Political Uncertainty and Accounting Conservatism: Evidence from the U.S. Presidential Election Cycle

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4 January 2013

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ABSTRACT

Election periods are associated with uncertainty about future governmental structure and public policy, i.e., political uncertainty, leading to an increase in agency costs. As a response to rising agency costs, we find that in the year prior to a U.S. presidential election, accounting conservatism increases by nearly 20 percent. This election year effect is stronger when the election is closer, when the incumbent president is not seeking re-election, and when the incumbent party is Democrat. In the post-election year, conservatism is lower relative to the non-election period when the incumbent party wins, but remains higher under an opposition party victory. Moreover, the election year effect varies across industries and companies, and remains unchanged under different empirical specifications. These findings add to the literature on how political forces can shape the nature of financial reporting by showing that accounting conservatism is driven by political concerns.

JEL Classification: M41, D72, G34, G38

Keywords: Accounting conservatism, Political uncertainty, Election cycle

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1. Introduction

We investigate the association between political uncertainty and accounting conservatism by exploiting the exogenous variation in political uncertainty induced by the U.S. presidential election cycle. The partisan view of politics argues that Republicans and Democrats differ with respect to economic, regulatory, and social policies, e.g., taxation rules, government expenditures, and welfare reforms (Alesina, 1987). Therefore, elections bring about potential change in the status quo leading to an increase in uncertainty about future policy outcomes. For example, during the 2012 U.S. presidential election, Republican candidate Mitt Romney was quoted as saying that, if elected, he would repeal the two major reforms introduced under the Obama administration: the Dodd-Frank Act and the universal health care reforms. Referring to the health care reforms, he vowed: "What the Court did not do on its last day in session, I will do on my first day if elected President of the United States, and that is I will act to repeal Obamacare." [1]

Prior literature defines accounting conservatism as the asymmetric verifiability of accounting gains versus losses, i.e., the verifiability threshold for gains is greater than that for losses (e.g., Basu, 1997; Watts, 2003a, 2003b), while an *official* definition in the *FASB Statement of Financial Accounting Concepts No. 2* states that conservatism is "a prudent reaction to uncertainty to try to ensure that uncertainties and risks inherent in business situations are considered." To develop a *political uncertainty hypothesis*, we argue that in an election year, uncertainty about the election outcome and consequent changes in public policy can have an effect on conservatism for two reasons.[2]

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[1] See, e.g., news reports by *Washington Post - Wonkblog*, Khimm (2012), and *ABC News Blogs*, Friedman (2012).
[2] Another explanation for the effect of elections on accounting choices is based on a *political cost hypothesis* (Watts and Zimmerman, 1978, 1986), i.e., manipulating accounting numbers to reduce costs related to adverse political scrutiny, especially during the election period (Ramanna and Roychowdhury, 2010). We cannot rule out this

First, political uncertainty increases the uncertainty about the future cash flows of assets that are already in place.[3] For example, legislative and regulatory changes can alter compliance costs, while changes in government expenditures and taxation rules might increase the uncertainty of firms' accounting performance. An increase in uncertainty about future cash flows makes "shirking" by managers harder to detect, and exacerbates the agency problem between managers and investors.[4] Kahn and Watts (2009) state that uncertainty can increase information asymmetry and raise moral hazard and adverse selection problems. Uncertainty of operations might also exacerbate conflicts between debt and equity holders over dividend policies and thus increase the demand for conservatism from debt holders (Ahmed et al., 2002; Ahmed and Duellman, 2012). Therefore, we conjecture that an increase in political uncertainty implies an increase in uncertainty in business operations, and consequently increases the verifiability threshold for good news relative to bad news, that is, an increase in conservatism.[5]

Second, Julio and Yook (2012) find that rising political uncertainty leads firms to increase cash holdings and reduce corporate investment before elections – firms defer investments until political uncertainty is resolved. On one hand, an increase in cash holdings can raise agency costs, because there is an increase in the amount of "free" cash that is available for managers to

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alternative explanation, but indeed find strong evidence to support the political uncertainty hypothesis and some weak evidence to support the political cost hypothesis.

[3] Moreover, the discount rate can also be affected by uncertainty about future government policies (Brogaard and Detzel, 2012).

[4] In standard models of outside financing with agency cost, the proportional difference between the probabilities of success if a manager "works" and if the manager "shirks" (known as the information ratio) is a key determinant of the size of agency costs. The larger the difference, the easier it is to detect shirking and the less likely the manager will shirk (Tirole, 2001). All else equal, when political uncertainty lowers the probability of success if a manager works, then it will be more difficult to detect shirking (a fall in the information ratio) – leading to an increase in agency costs.

[5] The verifiability threshold for bad news might increase as well. However, since investors are more concerned about the downside risk, the demand for conservatism should increase with uncertainty (Watts, 2003a). Moreover, we focus on conditional accounting conservatism, which carries new information and captures the effect of shocks to firm value (Ball et al., 2000; Ball and Shivakumar, 2005; Basu, 2005; Beaver and Ryan, 2005; Ball and Shivakumar, 2008).

pursue their personal interests (Jensen, 1986). On the other hand, the literature on real options and investment suggests that, *ceteris paribus*, deferring corporate investment increases the number of growth options – relative to assets in place – which are positively associated with agency costs (Smith and Watts, 1992).[6] The above reasoning implies an increase in agency costs in an election year resulting in an increase in demand for conservative accounting (Watts, 2003a).

Our empirical analysis is based on U.S. companies from *Compustat* and *CRSP* for the period of 1971-2012, which covers 11 presidential elections. We examine the association between political uncertainty and accounting conservatism using Kahn and Watts' (2009) conservatism measure, *C-Score*.[7] A consistent picture emerges: accounting conservatism increases in the year prior to the election date. The point estimates imply that in the year leading up to an election, accounting conservatism increases by 17 to 19 percent (depending on specifications). The results are robust to different empirical specifications and estimation techniques. We also perform sensitivity tests, e.g., controlling for the business cycle, political connections, and audit quality, conducting the analysis in pre- and post-SOX periods, using alternative pre-election windows and alternative measures of conservatism. The results remain unchanged.

Further, we find that the effect of political uncertainty on conservatism is stronger when an election is more competitive. This result is intuitively appealing as a closer election is associated with greater uncertainty about the eventual electoral outcome. Specifically, a decrease in the margin for victory by 10 percent increases the overall impact of political uncertainty on conservatism by 25 to 57 percent. We also find that the impact of political uncertainty becomes

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[6] The classic papers analyzing real options (e.g., McDonald and Siegel, 1986; Ingersoll and Ross, 1992) assume that the investment does not increase the firm's investment opportunities. Under this assumption, a company should have more growth options relative to assets in place because of deferred investment in an election year.

[7] In robustness tests, we perform the analyses using different measures of conservatism and find the similar results.

greater when the incumbent president is not seeking re-election and when the incumbent party is Democrat.[8] In the post-election year, conservatism remains higher relative to the non-election period, but lower relative to the election year. Further tests indicate that this post-election effect is driven by opposition party victories, i.e., after the election, conservatism is actually lower compared to the non-election period when the incumbent party wins. This suggests that under an opposition party victory, political uncertainty is higher than under an incumbent party victory, most likely since the policy stance of an incumbent party is more predictable.[9] Collectively, these results are consistent with the *political uncertainty hypothesis*.

Political uncertainty will impact on firms differently depending on factors that are associated with the political process and accounting conservatism, e.g., the firm's exposures to politics, government spending, contracting environment, litigation risk, taxation, and regulation.[10] Accordingly, we investigate cross-sectionally how these industry and firm level factors can exacerbate or moderate the positive relation between political uncertainty and conservatism. Across industries, we find that the election year effect on conservatism is stronger for politically sensitive industries, heavily regulated industries, industries that are sensitive to contract enforcement, and labor intensive industries with higher levels of employee union membership, while the election year effect tends to be weaker for industries with greater international trade exposures. At the firm level, for example, we find that the increase of conservatism in the election year is larger for firms with better external governance (lower G-index) mechanisms but

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[8] When an incumbent president is not seeking re-election, the likelihood of party turnover tends to be higher leading to higher political uncertainty (Gelman and King, 1990). A continuation of Democrat regime might be regarded as bad news by the markets (Santa-Clara and Valkanov, 2003), and result in higher conservatism.

[9] Please refer to Figure 1 for an illustration of conservatism cycles around the presidential election.

[10] Watts (2003a) provides four explanations for conservatism, i.e., contracting, litigation, taxation, and regulation.

smaller for firms with better internal governance (higher ratio of independent directors) mechanisms.[11]

This paper contributes to three streams of literature. First, it contributes to the literature on accounting conservatism.[12] Watts' (2003a) *regulatory explanation* argues that conservatism can be driven by the political process in which losses from overstated accounting numbers are more observable and usable for regulatory oversight. In this study, we explore the nature of conservatism in a particular political process, i.e., the U.S. presidential election, using a firm-year conservatism measure, *C-Score*, developed by Khan and Watts (2009). More importantly, beyond the scrutiny role of the political process (*political cost hypothesis*), we document another channel associated with *political uncertainty*, through which the political process can also influence accounting conservatism.[13]

Second, it also contributes to the literature on the impact of election cycles on economic outcomes, which argues that politicians have incentives to induce favorable macroeconomic outcomes before elections (e.g., McRae, 1977; Nordhaus, 1975; Rogoff and Sibert, 1988). We add to this line of literature, and find that the election cycle plays an important role not only at the macro-level, but also at the microeconomic level, i.e., accounting numbers disclosed by managers at the company level.

Third, the paper contributes to an emerging literature on the role of politics in determining corporate performance and corporate policy. Several asset pricing studies examine the impact of political uncertainty on stock returns (e.g., Belo et al., 2012; Boutchkova et al., 2012; Brogaard

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[11] We have no strong prior with regard to this finding – conservatism as a response to the agency problem might be either a substitute or complement to external (internal) governance mechanisms when political uncertainty rises.
[12] For a review, please see Watts (2003a, 2003b). Recent studies on conservatism include Ball and Shivakumar (2005), Ahmed and Duellman (2007), LaFond and Roychowdhury (2008), and LaFond and Watts (2008).
[13] We find strong evidence for the uncertainty explanation, e.g., the election effect is stronger for closer elections, but also evidence that may be consistent with both explanations, e.g., the effect is stronger for regulated industries.

and Detzel, 2012). For example, Belo et al. (2012) show that highly government-exposed companies experience higher stock returns during Democratic presidencies. In a recent corporate finance study, Julio and Yook (2012) find a decline in corporate investment corresponding with the timing of national elections around the world.

From the perspective of accounting practices, Ramanna and Roychowdhury (2010) focus on a sample of 563 firms that are politically connected with U.S. congressional candidates, and find that in the election year of 2004, when a firm has more outsourcing activities, it tends to report lower discretionary accruals to avoid political oversight (an example of the *political cost hypothesis*), because outsourcing was a major campaign issue in 2004.[14] This paper differs from their work and complements the literature by showing how political forces in general (not only for the outsourcing issue) affect another dimension of financial accounting choices, accounting conservatism,[15] for a large sample of firms in a period related to 11 elections.[16] From a theoretical view, in addition to the political cost channel, we find that accounting conservatism can be influenced through another undocumented channel related to political uncertainty. Lastly, the dynamics of accounting conservatism around elections shed some light on several unanswered questions arising from Ramanna and Roychowdhury (2010): whether their election results related to discretionary accruals in 2004 can be generalized to other aspects of accounting choices, and to other election years; and whether there is a time-series or cross-sectional variation in this political impact depending on the nature of elections, industries and companies.

There is a growing interest in the affect of politics on firm performance and management decisions, since politics and public policy play central roles in determining the external

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[14] Other studies, examining the relationship between politics and accounting practices, include Ramanna (2008), Guay (2010), Chaney et al. (2011), Kido et al. (2012), and Van Lent (2012).

[15] Ball and Shivakumar (2006), and Goh and Li (2011) argue that lower discretionary accruals are not necessarily associated with higher conservatism.

[16] Our sample covers both politically connected and non-connected firms.

boundaries in which a firm operates. In this paper, we document a new empirical finding – the tendency for firms to become more conservative with their accounting choices in the year leading up to a U.S. presidential election, which improves our knowledge on how political forces can shape the nature of financial reporting.

The rest of this paper is organized as follows. Section 2 discusses data sources and empirical design. Section 3 presents results of main and supplemental analyses. Section 4 concludes the paper.

2. Data and empirical design

Our full sample includes 147,894 firm-year observations of all the U.S. public firms from *Compustat - Fundamentals Annual Database and CRSP Monthly Stock Database* for fiscal years 1971-2011.[17] We construct firm-year estimates of accounting conservatism, *C-Score*, developed by Khan and Watts (2009), which allows us to capture both cross-sectional and time-series variation of asymmetric earnings timeliness. Khan and Watts (2009) develop their firm-year measure of conservatism based on Basu's (1997) cross-sectional model:

$$X_i = \beta_1 + \beta_2 D_i + \beta_3 R_i + \beta_4 D_i \times R_i + \varepsilon_i \tag{1}$$

where X is earnings, R is returns, and D is denoted as one when $R<0$ (bad news), and zero otherwise.[18] The incremental timeliness for bad news over good news is represented by β_4, while the timeliness measure for good news is β_3. They further define G-Score (timeliness of good news) and C-Score (incremental timeliness of bad news) as functions of firm size, market-to-book ratio and leverage:

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[17] We extract year-end earnings announcement dates from *Compustat - Fundamentals Quarterly Database*, which limits our sample period to start from 1971. Based on the differences between announcement dates and election dates, we define the pre-election and post-election dummy variables used in the analysis.

[18] Ball et al. (2013) show that in their model the Basu measure is unbiased and captures conditional conservatism.

$$\text{G-Score} = \beta_3 = \mu_1 + \mu_2 Size_i + \mu_3 M/B_i + \mu_4 Lev_i \tag{2}$$

$$\text{C-Score} = \beta_4 = \lambda_1 + \lambda_2 Size_i + \lambda_3 M/B_i + \lambda_4 Lev_i \tag{3}$$

Substituting G-Score and C-Score into *equation (1)*, an annual cross-sectional regression model is derived to estimate the parameters (μ_1-μ_4 and λ_1- λ_4) in equations (2) and (3). Then, the estimated parameters (λ_1- λ_4) can be used to calculate the C-Score in equation (3).

$$X_i = \beta_1 + \beta_2 D_i + R_i \times (\mu_1 + \mu_2 Size_i + \mu_3 M/B_i + \mu_4 Lev_i) + D_i \times R_i(\lambda_1 + \lambda_2 Size_i + \lambda_3 M/B_i +$$

$$\lambda_4 Lev_i) + (\delta_1 Size_i + \delta_2 M/B_i + \delta_3 Lev_i + \delta_4 D_i \times Size_i + \delta_5 D_i \times M/B_i + \delta_6 D_i \times Lev_i) + \varepsilon_i \tag{4}$$

Election timing in the U.S. is determined by law. Since 1845, Election Day occurs on the first Tuesday after November 1. We use the U.S. presidential election cycle as an exogenous shock to political uncertainty to investigate its impact on accounting conservatism. Presidential elections follow a four year cycle on even numbered years. The sample period is associated with 11 presidential elections from 1971 to 2012.[19] Let the election date be day $t = 0$, we construct a *PRE-ELECTION* dummy which equals one if a firm's annual earnings announcement date falls in the window [-360, 0), and zero otherwise.[20] The baseline regression takes the form:

$$\text{C-SCORE}_i = \alpha + \gamma_1 PRE\text{-}ELECTION + \gamma_Z Z_i + Industry/Firm\ Fixed\ Effects + \varepsilon \tag{5}$$

where α is the intercept and Z is a vector of control variables. The coefficient of PRE-ELECTION, γ_1, captures the change in accounting conservatism in the period leading up to a presidential election and is expected to be positive and significant according to the *political uncertainty hypothesis*. The control variables include: 1) *SIZE,* natural log of the market value of equity; 2) *MARKET/BOOK*, market-to-book ratio; 3) *LEVERAGE,* long-term and short-term debt

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[19] Please refer to the *U.S. Election Statistics: A Resource Guide* from the Library of Congress.
[20] We choose the actual earnings announcement date for the pre-election window, because managers might be aware of the increase in investors' demand for conservatism before the Election Day and therefore disclose accounting information more conservatively within this window. Also, we find results robust, when using different pre-election windows, e.g., 90 or 180 days.

deflated by market value of equity; 4) *VOLATILITY*, standard deviation of daily firm-level returns; 5) *NOACC*, non-operating accruals scaled by lagged assets; 6) *CFOA*, cash flow from operations deflated by lagged assets; 7) *INVEST CYCLE*, depreciation divided by lagged assets, a decreasing measure of the length of investment cycle; 8) *BID-ASK,* bid–ask spread scaled by the midpoint of the spread based on daily closing bid and closing ask from CRSP; and 9) *AGE*, firm age in years (Khan and Watts, 2009).[21]

Table 1 presents summary statistics of the variables for the full sample as well as the following sub-samples: 1) election year; 2) post-election year; and 3) non-election period. We find that conservatism as measured by C-Score is higher in election years (mean C-Score is 0.144) than in post-election years and non-election periods (mean C-Scores are 0.131, and 0.117, respectively). This suggests that compared to non-election period, on average, conservatism is 23 percent higher in the year prior to an election, and remains 12 percent higher in the year following the election in a univariate analysis.[22] In the next section, we perform multivariate regressions to examine whether the election-year effect holds after controlling for other factors that can influence accounting conservatism.

3. Results

3.1 Elections and conservatism

We present the results of our baseline model in Table 2. Consistent with our expectations, the coefficient estimate on PRE-ELECTION is positive and significant at the one percent level across all specifications. The result is robust to the inclusion of control variables, industry fixed

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[21] Khan and Watts (2009) include the probability of informed trading (*PIN*) as an additional control for information asymmetry. For a robustness test we rerun the analysis including the PIN estimate calculated by Brown and Hillegeist (2007) and find that the results (unreported) remain unchanged, however the sample size falls to 87,514.
[22] An increase by 23 percent is equal to (0.144-0.117)/0.117, and 12 percent is equal to (0.131-0.117)/0.117.

effects as well as firm fixed effects. Conservatism increases in the year prior to elections, with coefficients ranging from 0.0214 (Model 3) to 0.0246 (Model 4). Given an unconditional mean C-Score equal to 0.127 in Table 1, these estimates translate to an increase in conservatism by 17-19 percent depending on specifications. In Model 6, we include control variables and firm fixed effects and find that MARKET/BOOK, SIZE and BID-ASK are negatively correlated with conservatism while LEVERAGE, CFOA, INVEST CYCLE, VOLATILITY and AGE are positively correlated with conservatism.[23]

To further test the *political uncertainty hypothesis*, we study whether the degree of electoral competition exacerbates the election year effect in conservatism. Closer elections entail more uncertainty about the eventual winner and therefore are associated with higher political uncertainty. We construct a variable called *MARGIN* to measure the degree of political competition as follows: Let c be the total number of electoral colleges, let w be the number of votes cast for the winning candidate, and let l be the number of votes cast for the losing candidate, then the *MARGIN* is denoted as:

$$MARGIN = (w - l) / c \qquad (6)$$

The coefficient of interest is related to the interaction term between PRE-ELECTION and MARGIN (*PRE×MARGIN*).[24] We expect that strong political competition (small MARGIN) is associated with high political uncertainty and therefore greater conservatism. Table 3 presents the results from this analysis. As expected, the coefficient on PRE×MARGIN is negative and significant at the one percent level in all specifications. The coefficient estimates for the

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[23] We calculate robust standard errors adjusted for firm-level clustering. We do not include year fixed-effects or cluster errors by year, because our main variables of interest are *election-related* variables, and by definition, they capture the time effects, and are correlated across all the firms in a given period (Petersen 2009).

[24] We do not test the level effect of margin in our model, only the interaction term between margin and pre-election dummy, because in a *non-election* period we are unable to assign a value to this *election-related* variable. Similarly, in the next sub-section, we only include the interaction between incumbency advantage (or party affiliation) and the pre-election dummy.

PRE×MARGIN range from -0.0591 (Model 6) to -0.141 (Model 4) implying that a 10 percent decrease in MARGIN results in an increase in the election effect by 25 to 57 percent.[25]

3.2 Incumbency Advantage and Party Affiliation

In this sub-section, we investigate whether: 1) the incumbency advantage; and 2) the party affiliation of the incumbent president exacerbate the election year impact on conservatism. Prior studies document the *incumbency advantage* phenomenon: *ceteris paribus*, incumbents have an advantage at the polls (e.g., Gelman and King, 1990). Accordingly, we expect elections in which the incumbent president is running for re-election to be less competitive, and thereby be associated with lower political uncertainty. We capture the variation in incumbency advantage using an indicator variable, *INCUM*, equal to one if the incumbent president is seeking re-election,[26] and expect the coefficient on the interaction term between INCUMB and PRE-ELECTION to be negative. Table 4 presents the results. We find a negative and significant coefficient on PRE×INCUM, implying that the conservatism in an election year is reduced if the incumbent president is seeking re-election, which is consistent with the *political uncertainty hypothesis*.

Santa-Clara and Valkanov (2003) show that excess stock market returns are higher under Democratic than Republican presidencies after controlling for the business-cycle and stock riskiness. Belo et al. (2012) further show that during Democratic presidencies, firms with high government exposure experience higher cash flows and stock returns, and that the reverse is true for Republican presidencies. To this end, we investigate whether incumbent party affiliation alters the pattern of conservatism around elections. We define an indicator variable, *DEM*, equal

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[25] An increase by 25 percent is equal to (0.0591 x 0.1)/0.0241, and 57 percent is equal to (0.141 x 0.1)/0.0246. The benchmark election effects of, 0.0241, and 0.0246, are estimates of PRE-ELECTION in Table 2 for same models.

[26] Legislation in the U.S. allows a president to serve a maximum of two consecutive terms, meaning an incumbent president can run for re-election only once. Therefore, to a large extent, INCUM is exogenously determined by law - during our sample period, after their first presidential term, all the incumbent presidents seek re-elections.

to one if the incumbent president is a Democrat and zero otherwise. The coefficient of interest is the interaction between DEM and PRE-ELECTION (*PRE×DEM*). We may expect the coefficient on *PRE×DEM* to be positive, because a victory by the Democratic party is regarded as bad news around the announcement date of election outcome (Santa-Clara and Valkanov 2003), which might make managers more conservative in the election year. In Table 4, after controlling for the effect of incumbency advantage (Models 7 – 9), we find that the coefficients on DEM are negative, and the coefficients on PRE×DEM are positive (both significant at one percent level). That is, prior to an election, managers are more conservative with financial reporting when a Democratic regime is very likely to be continued,[27] however, during a long-term Democratic mandate, companies tend to have lower accounting conservatism. These results are consistent with findings in Santa-Clara and Valkanov (2003) who find a negative market reaction to the announcement of a Democratic victory but higher stock returns under a Democratic regime.

3.3 Post-election Conservatism

Our primary focus up to this point has been to study whether firms become more conservative with their financial reporting leading up to an election. A natural question to ask is whether conservatism decreases when political uncertainty falls after the election. We construct a variable, *POST-ELECTION*, equal to one if firms' annual earnings announcement date falls in the window (0, +360] and zero otherwise. Panel A of Table 5 shows positive and significant estimates for POST-ELECTION consistently across specifications, implying that conservatism remains high in the year after elections relative to non-election periods. Focusing on the most restrictive model (Model 6) the coefficient estimates for PRE-ELECTION and POST-

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[27] An incumbent party is highly likely to continue its administration. For example, for 29 elections from 1900 to 2012, the continuation rate of a political regime is 61 percent for Democrats and 62 percent for Republicans.

ELECTION are 0.0285 and 0.0136, respectively. Compared to the unconditional mean value for conservatism, these estimates imply that conservatism increases by about 22 percent in the year leading up to an election, and remains about 11 percent higher than all other years in the year following an election.[28] These results suggest that while the end of an election may signal no more uncertainty about who forms office, the period immediately after an election may still be associated with higher than average political uncertainty.

The persistence of high conservatism after the election date might simply be driven by a change in political party as a result of the election. One might expect that the policy stance of the incumbent party is more predictable, relative to that of the opposition party, given that they have been in office for at least one term. Therefore, consistent with the *political uncertainty hypothesis*, an election that results in the opposition party forming office is associated with continued political uncertainty, relative to an election where the incumbent party retains power, leading to higher than average post-election conservatism. We investigate this possibility by creating an indicator variable, *OPPWIN*, equal to one if the opposition party wins the election, and interacting it with POST-ELECTION, and expect the coefficient on *POST×OPPWIN* to be positive. In Panel B of Table 5, we find that the estimates on POST×OPPWIN are significantly positive, and after controlling for OPPWIN, the coefficients on POST-ELECTION become negative and significant at one percent, which is consistent with the notion that the election year effect on conservatism is reversed if the incumbent party retains power, but persists at a high level when the election is won by the opposition party. In Model 6, the estimates for PRE-ELECTION and POST-ELECTION are 0.0288 and -0.00546 respectively, implying an increase in conservatism by approximately 23 percent in the year leading up to an election, and a

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[28] These estimates are very close to those obtained from the univariate comparison of C-Score across election and non-election years in the previous section.

reduction in conservatism of approximately four percent in the year following when the incumbent party retains power (relative to the unconditional mean C-Score of 0.127 in Table 1). Figure 1 illustrates the cycles in conservatism using the estimates from Model 6 of Table 5. The dashed line displays conservatism before and after a presidential election regardless of the electoral outcome (Model 6 of Panel A). The solid line represents the cycles in conservatism around elections that are won by the incumbent party (Model 6 of Panel B). A significant decline in conservatism is observed in the post-election year, however, the magnitude of the post-election decline is smaller than that of the initial increase – roughly one-fifth the size of pre-election increase.[29] In Panel C, PRE-MARGIN is added into the specification. All the previous results remain qualitatively similar.

[Figure 1 is inserted here]

3.4 Industry Characteristics and Conservatism Cycles

Watts (2003a) argues that conservatism exists for four reasons: 1) to mitigate contracting problems (including debt and compensation contracts); 2) to reduce litigation risks; 3) to avoid regulatory costs; and 4) to minimise taxation obligations. Political uncertainty may affect accounting conservatism differently depending on firms' exposures to politics, government spending, contracting environment, litigation risk, taxation, and regulation. In this and the next sub-sections, we explore how the cross-sectional variation in political uncertainty, across industries and firms, affects the election year increase in conservatism. We first focus on industry characteristics including political sensitivity, regulatory oversight, contract enforcement, labor

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[29] The relative magnitude of the post-election decline in conservatism is calculated as (0.00546/0.0288)=0.19.

intensity, union membership and international trade exposure. The results from industry cross-sectional analyses are presented in Table 6.[30]

3.4.1 Political sensitivity and regulatory oversight

We first perform tests on two industry factors, i.e., political sensitivity, and regulatory oversight, and expect the election effect to be stronger for more sensitive and regulated industries. Following Julio and Yook (2012), we categorise the following industries as sensitive sectors: tobacco products, pharmaceuticals, health care services, defence, petroleum and natural gas, telecommunications, transportation, and finance. We create a variable, *SENSITIVE*, equal to one if a firm belongs to a sensitive industry. From the regulatory oversight perspective, we construct another indicator variable, *REGULATE*, equal to one if a firm operates in the finance or utilities industries. The results presented in Models 1 and 2 confirm our conjecture. In particular, estimates on *PRE×SENSITIVE* and *PRE×REGULATE* are both positive and significant, suggesting two possibilities: in these two groups of industries, 1) there is a greater potential for policy change (*political uncertainty hypothesis*); and/or 2) costs related to political scrutiny are higher (*political cost hypothesis*).

Ramanna and Roychowdhury (2010) document a decline in discretionary accruals for companies connected with U.S. congressional candidates in the election year of 2004, especially for outsourcing-intensive firms, based on a *political cost hypothesis*. Although we report evidence in favor of the *political uncertainty hypothesis* in previous sections,[31] we cannot easily rule out the possibility that the *political cost hypothesis* also partially explains our election year

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[30] We do not include firm/industry fixed-effects in the industry level analysis as our industry characteristics do not vary overtime.

[31] It is difficult to explain the results in the tests for electoral competition, incumbency advantage and post-election conservatism with the *political cost hypothesis*.

effect. Indeed, the findings here suggest that the two hypotheses may jointly explain the phenomenon of conservatism cycles.

3.4.2 Contract enforcement, labor intensity, unionism and international trade exposure

Following Boutchkova et al. (2012), we examine three additional industry characteristics, namely, contract enforcement, labor intensity, and international trade exposure and report the results in Models 3 to 5. Additionally, we also study the impact of union membership and report the results in Models 6 and 7. Since the protection of property rights and contract enforcement depend on the quality of institutions, which are in turn affected by political forces, complex industries with high sensitivity to contract enforcement (also with a high demand for institutional quality) are expected to be more conservative with financial reporting in election years, when political uncertainty leads to uncertainty in future institutional quality. Boutchkova et al. (2012) use the U.S. *Input-Output* tables from 1998 to 2006 to calculate the Blanchard and Kremer (1997) measure of contract enforcement sensitivity for 50 U.S. industries at the two-digit SIC code level. This measure is equal to one minus the Herfindahl index of industry input shares, and varies from zero (if the industry uses inputs from only one industry) to one. To study the impact of contracting environment, we construct a variable, *HIGH-CONTRACT,* equal to one if a firm belongs to an industry with an above median sensitivity to contract enforcement according to the Boutchkova et al. (2012) measure. In Model 3, we find that the coefficient on *PRE×HIGH-CONTRACT* is positive and significant, implying that companies, which rely more on contract enforcement and institutional quality, tend to be more conservative when there is an increase in political uncertainty related to the potential changes in institutional quality.

For firms with high exposure to international trade, revenues are less influenced by domestic politics, therefore a smaller election year effect is predicted. International trade exposure is the

proportion of export flows for each industry to a particular trading partner, and then is summed across all trading partners, available for 29 industries (Boutchkova et al., 2012). We construct a variable *HIGH-TRADE* equal to one if a firm belongs to an industry with an above median value for international exposure according to Boutchkova et al. (2012). From Model 4, consistent with the predictions, we find a smaller election-year effect for industries with higher international trade exposure (negative coefficient *PRE×HIGH-TRADE*).

Since labor-related issues often appear on parties' electoral agendas we expect the election year effect to be stronger in industries that are sensitive to potential change in labor laws. We use two variables to study the impact of labor on the election year effect. First, we adopt the labor intensity factor studied in Boutchkova et al. (2012), which is estimated as the value of labor inputs to the total value of production inputs using data from 1990 to 2005 for 32 sectors.[32] Second, we obtain industry level unionization data for the year 2007 from the *Union Membership and Coverage Database*.[33] We construct variables: *HIGH-LABOR* equal to one if a firm belongs to an industry with an above median value for labor intensity according to the Boutchkova et al. (2012) measure, and *HIGH-UNION* equal to one if a firm belongs to an industry with an above median level of employee union membership.

The results in Models 5 and 6 show the coefficients on *PRE×HIGH-LABOR* and *PRE×HIGH-UNION* are negative, implying that the election year effect is weaker for these industries. The results may simply reflect the fact that, seperately, these two labor proxies do not properly capture the industries that are sensitive to potential changes in labor legislation and policy. For example, an industry with a high level of unionization but with low level of labor

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[32] The data are obtained from the input–output database using information from the *Bureau of Economic Analysis* and *Bureau of Labor Statistics*.

[33] The data are maintained by Barry Hirsch and David Macpherson, and available from *www.unionstats.com*. Hirsch and Macpherson (2003) provide details on the construction of this dataset.

intensity might not be sensitive to potential changes in labor legislations. Similarly, labor intensive industries with a low level of union membership can be less beholden to the changes in government labor policies. Therefore, we create a new indicator variable for industries that are above the median value for *both* labor intensity and union membership, that is, the interaction between *HIGH-LABOR* and *HIGH-UNION,* to capture *labor-sensitive* industries. We report the results in Model 7, and as predicted, we find that labor intensive industries with high levels of unionization are more senstive to political uncertainty (i.e., positive coefficient on *PRE×HIGH-LABOR×HIGH-UNION*).

3.5 Firm Characteristics and Conservatism Cycles

In this sub-section, we examine the roles of corporate governance, tax avoidance and litigation risk in explaining the association between political uncertainty and accounting conservatism.

3.5.1 Corporate governance

Whether "good" governance has a moderating or exacerbating effect on the association between political uncertainty and accounting conservatism is unclear. As discussed, political uncertainty is positively associated with agency costs and thus demand for conservatism due to three reasons, i.e., greater difficulty in detecting managers' shirking behavior (Tirole, 2001), increased amount of cash available to the manager, and more growth options (Julio and Yook, 2012). We may expect governance to have a negative (positive) influence on the election year effect if it is a substitute (complement) to conservatism in solving agency problems. An exogenous shock to agency costs from the presidential election provides us an opportunity to explore these two possibilities.

We extract corporate governance information from *RiskMetrics - Directors and Governance Databases*, and employ two governance proxies in this analysis: 1) the external governance index developed by Gompers et al. (2003) (*G-INDEX*) which is the anti-takeover provision index for the market for corporate control, and 2) the percentage of independent directors on the board, *INDEPENDENT*, as a measure of internal governance associated with the monitoring roles of existing investors and board of directors.[34] In Models 1 to 3 of Table 7, we find negative coefficients on *PRE×G-INDEX* and *PRE×INDEPENDENT*, which implies that external (internal) governance might be a complement (substitute) to accounting conservatism in mitigating the increased agency costs caused by rising political uncertainty. These results are insightful for the literature on the relation between governance and conservatism for two reasons. First, we show that the substitute or complement relation between governance and conservatism may be different for internal versus external governance mechanisms. Second, previous studies such as Ahmed and Duellman (2007) and García Lara et al. (2009), which find a positive association between governance and conservatism, take agency costs as given, while we provide a new piece of evidence on the governance-conservatism relation in a setting where there is an exogenous increase in agency costs.

3.5.2 Tax and litigation

Finally, we consider the roles of tax avoidance and litigation risk. *TAX* is estimated as the effective tax rate under GAAP, an inverse measure of tax avoidance, equal to total tax expense divided by pre-tax accounting income less special items. A higher value of TAX implies a lower incidence of tax avoidance (McGuire et al., 2012). We estimate the measure of probability of litigation, *LITIGATION*, an inverse logit of a linear combination of firm fundamentals (Shu,

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[34] A lower level of the G-index implies better external governance, while higher percentage of independent directors reflects stronger internal governance. The sample size is reduced by about 90 percent because *RiskMetrics* data are not available for all the years and for small firms.

2000).[35] The results for TAX and LITIGATION are presented in Models 4 to 9. Focusing on Models 6 and 9 that control for firm fixed effects, we find that the coefficients are negative for the interaction terms, *PRE×TAX* and *PRE×LITIGATION*, but only significant for the latter. This indicates that the election year effect on conservatism is lessened for firms with higher litigation risk, which may represent the fact that managers of these firms are on average more conservative and accordingly do not respond as much to rising political uncertainty in the lead up to elections.

3.6 Robustness Tests

There may be alternative explanations for our findings and we take them into consideration by conducting several sensitivity tests in this section. We also employ alternative pre-election windows and different measures for accounting conservatism as robustness tests.

3.6.1 Political connections

Prior studies show that the political connectedness of a firm has implications for its behavior and performance due to preferential treatment, and that politicians can also potentially benefit from these connections. For example, using a sample of international firms, Chaney et al. (2011) find that the quality of earnings reported by politically connected firms is significantly poorer than that of similar non-connected companies. Ramanna and Roychowdhury (2010) document that politically connected companies report low discretionary accruals when their outsourcing activities are a major concern during the campaign.[36] Taking the Watts (2003a, 2003b) view that conservatism is a value enhancing mechanism to reduce agency costs, one may argue that the our conservatism results are largely driven by politically connected firms helping affiliated

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[35] Specifically, this combination equal to {-10.049 + 0.276 (Size) + 1.153 (Inventory) + 2.075 (Receivables) + 1.251 (ROA) - 0.088 (Current ratio) + 1.501 (Lev) + 0.301 (Sales growth) - 0.371 (stock return) - 2.309 (stock volatility) + 0.235 (beta) + 1.464 (stock turnover) + 1.060 (Delist dummy) + 0.928 (Technology dummy) + 0.463 (Qualified opinion dummy)}.

[36] See other studies related to political connections, for example, Johnson and Mitton (2003), Faccio (2006), and Faccio et al. (2006).

politicians win office. To address this issue, we include a dummy, *CONNECTED*, equal to one if a firm is politically connected based on the data in Faccio (2006) and re-run the analysis. In Models 1 and 2 of Table 8, we find that our results remain the same, and the interaction term, *PRE×CONNECTED,* has an insignificant coefficient.

3.6.2 The political business cycle

Conceptually, it is possible for the incumbent party to manipulate fiscal and monetary policy instruments to improve macroeconomic outcomes prior to an election in order to maximize the probability of re-election (e.g., McRae, 1977; Nordhaus, 1975; Rogoff and Sibert, 1988).[37] A rational firm may respond to this political business cycle by changing its accounting choices. If a policy change is favorable to the company, presumably managers may become less conservative, however when managers are aware of the transitory nature of favorable policy, they may report earnings in a more conservative manner. To investigate this possibility, we introduce two macroeconomic indicators: economic growth, *GROWTH*, and inflation, *INFLATION*, proxied by growth in real gross domestic product (GDP), and growth in the consumer price index (CPI), respectively. In Models 3-5 of Table 8, results are robust to the inclusion of business cycle variables and their interactions with PRE-ELECTION.

3.6.3 Auditor Quality

One may argue that the election effects might be driven by auditor quality. For example, firms may choose Big 4 auditors coincidentally in election years, and due to higher audit quality financial reports tend to be more conservative. To rule out this possibility, we add a dummy variable, *BIG 4*, into our analysis, which is equal to one if a firm is audited by a Big-4 CPA firm.

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[37] Empirical evidence in the U.S. to support this view is limited (Drazen 2000), while studies in emerging markets show some evidence that governments take actions to improve chances of re-election (Brown and Dinc, 2005; Dinc, 2005).

The results presented in Models 6 to 8 indicate that our election effects remain robust to the inclusion of BIG 4 and *PRE×BIG 4*.[38]

3.6.4 Pre- versus post-SOX

After the introduction of the Sarbanes-Oxley Act (SOX), the impact of the political process on conservatism may be stronger for two reasons. First, since public attention on accounting issues increases in the post-SOX period, firms may react to political uncertainty more because of an increased demand for conservatism from investors and politicians. Second, in the post-SOX period, the likelihood of a change in accounting standards due to a switch in political regime may become higher, therefore creating "accounting slack" in the form of conservatism is desirable. For example, in a campaign event leading up to the 2012 election, when asked by a voter, Mr. Romney pledged to repeal the Sarbanes-Oxley Act.[39]

We analyze the impact of SOX in two ways: 1) perform the analysis in two sample periods split by SOX; and 2) introduce an indicator variable, *SOX*, for the post-SOX period into the baseline model. The results presented in Table 9 show that the election year effects are robust in two sub-periods, and remain unchanged after the SOX dummy is included. In Models 7 to 9, we also find that, on average in post-SOX period, conservatism is higher (positive coefficient on SOX) and the election year effects are stronger (positive coefficient on *PRE×SOX*), which is consistent with our conjecture.

3.6.5 Alternative pre-election windows

There may be concern that our results are an artefact of our choice of pre-election window. Accordingly, we rerun the analysis using alternative windows of 90 days and 180 days. The

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[38] In order to preserve a larger sample size, we do not include BIG 4 in our main analyses.
[39] See, for example, a news report by *Wall Street Journal Blogs*, Murray (2012).

results presented in Table 10 indicate that the findings of election year effects are qualitatively the same.[40]

3.6.6 Alternative measures of accounting conservatism

As a final robutness test, we employ two additional measures of conservatism to test our conjecture that accounting conservatism increases in the year leading up to an election. First, instead of using C-Score, we directly adopt Basu's (1997) model for the asymmetric timeliness of earnings to news. Following prior research (e.g., Lafond and Roychowdhury, 2008; Lafond and Watts, 2008; Ahmed and Duellman, 2012; Ramalingegowda and Yu, 2012), we extend the Basu model of equation (1) as a function of our election year dummy and other documented determinants of conservatism:

$$X_i = \alpha + \beta_1 D_i \times R_i \times PRE\text{-}ELECTION + \beta_2 R_i \times PRE\text{-}ELECTION + \beta_3 D_i \times PRE\text{-}ELECTION$$

$$+ \beta_4 D_i \times R_i + \beta_5 R_i + \beta_6 D_i + \beta_7 PRE\text{-}ELECTION + \beta_a Z_i \times R_i \times D_i + \beta_b Z_i \times R_i$$

$$+ \beta_c Z_i \times D_i + \beta_x Z_i + Industry\ Fixed\ Effects + \varepsilon, \tag{7}$$

where X is earnings, R is returns, D is denoted as one when $R<0$ (bad news) as defined in equation (1), while *PRE-ELECTION* is denoted as one when a firm's annual earnings announcement date falls in the pre-election window, and Z is the same vector of control variables used in equation (5). Conservatism implies a positive coeffiicent (β_4) on $D \times R$, because bad news is incorporated into earnings on a more timely basis. Since political uncertainty in election years leads to an increase in conservatism, we expect a positive coefficient (β_1) on $D \times R \times PRE\text{-}ELECTION$. The results presented in Models 1 to 4 of Table 11 show that across all the specifications, the coeficient estimates of β_1 are positive and significant, which in turn confirms our conjecture.

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[40] We do not include firm fixed-effects in Table 10, as a pre-election dummy cannot capture all the firms in a short window (less than one year) prior to the election date.

Second, we employ a measure of conservatism related to the model of persistence of earnings change (Basu, 1997), which does not rely on stock returns.[41] Similar to equation (7), we extend the baseline model of persistence of earnings change by including our election year dummy and other control variables as follows:

$$\Delta NI_{i,t} = \alpha + \eta_1 NEGI_{i,t-1} \times \Delta NI_{i,t-1} \times PRE\text{-}ELECTION_t + \eta_2 \Delta NI_{i,t-1} \times PRE\text{-}ELECTION_t +$$

$$\eta_3 NEGI_{i,t-1} \times PRE\text{-}ELECTION_t + \eta_4 NEGI_{i,t-1} \times \Delta NI_{i,t-1} + \eta_5 \Delta NI_{i,t-1} + \beta_6 NEGI_{i,t-1} + \beta_7 PRE\text{-}$$

$$ELECTION_t + \eta_a Z_i \times \Delta NI_{i,t-1} \times NEGI_{i,t-1} + \eta_b Z_i \times \Delta NI_{i,t-1} + \eta_c Z_i \times NEGI_{i,t-1} + \eta_x Z_i + Industry$$

$$Fixed\ Effects + \varepsilon, \tag{8}$$

where ΔNI is the change in annual income before extra ordinary items deflated by total assets, $NEGI$ is an indicator equal to one if ΔNI is negative, $PRE\text{-}ELECTION$ is denoted as one if earnings annoucement date falls in the pre-election window, and Z is the same vector of control variables used previously in equation (5). Since greater conservatism implies less persistence of negative earnings changes, we expect η_1 to be negative indicating an increase in conservatism in election years. Consistent with our predictions, in models 5 to 8 of Table 11, η_1 is negative and significant across different specifications.

4. Conclusion

We exploit exogenous variation in political uncertainty induced by the U.S. presidential election cycle to study its impact on accounting conservatism. An interesting picture emerges: in the year leading up to an election, accounting conservatism increases by nearly 20 percent relative to other years. Further tests reveal that this electoral phenomenon is indeed caused by political uncertainty and is stronger when the election is closer, and when the incumbent president is not seeking re-election. In the post-election year, conservatism is lower relative to

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[41] Other papers using this model, for example, include Ball and Shivakuma (2005), Chung and Wynn (2008), and Ramalingegowda and Yu (2012).

the non-election period when the incumbent party wins, but remains high under an opposition party victory. This new empirical finding adds to our knowledge regarding how political forces shape the nature of financial reporting, and contributes to a growing literature on the role of politics in determining corporate performance and corporate policy. One avenue for future research is to investigate the impact of elections on the flow of accounting information, on firms' information environment and the behavior of the users, preparers, auditors, and disseminators of financial reports.

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Figure 1
Conservatism around presidential elections.
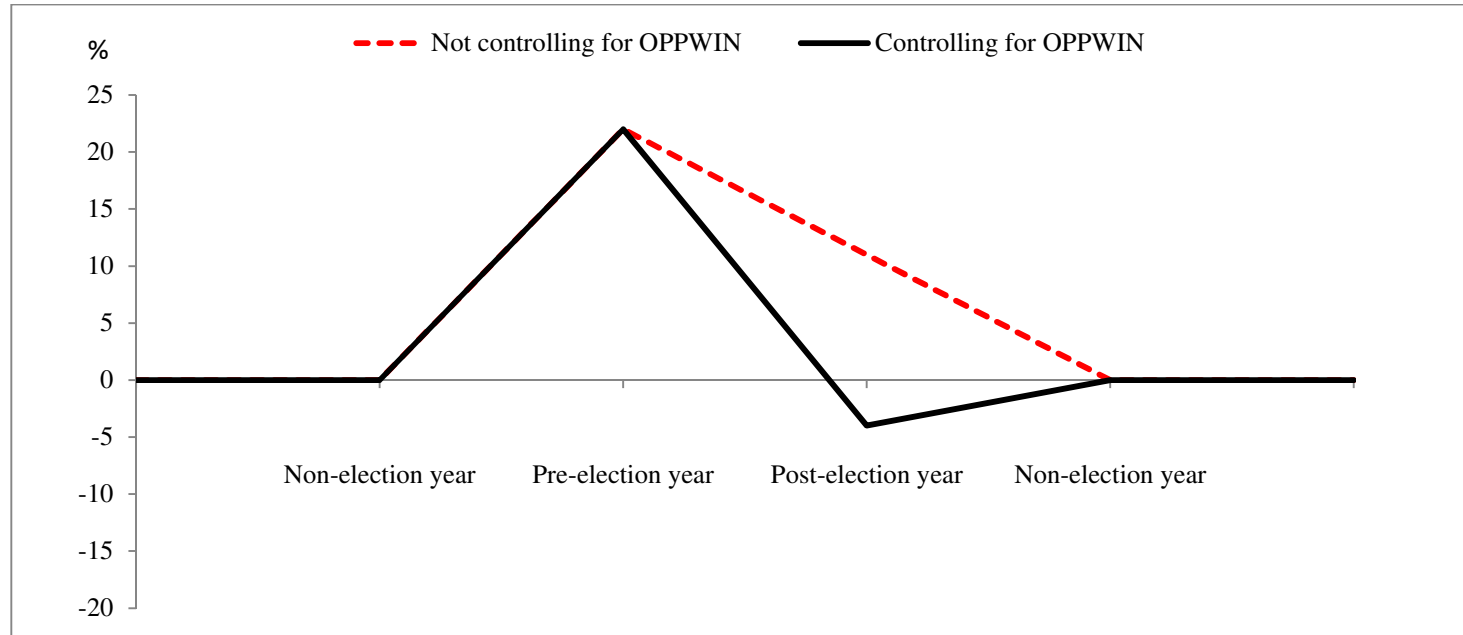
This figure displays estimates from the regression results reported in Model 6 of Table 5. OPPWIN is an indicator variable equal one if the election results in a opposition party's victory. The dashed line displays conservatism after presidential election regardless of the electoral outcome (Model 6 of Panel A). The solid line displays conservatism around presidential election when the incumbent party wins the campaign (Model 6 of Panel B). The vertical axis represents percentage change in conservatism relative to the unconditional mean.

Table 1

Summary statistics.

	Full Sample			Election Year			Post-election Year			All Other Years		
	Obs	Mean	Std. Dev.	Obs	Mean	Std. Dev.	Obs	Mean	Std. Dev.	Obs	Mean	Std. Dev.
C-SCORE	147894	0.127	0.154	38259	0.144	0.206	35327	0.131	0.144	74308	0.117	0.124
SIZE	147894	5.246	1.999	38259	5.286	2.012	35327	5.172	1.968	74308	5.260	2.006
MARKET/BOOK	147894	2.299	2.394	38259	2.401	2.728	35327	2.229	2.243	74308	2.280	2.274
LEVERAGE	147894	0.896	1.338	38259	0.897	1.333	35327	0.902	1.367	74308	0.893	1.327
NOACC	147894	-0.015	0.159	38259	-0.014	0.122	35327	-0.017	0.204	74308	-0.015	0.151
CFOA	147894	0.062	0.191	38259	0.061	0.187	35327	0.061	0.184	74308	0.063	0.196
INVEST CYCLE	147894	0.043	0.055	38259	0.043	0.048	35327	0.044	0.075	74308	0.043	0.047
VOLATILITY	147894	0.032	0.018	38259	0.032	0.018	35327	0.033	0.021	74308	0.031	0.017
BID-ASK	147894	0.027	0.030	38259	0.027	0.032	35327	0.029	0.031	74308	0.027	0.029
AGE	147894	13.282	10.160	38259	13.375	10.205	35327	13.061	9.976	74308	13.339	10.223
INDEPENDENT	22722	0.681	0.177	5704	0.694	0.174	5475	0.669	0.181	11543	0.680	0.175
G-INDEX	21952	9.054	2.753	5092	8.998	2.787	5093	9.084	2.739	11767	9.065	2.743
TAX	116411	0.325	0.165	30314	0.324	0.167	27969	0.327	0.164	58128	0.325	0.165
LITIGATION	123637	0.003	0.005	31872	0.003	0.004	29648	0.003	0.006	62117	0.003	0.005
CONNECTED	147894	0.001	0.035	38259	0.001	0.035	35327	0.001	0.036	74308	0.001	0.035
BIG 4	131403	0.850	0.357	33881	0.848	0.359	30585	0.858	0.349	66937	0.848	0.359
SENSITIVE	147894	0.314	0.464	38259	0.320	0.466	35327	0.309	0.462	74308	0.313	0.464
REGULATE	147894	0.226	0.418	38259	0.229	0.420	35327	0.222	0.416	74308	0.226	0.418
GROWTH	124111	0.028	0.020	31417	0.026	0.016	29959	0.034	0.021	62735	0.026	0.021
INFLATION	124111	0.038	0.026	31417	0.039	0.025	29959	0.042	0.026	62735	0.036	0.026

This table presents summary statistics for the main variables used in the analysis. C–SCORE is Kahn and Watts (2009) measure of accounting conservatism. SIZE is defined as the natural log of the market value of equity. MARKET/BOOK is market-to-book ratio. LEVERAGE is defined as long-term and short-term debt deflated by market value of equity. VOLATILITY is standard deviation of daily firm-level returns. NOACC is non-operating accruals, scaled by lagged assets. CFOA is cash flow from operations, deflated by lagged assets. INVEST CYCLE is a decreasing measure of the length of the investment cycle. BID-ASK is the bid–ask spread scaled by the midpoint of the spread based on daily closing did and closing ask from CRSP. AGE is firm age, in years. INDEPENDENT is proportion of independent directors. G-INDEX is Gompers et al. (2003) index of external governance. TAX is equal to total tax expense divided by pre-tax accounting income less special items. LITIGATION is Shu (2000) measure of the probability of litigation. CONNECTED is an indicator equal to one if the firm is politically connected. GROWTH is annual growth in real gross domestic product. INFLATION is annual growth in the consumer price index. BIG 4 is an indicator if a firm uses one of the Big-4 auditing firms. SENSISTIVE is an indicator variable equal one if firm belongs to a politically sensitive industry. REGULATE is an indicator equal one if a firm is in the finance or utilities industry.

Table 2

Political uncertainty and conservatism.

	(1)	(2)	(3)	(4)	(5)	(6)
PRE-ELECTION	0.0225***	0.0223***	0.0214***	0.0246***	0.0244***	0.0241***
	(23.52)	(23.40)	(21.75)	(27.60)	(27.29)	(25.33)
SIZE				-0.0386***	-0.0392***	-0.0515***
				(-88.05)	(-88.04)	(-68.67)
MARKET/BOOK				-0.00895***	-0.00856***	-0.00836***
				(-41.78)	(-40.76)	(-28.37)
LEVERAGE				0.0418***	0.0384***	0.0418***
				(65.97)	(55.19)	(37.18)
NOACC				-0.00752***	-0.00782***	0.00171
				(-3.873)	(-2.829)	(0.842)
CFOA				-0.0159***	-0.0102***	0.0104***
				(-4.384)	(-4.069)	(2.758)
INVEST CYCLE				-0.0699***	0.000795	0.0296***
				(-3.983)	(0.130)	(2.978)
VOLATILITY				1.426***	1.538***	0.522***
				(22.38)	(21.08)	(9.489)
BID-ASK				-0.746***	-0.742***	-0.463***
				(-17.31)	(-16.88)	(-8.927)
AGE				0.000626***	0.000977***	0.00452***
				(13.69)	(20.53)	(45.04)
Constant	0.122***	0.122***	0.122***	0.277***	0.271***	0.307***
	(135.1)	(144.8)	(478.2)	(79.13)	(74.97)	(74.23)
Observations	147,894	147,894	147,894	147,894	147,894	147,894
R-squared	0.004	0.063	0.443	0.415	0.429	0.559
Fixed-Effects	None	Industry	Firm	None	Industry	Firm

This table presents the baseline results from the estimation of equation (5). The dependent variable is Kahn and Watts (2009) C–SCORE. Our independent variable of interest is PRE-ELECTION, which is an indicator variable equal to one for all days in the year (360 days) prior to an election date. Our list of controls includes: (1) SIZE is defined as natural log of the market value of equity; (2) MARKET/BOOK is market-to-book ratio; (3) LEVERAGE is sum of long-term and short-term debt deflated by market value of equity; (4) VOLATILITY is standard deviation of daily firm-level returns; (5) NOACC is non-operating accruals, scaled by lagged assets; (6) CFOA is cash flow from operations, deflated by lagged assets; (7) INVEST CYCLE is a decreasing measure of the length of the investment cycle; (8) BID-ASK is the bid–ask spread scaled by the midpoint of the spread based on daily closing did and closing ask from CRSP; and (9) AGE is firm age, in years. Robust t-statistics are (clustered standard errors by firm) in parentheses. Significance levels of 10, 5, and 1 percent are represented by *, **, and ***.

Table 3

Electoral competition and conservatism.

	(1)	(2)	(3)	(4)	(5)	(6)
PRE-ELECTION	0.0621***	0.0587***	0.0485***	0.0768***	0.0728***	0.0459***
	(31.60)	(30.29)	(24.99)	(44.24)	(41.81)	(25.56)
PRE x MARGIN	-0.107***	-0.0989***	-0.0734***	-0.141***	-0.131***	-0.0591***
	(-31.60)	(-30.16)	(-23.98)	(-50.89)	(-47.23)	(-22.56)
SIZE				-0.0398***	-0.0403***	-0.0508***
				(-97.00)	(-96.04)	(-68.70)
MARKET/BOOK				-0.00916***	-0.00881***	-0.00857***
				(-45.02)	(-43.70)	(-29.49)
LEVERAGE				0.0416***	0.0385***	0.0419***
				(66.69)	(56.16)	(37.20)
NOACC				-0.00692***	-0.00728***	0.00185
				(-3.746)	(-2.798)	(0.927)
CFOA				-0.0153***	-0.0102***	0.00980***
				(-4.495)	(-4.190)	(2.686)
INVEST CYCLE				-0.0612***	0.000243	0.0279***
				(-3.889)	(0.0424)	(2.915)
VOLATILITY				1.210***	1.325***	0.485***
				(21.29)	(20.24)	(9.107)
BID-ASK				-0.692***	-0.691***	-0.459***
				(-17.38)	(-16.96)	(-9.021)
AGE				0.000596***	0.000909***	0.00423***
				(13.94)	(20.31)	(42.82)
Constant	0.122***	0.122***	0.122***	0.290***	0.284***	0.309***
	(135.1)	(144.9)	(480.8)	(89.30)	(84.31)	(75.70)
Observations	147,894	147,894	147,894	147,894	147,894	147,894
R-squared	0.015	0.073	0.447	0.434	0.445	0.562
Fixed-Effects	None	Industry	Firm	None	Industry	Firm

This table presents the results related to electoral competition. The dependent variable is Kahn and Watts (2009) C–SCORE. Our independent variables of interest are: (1) PRE-ELECTION which is an indicator variable equal to one for all days in the year (360 days) prior to an election date; and (2) PRE x MARGIN which is the interaction term between PRE-ELECTION and the normalize margin for victory. Control variables are the same as in Table 2. Significance levels of 10, 5, and 1 percent are represented by *, **, and ***.

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Table 4

Incumbency advantage and party affiliation and conservatism.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
PRE-ELECTION	0.0812***	0.0771***	0.0424***	0.0996***	0.0957***	0.0653***	0.0985***	0.0946***	0.0593***
	(34.72)	(33.03)	(17.53)	(39.60)	(38.30)	(25.31)	(35.65)	(34.44)	(20.82)
PRE x MARGIN	-0.144***	-0.135***	-0.0585***	-0.136***	-0.126***	-0.0551***	-0.136***	-0.126***	-0.0512***
	(-46.21)	(-43.28)	(-20.02)	(-51.89)	(-47.78)	(-21.90)	(-46.55)	(-43.16)	(-18.26)
DEM	-0.00296***	-0.00499***	-0.0178***				-0.00527***	-0.00734***	-0.0202***
	(-4.689)	(-7.862)	(-25.00)				(-8.193)	(-11.31)	(-27.45)
PRE x DEM	-0.00975***	-0.00917***	0.00981***				0.00559***	0.00631***	0.0237***
	(-6.133)	(-5.787)	(5.825)				(4.128)	(4.645)	(15.55)
PRE x INCUM				-0.0411***	-0.0414***	-0.0346***	-0.0424***	-0.0428***	-0.0402***
				(-21.49)	(-21.72)	(-17.19)	(-23.22)	(-23.45)	(-20.52)
Constant	0.290***	0.284***	0.312***	0.289***	0.283***	0.307***	0.290***	0.284***	0.311***
	(89.60)	(84.55)	(79.84)	(90.07)	(84.79)	(76.31)	(90.35)	(85.13)	(81.01)
Observations	147,894	147,894	147,894	147,894	147,894	147,894	147,894	147,894	147,894
R-squared	0.434	0.445	0.564	0.438	0.449	0.565	0.439	0.449	0.568
Fixed-Effects	None	Industry	Firm	None	Industry	Firm	None	Industry	Firm
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

This table presents the results related to incumbency advantage and party affiliation. The dependent variable is Kahn and Watts (2009) C–SCORE. PRE-ELECTION is an indicator variable equal to one for all days in the year (360 days) prior to an election date. PRE x MARGIN is the interaction term between PRE-ELECTION and the normalize margin for victory. DEM is an indicator variable equal to one if the incumbent president is a Democrat. INCUM is an indicator variable equal one if the incumbent president is seeking re-election. Control variables are the same as in Table 2 but not reported. Robust t-statistics are (clustered standard errors by firm) in parentheses. Significance levels of 10, 5, and 1 percent are represented by *, **, and ***.

Table 5

Post-election conservatism.

Panel A	(1)	(2)	(3)	(4)	(5)	(6)
PRE-ELECTION	0.0271***	0.0269***	0.0261***	0.0274***	0.0271***	0.0285***
	(27.28)	(27.24)	(25.80)	(29.64)	(29.33)	(29.06)
POST-ELECTION	0.0141***	0.0141***	0.0143***	0.00850***	0.00850***	0.0136***
	(20.20)	(20.35)	(20.63)	(14.79)	(14.71)	(22.85)
Constant	0.117***	0.117***	0.117***	0.275***	0.269***	0.304***
	(127.0)	(133.7)	(345.7)	(78.30)	(74.30)	(73.85)
Observations	147,894	147,894	147,894	147,894	147,894	147,894
R-squared	0.005	0.065	0.444	0.416	0.429	0.560
Fixed-Effects	None	Industry	Firm	None	Industry	Firm
Controls	No	No	No	Yes	Yes	Yes
Panel B	(1)	(2)	(3)	(4)	(5)	(6)
PRE-ELECTION	0.0271***	0.0269***	0.0261***	0.0275***	0.0272***	0.0288***
	(27.27)	(27.25)	(25.81)	(29.80)	(29.52)	(29.32)
POST-ELECTION	-0.0152***	-0.0147***	-0.0148***	-0.0117***	-0.0105***	-0.00546***
	(-22.48)	(-22.07)	(-24.08)	(-21.51)	(-18.99)	(-10.87)
POST x OPPWIN	0.0603***	0.0594***	0.0596***	0.0421***	0.0397***	0.0399***
	(45.70)	(46.13)	(48.78)	(39.60)	(35.21)	(41.09)
Constant	0.117***	0.117***	0.117***	0.280***	0.274***	0.309***
	(127.0)	(133.7)	(349.4)	(81.97)	(77.90)	(77.57)
Observations	147,894	147,894	147,894	147,894	147,894	147,894
R-squared	0.015	0.074	0.453	0.420	0.433	0.564
Fixed-Effects	None	Industry	Firm	None	Industry	Firm
Controls	No	No	No	Yes	Yes	Yes

Panel C	(1)	(2)	(3)	(4)	(5)	(6)
PRE-ELECTION	0.0666***	0.0633***	0.0537***	0.0805***	0.0766***	0.0515***
	(33.62)	(32.44)	(27.59)	(46.23)	(43.83)	(28.52)
PRE x MARGIN	-0.107***	-0.0990***	-0.0751***	-0.143***	-0.133***	-0.0617***
	(-31.60)	(-30.18)	(-24.47)	(-51.96)	(-48.39)	(-23.52)
POST-ELECTION	-0.0152***	-0.0147***	-0.0154***	-0.0127***	-0.0116***	-0.00644***
	(-22.48)	(-22.15)	(-25.05)	(-23.79)	(-21.42)	(-12.82)
POST x OPPWIN	0.0603***	0.0595***	0.0605***	0.0447***	0.0424***	0.0415***
	(45.70)	(46.17)	(49.46)	(43.92)	(39.60)	(43.35)
Constant	0.117***	0.117***	0.117***	0.293***	0.286***	0.311***
	(127.0)	(133.8)	(350.9)	(92.95)	(88.23)	(79.12)
Observations	147,894	147,894	147,894	147,894	147,894	147,894
R-squared	0.026	0.083	0.457	0.439	0.449	0.567
Fixed-Effects	None	Industry	Firm	None	Industry	Firm
Controls	No	No	No	Yes	Yes	Yes

This table presents the results related to post-election conservatism. The dependent variable is Kahn and Watts (2009) C–SCORE. PRE-ELECTION is an indicator variable equal to one for all days in the year (360 days) prior to an election date. PRE x MARGIN is the interaction term between PRE-ELECTION and the normalize margin for victory. POST-ELECTION is an indicator variable equal one for all days in the year (360 days) following an election. OPPWIN is an indicator variable equal one if the election results in the opposition party winning office. Control variables are the same as in Table 2 but not reported. Robust t-statistics are (clustered standard errors by firm) in parentheses. Significance levels of 10, 5, and 1 percent are represented by *, **, and ***.

Table 6
Industry-level characteristics and conservatism cycles.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
PRE-ELECTION	0.0727***	0.0688***	0.0733***	0.0631***	0.0796***	0.0813***	0.103***
	(40.76)	(38.72)	(35.52)	(24.37)	(34.37)	(40.03)	(28.32)
PRE x MARGIN	-0.137***	-0.135***	-0.143***	-0.109***	-0.136***	-0.136***	-0.124***
	(-49.33)	(-47.72)	(-48.94)	(-31.22)	(-42.36)	(-48.82)	(-39.01)
SENSITIVE	0.0180***						
	(17.98)						
PRE x SENSITIVE	0.00860***						
	(4.209)						
REGULATE		0.0215***					
		(16.99)					
PRE x REGULATE		0.0264***					
		(11.44)					
HIGH-CONTRACT			0.00562***				
			(6.160)				
PRE x HIGH-CONTRACT			0.00805***				
			(4.284)				
HIGH-TRADE				0.000712			
				(0.682)			
PRE x HIGH-TRADE				-0.00648***			
				(-2.886)			
HIGH-LABOR					-0.0131***		-0.0511***
					(-12.20)		(-16.67)
PRE x HIGH-LABOR					-0.00755***		-0.0239***
					(-3.593)		(-3.852)
HIGH-UNION						-0.0160***	-0.0462***
						(-17.62)	(-20.53)
PRE x HIGH- UNION						-0.0108***	-0.0386***
						(-5.788)	(-10.29)
HIGH-UNION x HIGH-LABOR							0.0472***
							(14.69)
PRE x HIGH-UNION x HIGH-LABOR							0.0251***
							(3.824)

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Constant	0.284***	0.281***	0.294***	0.260***	0.300***	0.297***	0.321***
	(86.83)	(82.82)	(96.50)	(85.94)	(101.2)	(91.03)	(105.7)
Observations	147,894	147,894	130,910	76,879	99,774	147,894	99,774
R-squared	0.437	0.439	0.438	0.414	0.428	0.437	0.439
Fixed-effects	None	None	None	None	None	None	None
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes

This table presents the results related to industry-level characteristics. The dependent variable is Kahn and Watts (2009) C–SCORE. PRE-ELECTION is an indicator variable equal to one for all days in the year (360 days) prior to an election date. PRE x MARGIN is the interaction term between PRE-ELECTION and the normalize margin for victory. SENSISTIVE is an indicator variable equal one if firm belongs to a politically sensitive industry. REGULATE is an indicator variable equal one if a firm is in the finance or utilities industry. HIGH-CONTRACT is an indicator variable equal one if a firm is in an industry that has an above median value for the Boutchkova et al (2012) measure of sensitivity to contract enforcement. HIGH-LABOR is an indicator variable equal one if a firm is in an industry that has an above median value for the Boutchkova et al (2012) measure of labor intensity. HIGH-TRADE is an indicator variable equal one if a firm is in an industry that has an above median value for the Boutchkova et al (2012) measure of international trade exposure. Control variables are the same as in Table 2 but not reported. Robust t-statistics are (clustered standard errors by firm) in parentheses. Significance levels of 10, 5, and 1 percent are represented by *, **, and ***.

Table 7

Firm-level governance, taxation, litigation and conservatism cycles.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
PRE-ELECTION	0.0585***	0.0583***	0.0435***	0.0663***	0.0620***	0.0317***	0.0747***	0.0738***	0.0462***
	(4.343)	(4.316)	(2.777)	(30.86)	(28.90)	(13.96)	(36.60)	(36.07)	(22.17)
PRE x MARGIN	-0.0688***	-0.0613***	-0.0271	-0.111***	-0.101***	-0.0389***	-0.122***	-0.119***	-0.0501***
	(-5.087)	(-4.541)	(-1.364)	(-36.09)	(-33.58)	(-12.54)	(-40.46)	(-39.77)	(-18.03)
INDEPENDENT	0.0381***	0.0401***	0.00892						
	(9.702)	(10.08)	(1.004)						
G-INDEX	0.000882***	0.000867***	3.46e-05						
	(3.391)	(3.323)	(0.0343)						
PRE x INDEPENDENT	-0.116***	-0.116***	-0.106***						
	(-6.264)	(-6.236)	(-4.847)						
PRE x G-INDEX	-0.00439***	-0.00443***	-0.00425***						
	(-3.772)	(-3.798)	(-3.193)						
TAX				-0.0558***	-0.0452***	-0.000197			
				(-24.11)	(-18.56)	(-0.0682)			
PRE x TAX				-0.0170***	-0.0166***	0.000535			
				(-3.184)	(-3.102)	(0.0924)			
LITIGATION							-0.327***	-0.459***	-0.124
							(-3.425)	(-4.434)	(-1.202)
PRE x LITIGATION							-3.373***	-3.380***	-2.825***
							(-13.02)	(-12.65)	(-11.23)
Constant	0.420***	0.417***	0.238***	0.309***	0.294***	0.297***	0.261***	0.261***	0.304***
	(77.91)	(75.89)	(13.69)	(98.59)	(93.77)	(64.68)	(69.11)	(68.96)	(71.16)
Observations	14,372	14,372	14,372	116,411	116,411	116,411	123,637	123,637	123,637
R-squared	0.537	0.540	0.593	0.425	0.437	0.553	0.422	0.426	0.552
Fixed-Effects	None	Industry	Firm	None	Industry	Firm	None	Industry	Firm
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

This table presents the results related to firm-level governance, taxation, litigation factors. The dependent variable is the Kahn and Watts (2009) C–SCORE. PRE-ELECTION is an indicator variable equal to one for all days in the year (360 days) prior to an election date. PRE x MARGIN is the interaction term between PRE-ELECTION and the normalize margin for victory. INDEPENDENT is the proportion of independent directors. G-INDEX is the Gompers et al. (2003) index of external governance. TAX is equal to total tax expense divided by pre-tax accounting income less special items. LITIGATION is the Shu (2000) measure of the probability of litigation. Control variables are the same as in Table 2 but not reported. Robust t-statistics are (clustered standard errors by firm) in parentheses. Significance levels of 10, 5, and 1 percent are represented by *, **, and ***.

Table 8
Robustness: Political connections, business cycle and big 4 auditor.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
PRE - ELECTION	0.0768***	0.0728***	0.0527***	0.0521***	0.0393***	0.0697***	0.0666***	0.0344***
	(44.24)	(41.81)	(22.60)	(22.29)	(15.90)	(31.22)	(29.51)	(14.31)
PRE x MARGIN	-0.141***	-0.131***	-0.110***	-0.105***	-0.0544***	-0.106***	-0.102***	-0.0406***
	(-50.87)	(-47.21)	(-33.26)	(-31.46)	(-15.22)	(-34.41)	(-33.03)	(-13.60)
CONNECTED	-0.0195	-0.0159						
	(-1.324)	(-1.014)						
PRE x CONNECTED	-0.00780	-0.00899						
	(-0.282)	(-0.322)						
GROWTH			-0.576***	-0.509***	0.234***			
			(-35.00)	(-30.00)	(16.52)			
INFLATION			-0.683***	-0.586***	0.812***			
			(-42.31)	(-34.90)	(47.19)			
PRE x GROWTH			-0.123***	-0.170***	-0.403***			
			(-2.645)	(-3.644)	(-8.527)			
PRE x INFLATION			0.374***	0.363***	0.282***			
			(7.850)	(7.611)	(5.577)			
BIG 4						-0.0274***	-0.0212***	-0.000299
						(-21.18)	(-17.10)	(-0.160)
PRE x BIG 4						-0.0179***	-0.0158***	-0.00328
						(-9.546)	(-8.393)	(-1.592)
Constant	0.290***	0.283***	0.370***	0.354***	0.240***	0.310***	0.303***	0.304***
	(89.24)	(84.26)	(113.4)	(97.84)	(56.89)	(86.31)	(83.44)	(67.99)
Observations	147,894	147,894	124,111	124,111	124,111	131,403	131,403	131,403
R-squared	0.434	0.445	0.454	0.462	0.573	0.462	0.469	0.575
Fixed-Effects	None	Industry	None	Industry	Firm	None	Industry	Firm
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

This table presents the results related to the factors of political connections, business cycle and big 4 auditor. The dependent variable is the Kahn and Watts (2009) C –SCORE. PRE-ELECTION is an indicator variable equal to one for all days in the year (360 days) prior to an election date. PRE x MARGIN is the interaction term between PRE-ELECTION and the normalize margin for victory. CONNECTED is an indicator variable equal to one if the firm is politically connected. GROWTH is the annual growth in real gross domestic product. INFLATION is the annual growth in the consumer price index. BIG 4 is an indicator variable equal to one if a firm appoints one of the Big-4 auditing firms. Control variables are the same as in Table 2 but not reported. Robust t-statistics are (clustered standard errors by firm) in parentheses. Significance levels of 10, 5, and 1 percent are represented by *, **, and ***.

Table 9

Robustness: Sarbanes-Oxley Act.

	(1) Pre-SOX	(2) Pre-SOX	(3) Pre-SOX	(4) Post-SOX	(5) Post-SOX	(6) Post-SOX	(7) Full Sample	(8) Full Sample	(9) Full Sample
PRE-ELECTION	0.0518***	0.0492***	0.0322***	0.100***	0.100***	0.0563***	0.0569***	0.0540***	0.0384***
	(34.75)	(32.16)	(17.58)	(20.22)	(20.16)	(9.358)	(36.80)	(34.22)	(21.83)
PRE x MARGIN	-0.0871***	-0.0813***	-0.0324***	-0.274***	-0.273***	-0.0981***	-0.109***	-0.102***	-0.0521***
	(-45.29)	(-40.78)	(-13.16)	(-17.20)	(-17.11)	(-4.976)	(-49.06)	(-44.77)	(-20.86)
SOX							0.0665***	0.0628***	-0.000468
							(63.61)	(59.12)	(-0.281)
PRE x SOX							0.00970***	0.0109***	0.0155***
							(4.923)	(5.501)	(7.239)
Constant	0.215***	0.211***	0.255***	0.530***	0.532***	0.587***	0.287***	0.281***	0.309***
	(125.6)	(116.9)	(76.07)	(89.53)	(86.00)	(31.20)	(114.2)	(104.6)	(74.60)
Observations	104,463	104,463	104,463	38,732	38,732	38,732	147,894	147,894	147,894
R-squared	0.436	0.443	0.546	0.647	0.648	0.705	0.464	0.471	0.562
Fixed-Effects	None	Industry	Firm	None	Industry	Firm	None	Industry	Firm
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

This table presents the results related to Sarbanes-Oxley Act. The dependent variable is the Kahn and Watts (2009) C–SCORE. PRE-ELECTION is an indicator variable equal to one for all days in the year (360 days) prior to an election date. PRE x MARGIN is the interaction term between PRE-ELECTION and the normalize margin for victory. SOX is an indicator variable equal to one for all years after the introduction of the Sarbanes-Oxley Act. Control variables are the same as in Table 2 but not reported. Robust t-statistics are (clustered standard errors by firm) in parentheses. Significance levels of 10, 5, and 1 percent are represented by *, **, and ***.

Table 10

Robustness: Alternative windows.

	(1)	(2)	(3)	(4)
90-PRE-ELECTION	0.0128***	0.0107***		
	(5.199)	(4.323)		
90-PRE x MARGIN	-0.0597***	-0.0488***		
	(-13.95)	(-11.23)		
180-PRE-ELECTION			0.0355***	0.0340***
			(11.80)	(11.32)
180-PRE x MARGIN			-0.0941***	-0.0842***
			(-20.41)	(-18.01)
Constant	0.284***	0.277***	0.285***	0.279***
	(80.27)	(75.88)	(81.11)	(76.61)
Observations	147,894	147,894	147,894	147,894
R-squared	0.411	0.424	0.412	0.425
Fixed-Effects	None	Industry	None	Industry
Controls	Yes	Yes	Yes	Yes

This table presents the results using alternative windows prior to elections. The dependent variable is the Kahn and Watts (2009) C–SCORE. Our key independent variables of interest are: (1) 90-PRE-ELECTION which is an indicator variable equal to one all days up to 90 days prior to an election date; (2) 90-PRE x MARGIN which is the interaction term between 90-PRE-ELECTION and the normalize margin for victory; (3) 180-PRE-ELECTION which is an indicator variable equal to one all days up to 180 days prior to an election date; and (4) 180-PRE x MARGIN which is the interaction term between 180-PRE-ELECTION and the normalize margin for victory. Control variables are the same as in Table 2 but not reported. Robust t-statistics are (clustered standard errors by firm) in parentheses. Significance levels of 10, 5, and 1 percent are represented by *, **, and ***.

Table 11

Robustness: Alternative measures of accounting conservatism.

	Timeliness of Earnings to News Dependent variable = X_i				Persistence of Earnings Changes Dependent variable = ΔNI_t			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
D x R$_i$ x PRE	0.0274***	0.0302***	0.0247***	0.0283***				
	(3.566)	(3.948)	(3.315)	(3.820)				
R$_i$ x PRE	-0.0177***	-0.0162***	0.00300	0.00328				
	(-5.126)	(-4.786)	(0.813)	(0.894)				
D x PRE	0.00495**	0.00331	0.00785***	0.00851***				
	(1.991)	(1.356)	(3.209)	(3.527)				
D x R$_i$	0.215***	0.184***	0.188***	0.169***				
	(49.18)	(41.49)	(9.216)	(8.396)				
D	-0.0137***	-0.0121***	-0.0179*	-0.0206**				
	(-9.755)	(-8.717)	(-1.809)	(-2.186)				
R$_i$	-0.0102***	-0.00305	0.0644***	0.0654***				
	(-4.115)	(-1.233)	(6.022)	(6.223)				
PRE-ELECTION	0.00491***	0.00547***	0.00319*	0.00305*	0.00130*	0.00137*	0.00234***	0.00253***
	(3.141)	(3.571)	(1.904)	(1.833)	(1.664)	(1.756)	(3.093)	(3.362)
NEGI$_{t-1}$ x ΔNI_{t-1} x PRE					-0.259***	-0.260***	-0.177***	-0.177***
					(-6.768)	(-6.788)	(-6.134)	(-6.077)
ΔNI_{t-1} x PRE					0.0493***	0.0492***	0.0291*	0.0285*
					(3.001)	(2.999)	(1.843)	(1.805)
NEGI$_{t-1}$ x PRE					-0.00768***	-0.00783***	-0.00454***	-0.00472***
					(-3.875)	(-3.931)	(-3.002)	(-3.121)
NEGI$_{t-1}$ x ΔNI_{t-1}					-0.0339**	-0.0357**	-0.290***	-0.123***
					(-2.438)	(-2.479)	(-4.626)	(-2.856)
NEGI$_{t-1}$					0.00678***	0.00688***	0.00107	-0.0188***
					(7.610)	(7.749)	(0.201)	(-4.349)
ΔNI_{t-1}					-0.0378***	-0.0378***	-0.0624**	-0.177***
					(-4.494)	(-4.392)	(-2.506)	(-4.710)
Constant	0.0755***	0.0703***	0.162***	0.153***	0.00122***	0.00112***	0.00277	0.0136***
	(69.24)	(64.80)	(17.79)	(17.10)	(3.082)	(2.658)	(1.590)	(6.498)
Observations	147,894	147,894	147,894	147,894	145,858	145,858	145,858	145,858
R-squared	0.085	0.123	0.258	0.272	0.017	0.019	0.160	0.161
Fixed-effects	None	Industry	None	Industry	None	Industry	None	Industry
Controls and their interactions	No	No	Yes	Yes	No	No	Yes	Yes

This table presents the results using alternative measures of accounting conservatism. The dependent variable is net income X_i in Models 1-4 and change in net income ΔNI_t

(deflated by total assets) in Models 5-8. R_i is the annual stock market return. D_i is an indicator variable equal to one if R_i is negative. PRE-ELECTION which is an indicator variable equal to one for all days in the year (360 days) prior to an election date. ΔNI_{t-1} is lagged change in net income. $NEGI_{t-1}$ is an indicator variable equal to one if ΔNI_{t-1} is negative. Our key independent variables of interest are: (1) D x RETURN x PRE; and (2) $NEGI_{t-1}$ x ΔNI_{t-1} x PRE. Control variables (and their interactions) are from Table 2 but not reported. Robust t-statistics are (clustered standard errors by firm) in parentheses. Significance levels of 10, 5, and 1 percent are represented by *, **, and ***.