002), respectively. The results reported are from an ordinary least squares regression estimation. *P*-values are displayed in parentheses below the coefficient estimate. *, **, *** represent significance at the 10, 5, and 1 percent level (two-tailed), respectively; variables are winsorized at 1% and 99% levels. See Table 1 for variable definitions.

Table 6: Propensity Score Matching**Panel A: Probit Regression Estimation of the Probability of receiving an AAER^a**

Variables	AAER Release Dummy
F-score 1	0.176*** (0.00)
Proximate 100	0.106*** (0.00)
ROA	-0.069 (0.36)
Big 4	-0.214*** (0.00)
Market-to-Book	0.010*** (0.00)
Leverage	-0.039 (0.645)
Log Firm Age	-0.107*** (0.00)
Log Assets	0.148*** (0.00)
Constant	-3.136*** (0.00)
Industry Dummies	Yes
Year Dummies	Yes
Observations	79,684
Pseudo R-squared	0.114

Notes to Table 6, Panel A:

^a The dependent variable for the model presented here is an indicator variable that is equal to one in the years a firm has received an AAER for allegedly misstating its financial statements, and zero otherwise for the period 1982–2012. The results reported are from a Probit regression estimation and are used to calculate the propensity scores. *P*-values are displayed in parentheses below the coefficient estimate. *, **, *** represent significance at the 10, 5, and 1 percent level (two-tailed), respectively; variables are winsorized at 1% and 99% levels. See Table 1 for variable definitions.

Panel B: Test of Matching^b

Variables	(1) Mean AAER firms	(2) Mean matched non-AAER firm	(3) Mean Difference (1) – (2)
F-score 1	1.436	1.457	-0.021 (0.70)
Proximate 100	0.368	0.359	0.009 (0.74)
ROA	-0.033	-0.042	0.009 (0.42)
Big 4	0.851	0.849	0.002 (0.94)
Market-to-Book	3.569	3.652	-0.083 (0.76)
Leverage	0.186	0.183	0.003 (0.78)
Log Firm Age	2.359	2.319	0.040 (0.38)
Log Assets	5.990	5.899	0.091 (0.43)

Notes to Table 6, Panel B:

^b Panel B reports the average values of the variables used in my matching procedure after matching and the average difference in these variables of AAER firms and the matched non-AAER firms. Propensity scores for matching are obtained from the probit model in Panel A. Each AAER firm observation is matched to a non-AAER firm observation within the same year and two-digit industry, using propensity score estimation, without replacement. I apply the nearest neighbor matching estimator. *P*-values are displayed in parentheses below the coefficient estimate. *, **, *** represent significance at the 10, 5, and 1 percent level (two-tailed), respectively. See Table 1 for variable definitions.

Panel C: Average Treatment Effect^c

Variable	Sample	N	(1) Mean AAER firms	N	(2) Mean matched non-AAER firm	(3) Mean Difference (1) – (2)
Labor Intensity	Unmatched	676	0.0008	79,008	0.0026	-0.0018***
Labor Intensity	Matched	676	0.0008	676	0.0020	-0.0012***

Notes to Table 6, Panel C:

^c Panel C reports the average treatment effect of receiving an AAER on labor intensity. The table reports both the average treatment effect for the unmatched and the matched sample; and the average difference in labor intensity between AAER firms and their matched and unmatched, respectively, non-AAER firms. *P*-values are displayed in parentheses below the coefficient estimate. *, **, *** represent significance at the 10, 5, and 1 percent level (two-tailed), respectively. See Table 1 for variable definitions.

Panel D: Logistic Regression Estimation on the Matched Sample of the Probability of receiving an AAER in Election Years^d

Variables	AAER Release
Labor Intensity	-13.72* (0.07)
Election Year	0.206 (0.12)
Labor Intensity * Election Year	-40.00* (0.09)
Constant	-0.02 (0.72)
Industry Dummies	No
Year Dummies	No
Observations	1,352
Pseudo R-squared	0.007

Notes to Table 6, Panel D:

^a The dependent variable for all the models presented here is an indicator variable that is equal to one in the years a firm has received an AAER for allegedly misstating its financial statements, and zero otherwise for the period 1982–2012. The results reported are from a logistic regression estimation on my matched sample of AAER and non-AAER firms. *P*-values are displayed in parentheses below the coefficient estimate. *, **, *** represent significance at the 10, 5, and 1 percent level (two-tailed), respectively; variables are winsorized at 1% and 99% levels. See Table 1 for variable definitions.

Table 7: Tobit and Logistic Regression Estimation of the Number of Comment Letters and the Probability of receiving a Comment Letter^a

Variables	(1) Number Comment Letters	(2) Comment Letter Dummy
Labor Intensity	-5.530* (0.06)	-2.084* (0.10)
F-score 1	0.296*** (0.00)	0.104*** (0.00)
Proximate 100	-0.164** (0.04)	-0.075** (0.04)
Lobbying Exp	0.001** (0.01)	0.000*** (0.01)
ROA	-2.291*** (0.00)	-0.950*** (0.00)
Big 4	-0.777*** (0.00)	-0.308*** (0.00)
Market-to-Book	0.023*** (0.00)	0.011*** (0.00)
Leverage	0.520*** (0.01)	0.226** (0.01)
Log Firm Age	0.219*** (0.00)	0.082*** (0.00)
Log Assets	0.435*** (0.00)	0.182*** (0.00)
Constant	-8.759*** (0.00)	-3.481*** (0.00)
Industry Dummies	Yes	Yes
Year Dummies	Yes	Yes
Clustered by	Firm	Firm
Observations	21,038	21,038
Pseudo R-squared	0.067	0.125

Notes to Table 7:

^a The dependent variable for model 1 is the number of comment letters a firm has either received or sent to the SEC, and for model 2 an indicator variable that is equal to one in the years a firm has received a comment letter to the SEC, and zero otherwise. As data on comment letters is only publicly available from 2004 onwards, these models are limited to the period 2004-2010. The results of model 1 are from a Tobit regression estimation; and for model 2 from a logistic regression estimation. *P*-values are displayed in parentheses below the coefficient estimate. *, **, *** represent significance at the 10, 5, and 1 percent level (two-tailed), respectively; variables are winsorized at 1% and 99% levels. See Table 1 for variable definitions.