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U.S. Congressional Committees and SEC Enforcement Against Financial Misconduct

Mihir N. Mehta
Stephen M. Ross School of Business
University of Michigan

Wanli Zhao
Southern Illinois University

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U.S. Congressional Committees and S.E.C. Enforcement Against Financial Misconduct

Mihir N. Mehta
University of Michigan
mnmehta@umich.edu

Wanli Zhao
Southern Illinois University
zhaowl@business.siu.edu

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ABSTRACT

We document that firms in jurisdictions served by powerful representation on U.S. congressional committees that have Securities and Exchange Commission (SEC) oversight responsibilities are less likely to face regulatory scrutiny for financial misconduct. Conditional on the issuance of an SEC enforcement action, the same firms also receive materially smaller monetary penalties relative to other transgressing firms. An exogenous decrease in a firm's powerful committee representation results in an *increase* in the likelihood that the firm will subsequently face SEC enforcement actions. Our findings do not appear to be driven by regulatory capture but rather, by firm and auditor efforts to limit exposure to political costs. In sum, political representation on specific U.S. congressional committees appears to have direct effects on the financial reporting practices of constituent firms.

Keywords: Political Economy; Corporate Governance; SEC Investigation; Senate Committee on Banking, Housing, and Urban Affairs; House Committee on Financial Services

JEL Codes: G34; M42; M48

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1. Introduction

The United States Congress plays a critical role in shaping government policy because of the power assigned to it via Article I of the U.S. Constitution. Congressional tasks are divided and delegated to committees that have specialized legislative and regulatory oversight responsibilities. Despite Congress's importance for virtually all elements of the U.S. economy, there is relatively little evidence about the direct impact of congressional committees on corporate activities.[1] Our objective in this paper is to investigate a unique channel through which politicians on congressional committees can affect constituent firms relative to other firms: oversight of the Securities and Exchange Commission (SEC). More specifically, we examine whether a politician's membership on certain congressional committees affects SEC enforcement activity against the politician's constituents. We focus on the two congressional committees that are tasked with SEC oversight responsibilities: the U.S. Senate Committee on Banking, Housing, and Urban Affairs and the U.S. House of Representatives Financial Services Committee (hereafter "influential committees"). We posit that politicians serving on these committees have both the *capability* and the *incentives* to influence the SEC's enforcement activities.

Influential committee members can influence the SEC's actions because the committees' jurisdictional power over financial markets and corporate reporting naturally results in SEC oversight. The scope and breadth of influential committee power over SEC actions is demonstrated in the following comments from former SEC Chairman Arthur Levitt:[2]

"[I received] a letter from the overseers of the SEC, the congressional committee that oversees the SEC that has a chokehold on the existence of the SEC, that can block SEC funding, that can block SEC rulemaking, that can create a constant pressure in terms of hearings and challenges and public statements, that can absolutely make life miserable for the commission."

[1] Two notable exceptions are Levitt and Poterba (1999) and Cohen et al. (2011) who examine how congressional committee representation affect state-level economic outcomes and corporate investment, respectively.
[2] http://www.pbs.org/wgbh/pages/frontline/shows/regulation/interviews/levitt.html

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and

"[The politicians] kept the heat on me by telephone calls, by letters, by congressional hearings, and ultimately by threatening the funding of the agency by threatening its very existence. I mean, we were at that point struggling with this same committee to see to it that the employees of the SEC received the same compensation as other financial regulators. At the time, we were getting about a third less than employees for the Federal Reserve Board and other banking entities. And certain members of this committee suggested to me that getting that pay parity was out of the question while we were proceeding with this issue. So we were really being held, well, an attempt was made to hold us captive." ~ Arthur Levitt, former SEC chairman

Influential committee members face competing incentives with respect to their ability to influence the SEC's actions. On the one hand, a political strategy may be to demonstrate a low tolerance for transgressions and financial misconduct in order to be viewed as effective and ethical lawmakers. A well-known example of this political strategy is former New York City mayor Rudolph Giuliani's successful campaign strategy during the 1990s that centered on "get-tough" policies against crime.

Furthermore, such actions are consistent with congressional member reelection-based incentives to undertake actions that pander to public opinion (Canes-Wrone et al., 2001; Maskin and Tirole, 2004). Under such a strategy, the politicians can pressure the SEC to aggressively prosecute financial misconduct. This may be especially likely for financial misconduct cases that occur in a politician's constituency so that he can demonstrate effective oversight to his constituents. This is especially apposite in our setting following multiple recent high-profile corporate failures that resulted in widespread dissatisfaction with corporate financial reporting practices (Strier, 2006). Furthermore, congress members who develop reputations as effective and ethical rule-makers are more likely to obtain lucrative post-congressional employment opportunities such as ambassadorships, federal executive positions, or non-executive corporate board directorships (Fenno, 1973; Parker, 2005).

Firms may rationally anticipate influential committee member incentives to increase SEC enforcement behavior and react by ex ante improving their financial reporting practices. Improved financial reporting quality in turn reduces the likelihood that a firm will subsequently face a financial misconduct investigation. Under this scenario, influential committee representation will be negatively related to the likelihood of SEC enforcement action against financial misconduct.

On the other hand, politicians may have reputation or capture-based incentives to pressure the SEC into reducing enforcement actions against financial misconduct. The revelation of financial misconduct can negatively affect public perceptions about the congressperson's effectiveness, especially when the misconduct occurs within the individual's constituency. Thus, members of Congress have reputational incentives to undertake actions that limit adverse reputational effects (Mayhew, 1974; Fiorina, 1977). Furthermore, their presence on influential committees may also result in "political capture" related incentives to pressure the SEC to limit enforcement action against financial misconduct by constituent firms. According to capture theory (Stigler, 1971; Laffont and Tirole, 1991), influential committee members have incentives to be more lenient towards transgressions by firms that provide financial and political support in order to maintain those beneficial relationships. Thus, these individuals have incentives to encourage the SEC to curtail enforcement actions against financial misconduct by firms within their districts.[3] Given these competing explanations, the relation between political representation on influential committee representation and SEC enforcement actions against constituent firms is an empirical question.

[3] We implicitly assume that influential committee politicians are most concerned about SEC enforcement action against firms within their states, relative to other states. This is feasible because publicity surrounding enforcement action against in-state firms are likely to be most visible to the politician's constituents, all else equal.

We address this issue by creating a unique dataset that links publicly-listed firms with state-level Senate and district-level House congressional representation. Our sample consists of 17,017 firm-year observations over the 2001 to 2010 period. Multivariate test results indicate that the power of a firm's influential committee representation is negatively related to the likelihood that the firm will be subject to SEC enforcement action for financial misconduct, based on the issuance of an Accounting and Auditing Enforcement Release (AAER). In economic terms, firms have a 14% lower likelihood of receiving a financial misconduct-related AAER when headquartered in a powerful influential committee member's electoral district, relative to other firms. We also find that conditional on receiving an AAER, firms in influential committee member constituencies receive significantly smaller penalties relative to firms within other constituencies. A one standard deviation increase in the seniority of a firm's influential committee representation is associated with a reduction in regulatory penalties of approximately $1 million after controlling for the magnitude of the financial misconduct.

In order to draw causal inferences, we exploit 112 cases of influential committee member turnover during our sample period. Firms located within constituencies that experience the loss of a powerful influential committee member are 16.4% more likely to subsequently be subject to SEC enforcement action for financial misconduct, relative to a matched sample of out-of-state firms that experience no shocks to their influential committee representation.

Next, to rule out the possibility that our results are driven by unobserved state-level effects (such as economic downturns) that simultaneously drive congressional committee member turnover and financial misconduct, we perform falsification tests that exploit representation on other congressional committees that have no jurisdiction over the SEC. The results indicate that drops in a firm's representation on these other powerful but unrelated

congressional committees has no effect on the initiation of SEC enforcement actions against the firm.

We next investigate alternative explanations for the negative relation between influential committee power and SEC enforcement actions. First, it is possible that our findings are driven by firm-side efforts to improve financial reporting practices and ex ante limit the risks of facing SEC regulatory scrutiny, as well as to satisfy demands for accounting transparency by investors seeking to protect their interests (Dyck and Zingales, 2004; Guedhami et al., 2013). Second, it is possible that our results are attributable to political capture-based explanations (Stigler, 1971; Laffont and Tirole, 1991). We differentiate between these possible explanations by examining the direction of the change in firms' financial reporting quality around exogenous shocks to influential committee representation.

We find that constituent firms' financial reporting quality *decreases* following influential committee member turnover, consistent with firm-side efforts to improve financial reporting practices. In other words, powerful influential committee politician representation appears to have a positive and causal effect on constituent firms' financial reporting quality. The findings suggest that the relatively lower penalties for financial misconduct by firms with influential committee representation documented above may be attributable to differences in the severity of the misconduct after controlling for the magnitude of the misconduct. Next, the overall evidence is inconsistent with a political capture based explanation. Under such an explanation, we expect to observe constituent firms increasing the quality of their financial reports following influential politician turnover because the firms no longer benefit from political protection against SEC investigations.

In supplementary analyses, we find that auditors are more likely to be named in

enforcement actions when client firms are influential committee member constituents. This indicates that the quality of financial reports is likely to at least partially influenced by auditor incentives to avoid politically motivated penalties.

In robustness tests, we check that our results are robust to: (1) membership on just the Senate or House influential committees, (2) sub-committee and full committee membership, (3) the inclusion of firm-level fixed effects, (4) checks for variation in state-level business-friendliness characteristics, and (5) alternative methods to identify firm locations and affiliated politicians. We also conduct numerous other tests and sensitivity checks. Our findings hold across alternative measures of committee power, the inclusion of a large set of control variables, and the inclusion of firm-level fixed effects.

In sum, our evidence suggests that influential committee representation has a causal effect on SEC enforcement actions against constituent firms. This finding appears to be driven by firm and auditor efforts to increase financial reporting quality to curtail potential financial misconduct-related enforcement action. Thus, political representation on influential committees appears to have direct corporate governance implications for constituent firms.

Our study is likely to be of interest to politicians, regulators, firms, and auditors. We highlight a unique mechanism through which congressional oversight responsibility for capital markets directly influences firm financial reporting practices and regulatory efforts against financial misconduct. We contribute to three streams of literature. First, we build on research in accounting that examines the implications of political power and connections for financial reporting including information disclosure and reporting (e.g., Chaney et al., 2011), discretionary accrual choices around congressional elections (Ramanna and Roychowdhury, 2010), and financial accounting standard rulemaking (Ramanna, 2008). Second, we also broadly contribute

to research in accounting and financial economics that examines the relation between political economy and other firm decisions and outcomes including fraud detection (Yu and Yu, 2011; Correia, 2014), tax aggressiveness (Kim and Zhang, 2014), auditor choice (Guedhami et al., 2014), IPO activity (Piotroski and Zhang, 2014), productivity (Amore and Bennedsen, 2013), firm performance and value (Faccio, 2006; Cooper et al., 2009; Goldman et al., 2009; Cohen et al., 2011;), financing (Leuz and Oberholzer-Gee, 2006; Claessens et al., 2008; Houston et al., 2014), employment (Bertrand et al., 2004), state-level federal expenditure allocations (Atlas et al., 1995; Levitt and Poterba, 1999; Hoover and Pecorino, 2005; Aghion et al., 2009; Belo et al., 2013), investment activity (Aggarwal et al., 2012); financial institution risk-taking and leverage (Kostovetsky, 2015), and corporate bailouts (Faccio et al., 2006; Duchin and Sosyura, 2012; Adelino and Dinc, 2014). This body of research advances our understanding of the effects of lobbying and political connections. We contribute by examining the specific effects of political economy via political representation on congressional committees that are relevant for financial reporting, after controlling for lobbying and political connections.

Third, we contribute to a large literature that examines the determinants of accounting quality (see Schipper and Vincent, 2003; and Dechow et al., 2010 for reviews of this literature). Our findings suggest that congressional representation appears to be a relevant factor in firm and auditor decisions when making financial reporting choices.

We proceed as follows. In Section 2, we describe the data and methodology. Descriptive evidence is presented in Section 3. In Section 4, we discuss our main results. Section 5 contains robustness analyses. We conclude in Section 6.

2. Data, Political Power Variables, and Methodology

In this section we describe the data source and criteria used to create our sample. We then outline the methodology used in empirical tests.

2.1 Data

We collect congressional membership and district data for the 2001 to 2010 period from two sources: the U.S. Census Bureau's website (www.census.gov/geo/maps-data/data/cd_state.html) based on the 2000 U.S. Census and from the University of Missouri Census Data Center (www.mcdc2.missouri.edu/websas/geocorr2k.html). The sample window covers the 106th Congress to the 111th Congress.[4] We identify each member's state and/or district of representation and the duration of service in the House or the Senate, committee membership assignments, committee membership appointment dates and service period, and party affiliation. The data also allows us to identify the duration of each politician's service on a committee (in years), which allows us to determine committee seniority. We identify the people who serve on the two committees responsible for oversight of the SEC: the Committee on Banking, Housing, and Urban Affairs in the Senate, and the Financial Services Committee in the House.

An important issue for our study is the accurate linkage between committee members and their constituent firms. While this is relatively straightforward for the members in the Senate, it is less straightforward for those serving in the House of Representatives because members of the House only represent a district *within* a state, whereas Senators represent an entire state. In order to accurately capture the relation between firms and House representatives, we link firms that are within a 20-mile radius of a House influential committee member's district based on the ZIP Code of the firm's headquarters.[5]

[4] We thank Charles Stewart for congressional member data (http://web.mit.edu/17.251/www/data_page.html).
[5] We use 20 miles because a 2009 U.S. Department of Transportation report (http://nhts.ornl.gov/2009/pub/stt.pdf) notes that this is the average commuting distance. As these distances are likely to vary substantially across the U.S.,

We merge these data with firm-specific data from Compustat, Compact Disclosure, and CRSP, political connection data from BoardEx and Roll Call's Political Money Line (PML), and auditor data from Audit Analytics. We impose a number of data restrictions on our sample. First, we remove utility firms and financial services firms (SIC codes between 4900 and 4999; and between 6000 and 6900) because the different accounting requirements for these firms may cause measurement errors in tests examining financial reporting quality. Results from untabulated tests indicate that our findings are qualitatively similar if we include these firms. Second, we remove all firms with foreign headquarters. Third, we remove all firms audited by Arthur Andersen LLP during the sample period because of increased regulatory scrutiny against those firms around Arthur Andersen's collapse. Fourth, we remove all firms that are not audited by one of the largest national auditing firms because of differences in the propensity of SEC enforcement action for firms audited by the Big 6 versus Non-Big 6 auditors (Lennox and Pittman, 2010).[6] The clients audited by the Big 6 represent 97.4% of aggregate total assets for all Compustat firms over our sample period. Our results are qualitatively similar if we include Non-Big 6 audited clients in our sample. After these restrictions, our sample consists of 17,017 firm-year observations, representing 2,641 unique firms.[7]

Finally, we identify SEC investigations into financial misconduct between 2001 and December 2013 by collecting Accounting and Auditing Enforcement Releases (AAERs) from

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we check alternative distance specifications up to 50 miles and find qualitatively similar results to those presented below (untabulated).

[6] The Big 6 is defined as BDO Seidman, Deloitte, Ernst & Young, Grant Thornton, KPMG, and PricewaterhouseCoopers.

[7] An important issue for our study is the link between firm headquarters location and influential committee representation. However, a limitation of using Compustat to identify firm location is that we can only obtain the current (i.e., non-historical) firm location data, which may result in biased estimates. In order to overcome this limitation, we obtain actual annual firm-year headquarters location details from Compact Disclosure for the 2001 to 2006 period and replicate all our tests. The tabulated results discussed below are qualitatively similar (and in many cases, more pronounced) when using Compact Disclosure over the shorter sample window to identify firm location.

the SEC's website (www.sec.gov) and the associated misconduct windows. We follow the approach in Armstrong et al. (2010) and read all the AAERs during our sample period to identify those that relate to financial misconduct. This includes all cases alleging earnings-estimate improprieties, financial misrepresentation, or failure to adhere to U.S. Generally Accepted Accounting Principles (GAAP). While SEC regulatory efforts span a broad set of activities, there are some advantages of focusing on financial misconduct.[8] First, we can directly observe changes in a firm's financial reporting characteristics around changes in influential committee membership. This is not feasible for other types of SEC investigated misconduct such as bribery or insider trading, for which firm behavior following SEC investigations is neither fully observable nor easily measurable. Second, the revelation of a financial-misconduct related AAER is a major event for an investigated firm. Feroz et al. (1991) observe abnormal cumulative average returns (CARs) of -6% over the two-day window around the disclosure of an SEC accounting investigation, even when the accounting transgression was reported earlier. We identify 331 AAERs issued to unique firms during our sample period.

2.2 Measures of Political Power on Influential Committees

We use three proxies to measure the power of the influential committee representation for each firm-year in the sample. Our primary tests aggregate a firm's Senate and House influential committee representation because we do not a priori expect different effects between the influential committees. In sensitivity tests discussed below, we find that our primary results are qualitatively similar when using separate proxies for the House and Senate committees. The first proxy is the aggregate years of influential committee member service (*Total_Seniority*). Prior

[8] The SEC also undertakes enforcement activities against (but not limited to) bribes and corruption, illicit insider trading, market manipulation, and securities offerings violations.

studies indicate that a key determinant of committee power is committee seniority (Levitt and Poterba, 1999; Cohen et al., 2011). Senior committee members determine a committee's actions and agenda and oversee regulatory bodies under their jurisdiction. Furthermore, senior committee members are also typically responsible for sponsoring legislation.

The *Total_Seniority* variable is easily illustrated using an example: Books-A-Million Inc. (NASDAQ: BAMM) is headquartered in Alabama's 6th congressional district. In 2004, Alabama had one representative on the Senate Committee on Banking, Housing, and Urban Affairs – Richard C. Shelby (D-AL) – who had served on the committee for 17 years. Alabama also had two representatives on the House's Financial Services Committee: Spencer Bachus (R-AL), who was the 6th congressional district representative, and Artur Davis (D-AL), who was the 7th congressional district representative. Bachus and Davis had served on the House committee for six years and one year respectively as of 2004. The value of *Total_Seniority* applied to Books-A-Million for 2004 represents the aggregate years of service for Shelby and Bachus only (17 + 6 = 23). Davis is not included in the seniority count as the firm is neither in Davis's congressional district nor located within 20 miles of his district.

Our second proxy for an influential committee member's political power is a continuous yearly variable for the total number of influential committee members (*Committee_Num*) that represent a firm. This variable captures the possibility that committee influence may stem from "power in numbers" - firms that have greater representation on influential committees can act cohesively to influence SEC actions. Note that we continue to require that for a politician serving in the House to be linked to a firm, the firm must be located within 20 miles of the representative's district.

The third proxy is an indicator variable set to one when a firm is located in a state and/or

within 20 miles of a district for which a Senator and/or Representative is in the top quartile of influential committee member seniority for that year, and zero otherwise (*Seniority_Dum*).

2.3 Methodology

We begin by investigating whether the power of a firm's representation on influential committees affects the likelihood that the firm receives an AAER for accounting misconduct. We estimate the following logit model:

$$Enforcement_{i,t} = \alpha + \beta_1 * Seniority_{i,t} + \beta_X * Controls_{i,t} + \xi_{i,t}, \quad (1)$$

where $Enforcement_{i,t}$ is an indicator variable set to one for detected fraudulent financial reporting cases against firm *i* in year *t* based on the SEC's issuance of an AAER and set to zero otherwise. $Seniority_{i,t}$ represents one of three measures of influential committee representation: *Total_Seniority*, *Committee_Num*, or *Seniority_Dum*.

$Controls_{i,t}$ is a vector of control variables as defined above, which have been shown to be associated with accounting fraud, including a litigation risk indicator variable (*Litigation Risk*), log of total assets (*Size*), long-term debt divided by total assets (*Leverage*), market-to-book ratio (*MtB*), scaled earnings (*Profit*), an indicator variable to capture recent debt or equity issuances (*Issuance*), the standard deviation of operating cash flows over the past five years (*Stdev_Cashflow*), the standard deviation of total sales over the past five years (*Stdev_Sales*), and the operating cycle (*Oper_Cycle*). We also include *Inst_Own*, the total stock ownership by institutional investors, the log of the number of analysts that cover the firm (*Analyst_Following*), and the log distance in miles between the firm's headquarters and the nearest SEC regional office (*Distance_to_SEC*). In addition, we control for multiple auditor quality variables that have been shown to affect the likelihood of financial misconduct: the auditor's city-level industry expertise (*Auditor_Share*), the number of years that the auditor has been retained (*Auditor_Tenure*), the

log number of clients of the firm's auditor office (*Office_Size*), and whether the firm received a going concern opinion in the prior year (*GC_Dummy*).

Finally, we also include controls for the possibility that committee member behavior is influenced by other connections to constituent firms. First, we control for political connections based on a committee member's connections to a firm via the individual's previous employment experience at the firm (in an executive or director capacity). We create an indicator variable (*Political_Connection*) set to one if a firm has a prior affiliation with a politician, and zero otherwise.[9] Second we control for the firm's logged monetary political contribution (*Politicial_Contribution*) via lobbying or PAC contributions (e.g., Duchin and Sosyura, 2012; Kostovetsky, 2015). We provide variable definitions in Appendix A. All specifications include state, year, Fama-French industry, and auditor fixed effects. Standard errors are adjusted for heteroscedasticity using a Huber-White sandwich estimator and clustered by firm.

Although we include multiple fixed effects to mitigate omitted variable biases, the specification above does not allow for causal inferences. In order to provide evidence about causality, we use a changes specification that regresses exogenous changes in a firm's influential committee representation on changes in financial misconduct enforcement actions. We exploit exogenous drops in a firm's influential committee representation that occurs via the cessation of influential committee membership.

Committee turnover occurs for a number of reasons, including defeat during a reelection campaign, the acceptance of a more lucrative appointment such as an ambassadorship or leadership role in an influential government department, committee transfer, retirement, resignation, or death. Our central argument is that SEC financial misconduct-related enforcement

[9] We find that 402 unique sample firms are professionally connected with 376 unique politicians during the sample period.

action against a firm is a function of the power of the firm's influential committee representation. Thus, the exogenous cessation of a state's powerful representation on influential committees should result in a change in the likelihood of enforcement actions against financial misconduct, ceteris paribus.

A subset of our committee turnover cases represent influential committee turnover that occurs due to election defeats. In order to rule out the possibility that committee member turnover and financial misconduct are both driven by a time-variant omitted variable such as a state-level economic downturn, we also conduct a series of falsification tests (described below in Section 3.2) to examine whether financial misconduct enforcement is affected by committee member turnover on other *unrelated* congressional committees.

We identify 112 influential committee exit cases (29 Senators and 83 Representatives) during our sample period.[10] We focus exclusively on committee member exit cases because of asymmetric power effects around exits and entries; new committee members begin their tenure as the lowest ranking members of a committee. Thus, such events have relatively little effect because new members have very little power. The minimum loss in a firm's influential committee seniority representation is 1 year and the maximum loss is 34 years. The median loss is 11.5 years and the top quartile is 22 years. Of the sample cases, 24 (11 Senators and 13 Representatives) depart while their seniority is in the top quartile of committee seniority.

In order to minimize the sample differences between firms that do/do not experience influential committee member exits, we use propensity score matching to identify treatment and

[10] For each of the 112 influential committee member turnover events, we use LexisNexis and Google.com to identify the reason for the turnover. Of the 112 sample turnover cases, 34 (30%) represent cases where a committee member loses an election or voluntarily chooses not to run for reelection. To the extent that these 34 cases might be related to enforcement cases in the committee member's home state, we drop those cases in alternative test. We find qualitatively and quantitatively similar results.

control group firms, with matching occurring in the year prior to member turnover. Treatment firms experience the loss of a powerful influential committee member during our sample window, while control firms are in other states and do not experience a shock to their influential committee representation in the same year, or in the two preceding or subsequent years.[11] All treatment cases are coded such that year 0 represents the year of the loss of a powerful influential committee member. We match firms based on size (log total assets), Fama-French industries, state GDP growth, and state unemployment rate, with no replacement, and with a caliper of 0.1%. The matching process results in 896 firms (i.e., 448 treatment and 448 control firms). We estimate the following difference-in-differences specification:

$$\Delta Enforcement_{i,t} = \alpha + \beta_1 * Senior\_Drop_{i,t} + \beta_X * Controls_{i,t} + \xi_{i,t}, \quad (2)$$

where $\Delta Enforcement_{i,t}$ is an indicator variable set to one if firm *i* does not receive an AAER in year *t*-1 or *t*-2, and does receive an AAER in year *t*+1 or *t*+2, where *t* is the year of influential committee member turnover.[12] $Senior\_Drop_{i,t}$ is an indicator variable set to one if a firm experiences the loss of a powerful influential committee member in year *t,* and zero otherwise (where "powerful" represents a committee member in the top quartile of committee seniority). We also estimate a specification in which we examine the effects of committee member turnover by non-senior influential committee members. In this specification, we replace *Senior_Drop* with a variable *Non-Senior_Drop*, a variable that represents all turnover cases of influential committee members who are not in the top quartile of committee seniority. $Controls_{i,t}$ represents a vector of control variables identical to those in equation (1), all measured in the year before the

[11] Our results are unaffected if we use the following conditions to identify possible control firms: firms in states 1) with no change to their influential committee membership; 2) with no change to their senior influential committee membership; or 3) with no influential committee membership in the year of turnover.

[12] To illustrate, consider a state that has an influential committee senior political representative who retires in year *t*. *ΔAAER* is only set to one for firms that did not receive an AAER in year *t*-1 and did receive an AAER in year *t*+1 or year *t*+2. For all other possible outcomes between *t*-1 and *t*+1 or *t*+2, *ΔAAER* is set to zero.

shock.[13] All specifications include state, industry, auditor, and year fixed effects. In untabulated sensitivity tests, we find that our results are robust to using matched-firm-pair fixed effects instead of state fixed effects. Standard errors are adjusted for heteroscedasticity using a Huber-White sandwich estimator and clustered by firm.

2.4 Summary Statistics

Table 1 displays descriptive information about influential committees. The House (Senate) committees we examine have an average of 69 (21) members during our sample period, representing 29 (21) states. Thus, conditional on a state having representation on a committee, each state has an average representation on the House (Senate) committee of about 2 (1) members. Politicians serving on the House (Senate) influential committee have an average tenure of approximately 3.6 (6.9) years, with a maximum tenure of 19 (29) years. Next, we tabulate states with representation in the top (bottom) quartile of influential committee power over the sample period based on the number of consecutive years of service on a committee. Influential committee power does not appear to be exclusively driven by the largest or most populated states, such as New York, California, or Texas. Rather, committee power appears to be spread across a large cross-section of states. The states with the longest representation on the Senate committee are Connecticut (10 years), Alabama (10 years), Utah (8 years), and Maryland (8 years). Only two states (Alaska and Maine) have no representation on influential committees during our sample period (representing 22 firm-year observations).

Table 2 presents descriptive statistics for the variables used in the multivariate tests. We begin with the three-abovementioned proxies of committee power based on state-level values (500 state-year observations based on 50 states multiplied by the 10 year sample period). The

[13] In sensitivity tests, we use the average value of pre and post-shock, or the differenced measure of control variables. Under each scenario, we find similar inferences to those presented.

average aggregate seniority of a state's influential committee representation is approximately 8.8 years, with a median of 6 years. Each state has an average of about one representative across the influential committees. In addition, approximately 26% of states have a committee member in the top seniority quartile across both influential committees. We also present seniority measures for the firm-level full sample of 17,017 observations. While quite similar, the differences in the state-level and firm-level seniority measure values are mechanically driven by an uneven distribution of sample firm headquarters across U.S. states and districts.

In Table 2, *Enforcement* has a mean value of 0.019, indicating that 1.9% of sample firm-year observations are subject to SEC enforcement action. We find that roughly 17% of firm-year observations have political connections, while on average each firm contributes about $466,000 to committee members. Approximately 32.8% of sample observations are in industries classified as having a high risk of litigation. The average (median) total assets is $3,303 ($407) million, while the median leverage is 11.3% and the median market-to-book ratio is 2.041. The median profitability (using ROA) is 3.3% and the average occurrence of firms issuing security is 44%. Sample firms have median institutional ownership of 62.3%, are followed by about 15 analysts, and the average auditor tenure is about 9.8 years.

3. Results

In Section 3.1 we discuss results from our primary tests examining the effects of influential committee membership on SEC enforcement actions. Section 3.2 presents results from falsification tests. We document the effects of influential committee membership on regulatory penalties in Section 3.3.

3.1 Influential Committees and Financial Misconduct Enforcement Actions

In Table 3 we present results from multivariate tests examining whether powerful political representation on influential committees is associated with financial misconduct-related regulatory enforcement actions. Columns 1-3 present coefficient estimates from tests of equation (1). Column 1 shows that firms with higher powerful influential committee representation are significantly *less* likely to receive financial misconduct-related AAERs. More specifically, the coefficient on *Total_Seniority* is negative and statistically significant at the 5% level (|z-statistic| = 2.36). Economically, a one standard deviation increase in *Total_Seniority* is associated with a 14% decrease in the odds that a firm will receive an AAER, relative to out-of-state firms. The evidence in columns 2 and 3 provides similar inferences when we use alternative measures of influential committee power (i.e., *Committee_Num* and *Seniority_Dum* respectively). The effects are also statistically significant at the 5% level. For instance, a one-politician increase in influential committee membership is associated with a 9% decrease in the odds that constituent firms will receive an AAER. Finally, coefficients on control variables are largely consistent with expectations.

Next, we undertake tests to provide evidence about causality. We exploit exogenous turnover of influential committee members and examine whether the issuances of AAERs changes around negative shocks to senior and non-senior influential committee membership. Columns 4 and 5 in Table 3 present coefficients from estimations of equation (2). The evidence indicates that firms that experience exogenous decreases in senior influential committee representation are significantly more likely to subsequently receive AAERs relative to firms in other states. The loss of a senior influential committee member results in a 16.4% increase in the odds that constituent firms will subsequently be subject to financial misconduct-related enforcement action, relative to a matched sample of firms with no changes to their influential

committee representation. Column 5 presents results of the effect of non-senior committee member turnover on AAERs against financial misconduct. The coefficient on *Non-Senior_Drop* is positive but statistically insignificant. Thus, the loss of a non-powerful influential committee member does not appear to have a statistical effect on financial misconduct-related enforcement actions against constituent firms. This is consistent with prior work that suggests that only senior committee members have the power to influence committee actions (e.g., Levitt and Poterba, 1999). The evidence in column 5 also serves as a falsification test: if some omitted variable drives both influential committee politician turnover and AAERs, then the omitted variable must affect turnover for all committee members, but only affect AAER likelihood for firms that experience the loss of a powerful influential committee member.

Figure 1 presents a graphical depiction of the impact of senior influential committee member turnover on subsequent AAERs. The evidence indicates that firms with (without) shocks to their influential committee representation subsequently experience an increase (no effect) in the propensity that they will receive a financial-misconduct related AAER.

In untabulated robustness tests, we find that the *addition* of a committee member to an influential committee has no statistical effect on the likelihood of AAER issuances. This is consistent with new committee members having relatively less political influence due to their junior status. We also examine the possibility that our results are affected by unobserved, time-invariant, firm-specific factors by replicating our tests after including firm-level fixed-effects. The untabulated results are economically and statistically similar to those presented in Table 3 across both levels and change specifications. In addition, we find that our results are qualitatively similar when we control for governance characteristics over the 2001 to 2007 period using firm-specific governance characteristics measured using G-Index. For years that are missing G-Index

values, we apply the previous year's G-Index value.

In sum, the results in Table 3 provide evidence consistent with a causal and economically significant relation between influential committee member representation and SEC financial misconduct-related regulatory enforcement actions.

3.2 Falsification Test: Senior Politicians on Other Powerful Congressional Committees

Next, we undertake a series of falsification tests using a firm's representation on the most powerful congressional committees that have no jurisdiction over the SEC (i.e., powerful committees other than the two "influential" committees). It is conceivable that our main results are driven by some factor that also drives representation on a powerful committee (i.e., an omitted variable problem). We identify the ten most powerful unrelated Senate and House committees from Edwards and Stewart (2006).[14] We create measures of committee power that are similar to our previously defined measures, but based on the power of a firm's political representation on these ten alternative committees.[15] We re-estimate equation (2) after replacing the *Senior_Drop* and *Non-Senior_Drop* variables with these new variables: *Senior_Drop_OtherComm* and *Non-Senior_Drop_OtherComm*. We match each firm that experiences the turnover of a senior/non-senior non-relevant committee politician with a firm in another state that also has representation on one of the ten committees but does not experience a shock to the committee representation. We use the same matching variables as previously discussed. For tests using senior and non-senior committee member turnover on other

[14] Committee rankings are based on a method developed by Groseclose and Stewart (1998) that involves tracking committee transfers. For instance, a politician switching from committee A to committee B implies that these individuals value the latter more highly than the former. The demand for a given committee is the proxy for committee power. The ten most powerful committees are as follows. Senate: Finance, Veterans Affairs, Appropriations, Rules, Armed Services, Foreign Relations, Intelligence, Judiciary, Budget, and Commerce. House: Ways and Means, Appropriations, Energy and Commerce, Rules, International Relations, Armed Services, Intelligence, Judiciary, Homeland Security, and Transportation and Infrastructure.

[15] In untabulated robustness tests, we find similar results to those presented if we focus on the top 3 or top 5 (instead of top 10) most powerful other committees.

committees, the matched sample yields 7,000 and 9,972 firm-year observations respectively.

Table 4 presents regression results. Coefficients on both *Senior_Drop_OtherComm* and *Non-Senior_Drop_OtherComm* in columns 1 and 2 respectively are negative and statistically insignificant. In other words, the loss of a powerful politician (or a relatively less powerful politician) from a non-influential congressional committee does not appear to change the likelihood that constituent firms will face financial reporting related enforcement actions. These findings show that it is unlikely that our results are driven by omitted variables that also drive senior committee member turnover.

3.3 Influential Committees and Financial Misconduct Enforcement Penalties

Next, we investigate whether the influential committee representation affects penalties for constituent firms subject to SEC investigations against financial misconduct. For each of the 331 AAERs during our sample window, we use the SEC's regulatory filings, court verdicts, LexisNexis, and Google.com to identify the scope of the alleged financial misconduct and subsequent regulatory penalties by the SEC or the Department of Justice (DOJ) on the transgressor firm and/or employees.[16] We exclude 21 ongoing investigations from our tests, as well as another 63 cases because of the difficulty in accurately mapping the assessed penalty with the scale of the financial manipulation.[17] For the remaining 247 cases, the mean aggregate income or profit manipulation is approximately $19.5 million and ranges from $76,000 to $15 billion. The regulatory penalties issued against these firms and/or their employees ranges

[16] Karpoff et al. (2008) undertake a comprehensive analysis of the consequences of financial misconduct for employees. Our analysis aggregates the consequences of financial misconduct across penalties issued to both firms and employees.

[17] For example, in the SEC's case against Dynegy Inc., the SEC "found that Dynegy violated federal securities laws by improperly disguising [a] $300 million loan as cash flow from operations on its financial statements, thereby misleading investors about the level of its energy trading activity." Our results are robust to including these non-income or sales manipulation related cases and either excluding the control variable that captures the amount of the manipulation amount (which is defined as total manipulation in income) or using a crude dollar value of manipulation in all income and non-income accounts to capture the amount of manipulation.

between $0 and $2.25 billion and the median is $12.5 million.[18] In almost all the cases, the SEC also issues a "cease and desist" notification against the firm. In four cases, the SEC simply drops the enforcement investigation into the firms. In roughly 13% (32 cases) of the 247 misconduct cases, employees receive jail sentences, ranging from several months up to 286 years (aggregated at the firm level). In the vast majority of cases that do not result in incarceration, the SEC imposes bans against convicted employees from subsequently serving as an executive or a director of a public company and/or suspends professional licenses. Bans range from one year up to a lifetime. We estimate the following multivariate specification to examine the effect of influential committee representation on penalties assessed for financial misconduct:

$$Penalty\$_{i,t} = \alpha + \beta_1 * Seniority_{i,t} + \beta_X * Controls_{i,t} + \xi_{i,t}, \quad (3)$$

where $Penalty\$_{i,t}$ is a continuous variable capturing the log monetary value of the aggregate penalty imposed by the SEC or Department of Justice (DOJ) on the firm and/or employees. $Seniority_{i,t}$ is one of the three measures of seniority as previously defined. $Controls_{i,t}$ is a vector of controls, including the log dollar value of the net profit misstatement alleged by the SEC (*IncomeInflation$*), *Litigation Risk*, *Size*, *Leverage*, *MtB*, *Profit*, *Issuance*, *Inst_Own*, *Analyst_Following*, and *Distance_to_SEC* as previously defined. We also include state, industry, and year fixed effects.[19]

We present multivariate test results in Table 5. Overall, the evidence indicates that the SEC imposes lower monetary penalties for financial misconduct by firms located in areas served by powerful influential committee representation, relative to financial misconduct by firms in

[18] We exclude amounts paid as a result of class action lawsuits by investors as such payments are separate to penalties issued as a result of SEC enforcement actions.

[19] It is possible that a state's influential committee representation changes between the issuance of an AAER and the date that a trial outcome or settlement is determined. Our results are unaffected if we use political representation at the time of the AAER or the time that the penalty is imposed.

other states. The results are robust across all three measures of committee power: *Total_Seniority*, *Committee_Num*, and *Seniority_Dum*. In economic terms, for a firm issued with an AAER, we find that a one standard deviation increase in their influential committee *Total_Seniority* is associated with a reduced penalty of approximately $1,077,000. This amount holds after controlling for a number of determinants of the magnitude of the penalty assessed, including the alleged amount of income manipulation and firm size. In further tests, we check whether our results are robust to the inclusion of two variables that capture the presence of political connections via personal relationships and monetary contributions. In the next section, we examine mechanisms that drive the negative relation between influential committee power and the likelihood that constituent firms will face SEC enforcement actions.

4. Mechanisms That Drive Variation in Enforcement Actions Against Financial Misconduct

In this section, we investigate two potential drivers of the negative relation between a firm's powerful influential committee representation and financial misconduct enforcement actions. First, if firms with influential committee representation rationally expect to be subject to greater SEC scrutiny because of their political representation, then they may ex ante increase financial reporting quality. Better financial reporting practices in turn reduce the likelihood of financial misconduct and SEC enforcement actions. Second, if firms have "captured" their influential committee members, then they are likely to have incentives to provide relatively lower financial reporting quality because of the perceived political protection from regulatory enforcement (Chaney et al., 2011). In order to differentiate between these two explanations, we examine the effect of exogenous drops to a firm's influential committee representation on firm-

specific financial reporting characteristics. In Sections 4.1 and 4.2 we discuss each of these explanations and in Section 4.3 we outline the tests and empirical findings. We consider the role of auditors in affecting financial reporting quality in Section 4.4.

4.1 Firm Incentives to Improve Financial Reporting Quality

Firms in influential committee member constituencies have at least two reasons to improve their financial reporting quality. First, they may rationally improve their financial reporting quality in anticipation of greater SEC scrutiny (and the associated politically motivated costs and penalties) that may arise due to their location in an influential committee member's jurisdiction. Second, they may improve their financial reporting because of demands for accounting transparency by investors seeking to protect their interests (Watts and Zimmerman, 1983; Dyck and Zingales, 2004; Guedhami et al., 2013). Thus, the negative relation between SEC enforcement for financial misconduct and the power of a state's influential committee representation (see Table 2) may manifest through improved financial reporting quality, which in turn decreases the pervasiveness and incidences of financial misconduct. We label this the *prevention hypothesis*.

4.2 Firm Incentives to Reduce the Quality of Financial Reports

Under regulatory capture or "capture theory," politicians have incentives to ignore or be more lenient towards transgressions by firms that provide financial and political support (Stigler, 1971; Laffont and Tirole, 1991). In our study, captured influential committee members are likely to have incentives to impose pressure on the SEC to constrain enforcement actions against affiliated firms. From a firm's perspective, capturing influential committee members will increase political protection against SEC enforcement actions. Thus, capturer firms can decrease the quality of their financial reporting without increasing their risk of regulatory penalties, all

else equal. Ramanna and Roychowdhury (2010) and Chaney et al. (2011) report that politically connected firms have lower financial reporting quality. We label this the "*protection hypothesis*".

4.3 Specification and Results

We use a changes specification to estimate the effect of influential committee member turnover on financial reporting quality. Our treatment sample consists of firms in constituencies that experience senior influential committee member turnover and a matched sample of control firms in other non-affected states (see Section 2.3).[20] We estimate the following ordinary least squares (OLS) specification:

$$\Delta FRQ_{i,t} = \alpha + \beta_1 * Senior\_Drop_{i,t} + \beta_X * Controls_{i,t} + \xi_{i,t}, \quad \textbf{(5)}$$

where $\Delta FRQ_{i,t}$ represents changes in financial reporting quality using one of three commonly used accruals-based earnings quality measures (*FRQ1*, *FRQ2,* and *FRQ3*) from the accounting literature. Detailed calculations for all three measures are in Appendix B. In order to facilitate easier interpretation of regression coefficients, we multiply each measure by -100 such that larger values indicate higher financial reporting quality. *FRQ1, FRQ2,* and *FRQ3* have mean values of -15.60, -0.41, and -4.07, respectively. $Senior\_Drop_{i,t}$ is as previously defined. A negative (positive) coefficient on *Senior_Drop* indicates that financial reporting quality decreases (increases) following the exit of a senior influential committee member, consistent with the prevention hypothesis (protection hypothesis).

Next, $Controls_{i,t}$ is a vector of control variables that have been used to explain earnings quality including *Political_Connection, Political_Contribution, Litigation Risk*, *Size*, *Leverage*, *MtB*, *Profit*, *Issuance*, *Stdev_Cashflow, Stdev_Sales, Oper_Cycle, Inst_Own, Analyst_Following,*

[20] Our results discussed below are qualitatively similar if we use the following conditions to identify possible control firms: firms in states 1) with no shock to their influential committee membership; 2) with no shock to their senior influential committee membership; or 3) without influential committee membership in the year of turnover.

Distance_to_SEC, Auditor_Share, *Auditor_Tenure*, *Office_Size*, *GC_Dummy,* as previously defined. In addition, all specifications include state, year, industry, and auditor fixed effects. Standard errors are adjusted using a Huber-White sandwich estimator and clustered by firm.

Figure 2, Panels A to C present graphical depictions of annual values for each of the three FRQ measures across 1) firms that experience a shock via the loss of an influential committee senior politician during our sample window; and 2) the matched sample of control firms that do not experience a shock to their influential committee representation in the same year, or in the two preceding or subsequent years. Year 0 represents the year of influential committee member turnover for the treatment group. The evidence across all three panels indicates that average financial reporting quality decreases for treatment firms immediately following committee member turnover, consistent with the prevention hypothesis. In contrast, control firms do not appear to experience any noticeable change in financial reporting quality around the turnover year.

Table 6 presents coefficients from tests of equation (4) for each of the three FRQ measures: *FRQ1, FRQ2,* and *FRQ3*. The evidence shows that financial reporting quality decreases following powerful influential committee member turnover, relative to firms that do not experience changes in their influential committee representation. The coefficients on *Senior_Drop* are negative and statistically significant at the 5% level in all three specifications (*t*-statistic > |2.05|). In economic terms, the loss of a powerful influential committee member results in constituent firms decreasing financial reporting quality by approximately 4.2% - 5.6% relative to matched control firms that do not experience changes in influential committee representation. The evidence is again consistent with the prevention hypothesis.

In robustness checks, we find no evidence that adding someone to an influential

committee significantly affects constituent firms' subsequent financial reporting quality. This finding is consistent with new committee members having little political influence due to their relatively junior status. We also find that the financial reporting quality does not significantly decrease following the exit of a non-senior influential committee member. In sum, the results in Table 6 are consistent with the argument that firms perceive senior influential committee member representation as increasing the risk of greater SEC scrutiny. The firms proactively act to improve financial reporting quality and reduce the risk of regulatory investigation. The evidence is inconsistent with the argument that political capture-related explanations drive financial reporting practices when firms have powerful influential committee representation.

4.4 Auditor Incentives To Influence Financial Reporting Quality

In this section, we examine whether the documented higher financial reporting quality for firms served by influential committee members is at least partially attributable to auditor preferences. In an ideal setting, we would be able to observe and measure the extent to which financial reports represent auditor versus firm preferences. As this is infeasible, we instead exploit SEC enforcement actions against auditors to proxy for Big N audit firm incentives to supply high-quality auditing services.[21] If auditors recognize that they are more likely to be subject to regulatory scrutiny when a client has powerful influential committee representation, it is likely that they rationally impose more stringent quality requirements for those clients' financial reports, all else equal. We use the following regression to identify whether the power of

[21] In 2009 the SEC fined Ernst & Young (EY) $8.5m and sanctioned multiple EY partners for the audits of Bally Total Fitness Inc. The SEC noted that there were "failures from the engagement team to the top of the firm's national office." The SEC barred five current and former EY partners from auditing public companies for up to three years (http://www.sec.gov/litigation/admin/2009/33-9096.pdf). In 2005, the SEC fined Deloitte & Touché (DT) $50 million relating to the audits of Adelphia Inc. and barred the lead partner from auditing public companies for four years (http://www.nytimes.com/2005/04/27/business/27account.html?_r=0). While only anecdotal, in both of these examples the affected clients were located in states (IL and PA, respectively) that had at least one congressional representative in the top quartile of influential committee seniority.

a client's influential committee representation affects whether financial misconduct AAERs are more likely to identify the firm's auditors:

$$Auditor\_AAER_{i,t} = \alpha + \beta_1 * Seniority_{i,t} + \beta_X * Controls_{i,t} + \xi_{i,t}, \quad (5)$$

where $Auditor\_AAER_{i,t}$ is an indicator variable set to one for all cases for which an auditor is named in an AAER against a client firm, and zero otherwise. $Seniority_{i,t}$ represents one of the three measures of influential committee power as previously defined: *Total_Seniority*, *Committee_Num*, or *Seniority_Dum*. $Controls_{i,t}$ represents a vector of control variables including log of total assets (*Size*), long-term debt divided by total assets (*Leverage*), market-to-book (*MtB*), scaled net profit (*Profit*), an indicator variable to capture recent debt or equity issuances (*Issuance*), the standard deviation of total sales over the past five years (*Stdev_Sales*), and a litigation risk indicator variable (*Litigation Risk*). We also include an indicator variable (*Prior_AAER_Auditor*) set to one if the audit firm has been named in an AAER in the previous three years, and zero otherwise. Further, consistent with prior work examining the effect of auditor characteristics on financial reporting quality, we control for the auditor's city-level market share (*Auditor_Share*), the number of years that the auditor has been retained (*Auditor_Tenure*), the log number of clients of the firm's auditor office (*Office_Size*), and a dummy variable indicating whether the firm receives a going concern opinion in the prior year (*GC_Dummy*). All the specifications include state, industry, auditor, and year fixed effects.

For each of our AAER cases, we identify whether the transgressing firm's auditor and/or the auditing firm's employees are named in the AAER. Of the 331 cases, auditors and/or the auditing firm's partners are named in 31 cases. The remaining 300 cases represent 17 different states. On average, states in which auditors are (are not) identified in the AAER have influential committee *Total_Seniority* of 15.1 (11.8) years in the year of the AAER issuance. The difference

is statistically significant at the 1% level.

Table 7 presents coefficient estimates from tests of equation (5). Conditional on enforcement action against client firms, auditing firms and/or their employees are more likely to be named in AAERs against clients with powerful influential committee representation. In column 1, the coefficient on *Total_Seniority* is positive and statistically significant at the 5% level (*z*-statistic = 2.40). In economic terms, a one standard deviation increase in total seniority is associated with a 1.52 times greater odds that an auditing firm and/or their employees will be named in a financial misconduct-related AAER against a client firm.[22] The results are economically and statistically similar across the other two politician power measures, *Committee_Num* and *Seniority_Dum*, in columns 2 and 3 respectively. The findings indicate that auditors are more likely to face regulatory scrutiny when clients with powerful political representation on influential committees are subject to SEC investigations for financial misconduct. In sum, the evidence suggests that auditors appear to recognize the possible adverse political costs from audit failure for clients in powerful influential committee member constituencies. Our findings are consistent with recent evidence by Allen et al. (2014) that suggests auditors attempt to influence the accounting standard setting process in order to limit regulatory scrutiny and litigation.

5. Robustness Checks

5.1 Effects of House and Senate Subcommittee Membership

Congressional committees divide their tasks among subcommittees that handle specific areas. The two subcommittees responsible for financial reporting oversight are the Subcommittee

[22] Calculated as $e^{(14.96*0.028)} = 1.52$.

on Securities, Insurance, and Investment (Senate) and the Subcommittee on Capital Markets and Government-Sponsored Enterprises (House). We repeat our analyses after partitioning influential committee politicians based on whether they serve on the abovenamed subcommittees. Under committee rules in both the Senate and the House, committee chairpersons and ranking members are ex-officio members of all subcommittees. Untabulated results indicate that the effects across both subcommittee and non-subcommittee partitions are statistically significant, but the effect for the subcommittee partition is statistically and economically larger. A potential explanation is that all powerful committee members (including those not on SEC-focused subcommittees) have the ability to influence firm and auditor actions, either directly or via relationships with other committee members.

5.2 Do Influential Committee Members Affect Financial Misconduct Enforcement?

We examine whether members on the Senate and House influential committees play differential roles in affecting auditor behavior. We calculate three new measures of committee member power based on a state's representation on the Senate and House committees separately. We then restrict equation (2) to either the Senate or House influential committee power measures instead of the corresponding three aggregate committee power measures. Results from untabulated tests indicate that the effect is statistically significant across both the Senate and House committee power measures. We find no evidence that power on one of the influential committees has a significantly different effect on enforcement against financial misconduct than the other committee. These results are similar across all three measures of committee power.

5.3 Potential Spillover Effects from Enron and WorldCom Collapses

In order to eliminate the possibility that our results are driven by increased scrutiny against financial reporting following the collapses of Enron and WorldCom, we check and find

that our results hold after removing all observations for 2001, 2002, and 2003.

5.4 House of Representatives State Apportionment

We examine whether our results are driven by states that are disproportionately represented on the House's Financial Services Committee. This possibility exists because House seats are apportioned to a state based on the state's population (i.e., each Representative serves an approximately equal number of constituents). Thus, the most populous U.S. states (California, Texas, Florida, New York, Pennsylvania, and Illinois) have the largest number of House seats. Firms located in these six states represent 47.6% of all firms in our sample. Tests excluding each of these five states provide qualitatively similar results to those presented above.

5.5 Alternative Identification Methodology to Link Firms and States

A possible issue for our study is that linking state politician representation with firm headquarters location may not capture politician incentives for geographically diverse firms. In order to overcome this issue, we use the Garcia and Norli (2012) firm-specific measure of state-level operational dispersion. The measure captures the number of times states are mentioned in a firm's 10-K filing. The greater the number of states mentioned, the greater the dispersion of the firm's operations. The more frequently a given state is mentioned, the greater the expected importance of that state for the firm.[23] The correlation between sample firm headquarters and the state (two states) with the highest count in the 10-K filing is 64% (80%). Our tabulated results are robust to two alternate methods to identify the most appropriate state-level Senate and House representation for each sample firm observation: 1) we use a weighted average of influential

[23] For example, in 2006 Boeing Corp. identifies six unique states in its 10-K filing. The six states represent that the firm is headquartered in Illinois and has manufacturing facilities in Washington, South Carolina, Missouri, Kansas, and Oklahoma. However, 50% of all the state mentions are Washington, where Boeing has major manufacturing facilities. Thus, it is possible that Washington's influential committee representatives have incentives to influence potential SEC enforcement action against Boeing.

committee member seniority based on the geographical distribution of operations using all states identified in the 10-K filing; and 2) we determine a firm's committee seniority measures based on the state that has the highest count in the 10-K filing. Note that a limitation of this robustness test is that House district-firm links are not identified.

5.6 Business-Friendly States

We also examine whether politicians who choose to serve on influential committees represent a state or a congressional district in a state that is viewed as "business friendly." Business-friendly states are likely to attract both higher quality and more successful firms relative to other states, and politicians from those states may be more eager to serve on influential committees. Using Forbes' annual survey of state-level business environment data between 2005 and 2010, we partition firms into high and low business-friendly state groups.[24] Untabulated tests indicate that our main results are qualitatively similar across both partitions.

6. Conclusion

We explore the corporate governance role of U.S. politicians by examining political representation on the two congressional committees that have responsibility for financial market regulation and SEC oversight - the U.S. Senate Committee on Banking, Housing, and Urban Affairs and the U.S. House of Representatives Financial Services Committee. Our evidence indicates that the power of the representation on these two influential congressional committees is negatively associated with SEC enforcement action against constituent firms for financial misconduct. Furthermore, conditional on the presence of enforcement action, firms with powerful influential committee representation receive smaller penalties relative to a matched

[24] See http://www.forbes.com/best-states-for-business/.

sample of firms in other states. In order to draw causal inferences, we exploit influential committee member turnover events: firms that lose powerful influential committee representation subsequently experience an *increased* likelihood of facing SEC investigations for financial misconduct relative to other firms. Evidence from a series of falsification tests indicates that our results do not appear to be attributable to omitted variable biases that drive both politician turnover and AAERs.

Next, we investigate the possible drivers of our findings. The lower enforcement activity in jurisdictions with powerful influential committee representation appears attributable to firm and auditor efforts to limit the risk of political costs from regulatory scrutiny. Furthermore, the evidence is inconsistent with the argument that reduced regulatory enforcement is attributable to political capture-based explanations. The findings are robust to a battery of specifications and sensitivity tests.

Our study should be of interest to regulators, politicians, and firms. While existing research largely focus on the effect of political connections between politicians and firms, we highlight a unique and direct mechanism through which politicians exert their influence on firms: their status on U.S. congressional committees that oversee the SEC. We believe that the impact of congressional committee membership for firm behavior and outcomes is relatively under-examined and thus presents many opportunities for further research.

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Appendix A. Variable Definitions

Dependent Variables:
Enforcement: An indicator variable set to one if the firm is the subject of a fraud-related AAER in the current year, and set to zero otherwise.
ΔEnforcement: An indicator variable set to one if the firm is (not) subject to fraud-related AAER (before) after the exit of influential committee member, and set to zero otherwise.
Turnover: An indicator variable set to one if the influential (other powerful) committee member from the firm's state leaves Congress, and set to zero otherwise.
Penalty$: Log of the monetary penalty extracted by the SEC from a firm and its employees for financial misconduct.
FRQ1: Unsigned abnormal accruals from Hribar and Nichols (2007) and detailed in Appendix B.
FRQ2: Industry-adjusted absolute value of DD residual from Dechow et al. (2011) and detailed in Appendix B.
FRQ3: Performance-matched discretional accruals from Kothari et al. (2005) and detailed in Appendix B.
Auditor_AAER: An indicator variable set to one if a financial misconduct-related AAER against a firm also names the auditor as a transgressing party.

Variables of Interest:
Total_Seniority: For each firm in a given state, the aggregate tenure of that state's current political representation for both influential committees (in years).
Committee_Num: For each firm in a given state, the total number of politicians from that state serving on influential committees.
Seniority_Dum: For each firm in a given state, an indicator variable set to one if that state's political representation on influential committees is in the top quartile of seniority on at least one of the influential committees, and zero otherwise.
Senior_Drop: For each firm in a given state, an indicator variable set to one if a powerful (i.e., top seniority quartile influential committee politician from that state ends his/her congressional appointment in that year, and zero otherwise.
Non-Senior_Drop: For each firm in a given state, an indicator variable set to one if a non-top seniority quartile) influential committee politician from that state ends his/her congressional appointment in that year, and zero otherwise.
Senior_Drop_OtherComm: For each firm in a given state, an indicator variable set to one if a state's powerful (i.e., top seniority quartile) political representative serving on one of the ten most powerful non-SEC relevant congressional committee ends his/her congressional appointment in that year, and zero otherwise.
Non-Senior_Drop_OtherComm: For each firm in a given state, an indicator variable set to one if a state's powerful (i.e., non-top seniority quartile) political representative serving on one of the ten most powerful non-SEC relevant congressional committee ends his/her congressional appointment in that year, and zero otherwise.
Recent_AAER: An indicator variable set to one if the firm has received a financial misconduct related AAER in the prior three years, and set to zero otherwise.

Control Variables:
Analyst_Following: The (log) of the number of analysts that cover the firm during the year.
Auditor_Share: The auditor's national industry share, measured by the proportion of the total assets of all firms in the same Fama-French industry.

Auditor_Tenure: Number of years that the firm has retained the current auditor.
Democratic: A dummy variable set to one if the influential committee member is a democrat, and zero otherwise.
Distance_to_SEC: The (log) miles between the firm's headquarters to the closest SEC regional office.
Female: A dummy variable set to one if the influential committee member is female, and zero otherwise.
GC_Dummy: An indicator variable set to one if the firm's auditor issues a going-concern opinion in that year, and set to zero otherwise.
IncomeInflation$: The log of the dollar amount of net profit financial misrepresentation.
Inst_Own: Year-end institutional ownership as a percentage of common stock.
Issuance: An indicator variable set to one if the firm has issued new long-term debt or stock worth more than ten percent of the prior year's long-term debt or common equity in the prior three years, and set to zero otherwise.
Leverage: Long-term debt divided by total assets.
Litigation_Risk: An indicator variable set to one if the firm is in one of the following industries: biotech (SIC codes 2833-2836 and 8731-8734), computer (3570-3577 and 7370-7374), electronics (3600-3674), retail (5200-5961), and zero otherwise.
MtB: Market value of equity divided by book value of equity.
Oper_Cycle: Log (days in account receivables + days in inventory).
Office_Size: Log number of clients of auditor office.
Penalty$: Log of monetary penalty imposed by SEC/DOJ on the firm/employees.
Political_Connection: An indicator variable set to one for each year that a firm in our sample that is affiliated with an U.S. politician based on whether the politician previously served as an executive or director of the firm, and zero otherwise.
Politicial_Contribution: Log of total dollar amount of a firm's political contributions during a year.
President Same Party: A dummy variable set to one if the influential committee member is from the same party as the incumbent president.
Presidential Election Year: An indicator variable set to one if the election occurs in a presidential election year, and zero otherwise.
Prior_AAER_Auditor: An indicator variable set to one if the auditor is also named in an AAER during the prior three years, and set to zero otherwise.
Profit: Earnings before extraordinary items divided by total assets.
Size: Log of total assets.
State GDP Growth: The GDP growth rate from year *t*-1 to *t*.
State Unemployment Rate: State unemployment rate for year *t.*
Stdev_Cashflow: Standard deviation of cash flow from operations between *t*-4 and *t*.
Stdev_Sales: Standard deviation of sales between *t*-4 and *t*.

Appendix B. Financial Reporting Quality Measures

FRQ1: Unsigned Abnormal Accruals (Hribar and Nichols, 2007)

We first estimate the following regression for each year and Fama-French industry:

$$TACC = \alpha + \beta_1 \Delta REV + \beta_2 PPE + \xi,$$

where *TACC* is total accruals, defined as income before extraordinary items minus cash from operations divided by lagged total assets. ΔREV is the change in sales adjusted for the change in receivables, divided by lagged total assets. *PPE* is gross property, plant, and equipment, scaled by lagged total assets. We then calculate the abnormal accruals as the residual term in the regression, i.e., $TACC - (\alpha + \beta_1 \Delta REV + \beta_2 PPE)$, and *FRQ1* is the absolute value of the residual (abnormal accruals).

FRQ2: Industry-adjusted Absolute Value of DD Residual (Dechow et al., 2011)

We first regress working capital accruals (*WC_ACC*) on operating cash flows in the current year (CFO_t), the preceding year (CFO_{t-1}), and the following year (CFO_{t+1}):

$$WC\_ACC_{i,t} = \alpha_{0,i} + \beta_{1,i}\, CFO_{i,t-1} + \beta_{2,i}\, CFO_{i,t} + \beta_{3,i} CFO_{i,t+1} + v_{i,t},$$

where $WC\_ACC = \Delta CA - \Delta CL - \Delta CASH + \Delta STDEBT + \Delta TAXES$; ΔCA is the change in current assets between year t-1 and t; ΔCL is the change in current liabilities between year t-1 and t; $\Delta CASH$ is the change in cash and short-term investments between year t-1 and t; $\Delta STDEBT$ is the change in short-term debt between year t-1 and t; and $\Delta TAXES$ is the change in taxes payable between year t-1 and t.

All variables are scaled by average total assets and winsorized at the 1% and 99% levels. We estimate equation (6) by year for each of the two-digit SIC industry groups. *FRQ2* is the absolute value of each firm's residual less the average absolute value for the corresponding industry.

FRQ3: Performance-Matched Discretional Accruals (Kothari et al., 2005)

We estimate abnormal accruals for each firm-year and subtract the value from the discretionary accruals of the performance-matched firm. The modified Jones model of abnormal accruals model is estimated cross-sectionally each year using all firm-year observations in the same Fama-French industry:

$$TA_{i,t} = \beta_0 + \beta_1 (1/ASSETS_{i,t-1}) + \beta_2 (\Delta SALES_{i,t} - \Delta AR_{i,t}) + \beta_3 PPE_{i,t} + \xi_{i,t},$$

where *TA* (total accruals) is the change in non-cash current assets minus the change in current liabilities excluding the current portion of long-term debt, minus depreciation and amortization, scaled by lagged total assets; $\Delta SALES_{i,t}$ is change in sales; $\Delta AR_{i,t}$ is change in account receivable; and $PPE_{i,t}$ is gross property, plant, and equipment, all scaled using lagged total assets, $ASSETS_{i,t-1}$. We use total assets as the deflator to mitigate heteroscedasticity in the residuals.

Residuals from the annual cross-sectional industry regression model in the modified Jones model are used to measure estimated abnormal accruals. We then match each firm-year observation with another firm from the same Fama-French industry and year with the closest return on assets in the current year, $ROA_{i,t}$ (net income divided by total assets). We define *FRQ3* for firm i in year t as the abnormal accrual in year t minus the performance-matched abnormal accrual for year t.

Figure 1: SEC Enforcement Against Financial Misconduct Around Powerful Influential Committee Politician Turnover Shocks

We present annual time series values of the percent of firms subject to enforcement across groups based on the turnover of powerful influential committee senior representatives. All observations are centered on the turnover shock year (year 0).

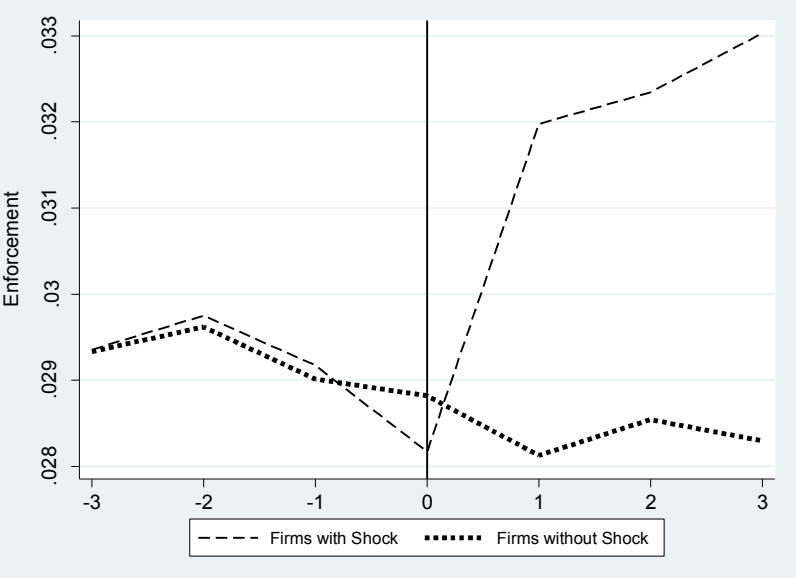
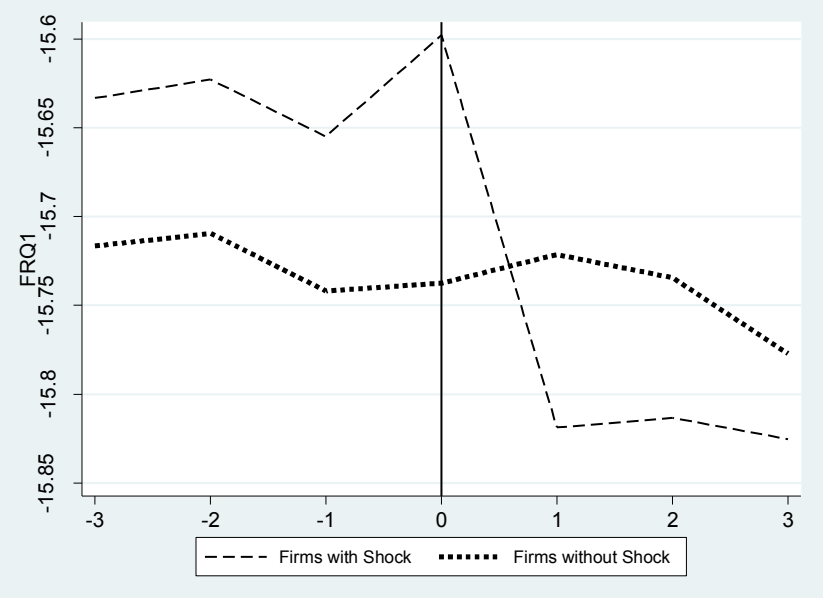


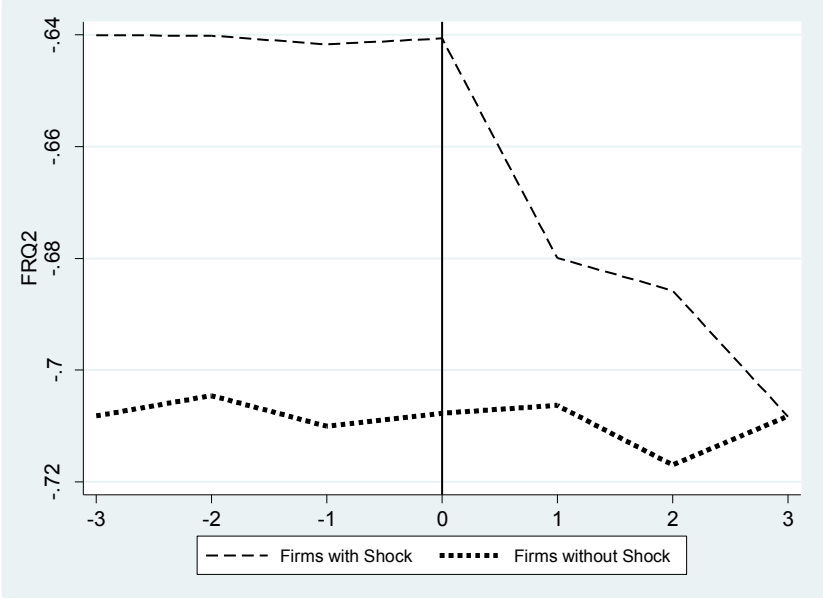
Figure 2: Financial Reporting Quality Around Influential Committee Powerful Politician Exit Shock

Panels A, B, and C present annual time series values of financial reporting quality for firms across groups based on the turnover of powerful influential committee senior representatives. All observations are centered on the turnover shock year (year 0). Financial reporting quality is measured using one of the following measures: *FRQ1*, *FRQ2*, or *FRQ3*. All three measures are defined in Appendix B.

Panel A: FRQ1



Panel B: FRQ2



Panel C: FRQ3

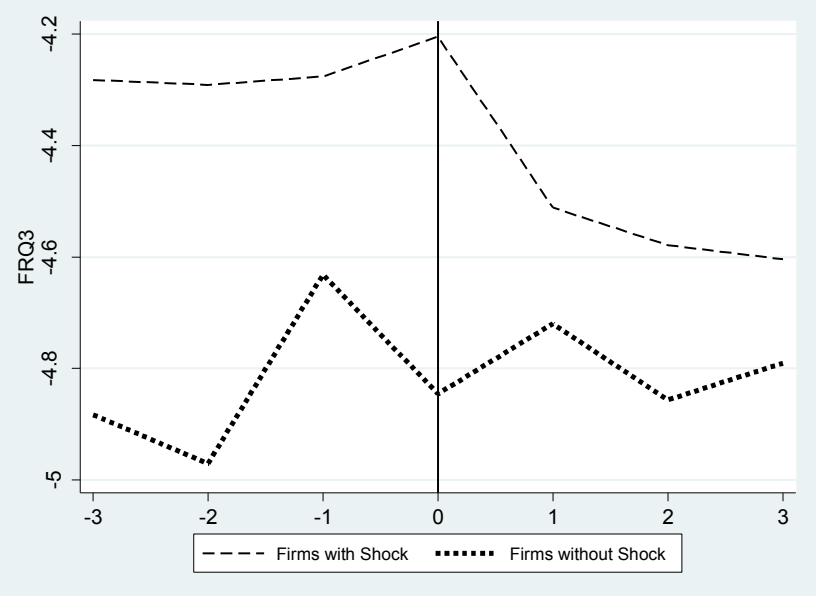

FRQ3
-4.2
-4.4
-4.6
-4.8
-5
-3
-2
-1
0
1
2
3
Firms with Shock
Firms without Shock

Table 1: Influential Committee Descriptive Statistics

This table presents statistics about the House Financial Services Committee (House Committee), and the Senate Committee on Banking, Housing, and Urban Affairs (Senate Committee) characteristics.

Panel A: Influential Committee Descriptive Statistics

	House Committee	Senate Committee
Average size (in number of members)	69.25	21.25
Average # of states represented on committee	29.05	20.67
Average # of state representatives	2.28	1.02
Max # of state representatives	11	2
Average politician tenure on committee (in years)	3.62	6.94
Maximum politician seniority on committee (in years)	19.00	29.00

States with the greatest number of years of representation (and corresponding duration) in the top quartile of influential committee between 2001 and 2010:

House Committee: CA, PA, NY, MA, AL, NC, IL, LA, DE (10 years); VT, IA, OK, (8 years); OK, KS, TX, NE (6 years); IN, OH, NJ (4 years); OR, MN, MO, FL (2 years);

Senate Committee: CT, AL (10 years); UT, MD (8 years); SD, TX, RI, (4 years); ID, ID, NE, MA, FL, WY, IN, CO, NY, KY (2 years)

States with the number of years of representation (and corresponding duration) in the bottom quartile of influential committee between 2001 and 2010:

House Committee: ME, AK (10 years); KY, WI (8 years); MN, MS (6 years); AR, AZ, CO, CT, MI, MO, NH, NJ, NM, SC, TN, UT, WV (4 years); GA, ID, NV, VA, WA (2 years)
Senate Committee: ME, AK (10 years); HI, NH, NJ (6 years); DE, FL, GA, MI, MT, NC, OH, PA, TN (4 years); CO, ID, IN, KY, LA, NE, NV, NY, OR, SC, TX, VA, WI (2 years)

States with no representation on influential committees during sample period: AK, ME.
Total # of sample firm-year observations from these states: 22.

Table 2: Descriptive Statistics

We present mean, median and standard deviation values for key variables used in multivariate tests. All variables are defined in Appendix A.

	(1)	(2)	(3)
	Mean	**Median**	**Std. Dev.**
State-year Seniority Measures (n = 500)			
Total_Seniority	8.763	6.000	9.981
Committee_Num	1.190	1.000	2.082
Seniority_Dum	0.262	0.000	0.443
Firm-year Seniority Measures (n = 17,017)			
Total_Seniority	10.576	2.000	14.962
Committee_Num	2.270	2.000	2.958
Seniority_Dum	0.271	0.000	0.448
Other Variables (n = 17,017)			
Enforcement	0.019	0.000	0.109
Political_Connection	0.169	0.000	0.375
Political_Contribution ($)	466,029	0.000	2,481,660
Litigation_Risk	0.328	0.000	0.469
Total Assets ($Million)	3,303	408	12,118
Size	6.064	6.010	2.039
Leverage	0.167	0.113	0.189
MtB	2.850	2.041	4.073
Profit	-0.010	0.033	0.174
Issuance	0.440	0.000	0.496
Stdev_Cashflow	0.110	0.062	0.167
Stdev_Sales	0.259	0.195	0.224
Oper_Cycle	4.567	4.646	0.810
Inst_Own	0.565	0.623	0.313
Analyst_Following	2.327	2.708	1.452
Distance_to_SEC (miles)	1,771	1,580	1,262
Auditor_Share	0.200	0.214	0.123
Auditor_Tenure	9.845	7.000	8.657
Office_Size	2.717	2.772	1.118
GC_Dummy	0.023	0.000	0.151

Table 3: Congressional Committee Seniority and Financial Misconduct

This table presents coefficients from levels and changes in logit regressions examining the relation between the power of a state's influential committee representation and the likelihood that in-state firms are subject to SEC enforcement for financial misconduct. In columns 1 to 3, the dependent variable is *Enforcement* and in columns 4-5 the dependent variable is *ΔEnforcement.* The independent variable of interest in columns 1-3 is set to one of our three measures of influential committee power. In columns 4 and 5, the variable of interest is the change in senior (non-senior) membership on influential committees respectively. All variables are defined in Appendix A. z-values are in parentheses. Standard errors are Huber-White sandwich estimator clustered at the firm level. All specifications include fixed effects for state, industry, year, and auditor. Statistical significance at the 1%, 5%, and 10% levels is denoted by ***, **, and *, respectively.

Panel A: Influential Committee Seniority and Financial Misconduct

	(1)	(2)	(3)	(4)	(5)
Variables	**Enforcement**			**ΔEnforcement**	
Constant	-7.667***	-6.520***	-5.108***	-2.769***	-2.522***
	(-7.50)	(-7.98)	(-8.75)	(-2.89)	(-2.72)
Total_Seniority	**-0.010****	**-**	**-**	**-**	**-**
	(-2.42)				
Committee_Num	**-**	**-0.095****	**-**	**-**	**-**
		(-2.35)			
Seniority_Dum	**-**	**-**	**-0.088****	**-**	**-**
			(-2.30)		
Senior_Drop	**-**	**-**	**-**	**0.152****	**-**
				(2.11)	
Non-Senior Drop	**-**	**-**	**-**	**-**	**0.070**
					(1.31)
Political_Connection	0.386*	0.360*	0.409*	0.092	0.067
	(1.80)	(1.82)	(1.72)	(0.99)	(1.02)
Political_Contribution	0.035*	0.034	0.028	0.011	0.008
	(1.82)	(1.42)	(1.32)	(1.02)	(1.10)
Litigation Risk	-0.046	-0.008	-0.013	0.316	0.329
	(-1.22)	(-0.28)	(-0.38)	(1.38)	(1.40)
Size	-0.382***	-0.473***	-0.437***	-0.652	-0.700
	(-5.06)	(-5.89)	(-5.27)	(-1.10)	(-1.21)
Leverage	1.017	0.715	0.762	0.107	0.104
	(1.55)	(1.06)	(1.26)	(0.79)	(0.88)
MtB	0.015	0.025	0.025	0.108	0.095
	(0.72)	(1.20)	(1.30)	(1.29)	(1.11)
Profit	0.075*	0.075*	0.078*	0.432	0.417
	(1.89)	(1.78)	(1.80)	(0.62)	(0.80)
Issuance	0.070	0.099	0.085	-0.062	-0.062
	(0.48)	(0.66)	(0.52)	(-1.06)	(-1.06)
Stdev_Cashflow	0.612	0.311	0.243	-1.829	-1.869
	(0.55)	(1.20)	(0.22)	(-1.30)	(-1.30)
Stdev_Sales	1.433***	1.409***	1.428***	-0.376	-0.407
	(3.01)	(2.89)	(2.91)	(-1.32)	(-1.11)
Oper_Cycle	0.575***	0.839***	0.867***	-0.727*	-0.701*
	(4.05)	(3.99)	(4.02)	(-1.75)	(-1.68)
Inst_Own	-0.046	-0.098	-0.082	0.308	0.316
	(-1.09)	(-1.19)	(-1.17)	(0.82)	(0.98)

Analyst_Following	-0.050	-0.042	-0.050	0.406	0.371
	(-0.42)	(-1.30)	(-1.36)	(1.32)	(1.30)
Distance_to_SEC	0.010	0.055	0.016	0.211	0.216
	(1.22)	(0.85)	(0.30)	(1.29)	(1.33)
Auditor_Share	-1.352	-1.703	-0.712	-0.282	-0.222
	(-1.62)	(-1.10)	(-1.22)	(-1.06)	(-1.00)
Auditor_Tenure	0.015	0.011	0.011	0.085	0.111
	(1.20)	(0.82)	(0.85)	(0.78)	(1.22)
Office_Size	-0.288**	-0.348**	-0.330**	-0.375	-0.337
	(-2.25)	(-2.47)	(-2.35)	(-1.50)	(-1.18)
GC_Dummy	1.118	0.850	-0.843	0.199	0.182
	(1.02)	(0.85)	(-0.72)	(0.95)	(1.03)
State, Industry, Year, and Auditor Fixed Effects	Yes	Yes	Yes	Yes	Yes
N	17,017	17,017	17,017	896	896
Pseudo R^2	0.072	0.146	0.142	0.071	0.070

Table 4: Counterfactual Tests: Non-Influential Committee Seniority

This table presents coefficients from logit regressions examining the relation between negative shocks to the power of a firm's representation on powerful committees that have no jurisdiction over financial misconduct regulation and changes in the likelihood that those firms are subject to SEC investigations for financial misconduct. The dependent variable is an indicator variable that captures whether a firm is subject to enforcement (Δ*Enforcement*). Column 1 (2) presents results from a specification in which the variable of interest is the change in senior (non-senior) membership on non-influential committees respectively. z-values are in parentheses. Standard errors are Huber-White sandwich estimator clustered at the firm level. All specifications include fixed effects for state, industry, year, and auditor. Statistical significance at the 1%, 5%, and 10% levels is denoted by ***, **, and *, respectively. All variables are defined in Appendix A.

	(1)	(2)
Variable	**ΔEnforcement**	
Constant	-3.469***	-1.040***
	(-3.52)	(-3.31)
Senior_Drop_OtherComm	**-0.055**	**-**
	(-1.03)	
Non-Senior_Drop_OtherComm	**-**	**-0.060**
		(-1.33)
Political_Connection	0.066	0.075
	(0.56)	(0.99)
Political_Contribution	0.070	0.069
	(0.89)	(0.88)
Litigation Risk	0.090*	0.092**
	(1.76)	(2.01)
Size	-0.155	-0.220
	(-0.50)	(-0.79)
Leverage	-0.001	0.003
	(-0.11)	(0.27)
MtB	0.006	0.007
	(0.36)	(0.40)
Profit	0.769*	0.707*
	(1.86)	(1.92)
Issuance	0.083	0.307
	(0.30)	(1.23)
Stdev_Cashflow	-0.045	0.010
	(-0.55)	(0.15)
Stdev_Sales	0.053	0.032
	(0.53)	(0.37)
Oper_Cycle	1.647***	1.830***
	(13.11)	(15.36)
Inst_Own	1.051***	0.970***
	(3.51)	(3.62)
Analyst_Following	-0.098	-0.084
	(-1.35)	(-1.30)
Distance_to_SEC	0.105	0.112
	(0.92)	(0.77)
Auditor_Share	0.211	-0.010
	(0.35)	(-0.03)
Auditor_Tenure	-0.028***	-0.013*
	(-2.99)	(-1.72)
Office_Size	-0.072	-0.077
	(-1.09)	(-1.23)
GC_Dummy	0.155	0.086
	(1.20)	(0.75)
State, Industry, Year, and Auditor Fixed Effects	Yes	Yes
N	7,000	9,972
Pseudo R^2	0.044	0.080

Table 5: Influential Committee Power and Penalty on Financial Misconduct

This table presents OLS regression results of the effect of influential committee power on the penalty for financial misconduct. The dependent variable is Penalty$, which is the log of monetary penalty imposed by SEC/DOJ on the firm/employees. Columns 1-3 present results from tests using one of the three measures of influential committee member power. All variables are defined in Appendix A. Standard errors are Huber-White sandwich estimator clustered at the firm level. All specifications include fixed effects for state, industry, and year. Statistical significance at the 1%, 5%, and 10% levels is denoted by ***, **, and *, respectively.

	(1)	(2)	(3)
Variable		**Penalty$**	
Constant	4.861	5.688	1.237
	(0.56)	(0.75)	(0.17)
Total_Seniority	**-0.034****	**-**	**-**
	(-2.29)		
Committee_Num	**-**	**-0.320****	**-**
		(-2.16)	
Seniority_Dum	**-**	**-**	**-0.449****
			(-2.26)
Political_Connection	-0.846	-0.845	-1.082
	(-0.58)	(-0.62)	(-0.72)
Political_Contribution	-0.034	-0.033	-0.038
	(-0.31)	(-0.31)	(-0.33)
IncomeInflation$	1.345***	1.322***	1.407***
	(4.41)	(4.46)	(4.72)
Litigation Risk	-0.824	-0.934	-0.727
	(-0.74)	(-0.83)	(-0.65)
Size	-1.041	-0.986	-1.059
	(-1.49)	(-1.42)	(-1.51)
Leverage	-5.183	-4.829	-6.902
	(-0.99)	(-0.98)	(-1.60)
MtB	0.049	0.068	0.035
	(0.29)	(0.40)	(0.21)
Inst_Own	3.673*	3.761*	3.692*
	(1.70)	(1.74)	(1.71)
Analyst_Following	-0.090	-0.068	-0.115
	(-0.14)	(-0.11)	(-0.18)
Distance_to_SEC	-0.117	-0.263	0.002
	(-0.41)	(-0.93)	(0.01)
State, Industry, and Year Fixed Effects	Yes	Yes	Yes
N	247	247	247
Adj. R^2	0.254	0.263	0.253

Table 6: Congressional Committee Membership Shocks and Financial Reporting Quality

This table presents evidence from analysis examining the association between changes in financial reporting quality for firms that experience negative shocks to their influential committee representation, relative to firms in other states. *t*-values are in parentheses. The dependent variable is set to annual changes in *FRQ1*, *FRQ2*, or *FRQ3*. Standard errors are Huber-White sandwich estimator clustered at the firm level. All specifications include fixed effects for state, industry, year, and auditor. Statistical significance at the 1%, 5%, and 10% levels is denoted by ***, **, and *, respectively. All variables are defined in Appendix A.

Panel B: Regression Results

	(1)	(2)	(3)
Variables	**ΔFRQ1**	**ΔFRQ2**	**ΔFRQ3**
Constant	-1.205	-3.048	-0.460
	(-1.31)	(-1.26)	(-1.20)
Senior Drop	**-0.089****	**-0.008****	**-0.056****
	(-2.05)	**(-2.15)**	**(-2.32)**
Political_Connection	-0.112	-0.085	-0.116
	(-1.41)	(-1.32)	(-1.22)
Political_Contribution	-0.072*	-0.003	-0.013
	(-1.80)	(-1.37)	(-1.50)
Litigation Risk	-0.158	-0.221	-0.738*
	(-0.50)	(-0.99)	(-1.90)
Size	0.534	0.044	0.154
	(1.38)	(0.17)	(0.32)
Leverage	-2.112	-1.311	-1.747
	(-1.60)	(-0.68)	(-1.39)
MtB	-0.115	-0.011	-0.322
	(-0.74)	(-0.12)	(-1.15)
Profit	-0.476	-0.675*	-0.327
	(-1.16)	(-1.80)	(-0.64)
Issuance	0.691	0.522	1.933
	(0.63)	(0.74)	(1.42)
Stdev_Cashflow	-0.453	-1.807	-1.151
	(-1.09)	(-1.24)	(-1.16)
Stdev Sales	-2.981	-0.743	-1.959
	(-1.22)	(-1.37)	(-0.65)
Oper_Cycle	-0.691	-0.104	-0.902
	(-0.72)	(-1.01)	(-1.22)
Inst_Own	-0.855	-1.820*	-0.109
	(-0.82)	(-1.84)	(-0.04)
Analyst_Following	-0.574	-0.426	-0.141
	(-1.07)	(-1.08)	(-0.20)
Distance_to_SEC	-0.220	-0.223	-0.013
	(-0.85)	(-1.38)	(-1.04)
Auditor Share	0.206	0.237	0.502
	(0.43)	(0.07)	(1.60)
Auditor_Tenure	-0.041	-0.004	-0.101
	(-0.76)	(-0.14)	(-1.63)
Office_Size	0.536	0.101	0.264
	(0.98)	(0.24)	(0.38)
GC_Dummy	-4.125	-7.874*	-3.239***
	(-0.97)	(-1.71)	(-2.77)
State, Industry, Year, and Auditor Fixed Effects	Yes	Yes	Yes
N	896	896	896
Adj. R^2	0.080	0.100	0.104

Table 7 Influential Congressional Committee Power and AAERs Against Auditors

This table presents coefficients from logit regressions examining whether auditors are more likely to be identified in SEC enforcement against financial misconduct in states with powerful influential committee representation. The dependent variable is *Auditor_AAER*. All variables are defined in Appendix A. z-values are reported in parentheses. Standard errors are Huber-White Sandwich estimator clustered at firm level. All specifications include fixed effects for state, industry, auditor, and year. Statistical significance at the 1%, 5%, and 10% level is denoted by ***, **, and *, respectively.

	(1)	(2)	(3)
Variables		**Auditor_AAER**	
Intercept	-3.119***	-4.545	-4.522
	(-5.25)	(1.60)	(-1.49)
Total_Seniority	**0.028****	-	-
	(2.40)		
Committee_Num	-	**0.416****	-
		(2.22)	
Seniority_Dum	-	-	**0.528****
			(2.11)
Size	-0.903*	-1.894	-1.779
	(-1.83)	(-1.55)	(-1.50)
Leverage	2.339	3.332	4.298
	(1.30)	(1.22)	(1.13)
MtB	-0.330**	-0.355	-0.530
	(-2.26)	(-1.50)	(-1.32)
Profit	-0.055	-1.767	-3.855
	(-0.50)	(-1.40)	(-1.20)
Issuance	-2.549*	-1.885	-2.115
	(-1.83)	(-1.60)	(-1.55)
Stdev_Sales	-9.033**	-8.689*	-16.993
	(-2.30)	(-1.70)	(-1.40)
Litigation Risk	-0.559*	-4.773	-3.897
	(-1.72)	(-1.42)	(-1.45)
Prior_AAER_Auditor	3.019**	3.118**	3.288**
	(2.55)	(2.45)	(2.52)
Auditor_Share	0.599	1.257	1.582
	(0.50)	(1.02)	(0.77)
Auditor_Tenure	-1.339*	-1.983	-1.073
	(-1.93)	(-1.48)	(-1.33)
Office_Size	1.529***	4.209*	3.520*
	(2.90)	(1.90)	(1.88)
GC_Dummy	2.108**	2.110**	2.107**
	(2.05)	(2.03)	(2.06)
State, Industry, Auditor, and Year Fixed Effects	Yes	Yes	Yes
N	331	331	331
Pseudo R^2	0.781	0.659	0.578