J. Account. Public Policy 41 (2022) 106999

Contents lists available at ScienceDirect

J. Account. Public Policy

journal homepage: www.elsevier.com/locate/jaccpubpol

Full length article

Can we trust the accounting discretion of firms with political money contributions? Evidence from U.S. IPOs

Antonios Kallias [a], Konstantinos Kallias [b,*], Song Zhang [c]

[a] Cardiff Business School, Cardiff University, Colum Drive, Cardiff CF10 3EU, UK
[b] Portsmouth Business School, University of Portsmouth, Portsmouth PO1 3DE, UK
[c] Centre for Responsible Banking & Finance, School of Management, University of St Andrews, St Andrews KY16 9RJ, UK

ARTICLE INFO

Article history:
Available online 8 July 2022

Keywords:
Initial public offerings
Discretionary accruals
Signaling
Political connections
IPO performance

ABSTRACT

Using hand-collected data from the U.S., we examine the influence of political money contributions (PMC) on IPO financial reporting. Unraveling the conflicting managerial incentives, we develop and test three distinct hypotheses whereby accounting discretion is utilized to downplay, embellish, or truthfully impart the PMC firm's prospects. Consistent with the last two hypotheses, we document income-increasing reporting. The effects are strongest for firms sensitive to policy outcomes, and least affected by contemporaneous political events. Post-issue analysis shows that at-issue discretionary accruals systematically predict future accounting performance but are unrelated to stock returns. Survival analysis indicates a lower probability of IPO failure. Robust to a battery of checks, our results support the value-relevance of financial information and a novel use of accounting discretion as a means of signaling expected political gains.

1. Introduction

Political money contributions (PMCs) by IPO issuers have recently emerged as a powerful certification mechanism. It is believed that proximity to the highest echelon of government confers legitimacy and protects new equities from excessive underpricing (Francis et al., 2009; Gounopoulos et al., 2017) in a manner that parallels the function of the most prestigious auditors, underwriters, and venture capital firms (Megginson and Weiss, 1991). Because of their reputational stake, the latter agents also act to restrain earnings management[1] (Lee and Masulis, 2011; Wongsunwai, 2013). Politicians similarly put their reputation on the line but do not have the monitoring capacity required to safeguard against the production of misleading financial information. The present study aims to shed light on how politically connected firms exercise their accounting discretion in computing IPO earnings via a complete and thorough investigation into PMC issuers' reporting incentives.

IPOs comprise an ideal research setting in which to assess the interface between accounting discretion and political connections. Prior to an IPO, there is scant coverage of the issuing firm, with the prospectus document (and the financial statements enclosed in it) often constituting the sole source of information. This suggests that the reported financial data are bound to have a formative impact on investment decisions, certainly a larger one than the financial statements issued by

* Corresponding author.
E-mail addresses: kalliasa@cardiff.ac.uk (A. Kallias), konstantinos.kallias@port.ac.uk (K. Kallias), sz59@st-andrews.ac.uk (S. Zhang).

[1] Clearly, *earnings management* in this case labels an opportunistic behaviour. However, throughout the paper, we use the terms *earnings management* and *discretionary accruals* interchangeably to refer to the incidence of managerial discretion in accounting methods. Such discretion, in line with Watts and Zimmerman (1990), may either foster or hamper the value- relevance of financial information.

https://doi.org/10.1016/j.jaccpubpol.2022.106999
0278-4254/

listed firms, for which investors typically have an abundance of other information (e.g., press releases, conference calls, and analyst and media coverage) to form a context for evaluating firm performance.

The information scarcity enables the distortion of the issuer's economic reality based on conflicting managerial incentives. On the one hand, managers who aim to attract less attention to themselves and the affiliated politicians, that is, to mitigate the firm's political costs (Watts and Zimmerman, 1978), could systematically recognize discretionary accruals that lead to lower earnings. On the other hand, the leverage that political connections confer on the institutional and regulatory environment (Yu and Yu, 2011; Correia, 2014) may encourage reporting choices that inflate the accounting bottom line and through this the IPO offer price. Although with opposite directions, both predictions are in line with prior studies that view political connections as being detrimental to accounting quality (Jones, 1991; Ramanna and Roychowdhury, 2010; Chaney et al., 2011; Gross et al., 2016; Li et al., 2016).

However, not all issuers capitalize on the information asymmetries to mislead investors. In a central dichotomy within the IPO literature (DuCharme et al., 2004; Morsfield and Tan, 2006; Chen et al., 2013; Billings and Lewis-Western, 2016), issuers report to mislead or inform, conditional on the corporate character and the information environment. Because political connections affect both, we argue that the reporting motives in our setting are broad enough to include value-relevant earnings. This alternative prediction draws support from two empirical regularities and a conundrum. Firstly, discretionary accruals are likely to convey information when investors appear to be likely to rely on it (Chen et al., 2013; Billings and Lewis-Western, 2016). Secondly, income-increasing reporting is an effective means for conveying imminent value while censoring sensitive information about the value driver (Linck et al., 2013; Hao and Li, 2016). Nevertheless, research on IPO issuers with PMC activity ascribes signaling capacity exclusively to PMCs, posing a conundrum in which the enormity of the observed effects contrasts issuers' modest political budgets.[2]

We scrutinize 1,082 U.S. common share IPOs for evidence of PMC activity and probe its influence on reported performance. Our results show that PMC issuers stand out in their use of income-increasing discretionary accruals with each dollar spent having incremental power in explaining the accruals beyond an array of firm- and IPO-specific characteristics. A rigorous treatment for the endogenous decision to set aside a political budget (via Heckman, instrumental variables, and maximum likelihood estimation) allays concerns due to the self-selection problem. Different methods for accruals recognition and alternative PMC measures ensure inferences least affected by bias due to measurement error. Overall, PMCs appear to lead to higher IPO earnings, a finding that runs contrary to the predictions for conservative reporting.

Income-increasing reporting needs not exclusively rely on accruals and two earlier studies justify why a politically connected firm could be attracted to alternate routes of intervention. In a cross-country analysis, Braam et al. (2015) argue that politically connected firms tend to manipulate real activities, as interventions at this level are harder to detect. In a U.S. context, Correia (2014) shows how political donations can lower the probability of SEC prosecution when financial information is restated, alluding to a window of opportunity for non-GAAP earnings management. Contrasting both studies, our tests for real earnings management yield insignificant results and when we carefully examine each IPO for restatements with an adverse effect on post-IPO earnings, we find that such cases fall outside the PMC sample. Thus, the upward pattern documented in the earnings of PMC issuers can be mainly attributed to the way these firms use (or abuse) accounting discretion.

To disentangle whether the result of income-increasing accruals is an artifact of opportunism or information revelation, we trace the implications of PMC issuers' accounting discretion deep in the aftermarket. Our investigation yields a threefold crop of findings. At an accounting level, at-issue discretionary accruals positively relate to future reported performance; using propensity score matching and differences-in-differences estimation based on a quasi-natural experiment, we confirm that this result is not simply due to the ability of better quality firms to spend more on political purposes. At a stock price level, the announcement of post-IPO earnings fails to elicit a systematic response by market investors. Relatedly, a correspondence between the accruals and long-run stock returns to flag ensuing market disappointment is absent. The third level of our investigation comprises IPO survival, where PMC firms exhibit a significantly lower probability of failure and remain in the public domain for a longer time. The survival models also infer that real earnings management accentuates the risk of failure, providing an explanation for its limited appeal to PMC issuers. In its entirety, our evidence validates the accounting choices made in preparation for the IPO and suggests that PMC issuers exercise their accounting discretion to inform, rather than mislead, investors.

Next, we identify conditions which are likely to moderate PMC issuers' use of discretionary accruals as a signaling device. First, we factor in a firm's dependence on politics. Access to policymakers confers a greater informational advantage when the government, either as a regulator or as a buyer, maintains the capacity to effect industry-wide wealth redistributions. Consistent with this intuition, our evidence shows that income-increasing reporting escalates within industries of heavy regulation and frequent government purchases. Moreover, by applying Christensen et al.'s (2017) measure of political sensitivity, we confirm that our results extend to the cross-section of issuers which generally exhibit a high sensitivity to policy outcomes. Signaling also hinges on low information-uncertainty. This could render certain periods more favorable than others, conditional on the prevailing political environment around the IPO. However, when we interact PMC amounts with variables capturing the level of the economy-wide interest in politics, the resulting evidence is, at best, weak, implying that, at any given time, corporate political activity engenders adequate information production to facilitate investors' correct

[2] For example, Gounopoulos et al. (2017) report that a 10 percent increase in political spending can curtail IPO underpricing by 2.5 percent; the median PMC is $71,500 ($80,000) in their (our) sample.

unraveling of the transmitted signal. Likewise, extending our investigation to capture potential variation by political preferences, we document that these play little, if any, role in IPO reporting.

Dechow et al. (2010, 344) assert that "the quality of a reported earnings number depends on whether it is informative about the firm's financial performance, many aspects of which are unobservable". In the first study to discern earnings quality in the presence of political connections, we contribute a novel perspective to a literature describing influential relationships as an inhibiting factor in the production of value-relevant financial information (e.g., Jones, 1991; Ramanna and Roychowdhury, 2010; Chaney et al., 2011; Gross et al., 2016; Li et al., 2016; Habib et al., 2017). Within this literature, we are aware of four studies explicitly focusing on how political money influences sponsor firms' accounting discretion. Two of them advocate the capacity of PMCs to alter a firm's regulatory costs, while taking opposite sides in developing the causal mechanism. On the one hand, Ahmed et al. (2018) argue that PMC firms generally exhibit higher earnings management levels, because they anticipate to receive a favorable treatment from independent agencies, such as the SEC. On the other hand, Jennings et al. (2021) refute the argument of SEC capture and even show the agency to intensify scrutiny of PMC firms, prompting the latter to engage in more conservative reporting. Two other studies, Notbohm et al. (2019) and Bhandari et al. (2020), factor in the heterogeneity in political ideologies, ascribing more (less) conservative financial reporting to managers spending primarily on Republican (Democratic) causes. Whether expressed as a fear of regulatory punishment or a clash with internal moral standards, a shared conviction in these studies is that opportunistic incentives are necessary for a high accruals level. From a setting particularly vulnerable to opportunism, our evidence refutes PMC firms' propensity to mislead and generalizes by alerting to the possibility that accounting discretion might be used to overcome the natural restrictions which political connections impose on communication with investors.

Our study contributes to the broader literature on the use of discretionary accruals for signaling by broadening the understanding of *when* and *how* managers resort to this practice. Examining the circumstances that induce signaling, Badertscher et al. (2012) establish a clean dichotomy in that managers utilize their accounting discretion to impart private information when a firm would meet (or miss) an earnings target anyway, suggesting that there is scope for informative accounting when it does not matter or, at least, when there are small stakes at risk. In our setting, however, the stakes are high. Our evidence is also at odds with prior findings on the persistence of signals. Perotti and Windisch (2017) provide large sample evidence of the value-relevance of discretionary accruals. Relatedly, Baik et al. (2020) find that managers who are capable of predicting future performance, on average, use this ability to smooth fluctuations in earnings. While also being in a better position to predict future performance through the political networks, managers of PMC issuers engage in signaling around the listing year, that is, when the information asymmetries are most pronounced, and subsequently relax the use of the signal so that, from the second year after the IPO, the difference in the level of discretionary accruals between PMC and non-PMC issuers becomes statistically insignificant. As such, we show that the use of accounting discretion for conveying private information is not only more pervasive but also more nuanced than suggested by prior studies.

Our contribution extends to IPO research wherein earnings management (Aharony et al., 1993; Teoh et al., 1998a; Teoh et al., 1998b; DuCharme et al., 2004; Morsfield and Tan, 2006; Aharony et al., 2010; Wongsunwai, 2013) and political connections (Fan et al., 2007; Francis et al., 2009; Gounopoulos et al., 2017) have hitherto been studied disparately. By establishing the connection, we derive their complementarity to an effective signaling mechanism. A maintained assumption is that issuers' political networks appeal to IPO investors. We expose an important part of the underlying mechanism by showing that investors evaluate an issuer's political strategy in conjunction with reported earnings, and their joint effect reflects on IPO pricing. Given the cash scarcity prior to going public, this finding should have resonance for prospective issuers, showing that a powerful signal is attainable without committing an excessively large political budget.

In addition to informing the IPO investor-issuer dyad, our findings have important policy implications. In particular, we offer a note of caution to standard setters against limiting the scope for accounting discretion, as the attempt to protect investors may engender the opposite result by undermining their informed decision making in cases in which issuers are faced with the problem of blocked communication. From the perspective of regulatory agencies, our evidence unburdens budget-constrained agencies, such as the SEC, suggesting that they do not have to commit more resources to the monitoring of PMC firms' financial disclosures. By extension, our findings also imply a need for a shift in focus from the veracity of the reported profits to their actual source and to whether they could be associated with an unfair competitive advantage. This raises concerns about the ability of the political system to self-regulate and maintain adequate checks and balances, which are of broader public interest.

The rest of the paper is structured as follows. Section 2 positions our research within the relevant literature and develops the hypotheses. We describe our sample in Section 3. The results from the multivariate analysis are in Section 4. Finally, Section 5 concludes the paper.

2. Related literature and hypotheses

Research on active political strategies in corporate America centers on the interdependencies between PMC firms and recipient politicians. Based on an implicit long-term contract, the former enjoy politically-enabled rents in excess of the contribution value and the latter maximize their personal welfare and probability of (re-)election (Snyder, 1990; Grossman and Helpman, 1994; Alexander et al., 2009; Chen et al., 2018). Unlike a private domain, which caters to the consolidation of the relationship by insulating the two parties from external scrutiny, an IPO marks a critical juncture. Because of the

requirement to produce audited financial statements, issuing firms are faced with an important decision on the extent and the manner in which accounting information will convey returns on their political investment. To be clear, PMCs statutorily constitute public information and, as per previous research, they draw significant attention from a diverse body of stakeholders (investors, regulators, media, etc.). What remains unknown to the latter is the nature, timing, and scale of politically-enabled value accruing to the donor firm. Thus, a window of opportunity arises for financial statement preparers to exert a formative influence on outsiders' perceptions by utilizing the discretion inherent in accounting principles. Balancing IPO and political objectives, we recognize three distinct motivations which are likely to permeate financial information in our context. Specifically, a PMC issuer may aim to conceal, inflate, or truthfully impart anticipated gains. The first two motivations are in line with political connections literature, which asserts the erosive capacity of relationships of influence in relation to financial reporting quality (Chaney et al., 2011; Gross et al., 2016; Li et al., 2016). The motivation to inform features in a stream of IPO literature which fails to take into account issuers' concurrent political objectives (Chen et al., 2013; Billings and Lewis-Western, 2016; Gounopoulos and Pham, 2017). On the other hand, studies dedicated to the role of political connections in IPOs have yet to draw the link with financial reporting (Fan et al., 2007; Francis et al., 2009; Gounopoulos et al., 2017). Uniting different streams of literature, we develop three hypotheses, one for each of the above motivations, which warrant differential financial reporting choices for politically connected issuers vis-à-vis their non-connected peers.

2.1. The conservatism hypothesis

Politically connected firms receive benefits which are normally denied to their non-connected peers. A lower effective tax rate (Brown et al., 2014), preferential allocation of government procurement contracts (Goldman et al., 2013), cheap bank loans (Claessens et al., 2008), and superior access to product markets (Sojli and Tham, 2017) are typical examples in a non-exhaustive list. Because many IPOs underperform or fail (Fama and French, 2004), it is essential that the firm continues to rely on the provision of similar benefits in the period subsequent to listing. A hefty accounting bottom line is likely to undermine this possibility for at least two reasons. Firstly, as per the political cost hypothesis of Watts and Zimmerman (1978, 1990), high profits breed suspicion and political heat, alluding to a socioeconomic disparity and the need for remedial action. This may come in various forms, including heavier taxes and regulation, which jointly constitute the firm's political costs: the more visible the firm's privileges, the greater the political costs. Secondly, expectations of future performance critically depend on earnings reported at IPO, with firms incurring a high probability of litigation should investors be disappointed. As a result, there is an inverse association between the level of investor sophistication and issuers' propensity to inflate earnings. Aharony et al. (2000) report that Chinese SOEs - firms intrinsically connected to the central government - engage in more earnings management when they list securities in mainland China than when they list on the Honk Kong stock exchange, a more institutionally robust capital market. In the U.S., the threat of IPO-related lawsuits is further magnified by legal opportunism and the abuse of Section 11 of the Securities Act of 1933 which places the burden of proof on the defendant firm (Walker et al., 2015). Regardless of the triggering cause, litigation can impair the firm's political network if the affiliated politicians, concerned about their reputation, respond by dissociating themselves from the possible source of infamy. In turn, the termination of connections adds to the political costs.

Thus, aiming to preserve its political network and resultant benefits in the post-IPO period, a PMC issuer is expected to make accruals choices that decrease reported earnings. Formally, we state the conservatism hypothesis as follows:

H.1. IPO issuers with PMC activity utilize income-decreasing discretionary accruals.

2.2. The opportunism hypothesis

In an inverted form, the incentives for conservative reporting may just as plausibly relate to issuers' opportunism. If deemed expendable, political connections could represent a means for self-serving insiders to maximize utility when the opportunity arises (Aggarwal et al., 2012; Tu et al., 2013). As Sun et al. (2016, 1802) highlight, "there is a potential irony that the very rent-generating capital can be leveraged for rent extraction". The root cause of this hypothesis is that connected firms discount environmental risks to a greater extent, with ample evidence validating their defiance: in incidents of business failure, governments may provide support and bailout packages (Faccio et al., 2006); in practicing outright fraud, supervisory authorities can turn a blind eye (Yu and Yu, 2011); and specifically in relation to misreporting, enforcement actions are relatively infrequent and less punitive (Correia, 2014). Given the massive wealth transfers of an IPO, the possibility exists that PMC issuers engage in aggressive accounting practices, with a clear emphasis on proceeds raised rather than on political costs incurred.

A parallel mechanism may come into play to temper fear of legal repercussions. Extrapolating from the setting of regulatory agencies, Gordon and Hafer (2005) offer the generalizable intuition that contributions can serve as a way of donor firms 'flexing their muscles', advertising their willingness to appeal an adverse decision fiercely. As the authors demonstrate, this behavior conforms to a signaling model wherein potential prosecutors construe excessive costs in confrontation and tend to refrain from it initially. As such, "the underlying logic of [the] causal mechanism extends readily to interest group conflict" (Gordon and Hafer, 2005, 258), which makes it relevant to the litigious IPO environment and disgruntled shareholders' likelihood of entering into a legal dispute with a PMC issuer.

In sum, because of the greater defiance of downside potential and/or legal remedies, a PMC issuer is liable to increase reported earnings to a point that is unsupported by the firm's intrinsic value. As such, future earnings are expected to

disappoint IPO investors and create the need to revise the market value of the firm downward. Our opportunism hypothesis is therefore stated as follows:

H.2. IPO issuers with PMC activity utilize income-increasing discretionary accruals, which are negatively associated with future accounting and stock price performance.

2.3. The signaling hypothesis

Between conservatism and opportunism lies a third motivation, which, unlike the former, permits the PMC issuer to realize its full valuation potential, and, unlike the latter, entails less risk. It manifests in the alteration of reported performance so as to convey private insight in a timely manner, rather than fabricate current standing and prospects. Exclusive to this motivation is value-relevant financial information enabled by the strategic use of accrual accounting. Signaling caters to the PMC issuer's objectives in at least three main ways.

Firstly, it addresses the problem of blocked communication, caused by an inability to disclose the quid pro quo arrangements with the affiliated politicians. As described in the seminal work by Demski and Sappington (1987), an agent may obtain proprietary information which is costly to share with the principal: the higher the cost, the larger the incentive for a value-maximizing manager to suppress disclosure. Dye (1988) theorizes the conditions under which this intuition becomes extensible to financial reporting and reveals a demand for earnings management to address the challenges of managerial contracting and firm valuation. Ample empirical evidence shows managers to cater to this demand by exercising their accounting discretion in a way that reduces the informational wedge in the principal-agent relationship. For example, financially constrained firms with investment opportunities systematically recognize income-increasing accruals with the dual aim of communicating imminent value to prospective financiers while concealing sensitive information about the investments, especially when these are R&D-intensive (Linck et al., 2013; Hao and Li, 2016). Relatedly, Baik et al. (2020) offer large-sample evidence suggesting that, when managers are able to make more accurate predictions with respect to future performance, an ability that in our setting derives from the information flowing through the political network, they will generally exercise their accounting discretion to report more informative earnings.

Secondly, the information environment reinforces the conveyed message. Recent IPO studies express the occurrence of informative (opportunistic) reporting as a decreasing (increasing) function of the uncertainty surrounding the issuing firm (Chen et al., 2013; Billings and Lewis-Western, 2016; Gounopoulos and Pham, 2017). The theoretical underpinning of such papers is disclosure theory, predicting that firms disseminate more information when the market response is likely to be positive and univocal (Dutta and Trueman, 2002; Suijs, 2007). PMC issuers using discretionary accruals as a signaling device can elicit such a response as: (1) the consensus view holds that staying in the good grace of politicians is beneficial, suggesting low value-uncertainty; and (2) ardent interest from the media creates an environment of low information-uncertainty.

Thirdly, the act of political contribution, a signal in itself, necessitates cost for substantiation. In addition to high observability, an effective signal is equally dependent on the cost component to establish the distinction of firms' type by rendering mimicking by issuers of subpar quality economically unprofitable. With a median amount of $80,000 in our sample, this condition is barely met, and because cash scarcity is the norm at IPO, this amount is unlikely to increase to a significantly higher level for the cross-section of issuers. A feasible alternative could lie in a pattern of positive discretionary accruals; if they link to unsatisfactory future performance, the consequences can be deleterious.[3] Bundling discretionary accruals together with a partially effective signal so as to reinforce the latter is a familiar practice in corporate finance literature. For example, this is how managerial optimism is externalized in the events of stock splits and share repurchases (Louis and Robinson, 2005; Louis and White, 2007). Evidence specifically related to IPOs exists in this literature. Fan (2007) identifies income-increasing accruals as a necessary complement to ownership retention in order for outsiders to credibly associate this act with issuers' quality rather than 'cheap talk'.

In framing political contributions as an incomplete signal, one might also reconcile the puzzling notion that issuers' political strategies to a large extent deter IPO underpricing. Gounopoulos et al. (2017) assert this relationship by drawing evidence from a sample of U.S. firms with political budgets comparable to those in our study. Francis et al. (2009), among other studies, document the lower first-day returns of politically connected issuers in a Chinese context, where connections are mainly an inheritance of the previous economic regime and therefore impose no incremental cost on affiliated firms. Although such studies rely on signaling interpretations, they fail to extend their investigation to issuers' financial reporting, casting doubt on the capacity of a low-cost political strategy to act as the sole driver of the observed effects.

Badertscher et al. (2012) indicate that, when managers' informational incentives dominate their incentives to mask the firm's underlying economic reality, the discretionary accruals tend to have high explanatory power over the future earnings. Perotti and Windisch (2017) further show that the information incorporated into the accruals enables the convergence of the stock price to its fundamental value. Thus, although issuers' income-increasing reporting is common to both opportunism and signaling, when accounting discretion serves the latter motivation, at-issue accruals tend systematically to predict post-IPO earnings—that is, the signal is valid. The signal is also observable by IPO investors who fully adjust the prices at listing so that accruals have no bearing on subsequent stock returns. Accordingly, our signaling hypothesis is as follows:

[3] Results in prior studies suggest a threefold cost due to litigation (DuCharme et al., 2004), operations disruption (Dye, 1988), and increased taxation (Trueman and Titman, 1988).

H.3. IPO issuers with PMC activity utilize income-increasing discretionary accruals, which are positively associated with future accounting performance but are unrelated to stock price performance.

3. Data and sample

3.1. Sample selection criteria: IPO

We obtain the population of U.S. common share IPOs for the period 1 January 1998 to 31 December 2013 from the Thomson Reuters' SDC new issues database. The start of our period is determined by the Lobbying Disclosure Act of 1995 which has made lobbying data available from 1998 onwards; the end is conditioned by the minimum five-year window of the IPO survival analysis. Following prior literature (e.g., Loughran and Ritter, 2004; Billings and Lewis-Western, 2016), we exclude IPOs with an offer price below $5 per share, rights issues, unit offerings, limited partnerships, reverse leveraged buyouts (RLBOs), American depositary receipts (ADRs), closed-end funds, real estate investment trusts (REITs), spin-offs, privatizations, and financial institutions (SIC code 6xxx). To minimize measurement error in the calculation of discretionary accruals, issuers with recent merger and acquisition activity are discarded in line with Loughran and Ritter, 2004. We match the IPOs with accounting and stock price information obtained from Compustat and the Center for Research in Security Prices (CRSP), respectively. Firms with missing values for any of the variables entering into the subsequent regressions are eliminated and all continuous variables are winsorized at the 1st and 99th percentile. The final sample consists of 1,082 IPOs.

3.2. PMC types: Lobbying and PAC

The political contributions data are entirely hand-collected and include money channeled toward lobbying and political action committees (PAC) over the two years before the IPO (i.e., the period from day −731 to day −1 relative to the IPO date). We associate 177 IPOs with either PMC strategy.

Lobbying relates to the essence of federal legislation and is aimed at influencing executive and legislative officials in ways that attend to the needs of organized interest groups. The underlying philosophy is that the comingling of those who set policy with those affected by it culminates in informed and participative policymaking. In the absence of a legal cap with respect to the dollar intensity of contributions, lobbying remains corporate America's most frequently used political strategy (de Figueiredo and Richter, 2014). Scrutinizing the archives of the Center for Responsive Politics (CRP), we identify lobbying contributions in 166 IPO firms.

PACs involve fund-raising to be utilized for or against the election of specific candidates. A PAC resembles lobbying in that it typically reflects a top management decision but is accompanied by a series of additional restrictions. Importantly, the firm is prohibited from financing a PAC in excess of its operating expenses, which leads to soliciting contributions from the firm's constituents (e.g., management team, employees, and shareholders). The amounts are also limited.[4] Even so, an important advantage of a PAC is its personalized nature which fosters bonding between recipient politicians and sponsoring firms (Cooper et al., 2010). Investigating the Federal Election Commission's (FEC) files of candidate contributions, we find PAC activity in 61 IPO firms.

3.3. Discretionary accruals

To measure discretionary accruals (DAC), we employ a performance-matched accruals model. We first measure a firm's abnormal accruals using the residual from the modified Jones (1991) model described in Dechow et al. (1995). We estimate the following cross-sectional model for all firms each year and 2-digit Standard Industrial Classification (SIC) industry that has at least 10 observations with available data:

$$\frac{TACC_{i,t}}{TA_{i,t-1}} = \beta_0 \frac{1}{TA_{i,t-1}} + \beta_1 \frac{\Delta SALES_{i,t}}{TA_{i,t-1}} + \beta_2 \frac{PPE_{i,t}}{TA_{i,t-1}} + \varepsilon_{i,t} \quad (1)$$

in which $TACC_{i,t}$ is total accruals computed as earnings before extraordinary items and discontinued operations less cash flow from operations[5]; $TA_{i,t-1}$ is lagged total assets; $\Delta SALES_{i,t}$ is the change in total sales from the year before the IPO to the issue year; and $PPE_{i,t}$ is the gross value of property, plant, and equipment.

We then use the coefficient estimates from equation (1) to estimate the expected component of total accruals $(NACC_{i,t})$ for IPO firms as follows:

$$NACC_{i,t} = \widehat{\beta}_0 \frac{1}{TA_{i,t-1}} + \widehat{\beta}_1 \frac{\Delta SALES_{i,t} - \Delta REC_{i,t}}{TA_{i,t-1}} + \widehat{\beta}_2 \frac{PPE_{i,t}}{TA_{i,t-1}} \quad (2)$$

in which $\Delta REC_{i,t}$ is the change in receivables from the year before the IPO to the listing year.

[4] A PAC may disburse up to $10,000 per candidate per (two-year) election cycle, a maximum of $15,000 annually to a political party, and $5,000 annually to other PACs.

[5] Hribar and Collins (2002) argue that measuring accruals directly from the statement of cash flows avoids the non-articulation problem of the balance sheet approach. Thus, we employ the cash flow method instead of the balance sheet approach to measure total accruals.

The abnormal accruals are computed as the difference between the total accruals and the expected accruals. Subsequently, the performance-matched abnormal accruals of an IPO firm are calculated as the difference between the abnormal accruals of an IPO firm and those of a non-IPO peer in the same 2-digit SIC industry and year with the closest prior-year return on assets (ROA).

3.4. Sample identification and descriptive statistics

Table 1 presents the sample distribution by year, industry, and PMC type. In Panel A, we observe the concentration of IPOs around two periods, the dot-com bubble of the late 1990s and the period 2004–2007, when the stock market was recovering from the early 2000s recession. The IPO activity plummets in 2008 due to the subprime mortgage crisis, followed by a gradual improvement in the subsequent years. Over the entire period, a sizeable increase in the percentage of PMC IPOs is discernible: for example, compare the three earliest with the three latest years. For identification of the surrounding political environment, the midterm and presidential elections columns flag the existence of either event.

Panel B arranges sample firms into 56 industries at the 2-digit level of the SIC code. The majority of IPOs, a third of the total, are clustered in 'computer equipment and services' industries (SIC codes 35 and 73). In accord with political connections literature (Zardkoohi, 1985; Hart, 2001), PMCs dominate (in relative terms) in industries with heightened sensitivity to politics. One example is 'oil and gas' as well as 'transportation and public utilities' due to the heavy regulatory framework; another is 'health services', which, according to the Congressional Budget Office, accounts for an important part of the federal healthcare spending.

Focusing on PMC IPOs, Panel C reveals the pattern of political spending. The dominance of lobbying is confirmed, with the majority of issuers exhibiting a clear preference for this contribution type over PAC. In particular, 116 firms disburse funds just for lobbying, 50 combine the two political strategies, and 11 are exclusive PAC donors. This frequency distribution of political spending is in agreement with Gounopoulos et al. (2017).

Table 2 reports descriptive statistics for the overall sample and the two subsamples created from the PMC dichotomy. At the univariate level, PMCs support significant differences across most dimensions. DAC is one of them, offering preliminary evidence of a positive association between income-increasing reporting and PMC activity. As shown, DAC has a mean (median) of 0.03 (0.02) for PMC IPOs, whereas both statistics are smaller for the rest of the issuers. In the PMC sample, the mean (median) contribution is 311.08 (80) thousand dollars which can be further decomposed into a mean (median) of 284.87 (80) thousand dollars for lobbying and 26.21 (0) thousand dollars for PAC, respectively. PMC firms, on average, remain in the private domain for longer periods, are larger, relate to improved profitability, and are more likely to operate in industries which are heavily regulated or reliant on government purchases. In addition, PMCs affect the likelihood of resorting to venture capital, a financing option which is utilized by the majority of IPOs in the full sample, but is underrepresented in the PMC sample. Notably, the significantly lower IPO underpricing, confirms the inverse association between the foremost cost of raising initial equity capital and political connections (Fan et al., 2007; Francis et al., 2009).

Rather than suggesting a particular IPO strategy, the tendency of PMC issuers to recognize high discretionary accruals may be attributable to factors external to the going-public process and common to the universe of politically connected firms. Prior studies (Chaney et al., 2011; Ahmed et al., 2018) describe at least two conduits through which PMCs could increase accruals' magnitude for the cross-section of donor firms as political connections may serve to insulate firms from market and regulatory pressures, causing managers to neglect the accounting quality and defy the legal repercussions of opportunism, respectively. In addition, the broader literature on accounting discretion (e.g., Perotti and Windisch, 2017; Baik et al., 2020) argues that high discretionary accruals may be a recurring phenomenon to mitigate the variation in earnings from one reporting period to the next (smoothening). Because our main aim in the paper, the identification of the prevailing reporting incentives at IPO, is meaningful only to the extent that this period prompts reporting behavior that one would generally not observe in a conventional (non-IPO) period, we expand our time window to analyze the time series patterns of discretionary accruals over five years $[t = -2, t = 3]$ around the IPO year $(t = 0)$. In the spirit of prior research (Aharony et al., 1993; Aharony et al., 2000), we supplement the accruals analysis with the examination of two key performance measures, the ROA and cash flow from operations (CFO), which provide an important context for evaluating the observed pattern in accruals. Table 3 compares the mean and median values of these variables between PMC and non-PMC issuers for each year surrounding the IPO. The results support two main inferences. First, we note that the time frame that generates systematic differences in accruals by PMC status is confined to the years that most closely surround the year of issue $[t = -1, t = 1]$, with the two subsamples reporting statistically indistinguishable mean and median DAC at $t = -2, 2,$ and 3. Consequently, we can rule out the possibility that the higher discretionary accruals of PMC issuers simply reflect systematic (i.e., unrelated to the IPO) differences between politically connected firms and their non-connected peers. Second, the analysis of the ROA and CFO shows that PMC issuers strongly outperform the rest of the issuers. Notably, while the discretionary accruals of PMC issuers reach a peak in the IPO year, the performance of these firms continues to rise in each of the subsequent years, which offers some important first indication in support of the signaling hypothesis.

The pairwise correlations of the variables feature in Table 4; the Spearman rank-order and Pearson correlation coefficients appear above and below the main diagonal, respectively. The reported coefficients have important methodological implications for the subsequent multivariate analysis, while also supporting inferences that are interesting in their own right. We first note the positive correlation between DAC and REM. This evidence contrasts with prior studies that show

Table 1
IPO distribution. This table presents the distribution of 1,082 U.S. IPOs from 1 January 1998 to 31 December 2013 by year, industry, and PMC type. The respective distributions for the sub-samples of IPOs with and without PMC activity supplement full-sample analysis. Years of midterm and presidential elections are indicated by ✓. All IPOs are retrieved from the Thomson Reuters' SDC new issues database. The sources for lobby and PAC contributions comprise the electronic archives of the Center for Responsive Politics (CRP) and the Federal Election Commission's (FEC) files of candidate contributions, respectively.

Panel A: IPO distribution by year

Year	Midterm election	Presidential election	All IPOs (*N* = 1,082)		PMC IPOs (*N* = 177)		Non-PMC IPOs (*N* = 905)	
			N	*% of all*	*N*	*% of year*	*N*	*% of year*
1998	✓		115	10.63	7	6.09	108	93.91
1999			187	17.28	7	3.74	180	96.26
2000	✓	✓	93	8.60	6	6.45	87	93.55
2001			23	2.13	5	21.74	18	78.26
2002	✓		32	2.96	7	21.88	25	78.13
2003			31	2.87	2	6.45	29	93.55
2004	✓	✓	100	9.24	16	16.00	84	84.00
2005			80	7.39	22	27.50	58	72.50
2006	✓		90	8.32	11	12.22	79	87.78
2007			90	8.32	24	26.67	66	73.33
2008	✓	✓	12	1.11	4	33.33	8	66.67
2009			34	3.14	14	41.18	20	58.82
2010	✓		53	4.90	10	18.87	43	81.13
2011			44	4.07	14	31.82	30	68.18
2012	✓	✓	50	4.62	17	34.00	33	66.00
2013			48	4.44	11	22.92	37	77.08

Panel B: IPO distribution by industry

Industry name	SIC code	All IPOs		PMC IPOs		Non-PMC IPOs	
		N	*% of all*	*N*	*% of industry*	*N*	*% of industry*
Oil and gas	13	26	2.40	11	42.31	15	57.69
Food products	20	15	1.39	4	26.67	11	73.33
Chemical products	28	134	12.38	25	18.66	109	81.34
Manufacturing	30–34	28	2.59	7	25.00	21	75.00
Computer equipment and services	35, 73	367	33.92	33	8.99	334	91.01
Electronic equipment	36	94	8.69	11	11.70	83	88.30
Scientific instruments	38	71	6.56	10	14.08	61	85.92
Transportation and public utilities	40–49	86	7.95	29	33.72	57	66.28
Wholesale and retail trade	50–59	98	9.06	9	9.18	89	90.82
Entertainment services	70, 78, 79	18	1.66	2	11.11	16	88.89
Health services	80	25	2.31	7	28.00	18	72.00
All others	1, 7, 12, 14, 15, 17, 23–27, 29, 37, 39, 72, 75, 82, 83, 87, 96	120	11.09	29	24.17	91	75.83
Total	56	1,082		177		905	

Panel C: IPO distribution by PMC type

	Lobby	PAC	Lobby & PAC	Just lobby	Just PAC
N	166	61	50	116	11
% of PMC IPOs	93.79	34.46	28.25	65.54	6.21
% of all IPOs	15.34	5.64	4.62	10.72	1.02

firms to treat the two methods as substitutes (e.g., Badertscher, 2011; Zang, 2012), highlighting the need to test for both earnings management types in subsequent analysis. At the same time, both correlation types display a higher coefficient between PMC dummy and DAC than PMC dummy and REM, implying that issuers prefer to manipulate accounting accruals rather than real activities. Second, we document the prevalence of PMCs among the more established and successful firms, calling for a research design that accounts for the confounding influence of firm age, profitability, and size. Beyond the nexus between PMCs and firm characteristics, we observe the differential correlation between DAC and key financial intermediaries of the going-public process. Although DAC is negatively associated with reputable auditors, the two correlation types report coefficients with opposite signs for top-tier underwriters and the presence of venture capital. Panel B mirrors PMC firms' tendency to blend both PMC types, lobbying and PAC, as part of their political strategy. It also shows how total PMC expenditure, and each of the two contribution types separately, relate to a number of PMC determinants suggested by the relevant literature (e.g., Zardkoohi, 1985; Hart, 2001). Because none of the reported correlations raises multicollinearity concerns, we use these variables to calculate the firm's PMC likelihood in multivariate analysis.

Table 2
Descriptive statistics. This table presents descriptive statistics of key variables used in the study for a sample of 1,082 U.S. IPOs from 1 January 1998 to 31 December 2013 and the sub-samples of PMC and non-PMC IPOs. The differences in sub-sample means and medians are compared by t-tests and Wilcoxon rank sum tests, respectively. All variables are defined in the Appendix. The accounting data are retrieved from Compustat and the stock market data come from the Center for Research in Security Prices (CRSP). Lobby and PAC contributions information is hand-collected from the electronic archives of the Center for Responsive Politics (CRP) and the Federal Election Commission's (FEC) files of candidate contributions, respectively.

Variables	All IPOs (*N* = 1,082)		PMC IPOs (*N* = 177)		Non-PMC IPOs (N = 905)		Difference in mean (p-value)	Difference in median (p-value)
	Mean	Median	Mean	Median	Mean	Median		
DAC	−0.02	0.01	0.03	0.02	−0.03	0.01	0.000	0.021
REM	−1.16	−0.39	−0.29	−0.19	−1.33	−0.42	0.078	0.002
PMC dummy	0.16	0.00	1.00	1.00	0.00	0.00	0.000	0.000
PMC total *(in thousand USD)*	46.58	0.00	311.08	80.00	0.00	0.00	0.000	0.000
- Lobby money *(in thousand USD)*	42.65	0.00	284.87	80.00	0.00	0.00	0.000	0.000
- PAC money (*in thousand USD)*	3.92	0.00	26.21	0.00	0.00	0.00	0.000	0.000
Firm age	16.93	9.00	27.46	13.00	14.87	8.00	0.000	0.000
Revenues (*in million USD)*	579.82	82.64	2,273.76	323.42	248.52	69.30	0.000	0.000
Market value (*in million USD)*	1,128.20	409.47	3,020.86	817.92	758.03	373.12	0.000	0.000
Book-to-market	0.31	0.24	0.31	0.29	0.31	0.24	0.766	0.037
Leverage	0.75	0.66	0.74	0.71	0.75	0.65	0.819	0.388
CAPEX	0.06	0.04	0.06	0.04	0.06	0.04	0.629	0.903
Industry-adjusted ROA	−0.26	−0.03	−0.10	−0.01	−0.29	−0.05	0.000	0.000
Loss dummy	0.52	1.00	0.42	0.00	0.54	1.00	0.006	0.007
Big6 auditor	0.90	1.00	0.89	1.00	0.90	1.00	0.589	0.586
Top-tier underwriter	0.47	0.00	0.51	1.00	0.46	0.00	0.220	0.221
Venture capital	0.52	1.00	0.41	0.00	0.55	1.00	0.001	0.001
Underpricing	0.27	0.11	0.17	0.07	0.29	0.12	0.004	0.037
Regulated	0.10	0.00	0.23	0.00	0.08	0.00	0.000	0.000
Government purchases	0.12	0.00	0.15	0.00	0.11	0.00	0.001	0.001
Bills Introduced	6,136.41	5,815.00	6,469.32	6,540.00	6,071.30	5,815.00	0.000	0.000
State PMC	191.89	109.00	231.97	133.00	184.05	109.00	0.009	0.006
Electoral College	29.45	20.00	26.11	16.00	30.10	29.00	0.015	0.033

Table 3
Discretionary accruals and performance measures surrounding the IPO year. This table presents the time-series patterns of discretionary accruals (DAC), return on assets (ROA), and cash flow from operations (CFO) from two years before and until three years after the IPO for all issuers, and the subsamples of PMC and non-PMC IPOs. The reported statistics include the means, medians, and their between comparisons by t-tests and Wilcoxon rank sum tests, respectively, for PMC and non-PMC IPOs. The number of observations in each year varies due to data availability.

	All IPOs			PMC IPOs			Non-PMC IPOs			Difference between PMC and non-PMC IPOs in:	
	Mean	Median	*N*	Mean	Median	*N*	Mean	Median	*N*	Mean (p-value)	Median (p-value)
DAC											
−2	−0.01	0.00	595	0.00	0.01	81	−0.01	0.00	514	0.194	0.242
−1	−0.01	0.01	1056	0.03	0.02	173	−0.02	0.01	883	0.008	0.037
0	−0.02	0.01	1082	0.03	0.02	177	−0.03	0.01	905	0.000	0.021
1	−0.01	0.01	924	0.01	0.00	151	−0.01	0.01	773	0.025	0.083
2	0.00	0.00	816	0.00	0.00	133	0.00	0.00	683	0.111	0.150
3	0.00	0.00	703	0.00	0.00	115	0.00	0.00	588	0.272	0.256
ROA											
−2	−0.14	−0.06	595	−0.10	−0.05	81	−0.16	−0.06	514	0.205	0.123
−1	−0.27	−0.06	1056	−0.08	−0.04	173	−0.32	−0.06	883	0.001	0.000
0	−0.23	−0.04	1082	−0.08	−0.02	177	−0.27	−0.04	905	0.002	0.000
1	−0.23	−0.03	924	−0.04	0.01	151	−0.28	−0.04	773	0.001	0.000
2	−0.28	−0.03	816	0.01	0.02	133	−0.33	−0.05	683	0.000	0.000
3	−0.23	−0.01	703	0.04	0.02	115	−0.27	−0.03	588	0.000	0.000
CFO											
−2	−0.10	−0.05	595	−0.06	−0.01	81	−0.12	−0.07	514	0.089	0.013
−1	−0.08	0.00	1056	0.01	0.05	173	−0.09	−0.02	883	0.021	0.000
0	−0.03	0.02	1082	0.02	0.06	177	−0.03	0.01	905	0.054	0.006
1	−0.08	0.04	924	0.05	0.09	151	−0.09	0.02	773	0.009	0.000
2	−0.13	0.04	816	0.05	0.09	133	−0.15	0.02	683	0.005	0.000
3	−0.05	0.05	703	0.06	0.10	115	−0.06	0.03	588	0.010	0.000

Table 4
Correlation matrix. This table presents the pairwise correlations of variables used in the study for a sample of 1,082 U.S. IPOs from 1 January 1998 to 31 December 2013. Panels A and B present the correlations of the IPO and PMC-related variables, respectively. The correlation method is Spearman (Pearson) above (below) the main diagonal. All variables are defined in the Appendix.

Panel A: IPO variables

		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)
1.	DAC	1.00	0.16	0.17	0.20	0.17	0.05	0.09	−0.12	−0.05	0.00	−0.15	0.16	0.08	0.19	−0.11
2.	REM	0.06	1.00	0.05	0.05	0.10	0.05	0.03	−0.11	0.06	0.03	−0.25	0.16	0.01	0.30	−0.28
3.	PMC dummy	0.11	0.01	1.00	0.20	−0.08	−0.03	0.00	0.23	−0.01	0.04	−0.10	0.27	0.02	0.07	−0.06
4.	Firm age	0.13	−0.06	0.21	1.00	0.36	0.20	0.00	0.06	−0.03	0.08	−0.35	0.38	0.14	0.14	−0.17
5.	Loss dummy	0.12	0.07	−0.08	−0.28	1.00	0.23	0.10	0.06	−0.08	−0.02	0.34	−0.11	−0.27	−0.14	0.04
6.	Leverage	−0.13	−0.09	−0.01	0.06	0.12	1.00	0.08	0.01	−0.00	0.03	−0.18	0.22	−0.07	−0.19	−0.10
7.	CAPEX	0.08	0.04	−0.01	−0.04	0.05	0.10	1.00	0.05	0.00	0.00	0.04	−0.10	0.03	0.01	−0.02
8.	Market value	0.00	−0.00	0.19	0.14	−0.07	−0.03	0.01	1.00	0.15	0.32	−0.03	0.41	0.02	−0.30	0.31
9.	Big6 auditor	−0.02	0.04	−0.01	0.02	−0.08	−0.02	0.01	0.05	1.00	0.20	0.19	0.05	−0.05	−0.09	0.09
10.	Top-tier underwriter	−0.09	0.03	0.04	0.09	−0.02	−0.03	0.03	0.02	0.20	1.00	0.05	0.02	−0.04	−0.09	0.05
11.	Venture capital	0.00	−0.02	−0.10	−0.38	0.34	−0.12	0.03	−0.04	0.19	0.05	1.00	−0.39	−0.12	−0.15	0.16
12.	Revenues	0.04	0.02	0.17	0.24	−0.08	0.01	−0.01	0.56	0.03	−0.01	−0.10	1.00	0.25	0.12	−0.04
13.	Industry-adjusted ROA	0.12	0.06	0.04	0.09	−0.37	−0.25	−0.00	0.07	−0.08	0.03	−0.08	0.10	1.00	0.11	−0.01
14.	Book-to-market	0.07	0.05	−0.00	0.08	−0.15	−0.24	−0.04	−0.07	−0.05	−0.10	−0.13	0.04	0.07	1.00	−0.35
15.	Underpricing	−0.03	−0.07	−0.09	−0.18	0.14	−0.05	0.04	0.09	0.08	0.05	0.18	−0.04	0.02	−0.22	1.00

Panel B: PMC variables

		(16)	(17)	(18)	(19)	(20)	(21)	(22)	(23)
16.	PMC total	1.00	0.97	0.53	0.10	0.12	0.21	0.06	−0.07
17.	Lobby money	0.99	1.00	0.41	0.11	0.11	0.22	0.11	−0.06
18.	PAC money	0.48	0.39	1.00	0.08	0.15	0.06	0.07	−0.05
19.	Regulated	0.07	0.06	0.09	1.00	0.21	−0.01	0.07	−0.03
20.	Government purchases	0.11	0.10	0.10	0.21	1.00	0.05	0.08	−0.08
21.	Bills introduced	0.06	0.05	0.05	0.06	0.05	1.00	0.23	−0.03
22.	State PMC	0.08	0.07	0.09	0.03	0.02	0.23	1.00	−0.00
23.	Electoral college	−0.06	−0.06	−0.06	−0.10	−0.07	−0.03	0.05	1.00

4. Multivariate analysis

This section proceeds in three steps. First, we examine how PMCs interact with issuers' accounting discretion at the time of the IPO. Then, we trace post-issue performance and survivorship. Finally, we identify environmental and industry-specific factors that are likely to amplify the divide between PMC and non-PMC issuers' accrual choices.

4.1. The effect of PMC involvement on IPO reporting

To assess the influence of PMCs on accounting discretion net of confounding factors, we specify the following equation:

$$\begin{aligned} DAC_{i,t} = {} & \alpha_0 + \beta_1 PMC\ dummy_i + \beta_2 Log(firm\ age + 1)_{i,t} + \beta_3 Log(revenues)_{i,t-1} + \beta_4 Leverage_{i,t-1} + \beta_5 Loss\ dummy_{i,t-1} \\ & + \beta_6 Industry - adjusted\ ROA_{i,t-1} + \beta_7 Big6\ auditor_{i,t} + \beta_8 Top - \text{tier underwriter}_{i,t} + \beta_9 Venture\ capital_{i,t} \\ & + \beta_{10} CAPEX_{i,t-1} + Industry\ dummies + Year\ dummies + \varepsilon_i \end{aligned} \quad (3)$$

where *DAC* are the discretionary accruals in the offering year and *PMC dummy* flags PMC activity, whether in the form of lobbying or PAC. We control for several firm- and IPO-specific characteristics which could impact DAC choices. The first control is *firm age*. Younger firms tend to have less robust management and accounting control systems. At the same time, the liability of newness increases earnings volatility, which fuels concerns about firm survival (Lee and Masulis, 2011). Thus, earnings management is not only easier to pursue but also provides a means of asserting the firm's prospects. Another important, yet controversial, factor is firm size. An extended scope of operations and complexity in financial structures provides managers with greater latitude to make operating and accounting decisions which inflict bias on earnings. On the other hand, large firms attract closer attention from market participants, which may act as a deterrent to earnings management. We proxy for firm size with *revenues*. *Leverage* also gives rise to opposing predictions: highly leveraged firms are inclined to overstate earnings to prevent debt covenant violations but are frequently subjected to monitoring from debtors, which leaves less freedom in terms of accounting discretion (Franz et al., 2014). Furthermore, we include a *loss dummy* for the possibility that firms manipulate earnings to report positive profitability, which Degeorge et al. (1999) view as the predominant behavioral threshold for earnings management. By the inclusion of *industry-adjusted ROA,* we control for false indication of high discretionary accruals in firms with unusual performance (Kothari et al., 2005). In addition, high quality auditors, such as a *Big6 auditor*, are more capable of detecting misreporting, thereby improving the quality of accounting disclosures (Gul et al., 2009). Prior studies also advocate the role of a *top-tier underwriter* and *venture capital* in restraining earnings management around IPOs (Morsfield and Tan, 2006; Lee and Masulis, 2011; Wongsunwai, 2013). Finally, we proxy for growth with *CAPEX* as in Fan (2007). Growth firms derive much of their value from high growth opportunities with a commensurately high degree of uncertainty. This creates a relatively safe environment to inflate reported performance, as the intrinsic value of the firm is, in any case, hard to determine. Detailed descriptions of all variables feature in the Appendix.

A major concern in estimating equation (3) relates to the endogeneity of the firm's decision to pursue an active political strategy. Clearly, firms determine whether they set aside a political budget, and they choose to do so when the anticipated benefits outweigh the sum of foreseeable costs, inclusive of nonmonetary costs. Endogeneity arises when the firm characteristics that determine accruals choices also have a bearing on PMC activity. It is intuitive, for example, that larger organizations can afford a more substantial contribution to political fundraising. Because the non-random assignment of PMCs to sample firms undermines the validity of OLS estimates, we apply three alternative econometric methods that jointly support least biased inferences: the Heckman treatment effect procedure, maximum likelihood estimation (MLE), and the generated instrumental variables (IV) approach.

Common to all three methods is a selection equation that models the probability of the endogenous regressor, i.e., *PMC dummy*. In specifying the selection equation, we frame the PMC decision in terms of factors that recur in the literature for their capacity to stimulate corporate political activity (Zardkoohi, 1985; Hart, 2001; Cooper et al., 2010; Gounopoulos et al., 2017). These factors pertain to the firm's resource availability, proxied by *revenues*; the industry's policy sensitivity, proxied by *regulated* and *government purchases*; and the overall PMC demand, proxied by the number of *bills introduced* in each two-year Congress and the size of the *Electoral College* in the state where the firm is headquartered. To satisfy the exclusion restriction, we use the instrument *state PMC*, defined as the number of firms with lobbying or PAC contributions in the state of the issuer's headquarters during the year of its IPO. In our calculation, we exclude the issuer's industry at the 2-digit SIC code level. Thus, we rule out the possibility that issuers' accounting is influenced by the PMC behavior of other firms in the industry, even at the state level.

The Heckman (1979) procedure for addressing self-selection bias involves two-stage estimation. Firstly, the *PMC dummy* is regressed on its key determinants as well as the exogenous determinants of the outcome variable. The predicted values from this regression allow the estimation of a selectivity correction term, the *Inverse Mills Ratio (IMR),* which is assumed to represent the omitted variable in the outcome equation. In the second stage, the inclusion of the *IMR* dispels the bias in OLS estimation. Outside the Heckman framework, and assuming a bivariate normal distribution of the selection-outcome error terms, we estimate the system via MLE. Although subject to a stronger assumption, this method processes the two equations simultaneously and is therefore more efficient. A criticism of treatment effect models concerns their sensitivity to the selection equation variables (see, for example, Briggs, 2004). In this respect, the IV method has an important

advantage. Because it instruments the endogenous variable by means of the fitted probabilities obtained from the selection equation, a suboptimal specification is less likely to affect the validity of inferences (An and Chan, 2008).

Table 5 presents the resulting coefficients from estimating equation (3) for the full sample of 1,082 IPOs. Across all models, our main variable of interest, *PMC dummy*, yields a positive coefficient which is significantly different form zero, at the 5 percent level for the Heckman and IV methods, and at 1 percent for MLE. This suggests that PMC issuers, on average, exercise their accounting discretion to increase reported earnings, a finding aligned with both the signaling and opportunism hypotheses, but not with the conservatism hypothesis. The control variables prove robust across the models and, when significant, conform to their theoretically predicted function. Specifically, the discretionary accruals are negatively related to the presence of a *Big6 auditor* but positively associated with a firm's growth opportunities (*CAPEX*). As previously discussed, *leverage* and *revenues* are covariates whose influence is ex ante difficult to predict. Because both variables generate significantly negative coefficients, our evidence lends support to monitoring interpretations, whereby issuers adopt a conservative stance on financial reporting when faced with increased scrutiny from debtors and other stakeholders. Econometrically, each of the three methods provides separate justification for its use. The Heckman model yields a significant coefficient on the *IMR* (at the 5% level), which confirms the selectivity problem. Based on the MLE approach, the likelihood-ratio test indicates high correlation (at the 1% level) between the error terms in the two equations. Finally, IV postestimation (i.e., Hausman test) suggests rejection of the null of no endogeneity at 5 percent.

4.2. The effect of PMC level on IPO reporting

As previously reported, variation in PMC amounts can be substantial. This may have different connotations for the nature of the PMC, from a token gesture of appreciation for low amounts to a full-scale political investment for large amounts. Based on the signaling hypothesis, accounting discretion is a means of previewing future economic rents. Alternatively, the opportunism hypothesis predicts that issuers rely on their connections to mitigate the costs of aggressive reporting. Either behavior is likely to be more pronounced toward the high end of the PMC distribution, where the firm-politician relationship is substantiated by very material amounts. To examine whether and how accounting discretion varies with PMC level, we replace the *PMC dummy* with the continuous variable *PMC total*, equal to a firm's total lobbying and PAC contributions, and estimate equation (3) for the subsample of PMC IPOs (N = 177). In supplementary analyses, we reiterate this estimation for three additional variables in order to examine whether a differential effect exists according to PMC type. The first two variables are *lobby money* and *PAC money*, capturing amounts channeled towards lobbying and PAC campaigns, respectively. The third variable, *PMC index*, is the first factor of applying principal component analysis (PCA) to *lobby money* and *PAC money*. An advantageous feature of the PCA method relates to its parsimony, stemming from the ability to summarize the variation in each political strategy into a single linear combination with minimal loss of information.

Table 6 displays the results. In each regression, the PMC proxies obtain positive and statistically significant coefficients. Lobbying and PAC contributions, in spite of their different philosophy and size, both generate coefficients significant at the 5 percent level. We note that the coefficients on the more comprehensive PMC proxies, *PMC total* and *PMC index,* attain statistical significance at the 1 percent level, which is a testament to the complementarity of the two PMC types in nurturing political connections. In conjunction with the full sample evidence, our findings show PMCs to engender income-increasing reporting, with an incremental effect per dollar spent. Contrary to the predictions of the conservatism hypothesis, therefore, when PMC issuers exercise their accounting discretion, evading potential scrutiny and other political costs tends to be a lesser concern.

4.3. Alternative earnings management methods: Real earnings management and restatements

An income-increasing effect is attainable via routes unrelated to accruals choices and, certainly, firms may blend different techniques to reinforce the intended bias in earnings. The reason is intuitively simple: "once we as managers start lying in the earnings management game, it is nearly impossible to stop" (Jensen 2005, 8). Evidence related to the IPO paradigm features in Darrough and Rangan (2005) who document that insider share selling is not only positively associated with discretionary accruals but also negatively associated with R&D spending. If managers in PMC firms are mainly focused on maximizing IPO offer price, they need not confine themselves to accrual-based earnings management. At a greater cost, such as the disruption in operations and the depletion of reputational capital, they could pursue a real earnings management (REM)[6] and/or a non-GAAP earnings management strategy,[7] especially if retail investors, as documented in Gao et al. (2017), are able to detect accruals-based manipulation but not REM. Our tests, however, fail to support the presence of either of these

[6] Roychowdhury (2006) suggests that managers can overstate earnings by employing generous credit policies or price discounts to boost sales, overproducing to reduce the cost of goods sold, and decreasing dicretionary expenditures such as selling, general, and administrative (SG&A), research and development (R&D), and advertising expenses. Accordingly, he employs abnormal cash flow from operations, abnormal production costs, and abnormal discretionary expenses as proxies for REM. We follow Roychowdhury (2006) to compute these proxies. We further account for the potential impact of performance on REM measures by matching REM measures of the IPO firms to those of non-IPO peers based on year, industry, and ROA to generate performance-matched REM measures.

[7] We use financial restatements as a proxy for non-GAAP earnings management (e.g., Badertscher, 2011). This is advantageous because restatements represent an actual event, whereas other earnings management measures depend on the models employed.

Table 5
The effect of PMC involvement on at-issue discretionary accruals. This table presents results of regressions of at-issue discretionary accruals (dependent variable) on a PMC dummy and a set of control variables for a sample of 1,082 U.S. IPOs over the period 1 January 1998 to 31 December 2013. The estimation methods include the Heckman two-stage procedure, maximum likelihood estimation (MLE), and the generated instrumental variables (IV) approach. Discretionary accruals are estimated using the modified Jones (1991) model adjusted for the discretionary accruals of performance-matched non-IPO firms following Kothari et al. (2005). Definitions for all variables feature in the Appendix. All regressions include industry (at the 2-digit level of SIC code) and calendar year dummies. The t-statistics reported in parentheses are based on standard errors adjusted for heteroskedasticity. *, **, and *** denote statistical significance at the 10%, 5% and 1% levels, respectively.

	Heckman		MLE		IV	
	Selection	Outcome	Selection	Outcome	Selection	Outcome
Dependent variable:	PMC dummy	DAC	PMC dummy	DAC	PMC dummy	DAC
PMC dummy		0.943**		0.839***		1.138**
		(2.02)		(6.49)		(2.11)
Log(firm age + 1)	0.429**	−0.404	0.451**	−0.378	0.094***	−0.290
	(2.34)	(-1.08)	(2.52)	(-0.47)	(2.74)	(-0.83)
Leverage	−0.104	−0.369***	−0.095	−0.368**	−0.015	−0.353**
	(-0.83)	(-4.67)	(-0.76)	(-2.12)	(-0.82)	(-2.02)
Loss dummy	−0.131	−0.079	−0.140	−0.066	−0.049*	−0.023
	(-0.99)	(-0.80)	(-1.11)	(-0.80)	(-1.86)	(-0.26)
Industry-adjusted ROA	−0.181	0.178	−0.089	0.184	−0.007	0.201
	(-0.76)	(1.20)	(-0.41)	(0.54)	(-0.30)	(0.58)
Big6 auditor	−0.173	−0.038***	−0.079	−0.037***	−0.011	−0.019***
	(-0.91)	(-3.27)	(-0.44)	(-3.26)	(-0.30)	(-3.12)
Top-tier underwriter	−0.146	0.004	−0.159	0.017	−0.048	0.054
	(-1.24)	(0.05)	(-1.44)	(0.23)	(-1.15)	(0.67)
Venture capital	−0.119	0.157*	−0.105	0.164	0.004	0.162
	(-0.87)	(1.69)	(-0.82)	(1.49)	(0.19)	(1.44)
CAPEX	−1.123	0.035***	−1.011	0.035***	−0.291	0.036***
	(-1.55)	(3.22)	(-1.42)	(6.21)	(-0.55)	(5.98)
Log(revenues)	0.336***	−0.162***	0.416***	−0.170***	0.059***	−0.211***
	(6.09)	(-4.38)	(5.96)	(-4.74)	(3.86)	(-4.60)
Regulated	0.402***		0.412***		0.107***	
	(3.19)		(3.20)		(2.82)	
Government purchases	0.265**		0.259**		0.076**	
	(2.13)		(1.98)		(2.29)	
Bills introduced	0.001**		0.001**		0.001*	
	(1.98)		(2.37)		(1.88)	
Electoral College	−0.003		−0.004		−0.001	
	(-0.37)		(-1.26)		(-0.79)	
State PMC	0.420***		0.486***		0.103***	
	(4.09)		(4.69)		(3.32)	
IMR		−0.538**				
		(-2.05)				
Likelihood ratio test against H_0: ρ = 0 (p-value)				0.000		
Durbin-Wu-Hausman test against H_0: variables are exogenous (p-value)						0.022
Observations		1,082		1,082		1,082

alternative earnings management mechanisms.[8] The absence of REM contrasts with international evidence from Braam et al. (2015) which suggests that firms with ties to their local governments are more inclined to REM because of its stealthier nature. Of additional interest is our investigation of sample firms in different sources (Audit Analytics, General Accounting Office, and the U.S. Government Accountability Office) for restatement of financial information within five years from listing which led to downward revisions of earnings; we find that none of the identified cases is a PMC firm. Hence, the remainder of our study centers on the principal mechanism by which PMC issuers increase reported earnings, i.e., discretionary accruals.

4.4. The post-issue performance of PMC IPOs

To distinguish whether the income-increasing effect of PMC represents an artifact of issuers' opportunism or signaling, we analyze the post-issue performance of PMC IPOs vis-à-vis the performance of IPOs issued by non-PMC firms. Our analysis spans three distinct levels. The first two comprise accounting and stock price performance over a time frame up to three years subsequent to listing. At a final level, we expand the post-IPO period to infer whether PMCs lead to systematic differences in survival likelihood.

[8] In the interest of space, these results are suppressed but are available upon request.

Table 6
The effect of PMC level on at-issue discretionary accruals. This table presents results of OLS regressions of at-issue discretionary accruals (dependent variable) on PMC amounts and control variables for a sample of 177 PMC IPOs over the period 1 January 1998 to 31 December 2013. The PMC amounts are measured as the sum of a firm's lobby and PAC contributions in Model 1; lobby contributions in Model 2; PAC contributions in Model 3; and the first factor of applying principal component analysis (PCA) to lobby and PAC contributions in Model 4. Discretionary accruals are estimated using the modified Jones (1991) model adjusted for the discretionary accruals of performance-matched non-IPO firms following Kothari et al. (2005). Definitions for all variables feature in the Appendix. The regressions include industry (at the 2-digit level of SIC code) and calendar year dummies. The t-statistics reported in parentheses are based on standard errors adjusted for heteroskedasticity. *, **, and *** denote statistical significance at the 10%, 5% and 1% levels, respectively.

Dependent variable:	DAC (1)	DAC (2)	DAC (3)	DAC (4)
Log(PMC total)	0.121***			
	(3.60)			
Log(lobby money)		0.024**		
		(2.05)		
Log(PAC money)			0.051**	
			(2.45)	
Log(PMC index)				0.120***
				(4.37)
Log(firm age + 1)	0.040	0.046	0.025	0.034
	(0.44)	(0.50)	(0.25)	(0.35)
Loss dummy	0.076	0.063	0.029	0.037
	(1.04)	(0.82)	(0.39)	(0.52)
Leverage	0.021	0.001	−0.001	−0.012
	(0.34)	(0.03)	(-0.00)	(-0.17)
CAPEX	0.407***	0.416***	0.473***	0.498***
	(4.85)	(4.83)	(5.68)	(5.84)
Big6 auditor	−0.185***	−0.193***	−0.169***	−0.194***
	(-2.95)	(-3.09)	(-2.77)	(-3.04)
Top-tier underwriter	0.047	0.017	−0.016	0.010
	(0.40)	(0.16)	(-0.13)	(0.08)
Venture capital	−0.021	−0.015	0.016	−0.003
	(-0.26)	(-0.19)	(0.21)	(-0.04)
Industry-adjusted ROA	−0.225	−0.222	−0.210	−0.315
	(-0.81)	(-0.77)	(-0.78)	(-1.17)
Log(revenues)	0.005	0.013	0.034	0.049
	(0.10)	(0.21)	(0.53)	(0.80)
Intercept	0.276	0.267	0.219	0.245
	(0.98)	(0.95)	(0.78)	(0.87)
Adjusted R-squared	0.230	0.229	0.228	0.239
Observations	177	177	177	177

4.4.1. At-issue discretionary accruals and future reported performance

In relating accounting discretion exercised at IPO to future reported performance, we are confronted with the challenge of finding a suitable proxy for the firm's economic performance. Subramanyam (1996) advocates the use of cash flow from operations (CFO) for its ability to remain unaffected by an important drawback of earnings-based measures: the correlation between current and future earnings caused by accrual reversals. However, CFO receives a different type of criticism focused on the lack of timeliness. For example, a negative CFO might arise from heavy investment in positive-NPV projects and therefore need not equate to bad news (Dechow, 1994). Acknowledging the trade-off characterizing either measure, we follow Bowen et al. (2008) and Gounopoulos and Pham (2017) and utilize CFO in parallel to ROA. Thus, our baseline specification obtains the following form:

$$\begin{aligned} Future\ performance_{t+x} = {} & \alpha_0 + \beta_1 DAC_{i,t} + \beta_2 DAC_{i,t} * PMC\ dummy_i + \beta_3 PMC\ dummy_i + \beta_4 At - issue\ performance_{i,t} \\ & + \beta_5 CAPEX_{i,t} + Industry\ dummies + Year\ dummies + \varepsilon_i \end{aligned} \quad (4)$$

where future performance is CFO or ROA measured on an unadjusted and industry-adjusted basis over two time periods: (1) the fiscal year subsequent to the IPO; and (2) the three-year period subsequent to the IPO. Conditional on whether future CFO or ROA is used as the dependent variable, at-issue performance is $CFO_{i,t}$ or $ROA_{i,t}$, respectively, aimed at controlling for potential mean reversion in accounting performance metrics (Bowen et al., 2008). An additional control variable is $CAPEX_{i,t}$, as firms which invest the IPO proceeds tend to exhibit less post-issue underperformance (e.g., Teoh et al., 1998b).

If PMC managers, as predicted by the signaling hypothesis, make accrual choices with the aim of leveling the informational playing field, at-issue discretionary accruals need to constitute reliable predictors of a firm's future performance. By contrast, if managerial intent is aligned with the opportunism hypothesis, the accruals serve the purpose of embellishing current standing and are therefore unrelated to future prospects. We then expect the sum of the estimated coefficients $\beta_1 + \beta_2$ to be significantly different from zero in the former case, but not in the latter. The results of estimating equation (4) feature in Table 7. We observe that both performance measures remain largely unrelated to at-issue accounting discretion as the weak significance documented on β_1 (Columns 1 and 2) disappears when industry-adjusted measures are used.

Table 7

Analysis of future reported performance. This table analyzes post-IPO reported performance based on at-issue discretionary accruals and PMC involvement. Panel A presents results of regressions of post-issue reported performance on at-issue discretionary accruals, a PMC dummy, their between interaction, and control variables. In Model 1, the dependent variable is cash flow from operations (CFO) in the fiscal year following the IPO, scaled by lagged total assets. In Model 2, the dependent variable is return on assets (ROA), measured as net income in the fiscal year following the IPO, scaled by lagged total assets. In Models 3 and 4, the dependent variables are the industry-adjusted (based on the industry median at the 2-digit level of SIC code) CFO and ROA, respectively. Models 5–8 repeat the analysis of Models 1–4, measuring the dependent variables over the three fiscal years following the IPO. Discretionary accruals are estimated using the modified Jones (1991) model, adjusted for the discretionary accruals of performance-matched non-IPO firms following Kothari et al. (2005). The t-statistics in parentheses are based on standard errors adjusted for heteroscedasticity. Panel B compares the post-issue reported performance of PMC and non-PMC IPOs using the propensity score matching (PSM) method of nearest neighbour with replacement and bootstrapped standard errors (100 replications). Columns 1–8 report the average treatment effect on the treated (ATT) for each outcome variable and, in parentheses, the t-statistics. Panel C repeats the analysis of Panel A with the inclusion of the three-way interaction of DAC * PMC dummy * Y2006. Definitions for all variables feature in the Appendix. The full sample includes 1,082 U.S. IPOs over the period 1 January 1998 to 31 December 2013. All regressions include industry and calendar year dummies. *, **, and *** denote statistical significance at the 10%, 5% and 1% levels, respectively.

Panel A	Year t + 1				Year t + 3			
			Industry-adjusted				Industry-adjusted	
Dependent variable:	CFO	ROA	CFO	ROA	CFO	ROA	CFO	ROA
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
DAC	−0.045*	−0.080*	−0.041	−0.059	−0.066	−0.122	−0.072	−0.090
	(-1.80)	(-1.74)	(-1.46)	(-1.21)	(-1.55)	(-0.24)	(-1.53)	(-0.91)
DAC * PMC dummy	0.189**	0.307***	0.151***	0.262***	0.293**	0.402**	0.250**	0.376**
	(2.25)	(2.94)	(2.71)	(2.88)	(2.19)	(2.10)	(2.37)	(2.02)
PMC dummy	0.013***	0.042**	0.022**	0.031**	0.029***	0.091**	0.033**	0.077***
	(2.64)	(2.52)	(2.27)	(2.50)	(2.94)	(2.44)	(2.46)	(2.63)
CFO_t	1.231***		0.836***		1.044***		0.640***	
	(5.18)		(3.33)		(4.05)		(4.24)	
ROA_t		1.619***		0.788***		0.983***		0.331***
		(3.39)		(4.06)		(2.87)		(5.11)
CAPEX	−0.009	−0.011	−0.004	−0.006	−0.013	−0.010	0.005	−0.009
	(-1.25)	(-0.99)	(-1.42)	(-0.75)	(-0.06)	(-0.63)	(0.11)	(-0.44)
Intercept	0.237***	0.173***	0.270***	0.192***	0.283***	0.265***	0.314***	0.252***
	(3.70)	(5.42)	(3.48)	(2.70)	(2.88)	(3.26)	(2.94)	(4.07)
P-value of F-test [DAC + DAC* PMC dummy = 0]	0.007	0.013	0.008	0.022	0.073	0.068	0.030	0.044
Adjusted R-squared	0.240	0.336	0.229	0.291	0.197	0.263	0.186	0.278
Observations	924	924	924	924	703	703	703	703

Panel B	Year t+1				Year t+3			
Dependent variable:			Industry-adjusted				Industry-adjusted	
	CFO	ROA	CFO	ROA	CFO	ROA	CFO	ROA
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
ATT	0.020***	0.051***	0.027***	0.035***	0.047***	0.102***	0.045***	0.089***
	(4.12)	(3.57)	(2.93)	(3.34)	(4.90)	(4.08)	(3.94)	(4.19)

Panel C	Year t+1				Year t+3			
Dependent variable:			Industry-adjusted				Industry-adjusted	
	CFO	ROA	CFO	ROA	CFO	ROA	CFO	ROA
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
DAC	−0.046*	−0.082*	−0.042	−0.060	−0.067	−0.125	−0.074	−0.092
	(-1.83)	(-1.77)	(-1.48)	(-1.23)	(-1.57)	(-0.24)	(-1.55)	(-0.92)
DAC * PMC dummy	0.240**	0.402***	0.198***	0.341***	0.383**	0.526**	0.327***	0.489**
	(2.57)	(3.45)	(3.18)	(3.38)	(2.57)	(2.45)	(2.78)	(2.37)
DAC * PMC dummy * Y2006	−0.072**	−0.121**	−0.094**	−0.107**	−0.089*	−0.173*	−0.078**	−0.121*
	(-2.04)	(-2.11)	(-1.99)	(-2.10)	(-1.88)	(-1.75)	(-2.02)	(-1.90)
PMC dummy	0.013***	0.043**	0.023**	0.032**	0.030***	0.094**	0.034**	0.079***
	(2.75)	(2.60)	(2.36)	(2.55)	(3.06)	(2.53)	(2.55)	(2.74)
Y2006	−0.014	−0.031	−0.012	−0.026	−0.039	−0.044	−0.037	−0.048
	(-0.72)	(-0.63)	(-1.00)	(-0.85)	(-0.12)	(-0.35)	(-0.11)	(-0.43)
CFO_t	1.225***		0.835***		1.050***		0.642***	
	(5.15)		(3.32)		(4.06)		(4.27)	
ROA_t		1.608***		0.785***		0.979***		0.330***
		(3.38)		(4.05)		(2.85)		(5.11)
CAPEX	−0.009	−0.011	−0.004	−0.006	−0.014	−0.010	0.005	−0.009
	(-1.25)	(-1.00)	(-1.42)	(-0.74)	(-0.06)	(-0.63)	(0.10)	(-0.44)
Intercept	0.227***	0.166***	0.258***	0.184***	0.271***	0.254***	0.301***	0.241***
	(3.66)	(5.35)	(3.44)	(2.67)	(2.85)	(3.22)	(2.91)	(4.02)
Adjusted R-squared	0.255	0.357	0.243	0.310	0.210	0.280	0.198	0.294
Observations	924	924	924	924	703	703	703	703

Yet, when we partition accruals based on PMC status, we find that donor firms' accruals are positively correlated with future performance across all specifications, with β_2 attaining significance at 5 percent or higher. In Columns 1–4, the sum of the two coefficients is highly significant, indicating a strong correspondence between accruals and post-issue reported performance. In Columns 5–8, the correspondence persists, albeit to a somewhat weaker degree. Based on these findings, the hypothesized role of PMC issuers' discretionary accruals as a signaling device overshadows interpretations centering on issuers' opportunism.

As previously noted, endogeneity constitutes a likely source of bias in our empirical setting, and in assessing performance outcomes, this concern emerges again strong. On the one hand, PMC firms systematically differ from their non-PMC counterparts in a number of key dimensions. According to the descriptive statistics, they generally have more resources, attain higher profitability, and are less dependent on leverage. On the other hand, the pre-IPO period is characterized by severe cash scarcity since before raising any proceeds, issuers need to incur a series of expenses related to the going-public process (auditing, legal, advertising, etc.). Given the discretionary nature of PMCs, it is therefore plausible that only the better-performing firms opt for this additional financial burden, causing a typical self-selection problem that can bias the OLS estimates as per Heckman (1979). In the remaining portion of our analysis, we address this problem in a twofold manner.

First, we set out to capture the pure effect of PMCs on future reported performance accounting for the influence of confounding factors through the use of the propensity score matching (PSM) method. Rosenbaum and Rubin (1983) advocate that when units that have been subjected to a treatment exhibit as many common attributes as possible with units that have not been treated, outcome comparisons between the two groups are least influenced by self-selection. With the treatment in our case being PMC involvement, we employ the same set of PMC drivers used in the first-stage of the treatment effect models to estimate the PMC likelihood (propensity score) for each firm in our sample. This procedure forms the basis for matching PMC issuers (treatment group) to non-PMC issuers (control group), which enables the estimation of the average treatment effect on the treated (ATT), i.e., the difference in mean performance attributable to PMCs. Panel B of Table 7 reports the ATT values for all different future performance measures. As shown, the ATT values are positive and statistically significant (at the 1 percent), which indicates that PMC issuers systematically relate to better post-IPO performance net of the influence of confounding factors.

In a second attempt to mitigate endogeneity, we exploit an exogenous shock to the political environment to conduct a differences-in-differences (DID) test. Amidst the overall stability characterizing the U.S. electoral system and, by extension, the PMC market, Borisov et al. (2016) identify a notable exception. On 3 January 2006, a prominent lobbyist of the U.S. Congress, Jack Abramoff, admitted to have bribed numerous elected representatives and other officials in key administrative positions. The news sent immediate shockwaves through the American political scene, causing politicians to distance themselves from their corporate sponsors and the latter to confront an unexpected impediment to their political strategy. The capital market consequences of the breakout of the scandal were substantial with sharp stock price declines for firms with prior lobbying expenditure. We use the Abramoff incidence to examine the financial reporting consequences for PMC issuers. If the accruals choices of the latter firms aim to impart information about bright prospects ahead because of politically enabled benefits, the scandal is expected to have made the attainment of these benefits, at least over the short run, more uncertain. In turn, this should have the result of influencing the correspondence between PMC issuers' accruals and future reported performance. To test this prediction, we use the 2006 year dummy, *Y2006*, and augment equation (4) with the three-way interaction term *DAC * PMC dummy * Y2006*. The results, presented in Panel C of Table 7, lend support to our prediction by means of a significantly negative coefficient on the three-way interaction. Specifically, our DID design infers that, for every unit change in DAC, the difference in the future performance between 2006 PMC and non-PMC issuers is smaller than the difference in the future performance between PMC and non-PMC issuers of other years in our period. At the same time, we observe that the coefficient on the two-way interaction remains significantly positive throughout. In addition, it has a higher magnitude in absolute value than the coefficient of the three-way interaction, which reveals a positive net correspondence between the accruals PMC issuers recognize in 2006 and future performance, consistent with the signaling hypothesis. On the whole, by mitigating endogeneity concerns, these tests add further confidence in assigning informational value to PMC issuers' accruals. Our next set of tests investigates the extent to which IPO investors correctly deduce the transmitted information.

4.4.2. At-issue discretionary accruals and stock price performance

A common approach of studies assessing reporting incentives around the IPO is to regress stock returns on at-issue discretionary accruals (e.g., Teoh et al., 1998a; Chen et al., 2013; Gounopoulos and Pham, 2017). An insignificant association is seen as indicative of a market which does not need to revise equity prices, ascribing an informative role to the accruals. If an association does emerge, future earnings are believed to come as a surprise to investors who act in a direction that mitigates the gap between market price and the firm's intrinsic value, suggesting the abuse of accounting discretion at IPO. Our methodological strategy combines an event study with analysis of long-term performance.

The event we use is the announcement of the first-quarter earnings in the fiscal year subsequent to the IPO. We examine how PMCs affect the relationship between at-issue accounting discretion and investors' reaction around this time by calculating the cumulative market-adjusted stock return *(CAR)* over the trading day interval [−1, +1], with 0 relating to the earnings announcement day. We are also interested in the way PMCs shape the relationship between at-issue accounting discretion and long-run stock performance. Because CAR has been identified as a conceptually flawed predictor of long-term performance (Barber and Lyon, 1997), we use the buy-and-hold abnormal return *(BHAR)*, measured from the

day following the release of the annual report for the IPO year to the earlier of the three-year anniversary or delisting date. CAR and BHAR comprise the dependent variables in the following regression model:

$$CAR_{i,q1} \text{ or } BHAR_{i,t1\sim 3} = \alpha_0 + \beta_1 DAC_{i,t} + \beta_2 DAC_{i,t} * PMC\ dummy_i + \beta_3 PMC\ dummy_i + \beta_4 Underpricing_{i,t} + \beta_5 Log(firm\ age + 1)_{i,t} + \beta_6 Book - to - market_{i,t} + \beta_7 Log(market\ value)_{i,t} + \beta_8 Industry - adjusted\ ROA_{i,t} + \beta_9 Venture\ capital_{i,t} + Industry\ dummies + Year\ dummies + \varepsilon_i \quad (5)$$

where *underpricing* is the difference between the offer price and the first-day close; and *book-to-market* is the ratio of book value of equity to market value of equity measured at the end of the IPO day. In the BHAR regression, we include an additional covariate, *market BHR,* calculated as the three-year buy-and-hold return on the CRSP value-weighted index. All control variables are documented by prior research to impact IPO performance (e.g., Ritter, 1991).

In a supplementary set of tests, we apply the Fama and French (1993) three-factor model and the Carhart (1997) four-factor model. This calendar-time portfolio approach, traceable to the seminal studies of Jaffe (1974) and Mandelker (1974), is advocated by Fama (1998) as a way to mitigate potential bias from drawing inferences about long-term performance solely based on BHAR.[9] Accordingly, we divide the sample period by calendar month, construct portfolios which include IPOs within the preceding three-year period, and compute the monthly returns for value-weighted portfolios. As in Chen et al. (2013), we classify firms into portfolios of aggressive earnings management—i.e., firms with an earnings management level above the sample median—and portfolios of conservative earnings management—i.e., firms with an earnings management level below the sample median. In a final step, we use the difference in returns between the portfolios as the dependent variable in the factor models and conduct the intercept test. A significant estimate for the intercept (α), the average monthly abnormal return, indicates a systematic difference in the post-IPO stock performance of earnings management aggressive and earnings management conservative firms, and vice versa. The regression model is estimated separately for PMC and non-PMC firms and, in the three-factor form, is as follows:

$$POSEM_{p,t} - NEGEM_{p,t} = \alpha_P + \beta_m MKT_t + \beta_s SMB_t + \beta_h HML_t + \varepsilon_t \quad (6)$$

where *POSEM – NEGEM* is the return from taking a long position in a positive earnings management IPO portfolio and a short position in a negative earnings management IPO portfolio; *MKT* is the excess monthly return on the CRSP value-weighted index for each calendar month in the sample period; *SMB* is a size premium, measured as the difference in returns between value-weighted portfolios of small and large market capitalization stocks; and *HML* is the difference in returns between value-weighted portfolios of stocks with high book-to-market ratios and stocks with low book-to-market ratios. The Carhart four-factor model derives from the Fama and French three-factor model by the inclusion of a momentum factor capturing the tendency of rising or falling stock prices to continue trading in the same direction. All factors are available at Professor Kenneth French's website, the source of the present study.

We report the results from estimation of the above equations in Table 8. Panel A features the CAR and BHAR regressions, which conclude similarly on the way market investors respond to at-issue accounting discretion upon the announcement of the first-quarter earnings in the fiscal year following the IPO and over the long-term, respectively. In both models, the coefficient on DAC (β_1) is significant and negative, aligned with the prediction that issuers with aggressive financial reporting tend to underperform in the aftermarket (Teoh et al., 1998a). In contrast, the coefficient on the interaction term (β_2) and the sum of the coefficient estimates ($\beta_1 + \beta_2$) remain statistically indistinguishable from zero. Thus, although investors, on average, revise downwards the valuations of issuers associated with income-increasing reporting, they refrain from doing so in light of a traceable PMC record. Panel B reports the intercept estimates based on the calendar-time approach. The Fama and French three-factor model and the Carhart four-factor model generate qualitatively similar results. In both models, the intercepts are insignificant for the PMC sample but highly significant (at the 1 percent level) for all other issuers. Indicative of a differential market response to at-issue discretionary accruals based on issuers' PMC status, this evidence corroborates the inference that PMC IPOs fully impound the informational content of the accruals into stock prices at the time of the IPO, whereas, for non-PMC IPOs, the adjustment remains ongoing several years after the event.

4.4.3. At-issue discretionary accruals and IPO survival

In this part, we extend our investigation to IPO survival to gauge the link between accounting choices made by PMC issuers and their likelihood of failure. The rationale is twofold: (1) on conceptual grounds, a value-maximizing manager would not utilize means that imperil the firm's viability to signal private information; and (2) on methodological grounds, survival offers an unbiased performance measure as it concerns a real event. For this analysis, we track each firm from the issue date to the earlier of delisting or the end of 2018, identifying as failed firms those delisted for negative reasons based on the CRSP codes. To estimate failure risk, we specify a Cox proportional hazards model as follows:

[9] BHAR captures overall investors' experience and hence features widely in long-term performance studies. Yet, Fama (1998) raises several points of concern, the most important referring to the overstatement of short-term estimation error due to compounding, distribution skewness, and cross-correlation arising from overlapping time-periods. Fama identifies the calendar-time approach as a possible treatment for the distribution and cross-correlation challenges.

Table 8
Analysis of post-issue stock performance. This table presents the analysis of the relationship between accounting discretion exercised at IPO and stock performance. Panel A features the regression results of stock returns on at-issue discretionary accruals, a PMC dummy, their between interaction, and control variables. The full sample includes 1,082 U.S. IPOs over the period 1 January 1998 to 31 December 2013. In the CAR model, the dependent variable is the cumulative market-adjusted stock return over the trading day interval [-1, +1] relative to the announcement day of the first-quarter earnings in the fiscal year following the IPO. In the BHAR model, the dependent variable is the three-year buy-and-hold abnormal return, measured from the day following the release of the IPO year annual report to the earlier of the three-year anniversary or delisting. Panel B features the analysis of long-run abnormal stock returns from taking a long position in IPO portfolios with upward earnings management and a short position in IPO portfolios with downward earnings management using the Fama-French three-factor and Carhart four-factor models. Discretionary accruals are estimated using the modified Jones (1991) model adjusted for the discretionary accruals of performance-matched non-IPO firms as in Kothari et al. (2005). Definitions for all variables feature in the Appendix. The regressions include industry (at the 2-digit level of SIC code) and calendar year dummies. The t-statistics reported in parentheses are based on standard errors adjusted for heteroskedasticity. *, **, and *** denote statistical significance at the 10%, 5% and 1% levels, respectively.

Panel A: Stock return performance - event-time approach Dependent variable:	CAR	BHAR
Time window:	*[-1,1] days*	*up to 3 years*
DAC	−0.028**	−0.223*
	(-2.03)	(-1.89)
DAC * PMC dummy	−0.177	−0.152
	(-1.23)	(-0.52)
PMC dummy	0.059	0.139*
	(1.14)	(1.87)
Underpricing	−0.046*	−0.205*
	(-1.71)	(-1.69)
Log(firm age + 1)	0.013	0.254***
	(0.27)	(2.96)
Book-to-market	−0.006**	0.011
	(-2.49)	(0.16)
Log(market value)	0.016	0.191
	(0.99)	(1.42)
Industry-adjusted ROA	0.110*	0.393
	(1.81)	(1.50)
Venture capital	0.084**	−0.118
	(2.14)	(-0.67)
Market BHR		0.688***
		(3.12)
Intercept	0.018	−2.388**
	(0.06)	(-2.31)
P-value of F-test [DAC + DAC*PMC dummy = 0]	0.195	0.243
Adjusted R-squared	0.107	0.164
Observations	1,027	1,082

Panel B: Stock return performance - calendar-time approach	*Fama-French three-factor*	*Carhart four-factor*
PMC	−0.004	−0.004
	(-0.68)	(-0.59)
Non-PMC	−0.011***	−0.011***
	(-3.08)	(-3.06)

$$h(t) = h_0(t)\, exp[\, \beta_1 PMC\ dummy_i + \beta_2 DAC_{i,t} + \beta_3 DAC_{i,t} * PMC\ dummy_i + \beta_4 REM_{i,t} + \beta_5 REM_{i,t} * PMC\ dummy_i + \beta_6 Log(firm\ age + 1)_{i,t} + \beta_7 Log(market\ value)_{i,t} + \beta_8 Venture\ capital_{i,t} + \beta_9 Top - \text{tier}\ underwriter_{i,t} + \beta_{10} Big6\ auditor_{i,t} + \beta_{11} Industry - adjusted\ ROA_{i,t} + \beta_{12} Underpricing_{i,t} + \beta_{13} Book - to - market_{i,t} + \beta_{14} Leverage_{i,t} + \beta_{15} CAPEX_{i,t} + Industry\ dummies + Year\ dummies\,] \quad (7)$$

where $h_0(t)$ is the baseline hazard function with t denoting the time to failure. In our specification, we separately interact *DAC* and *REM* with the *PMC dummy*, as both accruals-based and real earnings management affect IPO failure rates (Alhadab et al., 2014). The control variables include firm and offering characteristics which can potentially influence IPO survival (e.g., Gounopoulos and Pham, 2018). For robustness, we relax the constant hazard assumption and use an accelerated failure time (AFT) model.

Table 9
Survival analysis. This table presents the results of the Cox proportional hazards model and the accelerated failure time (AFT) model for a sample of 1,082 U.S. IPOs over the period 1 January 1998 to 31 December 2013. In the Cox model, the dependent variable is the probability of a firm being delisted for negative reasons based on the CRSP delisting codes until 31 December 2018. In the AFT model, the dependent variable is the natural logarithm of the survival time. Discretionary accruals are estimated using the modified Jones (1991) model and adjusted for the discretionary accruals of performance-matched non-IPO firms as in Kothari et al. (2005). Definitions for all variables feature in the Appendix. Both regressions include industry (at the 2-digit level of SIC code) and calendar year dummies. The t-statistics in the parentheses are based on standard errors adjusted for heteroskedasticity. *, **, and *** denote statistical significance at the 10%, 5% and 1% levels, respectively.

	Cox				AFT			
	Model 1		Model 2		Model 3		Model 4	
	Coefficient	Hazard ratio	Coefficient	Hazard ratio	Coefficient	Time ratio	Coefficient	Time ratio
PMC dummy	−0.950***	0.387	−1.415**	0.243	0.747***	2.111	0.964**	2.621
	(-3.66)		(-1.96)		(4.10)		(2.03)	
DAC	0.356***	1.428	0.554***	1.740	−0.280***	0.756	−0.329***	0.720
	(3.03)		(2.62)		(-3.30)		(-2.59)	
DAC * PMC dummy			−1.135	0.321			0.799	2.223
			(-1.03)				(1.19)	
REM	0.263*	1.301	0.170*	1.185	−0.197**	0.821	−0.107*	0.898
	(1.87)		(1.78)		(-1.99)		(-1.78)	
REM * PMC dummy			1.087**	2.966			−0.722**	0.486
			(2.20)				(-2.27)	
Log(firm age + 1)	−0.011	0.989	0.015	1.015	−0.012	0.989	0.109	1.115
	(-0.21)		(0.03)		(-0.24)		(0.32)	
Log(market value)	−0.573***	0.563	−0.680**	0.506	0.486***	1.625	0.405**	1.500
	(-4.40)		(-2.28)		(4.27)		(2.19)	
Venture capital	−0.299	0.741	−0.351	0.704	0.087	1.091	0.167	1.182
	(-1.52)		(-0.82)		(0.54)		(0.63)	
Top-tier underwriter	−0.517	0.596	−0.521	0.594	0.395	1.485	0.333	1.395
	(-1.25)		(-1.47)		(1.49)		(1.51)	
Big6 auditor	−0.904***	0.405	−1.063**	0.346	0.615***	1.850	0.775***	2.172
	(-3.98)		(-2.19)		(3.31)		(2.62)	
Industry-adjusted ROA	−1.451***	0.234	−1.820***	0.162	1.382***	3.982	0.916**	2.499
	(-4.06)		(-2.76)		(4.35)		(2.37)	
Underpricing	−0.196	0.821	−0.165	0.848	0.239	1.271	0.153	1.166
	(-1.12)		(-0.50)		(1.58)		(0.75)	
Book-to-market	0.555***	1.742	0.509***	1.664	−0.654***	0.520	−0.554***	0.575
	(2.58)		(2.58)		(-3.50)		(-2.99)	
Leverage	0.414***	1.513	0.411***	1.508	−0.547***	0.578	−0.429***	0.651
	(3.15)		(3.16)		(-4.43)		(-3.16)	
CAPEX	−0.001	0.998	0.004	1.004	0.005	1.005	0.002	1.002
	(-0.17)		(0.35)		(0.49)		(0.11)	
Observations	1,082		1,082		1,082		1,082	

Table 9 presents the estimated coefficients from both methods. In the Cox regressions, a significantly negative *PMC dummy* suggests that PMC firms exhibit a lower probability of failure than non-PMC ones. This result, novel to the IPO literature, is of high economic importance. For example, based on the hazard ratio in Model 2, PMC issuers' failure risk is shown to decrease by about three quarters in comparison to the failure risk of their non-PMC counterparts. Consistent with Alhadab et al. (2015), we also observe the adverse impact of *DAC* and *REM* on IPO survival. However, when these variables interact with the *PMC dummy*, an interesting dichotomy emerges. Specifically, the coefficient on *DAC * PMC dummy* becomes statistically indistinguishable from zero, whereas the interaction formed with *REM* yields a significantly positive coefficient. These results remain qualitatively similar in the AFT model. In conclusion, aligned with the signaling hypothesis, we establish that recognizing higher discretionary accruals poses no threat to PMC firms' viability. On the other hand, the manipulation of real activities tends to undermine survival prospects, which justifies our previous evidence indicating that PMC issuers generally refrain from this type of intervention.

4.5. Environmental factors at play in PMC issuers' financial reporting

All of our evidence supports the conclusion that PMC issuers, on average, utilize income-increasing reporting to impart private information. Yet the supply of private information may not remain constant in the cross-section; nor can we assume that any point in time is equally conducive to the practice of signaling. If, as we have posited, discretionary accruals are intended to unblock communication, they should be most valuable when the blockage appears greatest. Moreover, it is important that the accruals are not construed as opportunistic. Accordingly, the final part of our analysis probes the influence of key environmental contingencies on PMC issuers' propensity to use accruals as a signaling device. For a systematic study, we classify such factors in two categories, distinguishing between firms' political dependence and the surrounding political environment.

In assessing the firm's dependencies on politics, we first consider the industry environment. Our rationale is that access to policymakers confers a greater informational advantage when the government, either as a buyer or as a regulator, maintains the capacity to effect industry-wide wealth redistributions. We capture these dependencies by the variables *government purchases* and *regulated*. At the firm-level, we utilize Christensen et al.'s (2017) proxy for sensitivity to policy outcomes, *sensitive*. Because this variable utilizes the ratio of a firm's lobbying expenditure to revenues, it has a twofold advantage: 1) the focus on lobbying ensures that the firm explicitly acknowledges at least some environmental factors as a probable source of risk; and 2) the scale factor provides an indication of the perceived importance of the associated risk. Firms in the top quintile of the ratio's distribution are coded as 1, whereas the remaining firms are coded as 0.

In an additional set of analyses, we factor in the political environment. Chen et al. (2013) advocate the value-relevance of discretionary accruals within low information-uncertainty environments, and Bertrand et al. (2018) show how electoral events can determine corporate decisions. Reflecting on these findings, one might expect PMC issuers to systematically engage in more informative reporting during periods of heightened interest in politics. In the spirit of Bertrand et al. (2018), we capture such periods by the binary variables *midterm* and *presidential* which flag IPOs listed within midterm and presidential election years, respectively. Taking this investigation further, we study time-series results from the national poll survey conducted by the Gallup Organization about "the percentage of Americans who follow national politics very closely" and note the peak in 2012, a year of both midterm and presidential elections.[10] Accordingly, we introduce the binary variable *election 2012*.

In the subsample of PMC IPOs, we regress at-issue discretionary accruals on the interaction of each of the above variables with *PMC total* and present the main results in Table 10. The regressions use all the control variables featuring in Table 6; for brevity, we suppress the resulting coefficients. Panel A establishes political dependence as a key determinant of a PMC firm's accruals choices. The coefficients on the interactions with *government purchases* and *regulated* are positive and statistically significant at the 5 percent level, a result that echoes the centrality of government in the pertinent industries. The coefficient on the interaction with *sensitive* is also positive, attaining all conventional levels of statistical significance. Because of its comprehensive nature, this measure extends the insight obtained at the industry-level by showing that high stakes in politics will generally prompt income-increasing reporting. In relation to the recent literature, our findings tie in with Bradley et al.'s (2016) framing of PMCs as a hedge against policy risk, as well as Christensen et al.'s (2017) contention that politically sensitive firms with active political strategies tend to accumulate a high level of value-relevant private information. Panel B reports the results from the year dummies capturing the political environment. By and large, accruals choices are proven time invariant; of the three proxies, only *election 2012* attains some limited significance (at the 10 percent level) on the interaction term. We view this as indicative of a constant high demand for information on corporate political activity, which is adequately met by the various capital market information intermediaries. From this perspective, PMC firms are shown to constitute de facto low information-uncertainty environments irrespective of the presence of contemporaneous political events. Across all specifications, the significantly positive coefficient on *PMC total* corroborates the robustness of the main finding in our paper.

4.6. Partisan and state effects

This portion of our analysis examines partisan preferences and the local political environment as a probable source of variation in accruals recognition. Our investigation is twofold. We first consider active political strategies. As a top-down decision, PMC activity is bound to reflect managers' own political preferences (Cooper et al., 2010). Additionally, managers' characteristics are known to influence corporate policies (Bertrand and Schoar, 2003; Hutton et al., 2014). A growing body of research has united these empirical regularities by showing that financial reporting choices are also affected by managers' political ideologies. Consistent with the core values of the two major U.S. political parties, spending in support of Republican candidates is associated with conservatism, manifested in a lower level of discretionary accruals, whereas supporting the Democratic party is argued to result in higher accruals (Notbohm et al., 2019; Bhandari et al., 2020). To examine whether and how partisan bias affects PMC issuers' financial reporting, we distinguish PAC contributions by recipients' political party, introducing a *Democratic ratio,* defined as the total PAC amount disbursed to Democratic electoral campaigns over the firm's total PAC expenditure. We use this ratio to form interactions with all of our continuous PMC proxies except *lobby money,* which is not traceable at the recipient's level[11]. Of the remaining PMC proxies, *PMC total* and *PMC index* offer some weak evidence (at the 10% level of statistical significance) in accordance with previous studies documenting higher accruals when the PMC budget is skewed in favor of the Democrats[12]. However, as noted when discussing the sample distribution, only about a third of PMC issuers utilize a PAC. This relative scarcity of PACs, especially as a stand-alone political strategy, prompts caution in interpreting our findings.

The second and final step of our investigation focuses on geography, an alternative and more passive conduit through which partisan bias could reflect on accounting discretion (Gross et al., 2016). In particular, we investigate for systematic differences in financial reporting among issuers located in states that are traditionally known for their political ideology.

[10] Detailed information about the poll and Gallup Organization is available at https://www.gallup.com.

[11] The typical lobbying report filed with the Senate's Office of Public Records only displays the succinct indication that XYZ firm lobbied the "U.S. Senate" or the "U.S. House of Representatives".

[12] For brevity, the results of the tests in this subsection are not tabulated but are available on request.

Table 10
PMC issuers' accounting discretion by political dependence and political environment. This table presents results of OLS regressions of at-issue discretionary accruals (dependent variable) on *PMC total* and its interaction with PMC-related variables. In Panel A, these variables capture the firm's political dependence, proxied, at the industry-level, by *government purchases* and *regulated*, and, at the firm-level, by *sensitive*. In Panel B, the variables relate to the political environment, proxied by *midterm*, *presidential*, and *election 2012*. The sample consists of 177 U.S. IPO issuers with lobbying or PAC activity within the two-year period preceding the IPO day. All regressions include the control variables of Table 6; for expositional simplicity the resulting coefficients are supressed. Discretionary accruals are estimated using the modified Jones (1991) model adjusted for the discretionary accruals of performance-matched non-IPO firms as in Kothari et al. (2005). Definitions for all variables feature in the Appendix. All regressions include industry (at the 2-digit level of SIC code) and calendar year dummies. The t-statistics in the parentheses are based on standard errors adjusted for heteroskedasticity. *, **, and *** denote statistical significance at the 10%, 5% and 1% levels, respectively.

Panel A: Political dependence

	Industry-level		*Firm-level*
Dependent variable: DAC	Government purchases	Regulated	Sensitive
Log(PMC total)	0.104*	0.148**	0.190**
	(1.93)	(2.40)	(2.12)
Log(PMC total) * political dependence	0.079**	0.093**	0.115***
	(2.15)	(2.08)	(2.76)
Political dependence	−0.443**	−0.326	−0.053
	(-2.31)	(-1.59)	(-0.82)
Control variables	Included	Included	Included
Intercept	−0.541	−0.850*	−0.227**
	(-1.48)	(-1.81)	(-2.04)
Adjusted R-squared	0.264	0.255	0.282
Observations	177	177	177

Panel B: Political environment

Dependent variable: DAC	Midterm	Presidential	Election 2012
Log(PMC total)	0.128**	0.130**	0.104**
	(2.09)	(2.35)	(2.22)
Log(PMC total) * political environment	0.031	0.126	0.085*
	(1.10)	(0.92)	(1.81)
Political environment	−0.257	−0.794	−0.323
	(-0.44)	(-1.18)	(-1.43)
Control variables	Included	Included	Included
Intercept	−0.604	−0.621*	−0.655*
	(-1.62)	(-1.70)	(-1.94)
Adjusted R-squared	0.218	0.219	0.241
Observations	177	177	177

To capture this type of home state bias, we construct the variable *Blue state dummy*, indicating whether the headquarters are in a state consistently giving the majority of its votes to the Democratic party from the presidential election of 1996, the recent-most election to the start of the time period in the present study, to 2016, the presidential election most closely following our period end[13]. We use this variable to form an interaction with each PMC proxy. Furthermore, to mitigate the concern that the *Blue state dummy* is confounded by other state-level characteristics, we add state fixed effects to all models. These tests (untabulated) invariably generate insignificant coefficients on the *Blue state dummy* and the interaction terms, corroborating the robustness of our baseline results. Moreover, in conjunction with the evidence reported in the earlier subsection showing PMC issuers' accruals to remain invariant to the broader political environment, we demonstrate that this invariance also extends to the local (at the state level) political environment and, to a large extent, to issuers' own partisan preferences.

4.7. Investment in working capital and additional robustness tests

The ability to finance working capital investment comprises one of the main reasons for firms to transition into the public domain and when the IPO proceeds enable this investment, the magnitude of accruals mechanically increases. Premised on this intuition, Armstrong et al. (2016) use a large sample of U.S. IPOs to illustrate that when the working capital changes of the listing year are accounted for, earnings management is significantly less pervasive than depicted by prior literature. The authors therefore argue that for a more powerful test for misreporting, one should explicitly consider the influence of this confounding factor. The entirety of the evidence reported in our paper suggests against misreporting. However, in order to instill additional confidence in that the high magnitude of the accruals taken by PMC firms is incremental to normal economic activity, i.e., the investment of IPO proceeds in working capital, we follow Armstrong et al. and define the variable *Proceeds* as the amount of proceeds raised at IPO scaled by average assets, and the dichotomous variable *Intent*, set equal to 1 for IPO issuers that indicate working capital investment as the intended use of proceeds. We use these variables as addi-

[13] Specifically, the *Blue state dummy* is equal to 1 for issuers that, at the time of the IPO, were based in any of the following states: CA, CT, DE, HI, IL, MD, MA, MN, NJ, NY, OR, RI, VT, and WA.

Table 11
PMC involvement, discretionary accruals, and proceeds invested in working capital. This table presents the analysis of the relationship between discretionary accruals and PMC involvement controlling for the influence of IPO proceeds invested in working capital. The full sample includes 1,082 U.S. IPOs over the period 1 January 1998 to 31 December 2013. All estimations are repeated for the subsample of 548 IPOs that occurred during the first half of their fiscal year. Panel A presents results of regressions of at-issue discretionary accruals (dependent variable) on the PMC dummy, Proceeds, Intent, and all of the control variables used in Table 5. Discretionary accruals are estimated using the modified Jones (1991) model adjusted for the discretionary accruals of performance-matched non-IPO firms following Kothari et al. (2005). Proceeds are defined as the dollar amount of funds raised at IPO scaled by average assets. Intent is a dichotomous variable coded 1 for IPOs indicating investment in working capital as the intended use of proceeds. The estimation methods include the Heckman two-stage procedure, maximum likelihood estimation (MLE), and the generated instrumental variables (IV) approach. Panel B reports the average treatment effect on the treated (ATT) using the propensity score matching (PSM) method of nearest neighbour, with replacement and bootstrapped standard errors (100 replications). All regressions include industry (at the 2-digit level of SIC code) and calendar year dummies. The t-statistics, reported in parentheses, are based on standard errors adjusted for heteroscedasticity. *, **, and *** denote statistical significance at the 10%, 5% and 1% levels, respectively.

Panel A: Treatment effects and IV estimation
Dependent variable: DAC

	Heckman		MLE		IV	
	All IPOs	1st half of FY	All IPOs	1st half of FY	All IPOs	1st half of FY
PMC dummy	0.918**	0.281***	0.850***	0.317***	1.189**	0.224**
	(2.40)	(2.66)	(3.92)	(4.46)	(2.07)	(2.55)
Proceeds	0.075	0.051*	0.075	0.040*	0.083	0.046*
	(1.38)	(1.71)	(1.46)	(1.69)	(1.27)	(1.92)
Intent	0.034**	0.152**	0.037**	0.073***	0.037**	0.144**
	(2.12)	(2.27)	(2.19)	(3.05)	(2.08)	(2.42)
Controls	Included	Included	Included	Included	Included	Included
Observations	1,082	548	1,082	548	1,082	548

Panel B: PSM
Dependent variable: DAC

	All IPOs	All IPOs with *proceeds* and *intent*	1st half of FY	1st half of FY with *proceeds* and *intent*
ATT	0.750**	0.647**	0.296**	0.331**
	(2.53)	(2.51)	(2.42)	(2.49)

tional covariates in equation (3). If the increase in PMC issuers' accruals is mainly attributable to working capital, we expect their inclusion to make the coefficient of the *PMC dummy* statistically indistinguishable from zero. To challenge further the robustness of our findings, we extend this analysis to a subsample of issuers that are particularly likely to exhibit high accruals because of working capital investment. Armstrong et al. intuitively argue that discretionary accruals are more (less) likely to reflect investment in working capital when the IPO occurs earlier (later) in the issuer's fiscal year. Accordingly, we draw separate evidence from 548 firms that went public within the first half of their fiscal year. Panel A of Table 11 presents the results of estimating equation (3) with all three econometric methods used in our main analysis for the full sample and the sample of early IPOs. As shown, the coefficient of the *PMC dummy* remains qualitatively unchanged, significant at the 5 percent level or higher. The fourth and final method we apply is PSM. Panel B presents the resulting ATT values, i.e., the difference in mean DAC between PMC and non-PMC issuers attributable to PMCs. The ATT values remain significant at 5 percent with and without the inclusion of *Proceeds* and *Intent*. They are also invariant to the sampling method. Overall, these tests provide comfort that the observed accruals choices are not an artefact of working capital investment financed by the newly raised equity.

In untabulated tests, we challenge our results further by: (1) measuring discretionary accruals using the Dechow and Dichev (2002) model, modified by McNichols (2002) and Francis et al. (2005), in which current working capital accruals are regressed on past, present and future cash flows, change in sales and PPE; (2) estimating the Heckman regression without the exclusion restriction solely identified by the nonlinearity of the IMR; (3) weighting PMCs by IPO proceeds; and (4) expanding the PMC time frame to 5 years before the IPO date as in Gounopoulos et al. (2017). Invariably, these tests corroborate the main findings of the study.

5. Conclusion

In this paper, we explore how firms with active political strategies exercise their accounting discretion in IPO financial reporting. To date, the literature supports two broad conclusions about the role of firm-level political connections. The first is that they culminate in substantial wealth creation; the second is that they undermine the informativeness of financial disclosures. We use the former conclusion to challenge the pervasiveness of the latter in a corporate event traditionally vulnerable to opportunistic reporting. Our rationale is that political favoritism may generate countervailing incentives, larger than currently documented in the literature, to make accounting choices aimed at lessening friction due to information asymmetries.

Using hand-collected evidence from the U.S., we find that the money spent on politics strongly relates to income-increasing reporting at IPO. Considering probable sources of bias—i.e., self-selection and measurement error—and alternative

strategies to increase earnings—i.e., real and outside GAAP earnings management—we show that the effects remain robust and exclusive to accrual-based earnings management, conforming to both opportunistic and signaling interpretations. Post-issue analysis reveals that the discretionary accruals become fully embodied into stock prices upon issuance and predict reported performance in the subsequent years. In the long run, politically connected firms exhibit a significantly higher survival likelihood than their non-connected peers. Together, these findings justify the accounting discretion exercised in the going-public process and lend support to the use of discretionary accruals as a signaling device. Reinforcing this function, income-increasing reporting is shown to escalate among issuers that tend to be more dependent on politics.

By broadening our understanding of the manner in which political connections interact with financial reporting, this study becomes subject to an important caveat. Our results may not be extrapolated to other settings as conclusive evidence against opportunism, the ample room for which we expose in previous sections. Instead, they emphasize the complex tensions in financial reporting in light of concurrent political objectives, and how accounting discretion can serve various motivations, including the motivation to preview expected political gains that are difficult to communicate in other ways. Because value-relevant accounting is reconcilable with an active political strategy, investors need to be attentive, and the evidence from IPOs confirms that they are generally attentive to contextual characteristics that are likely to determine a firm's supply of private information and the disclosure barriers relating to it. This latter finding also resolves a perplexing notion in the recent IPO literature about the signaling capacity of low-cost political strategies, suggesting that they critically hinge on issuers' discretionary accruals for substantiation.

Declaration of Competing Interest

The authors declare that they have no known competing financial interests or personal relationships that could have appeared to influence the work reported in this paper.

Acknowledgements

We are grateful to Professor Marco Trombetta (Editor-in-Chief), an Associate Editor, and two anonymous Reviewers for their guidance and insightful comments. We are also indebted to Tim Loughran, Robin Lumsdaine, Jay Ritter, Nickolaos Travlos, Silvio Vismara, Andrew Wood and all conference and research seminar participants who provided helpful comments and suggestions. All remaining errors are our own.

Appendix A Variable definitions

Variable	Description	Data sources
Panel A: Earnings management		
DAC	Discretionary accruals estimated using the modified Jones (1991) model and adjusted for discretionary accruals of a performance-matched non-IPO firm as per Kothari et al. (2005). The methodology is described in detail in subsection 3.3.	Compustat
REM	Aggregate measure of real earnings management computed as the sum of three real earnings management proxies: abnormal cash flow from operations, abnormal production costs, and abnormal discretionary expenses. The real earnings management proxies are estimated following Roychowdhury (2006). The values of abnormal cash flow from operations and abnormal discretionary expenses are multiplied by (-1), so that higher values indicate higher real earnings management.	Compustat
Panel B: Firm and IPO characteristics		
Firm age	Number of years elapsing between the firm's foundation and the IPO.	Field-Ritter database
Loss dummy	Dummy variable equal to 1 for firms with negative earnings before interest and taxes, else 0.	Compustat
Book-to-market	Book value of common equity to market value of common equity ratio.	Compustat, CRSP
Leverage	Long-term debt and debt in current liabilities divided by total assets.	Compustat
CAPEX	Average capital expenditure of the offering year and the year before, divided by total assets in the year before.	Compustat
Revenues	Total revenues in millions of U.S. dollars.	Compustat
Market value	Firm market value calculated as shares outstanding multiplied by share price at the end of the IPO day in millions of U.S. dollars.	Thomson Reuters, CRSP

(*continued on next page*)

Appendix A (*continued*)

Variable	Description	Data sources
Big6 auditor	Dummy variable set to 1 for IPOs audited by the accounting firms of Arthur Andersen (ceased operations in 2002), Coopers & Lybrand (merged with Pricewaterhouse on 1 July 1998), Ernst & Young, Deloitte & Touche, KPMG, and Pricewaterhouse, else 0.	Compustat
Top-tier underwriter	Dummy variable set to 1 for IPOs underwritten by financial institutions with a score of 9 in the Loughran and Ritter (2004) rankings of underwriters' reputations, else 0.	Thomson Reuters
Venture capital	Dummy variable set to 1 for IPOs backed by venture capital, else 0.	Thomson Reuters
CFO	Cash flow from operations divided by total assets.	Compustat
Industry-adjusted CFO	Industry-adjusted CFO calculated by subtracting the median CFO in the industry (at the 2-digit level of the SIC code) from the firm's CFO.	Compustat
ROA	Net income divided by total assets.	Compustat
Industry-adjusted ROA	Industry-adjusted ROA calculated by subtracting the median ROA in the industry (at the 2-digit level of the SIC code) from the firm's ROA.	Compustat
Panel C: Stock returns		
CAR	Cumulative market-adjusted stock return over the trading day interval [-1, +1] relative to the date of the announcement of the first-quarter earnings in the fiscal year following the IPO. The market adjustment is made with reference to the CRSP value-weighted index.	CRSP
BHAR	The firm's three-year buy-and-hold abnormal return calculated from the day immediately following the release of the annual report for the fiscal year of the IPO to the earlier of the three-year anniversary or delisting date.	CRSP
Market BHR	Three-year buy-and-hold return on the CRSP value-weighted index.	CRSP
Underpricing	IPO-day return calculated as the difference between the first CRSP-available closing price in the secondary market and the offer price, divided by the offer price.	Thomson Reuters, CRSP
POSEM	Monthly return of the portfolio of IPO firms that report income-increasing discretionary accruals in the offering year.	Compustat, CRSP
NEGEM	Monthly return of the portfolio of IPO firms that report income-decreasing discretionary accruals in the offering year.	Compustat, CRSP
MKT	Excess monthly return on the CRSP value-weighted index.	K. French's website
SMB	Difference in monthly returns realized on value-weighted portfolios of small and large market capitalization stocks.	K. French's website
HML	Difference in monthly returns realized on value-weighted portfolios of high book-to-market and low book-to-market stocks.	K. French's website
Panel D: PMC-related		
PMC dummy	Dummy variable set to 1 for firms with lobbying or PAC contributions, else 0.	FEC, CRP
PMC total	Total amount spent on lobbying and PAC within the two-year period preceding the IPO.	FEC, CRP
Lobby money	Total amount spent on lobbying within the two-year period preceding the IPO.	CRP
PAC money	Total amount spent on PAC within the two-year period preceding the IPO.	FEC
PMC index	The first factor of applying principal component analysis to lobbying and PAC amounts.	FEC, CRP
Regulated	Dummy variable set to 1 for IPO firms with SIC codes of 4900–4939 (electric and gas), 1300 (oil and gas extraction), 4000–4700 (transportation), 4800–4899 (telecommunications), 4950–4959 (sanitary services), else 0.	Thomson Reuters
Government Purchases	Dummy variable set to1 for IPOs from the top 3 sectors in the Economic Census list of U.S. public spending (i.e., defense, healthcare, and education), else 0.	U.S. Census Bureau
Bills Introduced	Number of bills and joint resolutions brought before U.S. Congress per election cycle.	Congress.gov
State PMC	Number of firms with lobbying or PAC contributions in the state of the issuer's headquarters in the year of the IPO, excluding the issuer's industry at the 2-digit level of the SIC code.	FEC, CRP
Electoral College	Electoral College votes of the state of the IPO firm's headquarters.	Congress.gov

Appendix A (*continued*)

Variable	Description	Data sources
Sensitive	Dummy variable set to 1 for IPOs in the top quintile of relative lobbying expenditure, else 0. The relative lobbying expenditure is calculated as the total amount spent on lobbying within the two-year period preceding the IPO divided by average revenues.	CRP
Midterm	Dummy variable set to1 for IPOs in years of U.S. midterm elections, else 0.	CRP
Presidential	Dummy variable set to1 for IPOs in years of U.S. presidential elections, else 0.	CRP
Election 2012	Dummy variable set to1 for IPOs in the election year of 2012, else 0.	Gallup Organization

CRSP: Center for Research in Security Prices; CRP: Center for Responsive Politics; FEC: Federal Election Commission.

References

Aggarwal, R.K., Meschke, F., Wang, T.Y., 2012. Corporate political donations: investment or agency? Bus. Polit. 14 (1), 1–38.
Aharony, J., Lee, C.-W.-J., Wong, T.J., 2000. Financial packaging of IPO firms in China. J. Account. Res. 38 (1), 103–126.
Aharony, J., Lin, C., Loeb, M.P., 1993. Initial public offerings, accounting choices, and earnings management. Contemp. Account. Res. 10 (1), 61–81.
Aharony, J., Wang, J., Yuan, H., 2010. Tunneling as an incentive for earnings management during the IPO process in China. J. Account. Publ. Pol. 29 (1), 1–26.
Ahmed, A. S., Duellman, S., Grady, M., 2018. Corporate lobbying, political protection, and earnings management. Mays Business School Research Paper (3219428).
Alexander, R., Mazza, S.W., Scholz, S., 2009. Measuring rates of return on lobbying expenditures: an empirical case study of tax breaks for multinational corporations. J. Law Pol. 25, 401–437.
Alhadab, M., Clacher, I., Keasey, K., 2015. Real and accrual earnings management and IPO failure risk. Account. Bus Res. 45 (1), 55–92.
An, H.(., Chan, K.C., 2008. Credit ratings and IPO pricing. J. Corporate Finance 14 (5), 584–595.
Armstrong, C., Foster, G., Taylor, D., 2016. Abnormal accruals in newly public companies: opportunistic misreporting or economic activity? Manage. Sci. 62 (5), 1316–1338.
Badertscher, B.A., 2011. Overvaluation and the choice of alternative earnings management mechanisms. Accounting Rev. 86 (5), 1491–1518.
Badertscher, B.A., Collins, D.W., Lys, T.Z., 2012. Discretionary accounting choices and the predictive ability of accruals with respect to future cash flows. J. Account. Econ. 53 (1-2), 330–352.
Baik, B., Choi, S., Farber, D.B., 2020. Managerial ability and income smoothing. Account. Rev. 95 (4), 1–22.
Barber, B.M., Lyon, J.D., 1997. Detecting long-run abnormal stock returns: the empirical power and specification of test statistics. J. Financ. Econ. 43 (3), 341–372.
Bertrand, M., Kramarz, F., Schoar, A., Thesmar, D., 2018. The cost of political connections. Rev. Finance 22 (3), 849–876.
Bertrand, M., Schoar, A., 2003. Managing with style: the effect of managers on firm policies. Q. J. Econ. 118 (4), 1169–1208.
Bhandari, A., Golden, J., Thevenot, M., 2020. CEO political ideologies and auditor-client contracting. J. Account. Public Policy 39 (5), 106755. https://doi.org/10.1016/j.jaccpubpol.2020.106755.
Billings, M.B., Lewis-Western, M.F., 2016. When does pre-IPO financial reporting trigger post-IPO legal consequences? Contemp. Account. Res. 33 (1), 378–411.
Borisov, A., Goldman, E., Gupta, N., 2016. The corporate value of (corrupt) lobbying. Rev. Financ. Stud. 29 (4), 1039–1071.
Bowen, R.M., Rajgopal, S., Venkatachalam, M., 2008. Accounting discretion, corporate governance, and firm performance. Contemp. Account. Res. 25 (2), 351–405.
Braam, G., Nandy, M., Weitzel, U., Lodh, S., 2015. Accrual-based and real earnings management and political connections. Int. J. Account. 50 (2), 111–141.
Bradley, D., Pantzalis, C., Yuan, X., 2016. Policy risk, corporate political strategies, and the cost of debt. J. Corp. Finance 40, 254–275.
Briggs, D.C., 2004. Causal inference and the Heckman model. J. Educat. Behav. Statist. 29 (4), 397–420.
Brown, J.L., Drake, K., Wellman, L., 2014. The benefits of a relational approach to corporate political activity: evidence from political contributions to tax policymakers. J. Am. Taxation Assoc. 37 (1), 69–102.
Carhart, M.M., 1997. On persistence in mutual fund performance. J. Finance 52 (1), 57–82.
Chaney, P.K., Faccio, M., Parsley, D., 2011. The quality of accounting information in politically connected firms. J. Account. Econ. 51 (1-2), 58–76.
Chen, Z., Dyreng, S., Li, B., 2018. Corporate political contributions and tax avoidance. In 2014 American Taxation Association Midyear Meeting.
Chen, S.S., Lin, W.C., Chang, S.C., Lin, C.Y., 2013. Information uncertainty, earnings management, and long-run stock performance following initial public offerings. J. Business Finance Account. 40 (9–10), 1126–1154.
Christensen, D.M., Mikhail, M.B., Walther, B.R., Wellman, L.A., 2017. From K street to wall street: political connections and stock recommendations. Account. Rev. 92 (3), 87–112.
Claessens, S., Feijen, E., Laeven, L., 2008. Political connections and preferential access to finance: the role of campaign contributions. J. Financ. Econ. 88 (3), 554–580.
Cooper, M.J., Gulen, H., Ovtchinnikov, A.V., 2010. Corporate political contributions and stock returns. J. Financ. 65 (2), 687–724.
Correia, M.M., 2014. Political connections and SEC enforcement. J. Account. Econ. 57 (2-3), 241–262.
Darrough, M., Rangan, S., 2005. Do insiders manipulate earnings when they sell their shares in an initial public offering? J. Account. Res. 43 (1), 1–33.
Dechow, P.M., 1994. Accounting earnings and cash flows as measures of firm performance: the role of accounting accruals. J. Account. Econ. 18 (1), 3–42.
Dechow, P., Ge, W., Schrand, C., 2010. Understanding earnings quality: a review of the proxies, their determinants and their consequences. J. Account. Econ. 50 (2–3), 344–401.
Dechow, P.M., Sloan, R.G., Sweeney, A.P., 1995. Detecting earnings management. Account. Rev. 70 (2), 193–225.
de Figueiredo, J.M., Richter, B.K., 2014. Advancing the empirical research on lobbying. Annual Rev. Polit. Sci. 17 (1), 163–185.
Degeorge, F., Patel, J., Zeckhauser, R., 1999. Earnings management to exceed thresholds. J. Business 72 (1), 1–33.
Demski, J.S., Sappington, D.E., 1987. Delegated expertise. J. Account. Res. 25 (1), 68–89.
DuCharme, L.L., Malatesta, P.H., Sefcik, S.E., 2004. Earnings management, stock issues, and shareholder lawsuits. J. Financ. Econ. 71 (1), 27–49.
Dutta, S., Trueman, B., 2002. The interpretation of information and corporate disclosure strategies. Rev. Acc. Stud. 7 (1), 75–96.
Dye, R.A., 1988. Earnings management in an overlapping generations model. J. Account. Res. 26 (2), 195–235.
Faccio, M., Masulis, R.W., McConnell, J.J., 2006. Political connections and corporate bailouts. J. Financ. 61 (6), 2597–2635.
Fama, E.F., 1998. Market efficiency, long-term returns, and behavioral finance. J. Financ. Econ. 49 (3), 283–306.
Fama, E.F., French, K.R., 1993. Common risk factors in the returns on stocks and bonds. J. Financ. Econ. 33 (1), 3–56.
Fama, E.F., French, K.R., 2004. New lists: fundamentals and survival rates. J. Financ. Econ. 73 (2), 229–269.
Fan, Q., 2007. Earnings management and ownership retention for initial public offering firms: theory and evidence. The Accounting Review 82 (1), 27–64.
Fan, J., Wong, T., Zhang, T., 2007. Politically connected CEOs, corporate governance, and post-IPO performance of China's newly partially privatized firms. J. Financ. Econ. 84 (2), 330–357.

Francis, B.B., Hasan, I., Sun, X., 2009. Political connections and the process of going public: evidence from China. J. Int. Money Financ. 28 (4), 696–719.
Francis, J., LaFond, R., Olsson, P., Schipper, K., 2005. The market pricing of accruals quality. J. Account. Econ. 39 (2), 295–327.
Franz, D.R., HassabElnaby, H.R., Lobo, G.J., 2014. Impact of proximity to debt covenant violation on earnings management. Rev. Acc. Stud. 19 (1), 473–505.
Gao, S., Meng, Q., Chan, K.C., Wu, W., 2017. Earnings management before IPOs: Are institutional investors misled? J. Empiric. Finance 42, 90–108.
Goldman, E., Rocholl, J., So, J., 2013. Politically connected boards of directors and the allocation of procurement contracts. Rev. Finance 17 (5), 1617–1648.
Gordon, S.C., Hafer, C., 2005. Flexing muscle: Corporate political expenditures as signals to the bureaucracy. Am. Polit. Sci. Rev. 99 (2), 245–261.
Gounopoulos, D., Kallias, A., Kallias, K., Tzeremes, P.G., 2017. Political money contributions of US IPOs. J. Corporate Finance 43, 19–38.
Gounopoulos, D., Pham, H., 2017. Credit ratings and earnings management around IPOs. J. Bus. Financ. Account. 44 (1-2), 154–195.
Gounopoulos, D., Pham, H., 2018. Specialist CEOs and IPO survival. J. Corporat. Financ. 48, 217–243.
Gross, C., Königsgruber, R., Pantzalis, C., Perotti, P., 2016. The financial reporting consequences of proximity to political power. J. Account. Public Pol. 35 (6), 609–634.
Grossman, G.M., Helpman, E., 1994. Protection for sale. Am. Econ. Rev. 84 (4), 833–850.
Gul, F.A., Fung, S.Y.K., Jaggi, B., 2009. Earnings quality: some evidence on the role of auditor tenure and auditors' industry expertise. J. Account. Econ. 47 (3), 265–287.
Habib, A., Muhammadi, A.H., Jiang, H., 2017. Political connections and related party transactions: evidence from Indonesia. Int. J. Account. 52 (1), 45–63.
Hao, G.Q., Li, K., 2016. The bright side of discretionary accruals: evidence from finance and innovation. Eur. Financ. Manage. 22 (4), 540–575.
Hart, D.M., 2001. Why do some firms give? Why do some give a lot? High-tech PACs, 1977–1996. J. Polit. 63 (4), 1230–1249.
Heckman, J.J., 1979. Sample selection bias as a specification error. Econometrica: J. Economet. Soc. 47 (1), 153–161.
Hribar, P., Collins, D.W., 2002. Errors in estimating accruals: Implications for empirical research. J. Account. Res. 40 (1), 105–134.
Hutton, I., Jiang, D., Kumar, A., 2014. Corporate policies of Republican managers. J. Financ. Quantit. Anal. 49 (5-6), 1279–1310.
Jaffe, J.F., 1974. Special information and insider trading. J. Bus. 47 (3), 410. https://doi.org/10.1086/jb.1974.47.issue-310.1086/295655.
Jennings, R., Kartapanis, A., Yu, Y., 2021. Do political connections induce more or less opportunistic financial reporting? Evidence from close elections involving SEC-influential politicians. Contemp. Account. Res. 38 (2), 1177–1203.
Jensen, M.C., 2005. Agency costs of overvalued equity. Financ. Manage. 34 (1), 5–19.
Jones, J.J., 1991. Earnings management during import relief investigations. J. Account. Res. 29 (2), 193–228.
Kothari, S.P., Leone, A.J., Wasley, C.E., 2005. Performance matched discretionary accrual measures. J. Account. Econ. 39 (1), 163–197.
Lee, G., Masulis, R.W., 2011. Do more reputable financial institutions reduce earnings management by IPO issuers? J. Corporat. Financ. 17 (4), 982–1000.
Li, C., Wang, Y., Wu, L., Xiao, J.Z., 2016. Political connections and tax-induced earnings management: evidence from China. Eur. J. Finance 22 (4-6), 413–431.
Linck, J.S., Netter, J., Shu, T., 2013. Can managers use discretionary accruals to ease financial constraints? Evidence from discretionary accruals prior to investment. Account. Rev. 88 (6), 2117–2143.
Loughran, T., Ritter, J., 2004. Why has IPO underpricing changed over time? Financ. Manage. 33 (3), 5–37.
Louis, H., Robinson, D., 2005. Do managers credibly use accruals to signal private information? Evidence from the pricing of discretionary accruals around stock splits. J. Account. Econ. 39 (2), 361–380.
Louis, H., White, H., 2007. Do managers intentionally use repurchase tender offers to signal private information? Evidence from firm financial reporting behavior. J. Financ. Econ. 85 (1), 205–233.
Mandelker, G., 1974. Risk and return: The case of merging firms. J. Financ. Econ. 1 (4), 303–335.
McNichols, M.F., 2002. Discussion of the quality of accruals and earnings: the role of accrual estimation errors. Account. Rev. 77 (s-1), 61–69.
Megginson, W.L., Weiss, K.A., 1991. Venture capitalist certification in initial public offerings. J. Finance 46 (3), 879–903.
Morsfield, S.G., Tan, C.E., 2006. Do venture capitalists influence the decision to manage earnings in initial public offerings? Account. Rev. 81 (5), 1119–1150.
Notbohm, M., Campbell, K., Smedema, A.R., Zhang, T., 2019. Management's personal ideology and financial reporting quality. Rev. Quant. Financ. Acc. 52 (2), 521–571.
Perotti, P., Windisch, D., 2017. Managerial discretion in accruals and informational efficiency. J. Bus. Financ. Account. 44 (3-4), 375–416.
Ramanna, K., Roychowdhury, S., 2010. Elections and discretionary accruals: evidence from 2004. J. Account. Res. 48 (2), 445–475.
Ritter, J.R., 1991. The long-run performance of initial public offerings. J. Financ. 46 (1), 3–27.
Rosenbaum, P.R., Rubin, D.B., 1983. The central role of the propensity score in observational studies for causal effects. Biometrika 70 (1), 41–55.
Roychowdhury, S., 2006. Earnings management through real activities manipulation. J. Account. Econ. 42 (3), 335–370.
Snyder,, J.M., 1990. Campaign contributions as investments: the US house of representatives, 1980–1986. J. Polit. Econ. 98 (6), 1195–1227.
Sojli, E., Tham, W.W., 2017. Foreign political connections. J. Int. Bus. Stud. 48 (2), 244–266.
Subramanyam, K.R., 1996. The pricing of discretionary accruals. J. Account. Econ. 22 (1-3), 249–281.
Suijs, J., 2007. Voluntary disclosure of information when firms are uncertain of investor response. J. Account. Econ. 43 (2-3), 391–410.
Sun, P., Hu, H.W., Hillman, A.J., 2016. The dark side of board political capital: Enabling blockholder rent appropriation. Acad. Manage. J. 59 (5), 1801–1822.
Teoh, S.H., Welch, I., Wong, T.J., 1998a. Earnings management and the long-run market performance of initial public offerings. J. Finance 53 (6), 1935–1974.
Teoh, S.H., Wong, T.J., Rao, G.R., 1998b. Are accruals during initial public offerings opportunistic? Rev. Acc. Stud. 3 (1–2), 175–208.
Trueman, B., Titman, S., 1988. An explanation for accounting income smoothing. J. Account. Res. 26 (Supplement), 127–139.
Tu, G., Lin, B., Liu, F., 2013. Political connections and privatization: evidence from China. J. Account. Public Policy 32 (2), 114–135.
Walker, T., Turtle, H.J., Pukthuanthong, K., Thiengtham, D., 2015. Legal opportunism, litigation risk, and IPO underpricing. J. Business Res. 68 (2), 326–340.
Watts, R.L., Zimmerman, J.L., 1978. Towards a positive theory of the determination of accounting standards. Accounting Review 53 (1), 112–134.
Watts, R.L., Zimmerman, J.L., 1990. Positive accounting theory: a ten year perspective. Account. Rev. 65 (1), 131–156.
Wongsunwai, W., 2013. The effect of external monitoring on accrual-based and real earnings management: evidence from venture-backed initial public offerings. Contemp. Account. Res. 30 (1), 296–324.
Yu, F., Yu, X., 2011. Corporate lobbying and fraud detection. J. Financ. Quantitat. Anal. 46 (6), 1865–1891.
Zang, A.Y., 2012. Evidence on the trade-off between real activities manipulation and accrual-based earnings management. Account. Rev. 87 (2), 675–703.
Zardkoohi, A., 1985. On the political participation of the firm in the electoral process. South. Econ. J. 51 (3), 804–817.