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ABSTRACT

I examine whether political pressure by the government as a response to voters' general interest in protecting employment is reflected in the enforcement actions by the Securities and Exchange Commission (SEC). Using labor intensity as a measure for a firm's contribution to employment, I find that labor-intensive firms are less likely to be subject to an SEC enforcement action. Next, I show that labor-intensive firms are less likely to face an SEC enforcement action in presidential election years if they are located in politically important states. I also find evidence of a lower likelihood of SEC enforcement for labor-intensive firms that are headquartered in districts of senior congressmen that serve on committees that oversee the SEC. 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 political contributions. These findings suggest that voters' interests drive political pressure on SEC enforcement—independent of firms' lobbying for their special interests.

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1. Introduction

The Securities and Exchange Commission's (SEC) enforcement actions have been subject to increased scrutiny following the SEC's failure to detect several frauds such as those executed by Bernard Madoff and Sir Allen Stanford (see e.g., Henriques, 2009; Waas, 2012). A growing literature in accounting examines the reasons for such failure in SEC enforcement by investigating the choice of enforcement targets by the SEC. These studies indicate that the resource constraints of the SEC, as well as political pressure as a result of firms' political connections or lobbying activities on the SEC, affect the agency's choice of enforcement targets (Correia, 2014; Kedia and Rajgopal, 2011; Yu and Yu, 2011). Consistent with the latter argument, Correia (2014) and Yu and Yu (2011) show that firms with political connections or that engage in lobbying are less likely to be sanctioned by the SEC and face lower penalties if prosecuted by the SEC.

While these studies recognize that the SEC is subject to political pressure, they do not consider that the president and Congress ("government") may also react to voter pressure—independent of firms' political connections—according to which they may influence SEC enforcement.[1] Yet, economists such as Stigler (1971) and Peltzman (1976) have long emphasized that the government responds to both *voter* and *special interest* pressure by adjusting its political decisions accordingly to maximize political support. 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 promoted these conditions by supporting not only large employers in absolute terms, but also smaller, labor-

[1] Throughout the paper I use the term "government" when I refer to both the executive, i.e., the president, as well as the legislative, i.e., Congress, branches of the federal government.

intensive firms that contribute to future employment (Adams and Brock, 1987a; Audretsch, 2003; Caves, 1976).

The SEC's enforcement actions might significantly interfere with the government's goal of promoting employment. 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, b).[2] As job losses can be a direct consequence of bankruptcy, SEC enforcement actions not only affect the economic wealth of a firm's shareholders, but also that of a firm's employees as well as the overall employment conditions. In fact, the SEC (2006) has acknowledged that its enforcement actions and the fines associated with these actions might actually be counterproductive to its mission of protecting investors as they impose an additional burden on firms as well as innocent third parties that already face huge costs from the fraudulent activities.[3]

Following this line of argumentation, I investigate whether political pressure by the government as a response to voters' interests for employment is likely to be reflected in the SEC's decisions as to which firms to investigate. In particular, I use firms' labor intensity as a proxy to identify firms that contribute to the employment conditions and investigate whether the SEC reduces its enforcement actions for labor-intensive firms.[4]

The regulation models developed by Stigler (1971), Peltzman (1976), and Grossman and Helpman (1994) provide theoretical support that regulations and regulators are influenced by politicians. In the case of the SEC, Congress decides on the allocations of resources to the

[2] For instance, Karpoff et al. (2007, 2008b) show that about 34 percent of the firms that are subject to an SEC enforcement action file bankruptcy.
[3] Paul S. Atkins and Cynthia A. Glassman, two former SEC Commissioners, have emphasized that businesses could have used the money they spent on fines to hire more workers (Harkness and Siegel, 2006; Johnson, 2006).
[4] Several prior studies in the accounting literature (e.g., Hilary, 2006; Ramanna and Roychowdhury, 2010) use a firm's labor intensity to measure a firm's level of employment relative to its size.

SEC, while the president appoints SEC commissioners with the advice and consent of the Senate (SEC, 2013a; Weingast, 1984). Therefore, the government can influence the SEC through its congressional committees that are involved in setting the SEC's budget or overseeing the agency as well as through the presidential appointments of the SEC commissioners (Weingast, 1984; Weingast and Moran, 1983).

To test whether the SEC reduces its enforcement actions for labor-intensive firms, I use a sample of firms, for the time period 1982 to 2012, that have been sanctioned by the SEC for violating Generally Accepted Accounting Principles (GAAP) as reported in Accounting and Auditing Enforcement Releases (AAERs) and all other public firms that did not receive an AAER over this period. Consistent with my hypothesis, I find evidence that labor-intensive firms are less likely to be subject to an AAER. This result holds after controlling for a firm's size, performance, accounting quality, location, political contributions, the government's partisanship, union membership per industry, and other monitors such as analysts following. This finding is consistent with my hypothesis that voters' interests drive political pressure on SEC enforcement.

This finding, however, might be driven by latent firm characteristics of labor-intensive firms that might, for instance, have a higher firm quality in general, and a higher accounting quality in particular. To rule out this alternative explanation and to test more directly how political pressure from the government affects SEC enforcement, I further examine whether variations in government's sensitivity to voters' interests and power over the SEC result in variations of SEC enforcement actions against labor-intensive firms.

To investigate whether variations in government's sensitivity to voters' interests reflect in SEC enforcement, I examine SEC enforcement behavior during presidential election years. 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 Dinc, 2005; Kramer, 1971; Ramanna and Roychowdhury, 2010). I argue that this increased sensitivity to voters' interests during election years results in more political pressure on the SEC, leading to even fewer enforcement actions against labor-intensive firms. I find that the lower likelihood of SEC enforcement actions against labor-intensive firms is more pronounced in presidential election years and is concentrated in politically important states, i.e., closely contested states with high Electoral College counts.

To investigate whether variations in the power of Congress on the SEC reflect in SEC enforcement, I examine the impact of individual congressmen who sit on committees that oversee the SEC. Prior studies have documented that the ability of congressmen to influence SEC enforcement is likely to be higher for senior congressmen who serve on committees that set the budget, appoint the SEC's commissioners, and oversee the SEC (Correia, 2014; Ritt, 1976; Roberts, 1990; Weingast, 1984). I find evidence that the lower likelihood of SEC enforcement for labor-intensive firms is more pronounced if the firm is headquartered in a district of a senior congressman who serves on a committee that oversees the SEC.[5]

Alternatively, a potentially higher accounting quality of labor-intensive firms might also explain lower SEC enforcement. Even though I include a firm's F-score (Dechow et al., 2011) as a control variable in all of my earlier tests to control for a firm's accounting quality, I run several additional tests to investigate whether labor-intensive firms have a better accounting quality and thus fewer SEC enforcement actions.[6] In particular, I use all three specifications of the F-score as developed by Dechow et al. (2011), discretionary accruals based on the modified Jones model as in Dechow et al. (2011) and the Dechow and Dichev (2002) model, and the incidence of accounting restatements as proxies for a firm's accounting quality. I find

[5] In this study a senior congressman with the ability to influence SEC enforcement is a congressman who has served at least for one complete term on the Appropriations, Banking or Commerce committees.

[6] 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.

consistent evidence across all proxies that labor-intensive firms have a lower accounting quality than their less labor-intensive peers. This finding suggests that fewer SEC enforcement actions against labor-intensive firms cannot be explained by these firms having a higher accounting quality.

Furthermore, I run several sensitivity tests to address potential concerns of my research design. First, to address the concern that my measure of labor intensity reflects a firm's total labor intensity instead of a firm's U.S. labor intensity, I obtain data on firms' U.S. and non-U.S. labor intensity from Compustat Segments and examine whether both U.S. and non-U.S. labor intensity are associated with a lower likelihood of SEC enforcement. As reporting the number of employees per geographical region is not required under SFAS 131, the information is only available for a small subset of my original sample. For this small subset, I find that only a firm's U.S. labor intensity is associated with a lower likelihood of SEC enforcement, providing additional evidence that labor intensity is likely to proxy for government preferences instead of some underlying risk of engaging in fraudulent accounting choices. Second, I apply propensity score matching for a subset of my sample to better address the differences in the distribution of firm characteristics such as firm size between labor-intensive and less labor-intensive firms. By matching labor-intensive observations with non-labor-intensive observations that have insignificant propensity-score differences along a comprehensive set of firm characteristics, I can investigate whether labor-intensive firms are indeed less likely to be subject to SEC enforcement holding all identifiable firm characteristics constant. My results are largely robust to this alternative research design.

Finally, I investigate whether labor-intensive 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-intensive firms are less likely to receive such letters can provide indications at which stage of the SEC enforcement process the SEC adjusts its

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

This paper contributes to the accounting literature in the following ways. First, my study enhances our understanding on how regulatory agencies in general and the SEC in particular choose their enforcement targets. While the SEC is the central agency that is responsible for enforcing accounting regulation to secure the functioning of capital markets, not much is known about how this agency selects its enforcement targets. My study contributes by demonstrating that SEC enforcement is influenced by political pressure. Second, in contrast to studies that have focused on firms' attempts to impact SEC and other regulators' enforcement via lobbying and political connections (Correia, 2014; Gordon and Hafer, 2005; Hunter and Nelson, 1995; Yu and Yu, 2011), the findings of my study suggest that, in addition to such lobbying for firms' special interests, the government also imposes pressure on the SEC to ensure that this agency promotes voters' interests via fostering employment. Thus, my study also contributes by highlighting that political pressure to promote voters' interests affects SEC enforcement, which emphasizes the importance to consider political pressure as a response to both *voter* and *special interest* pressure. Finally, my study contributes to prior research in economics and political economy that documents governments' willingness to engage in costly activities to enhance employment conditions. While prior studies show that governments induce pressure on state-owned firms to engage in excess employment (Alesina et al., 2000; Borjas, 1986; Shleifer and Vishny, 1994) or bail out firms that are perceived as too big to fail (Adams and Brock, 1987a, b), my study sheds light on an additional measure the government potentially applies to foster employment, i.e., reduced SEC enforcement for labor-intensive firms. These results should be of interest to policy makers, regulatory agencies

such as the SEC, and firms subject to regulatory oversight by the SEC. Going forward, future research could investigate whether and how the government's preference for employment reflects in other regulatory agencies within and beyond the U.S.

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. Section 4 provides the empirical results and additional sensitivity tests. Section 5 concludes.

1. Hypothesis Development

1.1. Consequences of SEC enforcement and government preferences for labor-intensive firms

The SEC enforces accounting regulation which has a pivotal role in securing the functioning and fairness of the capital markets (SEC, 2013b). Its enforcement actions, however, can have significant adverse impacts on the affected firms and the associated stakeholders of these firms. Karpoff et al. (2008b), for instance, find that, in addition to the direct penalties, the SEC's enforcement actions can lead to huge reputational penalties imposed by the market.[7] As a result, about 34 percent of the firms do not survive the enforcement process and thus file bankruptcy.[8] 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).

Such potentially severe consequences might incentivize firms to try to influence SEC enforcement to minimize the probability and size of the wealth transfer generated by its

[7] 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).

[8] Karpoff et al. (2007) find that in their sample of enforcement actions over 70 percent of the firms that filed bankruptcy did so during the period of the enforcement action, but only a minority did so during the violation period or in the period between the violation and the enforcement action. Thus, while these findings do not rule out that firms that are subject to an SEC enforcement action might already have been on the verge of bankruptcy, they suggest that such action might trigger a firm's bankruptcy or accelerate the process that leads to a firm's bankruptcy.

enforcement actions (Correia, 2014; Watts and Zimmerman, 1978). In fact, a considerable stream of literature has—based on the general exchange relationships between groups of individuals and politicians described in regulation models developed by Stigler (1971), Peltzman (1976), and Grossman and Helpman (1994)—focused on the pressure politicians pose on regulatory agencies such as the SEC due to firms' political connections. The general argumentation in these studies is that firms can establish valuable political connections via lobbying expenditures or other political contributions as politicians can use these contributions to increase their political support. In line with this argumentation, studies find that politically connected firms are less likely to be involved in enforcement actions from regulatory agencies such as the Internal Revenue Service (Hunter and Nelson, 1995), the Environmental Protection Agency (Mixon Jr, 1995) and the SEC (Correia, 2014; Yu and Yu, 2011).

While this stream of literature recognizes that the government imposes pressure on regulatory agencies such as the SEC due to firms' political connections, i.e., to protect special interests, it has not considered that the government might also have preferences independent of firms' active attempts according to which it may influence SEC enforcement. In fact, the regulation models of Stigler (1971) and Peltzman (1976) argue 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 also promote *voters' interests* independent of *special interests*. In line with this theory, a pervasive body of research has since shown that the government indeed represents its voters' interests to increase political support (Hibbs, 2006; Kalt and Zupan, 1984; Mian et al., 2010; Peltzman, 1984, 1985, 1992; Potrafke, 2012). Hibbs (2006) and MacRae (1977) argue that voters' support is to a large degree influenced by economic variables such as employment, inflation, or the growth rate of private consumption. In fact, empirical studies show that employment conditions significantly influence voters

when deciding whether to re-appoint an incumbent government and, as a consequence, employment has been a core interest of governments (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 partisanships established policies to promote small businesses as these businesses are often more labor-intensive 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.[9] More recently, the Jumpstart Our Business Startups Act or JOBS Act, which is also intended to support small U.S. businesses by reducing various securities regulations for these firms, has been passed (Congress, 2012; 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, b, 2004). Chrysler, for instance, has been bailed out by the government to

[9] 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).

prevent huge job losses and destabilization of the entire manufacturing sector at the end of the 1970s and 2000s (Adams and Brock, 1987a; Barnes, 2009).

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

1.2. SEC behavior under government preferences

As outlined above, SEC enforcement can have severe effects on the affected firms. Since the government seeks to promote employment conditions to maximize political support, it is likely to impose pressure on the SEC whose enforcement actions, whether or not they result in a firm's bankruptcy, can significantly interfere with the government's goal to promote employment.

The literature on the political control of regulatory agencies highlights several mechanisms through which the legislative as well as executive branches of federal government, i.e., the Congress and the president, can influence that their preferences are likely to reflect in the SEC's decisions as to which firms to investigate. The SEC, as a regulatory agency, is dependent on Congress's budget decisions (Weingast, 1984). According to Weingast (1984) these budget decisions can be used to reward (or punish) agency decisions

that increase (or decrease) political support. Next to Congress's control over the SEC's budget, both branches of the government have several additional instruments at their disposal that can potentially create incentives for regulators to act in accordance with the government's goal to maximize political support. First, 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). Second, both branches of government can sanction the SEC and its employees. SEC Commissioners and other key employees often have political careers and their careers also depend on their political support from the incumbent government (Alesina and Tabellini, 2007). Finally, as described by Arthur Levitt, former Chairman of the SEC (Levitt and Dwyer, 2003), congressmen, as well as members of the presidential administration, can actively intervene with an SEC investigation. As a result, the SEC is likely to act in accordance with government's preference to foster employment and thus might have to exercise 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.[10] 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.[11] An SEC that is likely to adjust its enforcement actions in accordance with government's preference to foster employment has several possibilities to exercise judgment as to which firms to investigate during this process. For instance, the

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

[11] 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).

Commission contributes to the definition of enforcement priorities, which constrain the staff's resource allocation choices in the initial stage (Correia, 2014). As a consequence, the SEC might allocate fewer resources to general reviews or informal and confidential investigations of labor-intensive firms.[12] Such a behavior of the SEC potentially reduces the likelihood that the SEC detects misbehavior of labor-intensive firms. If the SEC starts a formal investigation of a labor-intensive 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 SEC enforcement process. Therefore, I argue that the government's preference for labor-intensive firms reflects in lower likelihood of SEC enforcement actions against these firms. This argumentation can be summarized in the following hypothesis:

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

1.3. Variations in government's sensitivity and power

Hypothesis 1 states that government's preference for labor-intensive firms results in a reduction of SEC enforcement for these firms. However, this finding might be driven by latent firm characteristics of labor-intensive firms that might, for instance, have a higher firm quality in general, and a higher accounting quality in particular. Government's sensitivity towards its voters as well as its power over the SEC are likely to vary over time and can thus be used to form different cross-sectional predictions on the probability of enforcement for labor-intensive firms, which can provide more robust evidence for hypothesis 1.

[12] 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).

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 voters to ensure political support in the upcoming election (Brown and Dinc, 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 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 reduce politically costly regulatory actions before elections. For instance, Hunter and Nelson (1995) and Young et al. (2001) document lower audit rates by the IRS in states that are important for the presidential election.

Therefore, both political economy theory and empirical evidence indicate that the government in general and the presidential administration in particular is likely to place more pressure on regulators 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 relatively fewer enforcement actions against labor-intensive firms prior to elections. Thus, I state the following hypothesis:

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

Such increased political pressure on the SEC in election years is, however, not necessarily constant across states. In fact, prior research has argued and found that during presidential elections the political pressure is directed to electoral-vote rich states that are tightly contested to enhance the presidential reelection prospects (or those of the president's party) (Grier et al., 1995; McCarty, 2000; Young et al., 2001). For instance, Grier et al. (1995) find that the president's decision to veto a bill can be predicted by the votes of senators from electorally important states. Young et al. (2001) find that the fraction of individual income tax returns audited is lower in districts that are important to the president electorally. Mebane and Wawro (1993) also show that the president specifically targets spending toward areas that are important for his reelection. These results suggest that the presidential administration may use the veto and other perquisites of the office to favor some states over others. Based on this argumentation, I argue that in presidential election years the SEC faces more political pressure to spare labor-intensive firms located in politically important states, i.e., electoral-vote rich states that are tightly contested. Thus, I state the following hypothesis:

Hypothesis 2b: In presidential election years, labor-intensive firms are relatively less likely to be subject to an AAER if they are located in politically important states.

In contrast to the president, members of the House as well as one third of the members of the Senate have to contest in elections every two years, potentially resulting in a constant attempt of congressmen to act in the interest of their voters. With respect to the SEC, the

ability of congressmen to put pressure on the SEC is likely to vary (Correia, 2014; Weingast, 1984). In particular, politicians who serve on committees that set the budget, appoint the SEC's commissioners, and oversee the SEC should have a higher ability to affect the agency's activities (Weingast, 1984). Prior research has identified the Appropriations, Banking or Commerce committee as committees that are mainly responsible for overseeing the SEC (e.g., Correia, 2014; Weingast, 1984).[13] The politicians' ability to affect the SEC should also increase with their seniority within committees (Grier and Munger, 1991; Ritt, 1976; Roberts, 1990). Therefore, I argue that labor-intensive firms located in districts of senior congressmen who serve on committees with the highest control over the SEC are less likely to be subject to an AAER. Thus, I state the following hypothesis:

Hypothesis 2c: Labor-intensive firms are relatively less likely to be subject to an AAER when they are located in districts of senior congressmen who serve on committees with the highest control over the SEC.

2. Data and Research Method

2.1. SEC enforcement data

To investigate SEC enforcement 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

[13] During the time period of my sample about 95% of all states had at least one of a state's two senators serving on one of these three committees. Due to this lack of variation in the Senate I focus on the members of the House of Representatives.

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 the 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 the government's preferences for firms that contribute to employment actually affect this very process.[14]

I obtain the data on AAERs from Dechow et al. (2011). All enforcement actions 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

[14] As a sensitivity test, I use the SEC's comment letters, which might result from a general SEC review, and investigate whether labor-intensive firms 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 the government's goal to foster employment.

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 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.

2.2. Methodology

To test whether labor-intensive 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:

$$\text{AAER Dummy}_{it} = \beta_0 + \beta_1 \text{Labor Intensity}_{it} + \sum_n \beta_n \text{Control Variables}_{it} + e_{it} \quad (1)$$

The *AAER DUMMY* is an indicator variable that is equal to one in the years the misstatements occurred as reported in the Accounting and Auditing Enforcement Releases, and zero otherwise (Dechow et al., 2011).

To test my first hypothesis, I use firms' labor intensity to proxy for a firm's contribution to employment. In line with prior research (e.g., Hilary, 2006; Ramanna and Roychowdhury, 2010), I measure *LABOR INTENSITY* as the ratio of the firm's total employees (Compustat item: EMP) scaled by current year's total average assets.[15] If labor represents a relatively large proportion of the factors of production, i.e., labor relative to capital, the firm employs

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

relatively more employees and therefore, I argue, is less likely to be subject to SEC enforcement actions. As the level of labor intensity varies across industries, 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*.[16] The higher this share, the more labor-intensive a firm is relative to other firms in its industry. Thus, a firm with higher *LABOR INTENSITY* contributes more to the government's preference for employment. H1 predicts a negative coefficient on β_1, i.e., higher labor intensity will be associated with a lower likelihood of receiving an AAER.

To test hypothesis 2a, whether labor-intensive firms are indeed even less likely to be subject to an AAER in election years, I adjust the logistic regression model for testing H1 in the following way:

$$\begin{aligned}\text{AAER Dummy}_{it} &= \beta_0 + \beta_1 \text{Labor Intensity}_{it} + \beta_2 \text{Election Year}_t + \beta_3 \text{Labor Intensity}_{it} \\ &* \text{Election Year}_t + \sum_n \beta_n \text{Control Variables}_{it} + e_{it} \qquad (2)\end{aligned}$$

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 higher scrutiny of voters towards their government. Thus, I use these years as my proxy for government's sensitivity towards voters' interests prior to elections. I interact this indicator variable with my firm-specific measure of *LABOR INTENSITY*. The underlying argument of H2a 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

[16] I rerun my models without adjusting these measures by industry-medians and with adjusting these measures by the four-digit SIC code median-industry labor intensity (see Table 3). My results are unaffected by applying these alternative measures.

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 the government, the point in time the market first learns about the start of an SEC investigation against labor-intensive firms, instead of the release of an AAER, which lags the initial revelation of the misconduct by on average over 1,000 days (Karpoff et al., 2008b), is important. To the extent that this point in time cannot be controlled by the SEC as such investigations can be revealed by the media, other stakeholders or even the firm itself, the SEC is likely to reduce the enforcement actions against labor-intensive firms. Thus, I use the same dependent variable as for testing H1, denoted *AAER DUMMY*, which is one in the year the misstatement has occurred, instead of the year when the AAER has been released. H2a predicts a negative coefficient on β_3, i.e., labor intensity has a greater impact on lowering the likelihood of being subject to an AAER in an election year compared to a non-election year.

To test hypothesis 2b, whether in election years labor-intensive firms are less likely to be subject to an AAER if they are located in politically important states, I adjust the logistic regression model for testing H2a in the following way:

$$\begin{aligned}\text{AAER Dummy}_{it} &= \beta_0 + \beta_1 \text{Labor Intensity}_{it} + \beta_2 \text{Election Year}_t + \beta_3 \text{Important State}_t \\ &+ \beta_4 \text{Labor Intensity}_{it} * \text{Election Year}_t + \beta_5 \text{Labor Intensity}_{it} \\ &* \text{Important State}_t + \beta_6 \text{Election Year}_t * \text{Important State}_t \\ &+ \beta_7 \text{Labor Intensity}_{it} * \text{Election Year}_t * \text{Important State}_t \\ &+ \sum_n \beta_n \text{Control Variables}_{it} + e_{it} \qquad (3)\end{aligned}$$

In line with prior research that argues and finds that presidential campaign resource allocations are concentrated in closely-contested states with a high Electoral College count (Brams and Davis, 1974; Grier et al., 1995), the variable *IMPORTANT STATE* captures the margin of victory as well as the number of Electoral College votes in each state. In particular,

I follow the methodology of Cebula et al. (2013) and express the political importance of a state by dividing the number of Electoral College votes at stake by the margin of victory for the winning candidate. The states are then ranked in descending order for each U.S. presidential election (see Appendix A). *IMPORTANT STATE* is an indicator variable that is one for the top ten most important states, and zero otherwise.[17] H2b predicts a negative coefficient on β_7, i.e., in election years labor-intensive firms are less likely to be subject to an AAER if they are located in a politically important state.

To test hypothesis 2c whether labor-intensive firms are relatively less likely to be subject to an AAER when they are located in districts of senior congressmen who serve on committees with the highest control over the SEC, I adjust the logistic regression model for testing H1 in the following way:

$$\begin{aligned}\text{AAER Dummy}_{it} &= \beta_0 + \beta_1 \text{Labor Intensity}_{it} + \beta_2 \text{Senior Congressman}_t \\ &+ \beta_3 \text{Labor Intensity}_{it} * \text{Senior Congressman}_t + \sum_n \beta_n \text{Control Variables}_{it} \\ &+ e_{it} \qquad (4)\end{aligned}$$

SENIOR CONGRESSMAN is an indicator variable that is one if a firm's headquarters are located in a congressional district with a congressman who has served for at least one complete term on the Appropriations, Banking or Commerce committee, and zero otherwise. These committees are mainly responsible for overseeing the SEC (e.g., Correia, 2014; Weingast, 1984). To construct this variable I obtain data from Charles Stewart's Congressional Data webpage for all members of the House for the time period 1982-2012 and

[17] For instance, according to that metric Florida and Ohio are in the top ten of the 2008 list. Obama-Biden won Florida's 27 Electoral College votes by a margin of 236,450 popular votes, and Ohio's 20 Electoral College votes went to Obama-Biden by a margin of 262,224 popular votes. California, the most populous state, was near the bottom of the 2008 list. California's 55 Electoral College votes went to Obama-Biden by a margin of about 3.3 million popular votes (Cebula et al., 2013).

match every firm to a specific district based on its zip code as reported in Compustat.[18] I exclude all firms located in states that only have one congressional district (i.e., Alaska, Delaware, Montana, North Dakota, South Dakota, Vermont, and Wyoming) to rule out that my results are driven by state level effects.[19] H2c predicts a negative coefficient on β_3.

I include several control variables in all of these models. First, 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).[20] 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 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, in different specifications of my models I either include *F-SCORE 1*, *F-SCORE 2* or *F-SCORE 3*. The higher the resulting F-score, the higher is the likelihood of earnings misstatement.[21]

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[18] http://web.mit.edu/17.251/www/data_page.html. During the time period of my sample about 95% of all states had at least one of a state's two senators serving on one of these three committees. Due to this lack of variation in the Senate I focus on the members of the House of Representatives.

[19] The results are unaffected by including firm-year observations from these states.

[20] It is possible that the F-score does not only capture firm's accounting quality but also partly the 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). In untabulated tests, I also use discretionary accruals according to the modified Jones model (Dechow et al., 1995) and the Dechow and Dichev (2002) discretionary accrual model to control for a firm's accounting quality. My results are not affected by using this alternative measure of a firm's accounting quality.

[21] For a detailed explanation of the development of the F-score, see Dechow et al. (2011).

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 U.S. Census Bureau Gazetter.[22] Based on these distances I create a dummy, *PROXIMATE 100*, which 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, 2014; Yu and Yu, 2011). To rule out that my results are driven by firms' active attempts to influence the SEC, I obtain data on firms' Political Action Committee (PAC) contributions from the Federal Election Commission's (FEC) website (www.fec.gov).[23] PAC contributions are widely used as a proxy for political connections (see Milyo et al., 2000 for an overview) and the FEC compiles this data from 1978 onwards, allowing me to apply this proxy for a firm's political connections for my whole sample period. I match the amount of PAC contributions to my sample of Compustat firms and measure political connections by scaling firms' PAC contributions by

[22] 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.

[23] A PAC is a political committee that is organized to raise money to elect or defeat candidates. It can be sponsored by a corporation that can cover the PAC's operating costs but cannot contribute directly to the PAC. Instead, PACs solicit contributions from executives, employees, and shareholders of the firm. The decision to distribute PAC contributions typically belongs to the top executives of the firm (Correia, 2014).

total average assets, denoted *PAC CONTRIBUTION,* to control for a firm's political contributions relative to its size.[24]

I also obtain data from the Union Membership and Coverage Database maintained by Hirsch and Macpherson (2003), which allows me to control for the percentage of employees who are union members per four-digit SIC code, denoted *UNION*.[25] To the extent that labor-intensive firms have a higher percentage of employees who are union members, controlling for such membership allows me to rule out that my results are primarily driven by pressure from unions instead of government preferences for fostering employment. I also include proxies for a firm's visibility used in prior studies on SEC enforcement (Correia, 2014; Kedia and Rajgopal, 2011). In particular, I include the natural logarithm of the number of analysts issuing annual earnings forecasts for firms covered by IBES, denoted *LOG ANALYST FOLLOWING*, and an indicator variable, *FORTUNE 500*, that is one if the firm is covered in the Fortune 500 index as reported in Compustat, and zero otherwise.

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*, which is one for all firms audited by a Big 4 firm, and zero otherwise. As Big 4 auditors are potentially of higher quality than non-Big 4 auditors (Defond, 1992; Palmrose, 1988), clients

[24] I also obtain data on firms' lobbying expenditures from the Center for Responsive Politics (CRP) as an alternative measure for firms' political connections (Blau et al., 2013; Correia, 2014; CRP, 2013). As the CRP compiles this data only from 1998 onwards, these tests are limited to the period 1998-2012. My results are robust to this alternative measure (see Table 3).

[25] This database is publicly available at www.unionstats.com.

of the Big 4 might be 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 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. To control for size I include the natural logarithm of a firm's total assets, *LOG ASSETS*. Finally, I include fixed effects for the tenure of each SEC Chairman as reported on the SEC homepage as well as for the tenure of each U.S. President.[26] Table 1 provides an overview of my variables.

- Table 1 here -

2.3. Descriptive statistics

Table 2 reports descriptive statistics of my sample, a comparison between more and less labor-intensive 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 of which on average 11.5% are union members, leverage of .179 (.119), a market-to-book ratio of 2.8 (1.8), and is 15 (10)

[26] http://www.sec.gov/about/sechistoricalsummary.htm.

years old. The skewness of these distributions suggests that my sample includes proportionately smaller and younger firms. The majority of firms are audited by a Big 4 auditor (81.4%), 31.3% of the firms are located within 100 km distance to a major SEC office, and are followed by 4.5 analysts on average. Furthermore, 27.4% of the firms contributed to PACs, spending on average $14,646 per year, and 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-intensive firms. I split the sample at the median value of labor intensity into two groups. The descriptives indicate that more labor-intensive firms are significantly smaller, older, more profitable, have less analysts following, employ a larger number of people and have less leverage. Labor-intensive firms also contribute less to PACs and engage in less lobbying, i.e., a smaller share of labor-intensive firms contributes to PACs and the absolute contribution amounts are lower. Furthermore, more labor-intensive 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-intensive 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, the descriptives show 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 more analysts following, 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 contributes to PACs and that the absolute contribution amounts are

larger. The descriptives also show that AAER firms employ more people as they are much bigger in size and operate in industries with a lower percentage of union members. However, AAER firms are significantly less labor-intensive than their non-AAER peers. This finding provides preliminary support for H1.

- Table 2 here -

3. Results

3.1. 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 labor intensity (β_1) in all of the models indicates that more labor-intensive firms are less likely to receive an AAER using industry-adjusted and non-adjusted measures of labor intensity. 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 preference of promoting employment. This finding is robust to controlling for firms' PAC contributions, lobbying expenditures, size, performance, accounting quality, and distance to an SEC office, among others.

The control variables are in line with prior research. In particular, the positive and significant coefficients on all three types of F-score, i.e., model (1), (2) and (3), 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 a positive and significant coefficient on the *PROXIMATE 100* dummy. Therefore, consistent with Kedia and Rajgopal (2011), I show that firms located closer to the SEC's main offices are more likely to be investigated and thus receive an AAER. The positive but insignificant coefficient on *PAC*

CONRIBUTIONS suggests that political contributions do not reduce the likelihood of being subject to an AAER. However, consistent with Correia (2014), 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 all models, suggesting that clients of the Big 4 are less likely to commit fraud. Finally, I also find that larger and younger firms as well as firms with a larger growth potential and more analysts following are more likely to be subject to an AAER.

- Table 3 here -

3.2. Test of H2

Model 1 and 2 in Table 4, Panel A present the results of estimating the probability of being subject to an AAER in a presidential election year to test H2a. 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 indicator and a firm's labor intensity, in both 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 25% (10%) in an election (non-election) year.[27] These results thus indicate that labor-intensive firms are relatively less likely to receive an AAER in a presidential election year. As the coefficient on labor intensity stays significant in all models, the results suggest that labor-intensive firms enjoy in general a favorable treatment by the SEC, and not just in election years. Moreover, the election year indicator is negative and

[27] 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).

significant in all models, suggesting that the SEC engages in less enforcement actions during presidential election years.

Model 3 and 4 of Panel A present the results of estimating the probability of being subject to an AAER in a presidential election year in a politically important state to test H2b. The results show a negative and significant coefficient on β_1, i.e., a firm's labor intensity, β_2, i.e., the election year indicator, and β_7, i.e., the interaction term between the election year indicator, being located in a politically important state and a firm's labor intensity, in both models. However, the interaction between a firm's labor intensity and the election year indicator is not significant anymore. Thus, in line with H2b, I find that the lower likelihood of SEC enforcement against labor-intensive firms in presidential election years is concentrated in politically important states, suggesting that the political pressure on the SEC is directed to electoral-vote rich states that are tightly contested to enhance the presidential reelection prospects (or those of the president's party).

Table 4, Panel C presents the results of estimating the probability of being subject to an AAER if headquartered in a district of a senior congressman who serves on a committee that oversees the SEC to test H2c. 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 senior district congressman indicator and a firm's labor intensity, in both models. The coefficient on the senior district congressman indicator is not significant. The coefficient estimates are not only statistically significant but also economically significant, as reported in Table 4, Panel D. 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 29% (8%) if (not) headquartered in a district of a senior congressman. In line with H2c, I find that firms headquartered in a district of a senior congressman who serves on a committee that oversees the SEC are less likely to be subject to SEC enforcement. These findings suggest that senior

congressmen can induce pressure on the SEC to reduce the likelihood that labor-intensive firms located in their district are subject to SEC enforcement.

Overall, these findings provide more robust evidence that SEC enforcement is influenced by both branches of federal government and are consistent with H2.

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.

- Table 4 here -

3.3. Sensitivity tests

3.3.1. Accounting quality as alternative explanation for reduced SEC's enforcement actions against labor-intensive firms

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

$$\text{Accounting Quality}_{it} = \beta_0 + \beta_1 \text{Labor Intensity}_{it} + \sum_n \beta_n \text{Control Variables}_{it} + e_{it} \quad (5)$$

ACCOUNTING QUALITY is measured using six different proxies. In particular, in three of the six 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. More specifically, 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:

$$\Delta WC_t = \beta_0 + \beta_1 (1/A_{t-1}) + \beta_2 \frac{\Delta S_t - \Delta Rec_t}{A_{t-1}} + \beta_3 \frac{\Delta PPE_t}{A_{t-1}} + e_t \quad (6)$$

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 absolute 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:

$$\Delta WC_t = \beta_0 + \beta_1 (1/A_{t-1}) + \beta_2 CFO_{t-1} + \beta_3 CFO_t + \beta_4 CFO_{t+1} + e_t \quad (7)$$

where ΔWC_t is defined as above and *CFO* is cash flow from operations. The estimated absolute residuals are my proxy for discretionary accruals, denoted *DD DIS. ACC*.[28]

As a final measure of firms' accounting quality, I obtain all restatements from the Government Accountability Office (GAO) Financial Statement Restatement Database, which covers the time period 1997-2006. I run the aforementioned model as a logistic regression model where *ACCOUNTING QUALITY* is measured using restatements as an indicator variable that is equal to one in the years a restatement has been released by firms. Prior research suggests that a substantial number of restatements are due to unintentional errors rather than intentional misstatements (Hennes et al., 2008; Plumlee and Yohn, 2010). I include both intentional as well as unintentional errors in my sample due to two reasons. First, restatements are an important trigger event for SEC enforcement actions (Dechow et al., 2011;

[28] To address the possibility that labor-intensive firms are more likely to manage their earnings downward, which potentially does not result in the same regulatory scrutiny as upward earnings management, I also use the signed residuals from both models as an alternative proxy for discretionary accruals. The results remain unchanged.

Kedia and Rajgopal, 2011). As a consequence, firms that do not enjoy preferential treatment by the SEC might exercise more care in the preparation of their financial statements making it less likely that these firms make unintentional errors as well as intentional misstatements. Second, a large number of restatements due to intentional misstatements are initiated by regulatory action (Dechow et al., 2011). Thus, firms that enjoy preferential treatment by the SEC and thus are likely to face fewer enforcement actions are potentially less likely to be required to restate their financials due to intentional misstatements. In accordance with prior studies, I control for firm performance, Big 4 auditor, firms' growth expectations, leverage, firm age, and firm size (e.g., Beneish, 1997; Brazel et al., 2009; Dechow et al., 1996). All variables are defined as described in Table 1.

Table 2, Panels A through C provide descriptive statistics on the discretionary accruals measures. In particular, Panel B shows that labor-intensive 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 six 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-intensive firms do not have a higher accounting quality, which might explain fewer enforcement actions against these firms. Instead, the results consistently suggest that labor-intensive 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.

- Table 5 here -

3.3.2. U.S. labor intensity versus non-U.S. labor intensity

To address the concern that my measure of labor intensity reflects a firm's total labor intensity instead of a firm's U.S. labor intensity, I obtain data on firms' U.S. and non-U.S. number of employees and total average assets from Compustat Segments. As reporting the number of employees per geographical region is not required under SFAS 131 and has only been voluntarily reported as of 1999, the information is only available for a relatively small subset of my original sample, i.e., 5,018 firm-years representing 1,217 individual firms. The descriptive statistics of this subsample (untabulated) indicate that about 90% of the sample firms do not have employees and assets outside of the U.S., suggesting that using firms' overall labor intensity is by and large reflective of firms' U.S. labor intensity. In addition, for the subsample of firms that have both U.S. and non-U.S. employees, the correlation between U.S. and non-U.S. labor intensity is .43 ($p<0.01$), between U.S. and total labor intensity is .80 ($p<0.01$), and between non-U.S. and total labor intensity is .63 ($p<0.01$), suggesting that the overall measure of labor intensity is reflective of firms' U.S. employment.

Finally, the subset of firms with U.S. and non-U.S. labor intensity allows me to further substantiate whether my proxy of government's preferences for employment, i.e., a firm's labor intensity, captures these preferences or is associated with some underlying omitted variable. In particular, I rerun model (1) but replace the firm's total labor intensity by its U.S. and non-U.S. labor intensity. As the government wants to foster U.S. employment in response to voters' pressure instead of non-U.S. employment and thus has preferences for firms with a higher U.S. labor intensity, I expect a negative and significant coefficient on U.S. labor intensity but a non-significant coefficient on the non-U.S. labor intensity.

The results of this test are shown in Table 6. The coefficient on U.S. labor intensity but not on non-U.S. labor intensity is negative and significant suggesting that a firm's U.S. labor intensity influences regulatory actions by the SEC instead of non-U.S. labor intensity.

Overall, the results of this additional test indicate that a majority of firms seem to mainly employ people in the U.S. and that regulatory preferences seem to be related to U.S. labor intensity. Thus, these results suggest that the bias introduced by using a firm's total labor intensity in my main tests is likely to work against me finding results for my hypotheses and also provide some additional evidence that labor intensity measures government preferences instead of a latent firm characteristic related to a firm's accounting quality, for instance. However, given that firms that voluntarily report their number of employees in different geographic areas might not be representative of the overall sample, these results should be interpreted with caution.

- Table 6 here -

3.3.3. Propensity Score Matching

As an additional test of my two hypotheses, I apply a research design that better addresses the differences in the distribution of firm characteristics such as firm size between labor-intensive and less labor-intensive firms. To better address these differences, I employ a propensity-score matched pair research design to match labor-intensive observations with non-labor-intensive observations that are similar along a comprehensive set of firm characteristics (Dehejia and Wahba, 2002; Rosenbaum, 2010).

In particular, I estimate a probit propensity-score model, which is the probability that a firm will be in the top decile of labor intensity (i.e., the treatment) conditional on observable firm characteristics. As I do not have a binary treatment (i.e., treatment or no treatment), I have to create a cutoff point (e.g., median, quartiles, deciles) for a firm's labor intensity. I group firms in the top decile of labor intensity versus all other firms as such cutoff point allows me to form pairings that result in observations with insignificant propensity-score differences without having to remove any dissimilar matched pairs. The drawback of this approach is that I only have a subset of enforcement actions, i.e., 102 firm-year observations,

in my final matched sample.[29] To calculate each non-labor-intensive firm's propensity score to be in the top decile of labor intensity, I run the following probit regression model, where subscript *i* represents the firm and *t* the year:

$$Top\ Decile\ Labor\ Intensity_{it} = \beta_0 + \beta_1 Controls_{it} + e_{it} \quad (8)$$

This regression includes the same variables as model (1) in Table 4 except for the firm's labor intensity, the election year indicator, and the senior congressman indicator, which are my variables of interest. Due to the small number of firm-year observations subject to an AAER, I cannot test H2b with this alternative research design. All variables are defined as before and as described in Table 1. The results of this probit model are shown in Table 7, 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., top decile in labor intensity, and selecting another observation with the closest propensity score that did not receive the treatment. This matching process is done without replacement, indicating that labor-intensive observations do not have the same non-labor-intensive observation as a pair. As reported in Table 7, Panel B, the results of the mean comparisons of matched pairs indicate that the matching procedure successfully finds non-top decile labor intensity firms that are similar to the top decile labor intensity firms. In particular, there are no significant differences between my 9,550 matched pairs of top decile labor intensity and non-top decile labor intensity 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 the likelihood or receiving an AAER

[29] As an alternative, I also use the median of firms' labor intensity as a cutoff point. Using that cutoff point, I have to drop an even larger number of observations. In particular, this approach results in a subset of 13,028 firm-year observations, including 91 firm-year observations subject to SEC enforcement actions. Therefore, I use the top decile cutoff point for the tests reported. The results using this alternative cutoff point, however, do not alter my primary inferences. It is important to note that both cutoff points do not induce estimation bias as both cutoff points only identify and remove matched pairs for which the matching algorithm did not produce an effective covariate match (Armstrong et al., 2010).

between firms that are in the top decile of labor intensity and the matched non-top decile labor intensity firms. The results of this comparison are shown in Table 7, Panel C and indicate that the matched non-labor-intensive firms are more likely to receive an AAER than the matched labor-intensive 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 model on the matched sample of 9,550 matched pairs of labor-intensive and non-labor-intensive firms:

$$AAER\ Dummy_{it} = \beta_0 + \beta_1 Top\ Decile\ Labor\ Intensity_{it} + \beta_2 Election\ Year_t + \beta_3 Top\ Decile\ Labor\ Intensity_{it} * Election\ Year_t + e_{it} \quad (9)$$

$$AAER\ Dummy_{it} = \beta_0 + \beta_1 Top\ Decile\ Labor\ Intensity_{it} + \beta_2 Senior\ Congressman_t + \beta_3 Top\ Decile\ Labor\ Intensity_{it} * Senior\ Congressman_t + e_{it} \quad (10)$$

These regressions include my variables of interest, i.e., top decile of labor intensity indicator, the election year indicator, the senior congressman indicator, and the interaction between these variables, respectively. The results of these regressions are shown in Table 7, 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. Thus, the propensity score matching also provides additional evidence in favor of H2a. As the coefficient on the interaction term between the senior congressman indicator and a firm's labor intensity is not significant, I do not find additional evidence in favor or H2c. It is, however, important to notice that one potential explanation for this result is a lack of power in my test. In particular, in my matched sample there are only 12 firm-year observations of labor-intensive firms that are located in a district of a senior congressman who serves on a committee overseeing the SEC.

- Table 7 here -

3.3.4. Partisanship of Presidential administration

I also investigate whether the preference for labor-intensive firms is dependent on an administration's partisanship. In unreported tests, I find that the partisanship of the president does not affect the likelihood of enforcement against labor-intensive firms.

3.3.5. Comment letters

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.[30] 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 (Cassell et al., 2013). 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

[30] 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).

an important trigger event for SEC's enforcement actions. A resource-constrained SEC that is likely to adjust its enforcement actions in accordance with government's preference to foster employment might also allocate fewer resources to reviews of labor-intensive firms. As a consequence, labor-intensive firms are less likely to receive a comment letter. In order to test whether labor-intensive firms are indeed less likely to receive a comment letter and receive fewer comment letters, respectively, I use the following regression model where subscript *i* represents the firm and *t* the year:

$$\text{Comment Letter}_{it} = \beta_0 + \beta_1 \text{Labor Intensity}_{it} + \sum_n \beta_n \text{Control Variables}_{it} + e_{it} \qquad (11)$$

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 8. I find that labor-intensive firms are less likely to receive a comment letter and the total number of letters exchanged between the SEC and a labor-intensive firm is also lower. This result suggests that the SEC allocates fewer resources to reviews of firms that contribute to the employment conditions. To the extent that these reviews are an important trigger event of an enforcement action, allocating fewer resources to reviews of labor-intensive firms might result 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 (Cassell et al., 2013).

- Table 8 here -

4. Conclusions

The SEC has been criticized for its failure to detect several accounting fraud scandals in the last decade. As a consequence, a growing literature in accounting examines the reasons for such failure by studying the SEC's choice of enforcement targets. Studies in this growing literature find that the SEC's resource constraints as well as political pressure as a result of firms' political connections or lobbying activities on the SEC affect the agency's choice of enforcement targets. Economists, however, have long argued that regulators such as the SEC are influenced by the president and Congress ("government") and that the government responds to both *voter* and *special interest* pressure by adjusting its political decisions accordingly to maximize political support. As voters' political support is largely affected by the employment conditions, the government is likely to have preferences for firms that contribute to these conditions. Thus, I investigate whether the SEC, as a consequence of government pressure, reduces its enforcement actions for labor-intensive firms, a proxy for a firm's contribution to employment conditions. My results indicate that labor-intensive firms are less likely to face an SEC enforcement action, after controlling for firm size, performance, accounting quality, location, and political contributions, among others. I further exploit the variation in government's sensitivity to voters' interests as well as government's power over the SEC to provide more robust evidence that labor-intensive firms face less SEC enforcement actions due to government preferences for these firms instead of, for instance, higher accounting quality of labor-intensive firms. I find that the lower likelihood of SEC enforcement actions against labor-intensive firms is even more pronounced in presidential election years and is concentrated in politically important states. I also find evidence that

firms located in districts with senior congressmen serving on committees that oversee the SEC face a lower likelihood of SEC enforcement.

I further investigate whether labor-intensive firms' lower likelihood of being subject to an AAER can be explained by the accounting quality of these firms. My findings suggest that labor-intensive firms have a lower accounting quality than their less labor-intensive peers, indicating that fewer SEC enforcement actions against labor-intensive firms cannot be explained by those firms' higher accounting quality.

Finally, I run several sensitivity tests such as splitting my measure of labor intensity into U.S. and non-U.S. labor intensity and applying propensity score matching as an alternative research design. The results from these additional tests corroborate my findings.

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 cannot conclusively state or test at which exact stage of the SEC enforcement process political pressure impact the enforcement process. However, by investigating the likelihood of receiving an SEC comment letter as an additional test, I find evidence that labor-intensive 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 the employment conditions. Second, my study only controls for the tenure of the SEC Chairman but ignores that SEC Commissioners themselves might have incentives to impact the SEC enforcement process around the end of their terms.

Overall, my results indicate that voters' interests drive political pressure on the SEC and that the SEC incorporates such pressure in its enforcement actions, independent of firms' lobbying for their special interests. 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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Appendix A: Top 10 most important states per presidential election[a]

Top 10, 1984		
Rank	**State**	**Score**
1	MN	85.00
2	RI	8.54
3	MA	5.83
4	MD	3.48
5	HI	3.37
6	IA	2.62
7	VT	2.39
8	PA	2.24
9	NY	2.11
10	WV	2.07

Top 10, 1988		
Rank	**State**	**Score**
1	VT	5.57
2	WA	5.35
3	IL	4.01
4	PA	3.78
5	MD	3.19
6	NM	3.07
7	MT	2.96
8	WV	2.57
9	WI	2.20
10	NY	2.15

Top 10, 1992		
Rank	**State**	**Score**
1	GA	11.61
2	NC	8.32
3	NH	7.47
4	NV	3.69
5	MT	3.57
6	AZ	3.37
7	WY	3.28
8	SD	3.11
9	FL	3.04
10	OH	2.84

Top 10, 1996		
Rank	**State**	**Score**
1	NV	13.47
2	KY	9.56
3	GA	7.67
4	CO	6.16
5	VA	4.38
6	SD	4.26
7	AZ	4.08
8	MT	4.07
9	TN	3.84
10	ND	2.63

Top 10, 2000		
Rank	**State**	**Score**
1	FL	1115.40
2	NM	327.31
3	WI	46.17
4	IA	40.47
5	OR	24.79
6	NH	13.29
7	NV	4.43
8	MN	4.09
9	MO	3.35
10	TN	3.28

Top 10, 2004		
Rank	**State**	**Score**
1	WI	18.56
2	NM	13.34
3	IA	11.38
4	NH	9.57
5	NV	5.09
6	PA	3.61
7	OH	3.21
8	HI	2.36
9	DE	2.32
10	OR	2.28

Top 10, 2008		
Rank	**State**	**Score**
1	MO	86.85
2	NC	32.60
3	IN	11.94
4	MT	8.33
5	FL	3.52
6	ND	3.38
7	SD	2.88
8	OH	2.35
9	GA	2.26
10	NH	1.80

Top 10, 2012		
Rank	**State**	**Score**
1	FL	11.95
2	NC	4.99
3	OH	3.32
4	NH	3.09
5	NV	2.71
6	VA	2.67
7	AK	2.19
8	CO	2.00
9	IA	1.98
10	PA	1.95

Notes to Appendix A:

[a] Appendix A includes an overview of the top ten most important states per presidential election over the period 1982-2012. I follow the methodology of Cebula et al. (2013) and express the political importance of a state by dividing the number of Electoral College votes at stake by the margin of victory for the winning candidate, denoted "Score". The states are then ranked in descending order for each U.S. presidential election based on that score.

Table 1: Overview of variables

Variable	Definition
Dependent Variables	
AAER Dummy	1 in the years a misstatement occurred as reported in the Accounting and Auditing Enforcement Releases, 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.
(Non-)U.S. Labor Intensity	Firm's (non-)U.S. employees (Compustat Segments item: EMPS) scaled by firm's (non-)U.S. total average assets (Compustat Segments item: IAS; sum of beginning and end of year total assets divided by two).
Election Year	1 in all presidential election years (i.e., 1984, 1988, 1992, 1996, 2000, 2004, 2008 and 2012), and zero otherwise.
Important State	1 for the top ten most important states for each U.S. presidential election, and zero otherwise. The top ten most important states are defined by following the methodology of Cebula et al. (2013) who express the political importance of a state by dividing the number of Electoral College votes at stake by the margin of victory for the winning candidate. The states are then ranked in descending order for each U.S. presidential election.
Senior Congressman	1 if a firm's headquarters are located in a congressional district with a congressman who has served for at least one complete term on the Appropriations, Banking or Commerce committee, and zero otherwise. To construct this variable data is obtained from Charles Stewart's Congressional Data webpage for all members of the House for the time period 1982-2012 and every firm is matched to a specific district based on its zip code as reported in Compustat. Firms located in states that only have one congressional district (i.e., Alaska, Delaware, Montana, North Dakota, South Dakota, Vermont, and Wyoming) are excluded.
Control Variables	
F-score 1	Predicted value = -7.893 + 0.79 * RSST accruals + 2.518 * Change in receivables + 1.191 * Change in inventory + 1.979 * % Soft assets + 0.171 * Change in cash sales + -0.932 * Change in ROA + 1.029 * 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., misstating firm-years/(non-misstating firm-years + misstating firm years). For more details see Dechow et al. (2011).
F-score 2	Predicted value = -8.252 + 0.665 * RSST accruals + 2.457 * Change in receivables + 1.393 * Change in inventory + 2.011 * % Soft assets + 0.159 * Change in cash sales + -1.029 * Change in ROA + 0.983 * Actual issuance + -0.15 * Abnormal change in employees + 0.419 * 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., misstating firm-years/(non-misstating firm-years + misstating firm years). For more details see Dechow et al. (2011).
F-score 3	Predicted value = -7.966 + 0.909 * RSST accruals + 1.731 * Change in receivables + 1.447 * Change in inventory + 2.265 * % Soft assets + 0.160 * Change in cash sales + -1.455 * Change in ROA + 0.651 * Actual issuance + -0.121 * Abnormal change in employees + 0.345 * Existence of operating leases + 0.082 * Market-adjusted stock return + 0.098 * 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., misstating firm-years/(non-misstating firm-years + 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 $\Delta WC_t = \Delta AR_t + \Delta Inventory_t - \Delta AP_t - \Delta TP_t + \Delta other\ Assets\ (net)_t$. 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 ΔWCt 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.
Restatement	1 in the years a restatement has been released by firms, and zero otherwise. Restatements include intentional as well as unintentional misstatements as per the criteria of Hennes et al. (2008).
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).
PAC Contributions	A firm's PAC contributions as reported in the FEC dataset scaled by total average assets.
Lobbying Exp	A firm's lobbying expenditures as reported in the CRP dataset scaled by total average assets.
Union	Percentage of employees who are union members per four-digit SIC code as reported in the Union Membership and Coverage Database maintained by (Hirsch and Macpherson (2003)).
Log Analysts Following	Natural logarithm of the number of analysts issuing annual earnings forecasts for firms covered by IBES. Set equal to zero if the firm is not covered by IBES.
Fortune 500	1 if the firm is covered in the Fortune 500 index as reported in Compustat, zero otherwise.
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.
SEC Chairman	Fixed effects for the tenure of each SEC Chairman as reported on the SEC homepage (http://www.sec.gov/about/sechistoricalsummary.htm).
U.S. President	Fixed effects for the tenure of each U.S. President.

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
PAC Contribution Dummy	93,207	.274	.446	0	0	0	1	1
PAC Contributions	93,207	14,646	211,891	0	0	0	570	291,268
Lobbying Amount	55,913	71,621	284,129	0	0	0	0	1,740,000
Union	93,207	0.115	0.116	0	0.027	0.0755	0.162	0.499
Analyst Following	93,207	4.47	6.14	0	0	2	6	28
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-intensive 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***
PAC Contribution Dummy	93,207	.256	.293	-0.037***
PAC Contributions	93,207	8,472	20,819	-12,347***
Lobbying Amount	55,913	40,486	100,746	-60,260***
Union	93,207	0.114	0.117	-0.003***
Analyst Following	93,207	3.43	5.51	-2.08***
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-intensive firms; and (ii) less labor-intensive 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-intensive firms sample as compared to the less labor-intensive 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***
PAC Contribution Dummy	694	.412	92,513	.273	0.13***
PAC Contributions	694	27,265	92,513	14,555	12,710*
Lobbying Amount	509	113,658	55,404	71,235	42,423***
Union	694	0.096	92,513	0.115	-0.019***
Analyst Following	694	7.51	92,513	4.45	3.06***
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	(7) AAER Dummy
Labor Intensity	-23.147**	-22.581**	-28.610***	-20.810**	-23.347***	-34.659***	-21.795**
	(0.02)	(0.02)	(0.01)	(0.02)	(0.00)	(0.01)	(0.05)
F-score 1	0.476***			0.476***	0.474***	0.483***	0.547***
	(0.00)			(0.00)	(0.00)	(0.00)	(0.00)
F-score 2		0.454***					
		(0.00)					
F-score 3			0.424***				
			(0.00)				
Proximate 100	0.346**	0.337**	0.338*	0.344**	0.348**	0.171	0.274**
	(0.05)	(0.04)	(0.06)	(0.05)	(0.04)	(0.41)	(0.05)
PAC Contribution	0.001	0.001	0.001	0.001	0.001		0.001
	(0.49)	(0.46)	(0.45)	(0.49)	(0.49)		(0.86)
Lobbying Exp						-0.001*	
						(0.06)	
Union	0.013	0.014	0.017	0.013	0.013	0.004	-0.009
	(0.32)	(0.32)	(0.24)	(0.32)	(0.32)	(0.84)	(0.24)
Log Analyst Following	0.287***	0.299***	0.297***	0.286***	0.301***	0.606***	0.343***
	(0.01)	(0.01)	(0.01)	(0.01)	(0.01)	(0.00)	(0.01)
Fortune 500	-0.243	-0.251	-0.274	-0.244	-0.221	-0.351	-0.084
	(0.28)	(0.26)	(0.22)	(0.28)	(0.32)	(0.19)	(0.75)
ROA	0.026	0.106	0.312	0.028	0.028	0.332	0.074
	(0.92)	(0.69)	(0.30)	(0.92)	(0.92)	(0.36)	(0.81)
Big 4	-0.550**	-0.509**	-0.508**	-0.549**	-0.550***	-0.174	-0.466**
	(0.02)	(0.02)	(0.03)	(0.02)	(0.01)	(0.62)	(0.02)
Market-to-Book	0.026***	0.026***	0.020**	0.026***	0.027***	0.013	0.027***
	(0.00)	(0.00)	(0.04)	(0.00)	(0.00)	(0.27)	(0.01)
Leverage	0.128	0.134	0.124	0.123	0.109	0.213	-0.274
	(0.69)	(0.68)	(0.73)	(0.70)	(0.74)	(0.58)	(0.44)
Log Firm Age	-0.194**	-0.213**	-0.244**	-0.201**	-0.204**	0.013	-0.220***
	(0.02)	(0.02)	(0.02)	(0.02)	(0.02)	(0.90)	(0.01)
Log Assets	0.243***	0.246***	0.258***	0.233***	0.246***	0.157*	0.180***
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.06)	(0.00)
Constant	-10.063***	-10.092***	-10.044***	-9.950***	-10.112***	-10.577***	-9.293***
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
SEC Chairman Dummies	Yes	Yes	Yes	Yes	Yes	Yes	Yes
U.S. President Dummies	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry Dummies	Yes	Yes	Yes	Yes	Yes	Yes	No
Year Dummies	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Clustered by	Firm	Firm	Firm	Firm	Firm	Firm	Firm and Industry
Observations	79,597	78,598	72,494	79,597	79,597	38,419	84,970
Pseudo R-squared	0.124	0.126	0.137	0.124	0.123	0.154	0.099

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, 2 and 3 differ in the F-score control variable. In Model 4 labor intensity is not adjusted by the two-digit SIC code median-industry labor intensity. In Model 5 labor intensity is adjusted by the four-digit SIC code median-industry labor intensity. Model 6 includes a control variable for a firm's lobbying efforts instead of a firm's PAC contributions. As the data on lobbying expenditures is only available from 1998 onwards, this model is limited to the period 1998-2012. Model 7 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 being subject to an AAER in an election year (in highly contested states)[a]

Variables	(1) AAER Dummy	(2) AAER Dummy	(3) AAER Dummy	(4) AAER Dummy
Labor Intensity	-16.112*	-21.542*	-23.932**	-23.942*
	(0.09)	(0.08)	(0.04)	(0.09)
Election Year	-0.935**	-0.915**	-0.872**	-0.848*
	(0.02)	(0.03)	(0.03)	(0.06)
Labor Intensity * Election Year	-26.614*	-22.617**	-8.170	-9.037
	(0.08)	(0.03)	(0.59)	(0.38)
Important State			-0.128	-0.146
			(0.52)	(0.46)
Important State * Labor Intensity			25.648	29.720
			(0.15)	(0.20)
Important State * Election Year			0.213	0.191
			(0.36)	(0.41)
Labor Intensity * Election Year * Important State			-74.299*	-67.539*
			(0.10)	(0.07)
F-score 1	0.439***	0.522***	0.477***	0.550***
	(0.00)	(0.00)	(0.00)	(0.00)
Proximate 100	0.342**	0.274**	0.339**	0.269**
	(0.04)	(0.04)	(0.04)	(0.04)
PAC Contribution	0.001	0.001	0.001	0.001
	(0.42)	(0.45)	(0.50)	(0.57)
Union	0.014	-0.010	0.014	-0.009
	(0.30)	(0.21)	(0.32)	(0.26)
Log Analyst Following	0.246**	0.295**	0.287***	0.335***
	(0.02)	(0.02)	(0.01)	(0.01)
Fortune 500	-0.263	-0.112	-0.238	-0.092
	(0.24)	(0.66)	(0.29)	(0.72)
ROA	-0.061	-0.016	0.037	0.072
	(0.81)	(0.97)	(0.89)	(0.80)
Big 4	-0.588***	-0.503**	-0.552**	-0.476**
	(0.01)	(0.01)	(0.02)	(0.02)
Market-to-Book	0.020**	0.021**	0.026***	0.027**
	(0.03)	(0.02)	(0.00)	(0.02)
Leverage	0.066	-0.355	0.140	-0.280
	(0.84)	(0.37)	(0.66)	(0.44)
Log Firm Age	-0.182**	-0.196**	-0.196**	-0.211***
	(0.03)	(0.02)	(0.02)	(0.01)
Log Assets	0.257***	0.198**	0.229***	0.178***
	(0.00)	(0.01)	(0.00)	(0.00)
Constant	-10.075***	-9.295***	-10.045***	-9.247***
	(0.00)	(0.00)	(0.00)	(0.00)
SEC Chairman Dummies	Yes	Yes	Yes	Yes
U.S. President Dummies	Yes	Yes	Yes	Yes
Industry Dummies	Yes	No	Yes	No
Year Dummies	Yes	Yes	Yes	Yes
Clustered by	Firm	Firm and Industry	Firm	Firm and Industry
Observations	79,597	84,970	79,597	84,970
Pseudo R-squared	0.120	0.096	0.125	0.103

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 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 and 2 provide the results for testing H2a and model 3 and 4 provide the results for testing H2b. In addition, model 1 and 3 include industry dummies and I cluster by firm, whereas model 2 and 4 do not include industry dummies and I 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	.0009	.0026
Probability of Labor Intensity at Lower Quartile	.0012	.0029
Interquartile Marginal Change	-.0003	-.0003
Interquartile Marginal Change in %	-25.00%	-10.34%

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.

Panel C: Logistic regression estimation of the probability of being subject to an AAER if headquartered in a district of a senior congressman who serves on SEC committee[c]

	(1)	(2)
Variables	AAER Dummy	AAER Dummy
Labor Intensity	-18.969*	-20.726*
	(0.09)	(0.10)
Senior Congressman	0.168	0.153
	(0.23)	(0.23)
Labor Intensity * Senior Congressman	-29.322*	-24.979*
	(0.10)	(0.10)
F-score 1	0.469***	0.543***
	(0.00)	(0.00)
Proximate 100	0.322*	0.253*
	(0.07)	(0.07)
PAC Contribution	0.001	0.001
	(0.51)	(0.56)
Union	0.013	-0.008
	(0.35)	(0.29)
Log Analyst Following	0.341***	0.387***
	(0.00)	(0.02)
Fortune 500	-0.259	-0.138
	(0.26)	(0.61)
ROA	0.074	0.112
	(0.78)	(0.70)
Big 4	-0.490**	-0.419*
	(0.03)	(0.06)
Market-to-Book	0.025***	0.025**
	(0.00)	(0.03)
Leverage	0.105	-0.312
	(0.74)	(0.41)
Log Firm Age	-0.192**	-0.213***
	(0.02)	(0.01)
Log Assets	0.188***	0.142***
	(0.00)	(0.00)
Constant	-9.908***	-9.164***
	(0.00)	(0.00)
SEC Chairman Dummies	Yes	Yes
U.S. President Dummies	Yes	Yes
Industry Dummies	Yes	No
Year Dummies	Yes	Yes
Clustered by	Firm	Firm and Industry
Observations	78,071	83,300
Pseudo R-squared	0.123	0.099

Notes to Table 4, Panel C:
[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 includes industry dummies and I cluster by firm, whereas model 2 does not include industry dummies and I 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 D: Marginal effects[d]

Variables	Marginal Effect in District of Senior Congressman	Marginal Effect outside of District of Senior Congressman
Probability of Labor Intensity at Upper Quartile	.0017	.0017
Probability of Labor Intensity at Lower Quartile	.0024	.00185
Interquartile Marginal Change	-.0007	-.00015
Interquartile Marginal Change in %	-29.17%	-8.11%

Notes to Table 4, Panel D:
[b] The marginal effects presented here are calculated based on model 1, Table 4, Panel C. All variables except for labor intensity and senior congressman are at their mean values to calculate the probabilities at the upper and lower quartile of labor intensity.

Table 5: OLS and logistic 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.	(6) Restatement
Labor Intensity	8.455***	8.562***	8.575***	0.091***	0.085*	7.814*
	(0.00)	(0.00)	(0.00)	(0.01)	(0.05)	(0.10)
ROA	0.187***	0.139***	0.176***	-0.043***	-0.036***	-1.105***
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Big 4	-0.104***	-0.099***	-0.111***	-0.005***	-0.006***	-0.119
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.20)
Market-to-Book	0.007***	0.007***	0.008***	0.000***	0.001***	-0.11*
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.10)
Leverage	0.336***	0.397***	0.376***	-0.007***	0.016***	.184
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.25)
Log Firm Age	-0.089***	-0.096***	-0.077***	-0.003***	-0.005***	-0.017
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.70)
Log Assets	0.037***	0.042***	0.039***	-0.006***	-0.004***	0.170***
	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
Constant	0.759***	0.680***	0.721***	0.119***	0.034***	-3.674***
	(0.00)	(0.00)	(0.01)	(0.00)	(0.00)	(0.00)
Industry Dummies	Yes	Yes	Yes	Yes	Yes	Yes
Year Dummies	Yes	Yes	Yes	Yes	Yes	Yes
Clustered by	Firm	Firm	Firm	Firm	Firm	Firm
Observations	93,207	91,953	85,215	91,870	72,954	37,907
Adj. R-squared / Pseudo R-squared	0.174	0.183	0.186	0.177	0.134	0.084

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 (model 1-5) and 1997-2006 (model 6). 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 absolute discretionary accruals estimated from a modified Jones model as in Dechow et al. (2011) and estimated according to Dechow and Dichev (2002), respectively. The dependent variable in model 6 is an indicator variable that is one in the years a restatement has been released by firms, and zero otherwise. The results reported for models 1-5 are from an ordinary least squares regression estimation and for model 6 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.

Table 6: Logistic regression estimation of the probability of being subject to an AAER with US vs. non-US labor intensity[a]

Variables	(1) AAER Dummy	(2) AAER Dummy
US Labor Intensity	-49.744**	-49.744**
	(0.03)	(0.03)
Non-US Labor Intensity	-10.640	-11.014
	(0.75)	(0.74)
F-score 1	0.511***	0.513***
	(0.00)	(0.00)
Proximate 100	0.635	0.644
	(0.18)	(0.18)
PAC Contribution	0.001	
	(0.99)	
Lobbying Exp		-0.001
		(0.54)
Union	0.004	0.041
	(0.51)	(0.51)
Log Analyst Following	0.400	0.401
	(0.22)	(0.22)
Fortune 500	-0.737	-0.746
	(0.26)	(0.25)
ROA	-0.989	-0.989
	(0.32)	(0.32)
Big 4	-0.849*	-0.823
	(0.10)	(0.11)
Market-to-Book	0.011	0.011
	(0.72)	(0.72)
Leverage	0.987	0.986
	(0.33)	(0.33)
Log Firm Age	0.176	0.191
	(0.50)	(0.50)
Log Assets	0.453**	0.452**
	(0.02)	(0.01)
Constant	-11.157***	-11.157***
	(0.00)	(0.00)
SEC Chairman Dummies	Yes	Yes
U.S. President Dummies	Yes	Yes
Industry Dummies	Yes	Yes
Year Dummies	Yes	Yes
Clustered by	Firm	Firm
Observations	5,018	5,018
Pseudo R-squared	0.241	0.241

Notes to Table 6:

[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 1999–2012. The results reported are from a logistic regression estimation. Model 2 includes a control variable for a firm's lobbying efforts instead of a firm's PAC contributions. As the data on lobbying expenditures is only available from 1998 onwards, this model is limited to the period 1998-2012. *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: Propensity Score Matching

Panel A: Probit Regression Estimation of the Probability of being in the Top Decile of labor intensity[a]

Variables	Top Decile Labor Intensity
F-score 1	0.127***
	(0.00)
Proximate 100	-0.024*
	(0.08)
PAC Contribution	0.002***
	(0.00)
Union	-0.007***
	(0.00)
Log Analyst Following	-0.044***
	(0.00)
Fortune 500	0.103***
	(0.00)
ROA	0.812***
	(0.00)
Big 4	0.040**
	(0.01)
Market-to-Book	-0.003***
	(0.00)
Leverage	0.175***
	(0.00)
Log Firm Age	0.046***
	(0.00)
Log Assets	-0.156***
	(0.00)
Constant	-0.875***
	(0.00)
SEC Chairman Dummies	Yes
U.S. President Dummies	Yes
Industry Dummies	No
Year Dummies	Yes
Observations	92,690
Pseudo R-squared	0.078

Notes to Table 7, Panel A:

[a] The dependent variable for the model presented here is an indicator variable that is equal to one if a firm's labor intensity is in the top decile of labor intensity, 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 top decile labor intensity firms	(2) Mean matched non-top decile labor intensity firms	(3) Mean Difference (1) – (2)
F-score 1	1.161	1.149	0.012
			(0.32)
Proximate 100	0.333	0.333	0.000
			(0.96)
PAC Contribution	10.661	10.974	-0.313
			(0.57)
Union	0.102	0.101	0.001
			(0.59)
Log Analyst Following	0.789	0.774	0.015
			(0.26)
Fortune 500	0.040	0.036	0.004
			(0.13)
ROA	-0.032	-0.029	-0.003
			(0.20)
Big 4	0.765	0.759	0.006
			(0.32)
Market-to-Book	2.749	2.680	0.069
			(0.28)
Leverage	0.165	0.162	0.003
			(0.38)
Log Firm Age	2.362	2.347	0.015
			(0.18)
Log Assets	3.992	3.985	0.007
			(0.79)

Notes to Table 7, 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 top decile labor intensive firms and the matched non-top decile labor intensive firms. Propensity scores for matching are obtained from the probit model in Panel A. Each top decile labor intensive firm observation is matched to a non-top decile labor intensive firm observation within the same year and SEC Chairman years, 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 top decile labor intensity firms	N	(2) Mean matched non-top decile labor intensity firms	(3) Mean Difference (1) – (2)
AAER Dummy	Matched	9,550	0.003	9,550	0.007	-0.004***

Notes to Table 7, Panel C:
[c] Panel C reports the average treatment effect of labor intensity on being subject to an AAER. *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 being subject to an AAER in Election Years and Majority Years[d]

Variables	AAER Dummy	AAER Dummy
Top Decile Labor Intensity	-0.528**	-0.669***
	(0.02)	(0.01)
Election Year	-0.093	
	(0.75)	
Top Decile Labor Intensity * Election Year	-1.164*	
	(0.08)	
Senior Congressman		-0.121
		(0.66)
Top Decile Labor Intensity * Senior Congressman		-0.646
		(0.25)
Constant	-4.982***	-4.910***
	(0.00)	(0.00)
SEC Chairman Dummies	No	No
U.S. President Dummies	No	No
Industry Dummies	No	No
Year Dummies	No	No
Observations	19,100	18,959
Pseudo R-squared	0.014	0.015

Notes to Table 7, 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 been subject to 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 top decile labor intensity and non-top decile labor intensity 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 8: 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) Number Comment Letters	(3) Comment Letter Dummy	(4) Comment Letter Dummy
Labor Intensity	-5.919*	-5.919*	-2.324*	-2.324*
	(0.06)	(0.06)	(0.08)	(0.09)
F-score 1	0.295***	0.295***	0.104***	0.104***
	(0.00)	(0.00)	(0.00)	(0.00)
Proximate 100	-0.183**	-0.183**	-0.084**	-0.084**
	(0.03)	(0.03)	(0.02)	(0.02)
Pac Contribution	0.001		0.001	
	(0.75)		(0.37)	
Lobbying Exp		0.001***		0.001***
		(0.01)		(0.00)
Union	-0.022**	-0.022**	-0.008	-0.008*
	(0.04)	(0.04)	(0.11)	(0.10)
Log Analyst Following	-0.043	-0.043	-0.012	-0.012
	(0.45)	(0.45)	(0.62)	(0.62)
Fortune 500	0.596***	0.596***	0.253***	0.253***
	(0.00)	(0.00)	(0.00)	(0.00)
ROA	-2.121***	-2.121***	-0.880***	-0.880***
	(0.00)	(0.00)	(0.00)	(0.00)
Big 4	-0.728***	-0.728***	-0.290***	-0.290***
	(0.00)	(0.00)	(0.00)	(0.00)
Market-to-Book	0.022***	0.022***	0.011***	0.011***
	(0.01)	(0.01)	(0.01)	(0.01)
Leverage	0.592***	0.592***	0.259***	0.259***
	(0.00)	(0.00)	(0.01)	(0.01)
Log Firm Age	0.177***	0.177***	0.067***	0.067***
	(0.00)	(0.00)	(0.00)	(0.00)
Log Assets	0.375***	0.375***	0.156***	0.156***
	(0.00)	(0.00)	(0.00)	(0.00)
Constant	-5.944***	-5.944***	-2.417***	-2.417***
	(0.00)	(0.00)	(0.00)	(0.00)
SEC Chairman Dummies	Yes	Yes	Yes	Yes
Industry Dummies	Yes	Yes	Yes	Yes
Year Dummies	Yes	Yes	Yes	Yes
Clustered by	Firm	Firm	Firm	Firm
Observations	20,768	20,768	20,768	20,768
Pseudo R-squared	0.067	0.067	0.127	0.127

Notes to Table 8:

[a] The dependent variable for model 1 and 2 is the number of comment letters a firm has either received or sent to the SEC, and for model 3 and 4 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 and 2 are from a Tobit regression estimation; and for model 3 and 4 from a logistic regression estimation. While model 1 and 3 include a firm's PAC contributions, model 2 and 4 include a firm's lobbying expenditures. *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.