Board Membership, Political Connection and Audit Pricing: A Meta-Analysis from Nigeria

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Abstract

This paper investigates how personal ties of politically connected boards affect auditors' assessments of audit risk as reflected in audit feesin Nigeria. The study sought information on board of directors from companies' portable document format (PDF) annual reports and accounts, Nigerian Securities and Exchange Commission (NSE) and Nigerian Stock Exchange (NSE) filings froma comprehensive data set of 1893 firm–year observations obtained from 116 companies across 24 sectors between 2001 and 2009. Our finding suggests that auditors charge higher fees to politically connected firms compared to others. We also find that this incremental effect of a firm's board political connections on audit fees is stronger among firms with weakercorporate governance, andmore complicated operating structures. This finding is an indication that auditors perceive politically connected firms as riskier. Accordingly, they exercise greater effort and charge higher fees to these firms. Our evidence is sturdy to a battery of econometric endogeneity remedies and to exogenous events such as presidential and mid-term elections and the intense financial crisis of 2008–2009.Our findings is robust in the presence of political influence, including campaign contributions and lobbying expenditures affecting auditors' perceived business risk in politically connected boards and the implications for audit pricing.

Keywords: Political connections, audit risk, audit fees, corporate governance, political influence

1. Introduction

This study examineshow clients' political connections influence auditor assessment of audit riskas reflected in audit fees in Nigeria.There is evidence (Ramanna & Roychowdhury, 2010; Yu & Yu, 2011) that firms with connections acquired through political contributions are more likely to manage earnings. These findings suggest that client's political connections influence auditors' assessment of audit risk due to their differential reporting behaviour, an issue that has received increasing attention from practitioners (Deloitte, 2012). This is necessary for improved transparency on corporate political activity and the acceptance of boards with political backgrounds. In this regard, an examination of how board's political connection affects auditors' assessment of audit risk and, in turn, audit fees becomes imminent.

Political connections may help improve the financial performance of connected firms through their receipt of economic rents, including lower costs of capital and more government procurement contracts (: :). Such political benefits may reduce management incentives to misreport the earnings of connected firms ().Moreover, politically connected firms may face a lower failure risk because they are more likely to be bailed out by their government when distressed (:). This mitigates potential class action lawsuits by shareholders due to corporate failure. As such, auditors may charge lower fees to clients with political connections.

However, the covert nature of corporate rent-seeking activities can increase the opaqueness of financial statements prepared by politically connected firms. The executives of such firms have incentives to obscure their financial statements to protect political favors, which are often dubious in nature ():),). These problems suggest that accounting quality could be poorer in politically connected firms.This is confirmed by prior research (;;).

Also, politically connected firms could be riskier because their performance can change significantly due to changes in political power (:). For instance in the United States, the market values of politically connected firms are influenced by election outcomes (). Furthermore, politically connected firms tend to commit more accounting fraud and have a higher chance of

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collapse due to their riskier business models, as stated by Enron and WorldCom ().

The aforementioned arguments indicate higher audit risks for politically connected clients. This perspective predicts that auditors will exercise more effort in auditing politically connected firms and thus charge such firms higher audit fees. We also expect that the phenomenon of higher audit fees charged to connected firms be more prominent in Nigeria due to the dominance of the Big N firms among quoted companies. Thus, our empirical evidence is between2001 and 2009 and it is aimed at assessing the effect of political connection on professional audit fees. We use personal tie-based political connections. The study describes a firm as politically connected if one or more of its directors held a political position at any time prior to appointment on the board. Our findings suggest that auditors charge significantly higher audit fees tofirms with directorswho have political experience. In addition, this outcome is robust to the presence of other measures for political connections, including campaign contributions and lobbying expenditures.

2. Literature Review and Hypotheses Development

2.1 Political Connection and Audit Risk

Audit risk is a major consideration for audit fees, which is, in turn, affected by managers' incentives to misreport and by the probability of corporate failure (: : :). When managers' incentive to misreport is stronger, auditors exercise greater effort to detect potential accounting irregularities. This often serves as a platform for charging higher professional fees. Similarly, auditors may charge a premium to clients with higher risk of shareholder litigation is often triggered by corporate failure (). Extant political economy literature shows that political connections add value to connected firms. In a cross-country study,) finds that stock prices rise upon the news of firms' top officers entering politics.) show that U.S. firms accumulate abnormal stock returns upon the nomination announcement of politicians to their boards. Consistent with this conjecture, other studies show that political connections benefit connected firms in various forms, such as preferential treatment from banks in countries as Brazil (), China (), India (), Pakistan (), Thailand (), and the United States (); financial subsidies from the government (:);

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government procurement contracts (); lighter taxation (); and relaxed regulatory oversight ().

Prior studies also evidenced that politically connected firms have better access to bank finance. However, such connected firms suffer higher default rates in the future (, ,,). argue that U.S. banks considerpotential political favors in their lending decisions by showing bankers making loans at lower interest rates to companies with political connections. Regarding government subsidies, document that in 35 countries politically connected firms are more likely to be bailed out by their governments in case of financial distress. find that the allocation of government funds under the U.S. Troubled Asset Relief Program (*TARP*) in response to the subprime mortgage crisishas bias toward politician-favored firms. For empirical evidence of government procurement contracts,show that U.S. firms connected with the winning party in the 1994 mid-term and 2000 presidential elections obtained significantly more government contracts after the elections. With respect to lighter taxation,provides evidence that politically connected firms in Peru pay substantially lower taxes.

To the extent that political connections can help improve the financial performance of connected firms via preferential treatment from banks—thereby obtaining lower costs of private debt,direct subsidies from the government,more government procurement contracts, and lighter taxation—such connections may reduce management incentives for misreporting. If so, auditors should face lower risks in auditing clients with political connections. In the same vein, politically connected firmshave better access to government intervention in case of financial distress. Since corporate failure more often trigger shareholder lawsuits against auditors, a lower bankruptcy risk of politically connected firms should reflect favourably in auditors' assessments of risk). This perspective suggests that auditors should charge lower audit fees to politically connected clients.

Although, political connections may attract lucrative benefits, it is by no means costless for firms to build and maintain such connections. Politicians seek rents from connected firms in various forms, including political donations, lobbying expenses, and directorships. In Nigeria, there no statutory or regulatory requirements exist on "hard money" expenditures on political activity disclosures including political contributions via political action committees (PACs) and lobbying expenditures. Hence, the true

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amount of corporate political spending, including "soft money," is extremely difficult to track. Such donations are not visible to outside shareholders and there is no evidence of monitoring by outside directors. The secret nature of corporate political expenditures and their rent-seeking activities increase the opaqueness of financial statements in politically connected firms).

Executives of politically connected firms tend to make their financial statements less transparent to protect the political favours they obtain, because such favours are often of dubious legality (). show that politically connected firms in Indonesia are often reluctant to issue foreign securities, since they wish to avoid the more stringent disclosure requirements imposed by foreign regulators. argue that the earnings quality reported by politically connected firms is lowerthanthat reported by their non-connected counterparts, for two potential reasons. First, insiders have incentives to divert benefits brought about throughout political connections and thus intentionally make their accounting information more opaque to avoid outside monitoring. Second, politically connected firms have preferential access to external financing, such as state bank loans and government subsidies, which may render accounting quality less important to these firms. Thus, their managers may pay less attention to accrual quality, thereby resulting in a lower quality of accruals. show that politically connected firms around the world have lower accrual quality than non-connected firms.

Some researchers argue that politically connected firms are more likely to manage earnings than their non-connected counterparts ().)also show that politically connected companies are associated with higher incidences of accounting fraud. Companies such as Enron and WorldCom that committed massive accounting fraud and subsequently collapsed in the early 2000swere politically connected. Such connections helped these firms avoid fraud detection by regulators and thus continue their misconduct for longer period, which may have partly contributed to their eventual collapse. examine how political forces can affect financial reporting quality in a somewhat different setting. They show that incumbent governors tend to manipulate their state government's accounting numbers to present a strong financial picture in election years. The above findings suggest that political factors adversely affect accounting quality.

Politically connected firms could also be inherently riskier because their

performance "might vary dramatically over time depending on the political fortunes of their backers" and "political connections can lose their value overnight when the government fails to win an election" (pp. 2–3]).) shows that the stock prices of Indonesian firms connected to then-president Suharto moved up and down according to a string of rumors concerning his health. Similar evidence exists in the United States. find that after the 2000 presidential election, firms connected with the Republican Party gained positive stock returns, whereas those connected with the Democratic Party lost value. Corroborating these findings,) show that after the 1994 mid-term election and the 2000 presidential election (both elections leading to power shifts from the Democratic to the Republican Party), companies connected withthe Republican Party obtained significantly more procurement contracts than before, while those connected withthe Democratic Party lost such contracts.

It is probable that politically connected boards in Nigeria have no impact on audit risk or audit fees. Nigeria is commonly believed to be characterised by weak institutions, such as a dependent jurisdictional system and very limited media networks for monitoring both business elites and politicians, even after the promulgation of the (Freedom of Information) FOI Act. Thus, these institutions are not effective in curbing rentseeking through personal ties with politicians. As a result, political connections may generate significant value to connected firms. Public firms employing politicians may simply be harnessingthe expertise and knowledge their business requires. support this view by providing evidencethat connections with then-vice president Cheney did not add valueto the companies concerned. also document similar evidence that politicians in France, an industrialised and democratic country much like the United States, deliver only very limited favours to their connected firms.

2.2 Hypothesis Development

The foregoing discussion suggests that the way political connections affect audit risks and consequently audit fees is ultimately an empirical issue. However, we argue that audit fees increase with firms' political connections, contrary to Gul's [2006] finding of the negative relation between political connections and audit fees, for the following two major reasons. First, argue that a country with strong institutions, such, has a much lower probability of

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bailouts until recently. This suggests thatany reductions in audit risk for politically connected firms in developed markets arising from potential government bailouts may not have greater implications compared totheir counterparts in developing countrieslikeNigeria. Second, auditors may exert more effort in auditing politically connected clients, which are usually more visible and riskier. The value of the litigation index, used to measure auditors' country-level litigation risks (), is 15 for the U. S., 3.67 for Malaysia but only 1.67 for Nigeria. This suggests that the litigation risk facing auditors is much higher in the United States and Malaysia compared to Nigeria. also provide evidence that the threat of shareholder lawsuits encourages auditors to be more conservative in auditing relatively risky clients such as large public companies. We focus on the local office subsidiaries of the Big-N firms namely KPMG, PwC, Ernst & Young, and Deloitte. Thus, we state our first hypothesis as follows.

> *H1*: Auditors charge higher audit fees to politically connected firms than to non-connected ones, *ceteris paribus*.

Well-governed firms mitigate the problem of insiders' agency problems. If directors and outside institutional shareholders closely monitor corporate managers, this would mitigate any perverse effects of political connections on audit risk and audit fees. The strength of such monitoring is in turn, affected by the monitors' incentives and ability. Numerous theoretical and empirical studies show that the incentives and abilities of directors or institutional investors to monitor company managers increases with their equity ownership (e.g., ,,). However, their ability to monitor is reduced if firm operations are more complicated due to extensive geographic or product-line diversification (). These discussions lead to the following two collaborating hypotheses.

> *H2a*: Director and/or institutional shareholding structures mitigate the adverse effect of political connections on audit fees.
>
> *H2b*: Firms with more complicated structures have politically connected boards and experience higher audit fees.

3. Research Design

3.1 Definition of Politically Connected Firms

We sought biographic information about board directors from filings, including individual portable document format (PDF) reports generated from websites, the Nigerian Securities and Exchange Commission (SEC) as well as NSE filings. In our opinion a firm with one or more directors holding a political position before sitting on the board is politically connected. As in, we definepolitical positions asfollows (Incumbent and former): President, presidential candidate, Senator, member of the House of Representatives, (assistant) secretary, deputy secretary, deputy assistant secretary, undersecretary, governor, director, deputy director, commissioner,other representatives, ambassador, chairman of a party caucus, chairman or staff of a presidential election campaign, and chairman or member of the presidential committee/council.

In addition to using a binary variable (*PC Dummy*) to indicate that a firm is politically connected, we apply several other measures that indicate not only the presence of political connections but also theirstrength. The basic idea is that, if political connections matter to audit risk, then their effect should increase with theirstrength. The additional measures are the number of political directors on the board *(PC Directors)*,the number of elapsed years since the most recent political position held by thepolitical directors*(PC Freshness)*,number of years the political directors served in the government *(PC Tenure)* and the political power associated with political positions held by connected directors*(PC Rank)*. For these additional measures, a greater value corresponds to the greater strength of a firm's political connections. The assigned value for these variables in non-connected firms is zero.

3.2 Audit Fee Model

Building on Simunic's[1980] work, various researchers have modeled audit fees based on audit complexity and risk.Client characteristics such as size, leverage, asset liquidity, growth, profitability, and business and geographic diversifications are related to audit complexity and risk and are thus found to influence audit fees (e.g., ,Choi et al.[2008,2009],Gul [2006],). Accordingly, we include a number of variables related to these firm characteristics. We also control for the peak pricing of audit services by including an indicator variable that equals one for firms with a December fiscal year-end and zero otherwise (Gul and Goodwin [2010]). Prior auditing research (e.g., ,,, Gul and Goodwin [2010]) suggests that Big N auditing firms or auditors that are

national or city-specific industry leaders may provide higher-quality audits and thus charge fee premiums.

Following these studies, we control for dummy variables that indicate Big 4 auditors, national industry leaders, or city-specific industry leaders. Year and industry effects are also included. We use the following baseline audit fee model to test the audit fee effects of political connections:

$$AFEE = \alpha + \beta_1 PCON + \beta_2 SIZE + \beta_3 LEV + \beta_4 INVREC + \beta_5 QUICK + \beta_6 CURRENT + \beta_7 ROA + \beta_8 LO$$

AFEE	=	natural logarithm of audit fees;
PCON	=	one of the political connection measures, including *PC Dummy*, *PC Directors*, *PC Freshness*, *PC Tenure*, and *PC Rank*;
SIZE	=	natural logarithm of total assets;
LEV	=	ratio of total liabilities to total assets;
INVREC	=	ratio of the sum of inventory and receivables to total assets;
QUICK	=	ratio of current assets minus inventory to total assets;
CURRENT	=	ratio to current assets to total assets;
ROA	=	ratio of net income to total assets;
LOSS	=	1 for firms with negative net income and 0 otherwise;
NGS	=	number of geographic segments;
NBS	=	number of business segments;
FOREIGN	=	ratio of foreign sales to total sales;
YE	=	1 for firms with fiscal year-end December and 0 otherwise;
OPINION	=	1 for firms receiving a going-concern opinion and 0 otherwise;
BIG4	=	1 for firms audited by Big 4 auditors and 0 otherwise;
NLEADER	=	1 if the audit firm is the national leader for the client's industry (two digit Standard Industrial Classification code) that year and 0 otherwise;
CLEADER	=	1 if the audit firm is the city -specific industry leader for the city where the client's headquarters are located that year and 0 otherwise;
VOLATILITY	=	standard deviation of daily stock returns that year;
MB	=	natural logarithm of the ratio of market equity to book equity;
YEAR	=	year dummies;
INDUSTRY	=	industry dummies.

4. Empirical Results

4.1 Sample and Data

The sample period starts in 2001 and ends in 2009. Data availability predicate our study period, leading to 1,893 firm–years in the final sample after excluding entities with incomplete data elements for analyses and control variables in the audit fee model.

Table 1 reports the descriptive statistics for the firms' political connections and financial characteristics that may affect audit fees. This table shows that about 38% of our sample firm–year observations have political connections, as opposed to less than 3% of firms in Faccio's [2006] study. Politically connected firms have, on average, 1.3 politicians on their boards. The median number of years in government service for political directors is five and the median political rank is three. The distributions values for firm characteristicsare roughly similar to those reported by Gul and Goodwin [2010]. Thus, we do not discuss this in detail for the sake of brevity.

[Insert Table 1 about here]

The Pearson correlations between various political connection measures show that these measures are highly correlated. Politically connected firms are significantly larger, and are more profitable than non-connected ones. These findings are consistent with the findings of .

4.2 Main Analyses

Table 2, reports the results for testing H_1, that auditors charge higher audit fees to politically connected firms than to non-connected clients. The coefficient of *PCON* is 0.114 and significant at the 1% level when we measure political connections by *PC Dummy*. This suggests that audit fees charged to politically connected firms are 12% higher than others not politically connected. In addition to examining the existence of corporate political connections, we investigate the audit fee effects of the differential strength of political connections. We report the results in columns 2–5 of Table 2. The coefficient of *PCON* is 0.087 and significant at the 1% level when *PC Directors* are considered. This suggests 9% extra audit fees for politically connected firms with 1 political director and 18% for those with 2 political directors. The coefficients of *PCON* are 0.042, 0.007, and 0.064.

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When PC Rank, PC Tenure, measures the strength of political connections and *PC Freshness,* all variables become significant at the 1% level.

These findings imply that auditors charge higher fees to firms with politically connected directors who have served more powerful positions and longer years in public service. The results reported in columns 2–5 are in line with the notion that audit fees increase with the strength of political connections. These findings support H_1 that auditors charge higher audit fees to politically connected firms. The coefficients of the control variables are generally comparable to the statistics reported in prior audit pricing research in terms of significance levels and coefficient magnitudes (e.g., Gul and Goodwin [2010]). Accordingly, we do not discuss them in detail for the sake of brevity.

[Insert Table 2 about here]

4.3 *Distress Risk, Political Connections, and Audit Fees*

Prior literature shows that politically connected firms in developing countries are more likely to be rescued by the government in case of distress (). In Section 2, however, we argue that this type of benefit tends to be small in Nigeria, because the size and frequency of bailouts there have been minor except during the last financial crisis. One way to evaluate this argument is to examine the effect of political connections on the audit fees for firms close to distress. We assume that firms showing a financial loss are close to distress and we modify the baseline model by adding the interaction term *LOSS*PCON*. If political connections significantly increase the probability of being bailed out by the government in case of financial distress, then the coefficients of the interaction term *LOSS*PCON* should be negative. The results reported in Table 3, however, show that the coefficients of the interaction term *LOSS*PCON* are not significant. This supports our hypothesis that the net effect of political connections on audit fees should be positive, because political connections do not bring much benefit in the form of bailouts to politically connected firms in the United States.

[Insert Table 3around here]

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4.4 *Audit Opinion Analysis*

We have shown that auditors charge higher fees to politically connected clients, implying that such clients are riskier. In addition, we test whether auditors tend to issue going-concern opinions more frequently to connected firms. Prior studies (e.g.,) show that auditors are more conservative toward clients that may impose higher audit risks (e.g., relatively large clients). The auditors, therefore tend to lower their threshold for issuing modified opinions on such firms. Prior research suggests that auditors should be more likely to issue going-concern opinions to politically connected clients, *ceteris paribus*, if they indeed perceive such clients to be riskier. This discussion motivates our final analysis.

For our last test, we run an audit opinion model with a dummy variable that indicates the reception of a going-concern opinion as the dependent variable. Following , we control for financial characteristics that proxy for audit risk, variables that measure auditor independence, and indicator variables for audit quality (such as Big N, national leader, and city-specific leader). We run this audit opinion model for both the whole sample and the sub-sample consisting of firms in financial distress. Table 4 reveals the results.The results show that in both the whole sample and the distressed sub-sample, auditors are more likely to issue going-concern opinions to politically connected clients. The coefficients of *PCON*, based on most political connection measures, are significantly positive. These results suggest that auditors are more conservative toward politically connected clients.

[Insert Table 4 around here]

4.5 *Pre- and Post-Financial Crisis Periods*

Table 5 presents the audit fee effects of corporate political connections for one year prior to the financial crisis of October 2008 and for the corresponding post-financial crisis year. Auditors charge higher audit fees to connected firms than to non-connected ones in both the pre- and post-financial crisis periods, evidenced by the significant and positive coefficients of the political connection variables for both periods. Table 5 also tests the difference in the adverse audit fee effects of political connections between the Pre- and Post-financial crisis periods and finds the difference to be statistically insignificant. These results do not lend credit to

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the view that the recent past financial crisis influence auditors' perceived risk for firms with political connections.

[Insert Table 5around here]

5 Conclusion

Political connections significantly affect accounting quality and business risk. They may help connected firms improve financial performance and reduce firms' incentives to misreport earnings. Moreover, politically connected firms are less likely go into extinction because they have a higher chance of obtaining government assistance in case of financial distress. These arguments suggest that auditors should expect lower risks in auditing clients with political connections than those without. However, managers inside politically connected firms have greater incentives to obscure financial statements to hide politicians' rent-seeking activities and/or to protect their political benefits from public exposures. Volatile performance is common in politically connected firms and often results in occasional changes within the political landscape. This perspective predicts a higher risk associated with auditing such clients. Audit risk determines the level of audit effort and consequently audit fees. We thus examine empirically how clients' political connections affect audit fees to help resolve the issue of how political connections affect audit risk.

This issue is also important because political connection is common among public firms in Nigeria. We find that about 38% of firms have politically connected members on their boards. Focusing on the period from 2001 to 2009, we find that auditors charged higher fees to clients with political connections. This finding suggests that, overall, political connections increase audit risk and, consequently, audit fees in Nigeria. We attribute this result to two major factors. One of the important benefits brought about by political connections is greater likelihood of government bailout. These institutional factors enable political connections to have positive effects on audit fees and diminish any negative effect.

Our findings show that auditors charge higher fees to politically connected firms than to others. We contend that this relation is common among firms with weakercorporate governance and more complicated structures including, multi-segment firms and multinational corporations.

However, our findings are also subject toendogeneity problems common in the auditing literature.The firstconcern is the reverse causality problem, that is, firms thathave more opaque external reporting and/or are riskier in their businessare highly likely to establish political connections. The other concern is the omitted correlated variable problem, that is, the audit fee model fails to control for unobservable firm characteristics that may simultaneously increase audit risk and political connections.

Our findings have two alternative explanations. First, one can argue that political directors may lack expertise and incentives to monitor managers. Thus, the managers of such firms may have more opportunities to misreport earnings. In this regard, auditors may have to exercise greater efforts in auditing firms with political directors. Second, since political directors receive greater publicity they requirehigh-quality audit from auditors to protect their political reputations. To evaluate these alternative interpretations, we partition our sampleof connected firms based on political directors sittingon audit committee. If our findings are consistent with the view that political directors lack incentives and expertise or excessively demand higher audit quality to protect their reputations, these audit fee effects of political connections should be more pronounced among firms with political directors sitting on their audit committees. However, we fail to find a significant difference in audit fees between firms with and without political directors sitting on the audit committee.Therefore, this evidence provides little support for these alternative explanations.

Our study contributes to extant literature in several aspects. First, to the best of our knowledge, to the knowledge of the author our paper is the first to investigate how firms' personal ties with politicians on corporate boardsinfluence auditors' assessments of audit riskin Nigeria. We conduct our empirical studyusing a large data set of 1,893 firm–year observations from 116 listed firms between 2001 and 2009. The sample of) contains only 740 firm–year observations because the author focuses on an abnormal period, such as the Asian financial crisis of 1997 and 1998 in Malaysia. Furthermore, we make use of more comprehensive data by incorporating larger proportion (approximately 39%) of all listed firm filing, unlike) and), whose studies include only Standard & Poor's (S&P) 500 firms. Following), we provide country-specific evidence that overcomes the interpretation problems of cross-country studies due to differences in legal/judicial

systems and cultural factors.

Second, our study extends the growing literature on the relations between political connections and financial reporting by examining the effects of such connections on audit pricing. More specifically, our studycontributes to the literature on how political and institutional factors affect auditor behaviour (),: :). Our findings suggest that auditors perceive politically connected clients as riskier. To the extent that auditors exercise more effort in response to higher audit risksand charge higher audit fees, our findings provide indirect evidence that political connections impose significant costs on connected firms by increasing information opaqueness and business risks.By doing so, this paper documents the additional cost associated with corporate political activities on top of corporate expenditures for establishing and maintaining political connections. This is contrary to the conventional political connection literature, which documents firms' political benefits.

Third, we extend prior studies that examine the impact of independent audit committees on firm reporting quality.),),), and) documentmixed empirical results. Fourth, unlike prior research on political economy (: : Gul, 2006), we carefully control for the endogeneity issue of political connections in the absence of requisite data. Our results are robust to econometric solutions and exogenous events such as presidential and mid-term elections. Our findings are also robust to the financial crisis period of 2008 and 2009.

Finally, this study shows that political connections matter to auditors and incorporates firm political connectedness in comparing audit risk of connected and unconnected firms. In this regard, our study is in line with those of) and). These authors maintain that auditors play governance role in mitigating agency problems. We provide evidence that the governance role of auditors extend to politically connected firms. Our findings are also consistent with those of the international studies of) and), who document the corporate governance role of auditors.

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Table 1: Descriptive Statistics

	# of Obs.	Mean	Std Dev	P10	P25	Median	P75	P90
PC Dummy	29,785	0.112	0.315	0.000	0.000	0.000	0.000	1.000
PC Directors	3,327	1.315	0.741	1.000	1.000	1.000	1.000	2.000
PC Rank	3,327	2.466	1.239	1.000	1.000	3.000	3.000	4.000
PC Tenure	3,327	8.715	8.140	1.000	2.000	5.000	14.000	22.000
PC Freshness	3,327	1.589	0.862	0.533	0.995	1.431	2.219	2.730
AFEE	29,785	6.241	1.333	4.594	5.216	6.142	7.130	8.039
SIZE	29,785	5.735	2.055	3.122	4.238	5.619	7.094	8.480
LEV	29,785	0.484	0.362	0.155	0.268	0.456	0.632	0.799
INVREC	29,785	0.253	0.189	0.038	0.098	0.219	0.363	0.527
ROA	29,785	0.029	0.257	-0.245	0.000	0.097	0.158	0.222
LOSS	29,785	0.393	0.488	0.000	0.000	0.000	1.000	1.000
NGS	29,785	2.275	2.507	0.000	0.000	2.000	4.000	5.000
NBS	29,785	2.016	1.640	1.000	1.000	1.000	3.000	4.000
YE	29,785	0.716	0.451	0.000	0.000	1.000	1.000	1.000
OPINION	29,785	0.040	0.196	0.000	0.000	0.000	0.000	0.000
BIG4	29,785	0.790	0.407	0.000	1.000	1.000	1.000	1.000
NLEADER	29,785	0.043	0.202	0.000	0.000	0.000	0.000	0.000
CLEADER	29,785	0.600	0.490	0.000	0.000	1.000	1.000	1.000
VOLATILITY	29,785	0.161	0.107	0.063	0.089	0.133	0.200	0.293
MB	29,785	2.872	4.498	0.582	1.149	2.011	3.537	6.214
FOREIGN	29,785	0.062	0.085	0.000	0.000	0.014	0.105	0.195
QUICK	29,785	2.469	2.912	0.586	0.944	1.516	2.789	5.257
CURRENT	29,785	0.509	0.256	0.146	0.312	0.512	0.715	0.858

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Table 2: Political Connections and Audit Fees

		(1) PC Dummy	(2) PC Directors	(3) PC Rank	(4) PC Tenure	(5) PC Freshness
PCON	+	0.114***	0.087***	0.042***	0.007***	0.064***
		[6.41]	[6.89]	[6.34]	[4.83]	[6.76]
SIZE	+	0.499***	0.498***	0.499***	0.501***	0.499***
		[98.30]	[97.68]	[98.25]	[98.80]	[98.34]
LEV	+	0.167***	0.167***	0.167***	0.168***	0.167***
		[6.75]	[6.75]	[6.75]	[6.74]	[6.75]
INVREC	+	0.170***	0.167***	0.170***	0.170***	0.169***
		[3.20]	[3.14]	[3.21]	[3.20]	[3.18]
ROA	-	-0.250***	-0.248***	-0.251***	-0.254***	-0.250***
		[-9.26]	[-9.18]	[-9.33]	[-9.43]	[-9.29]
LOSS	+	0.118***	0.118***	0.117***	0.118***	0.118***
		[10.08]	[10.07]	[10.05]	[10.09]	[10.12]
NGS	+	0.040***	0.040***	0.040***	0.040***	0.040***
		[12.39]	[12.36]	[12.40]	[12.36]	[12.38]
NBS	+	0.040***	0.039***	0.040***	0.041***	0.040***
		[10.25]	[10.10]	[10.30]	[10.38]	[10.28]
YE	+	0.128***	0.128***	0.128***	0.128***	0.128***
		[8.33]	[8.38]	[8.36]	[8.36]	[8.34]
OPINION	+	0.227***	0.227***	0.227***	0.229***	0.227***
		[9.84]	[9.84]	[9.84]	[9.88]	[9.83]
BIG4	+	0.230***	0.231***	0.230***	0.229***	0.231***
		[15.06]	[15.09]	[15.05]	[14.95]	[15.13]

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		(1) PC Dummy	(2) PC Directors	(3) PC Rank	(4) PC Tenure	(5) PC Freshness
NLEADER	+	0.304***	0.305***	0.303***	0.306***	0.304***
		[11.60]	[11.66]	[11.60]	[11.64]	[11.60]
CLEADER	+	0.031***	0.030***	0.031***	0.030**	0.030**
		[2.61]	[2.58]	[2.62]	[2.53]	[2.56]
VOLATILITY	+	0.203***	0.204***	0.203***	0.202***	0.202***
		[4.20]	[4.22]	[4.19]	[4.17]	[4.17]
MB	+	0.002**	0.002**	0.002**	0.003**	0.002**
		[2.32]	[2.29]	[2.32]	[2.49]	[2.34]
FOREIGN	+	0.814***	0.800***	0.807***	0.819***	0.818***
		[6.45]	[6.38]	[6.39]	[6.50]	[6.48]
QUICK	-	-0.042***	-0.042***	-0.042***	-0.042***	-0.042***
		[-15.10]	[-15.10]	[-15.07]	[-15.00]	[-15.03]
CURRENT	+	0.482***	0.481***	0.482***	0.482***	0.481***
		[11.63]	[11.61]	[11.63]	[11.59]	[11.60]
Constant		1.904***	1.914***	1.904***	1.898***	1.905***
		[25.82]	[25.90]	[25.90]	[25.66]	[25.86]
Industry effects		Yes	Yes	Yes	Yes	Yes
Year effects		Yes	Yes	Yes	Yes	Yes
Observations		29,785	29,785	29,785	29,785	29,785
Adj. R^2		0.82	0.82	0.82	0.82	0.82

All continuous variables are winsorized at the 1% and 99% levels. All *t*-statistics reported in brackets are based on standard errors clustered at the firm level. The superscripts ***, **, and * denote two-tailed significance levels of 0.01, 0.05, and 0.10, respectively.

Table 3: Political Connections and Audit Fees for Financially Distressed Firms

		(1)	(2)	(3)	(4)	(5)
		PC Dummy	*PC Directors*	*PC Rank*	*PC Tenure*	*PC Freshness*
PCON	+	0.058**	0.048***	0.015	0.003	0.02[illegible]
		[2.32]	[3.15]	[1.63]	[1.64]	[1.[illegible]]
LOSS	+	0.093***	0.092***	0.091***	0.092***	0.093***
		[6.34]	[6.37]	[6.28]	[6.42]	[6.44]
*PCON*LOSS*	?	-0.011	-0.005	0.002	-0.000	-0.007
		[-0.32]	[-0.22]	[0.17]	[-0.09]	[-0.39]
Control variables		Yes	Yes	Yes	Yes	Yes
Industry effects		Yes	Yes	Yes	Yes	Yes
Year effects		Yes	Yes	Yes	Yes	Yes
Observations		29,785	29,785	29,785	29,785	29,785
Adj. R^2		0.73	0.73	0.73	0.73	0.73

All continuous variables are winsorized at the 1% and 99% levels. All t-statistics reported in brackets are based on standard errors clustered at t he firm level. The superscripts ***, **, and * denote two -tailed significance levels of 0.01, 0.05, and 0.10, respectively.

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Table 4: Political Connections and Audit Opinions

Panel A: Whole sample

		(1)	(2)	(3)	(4)	(5)
		PC Dummy	*PC Directors*	*PC Rank*	*PC Tenure*	*PC Freshness*
PCON	+	0.239***	0.112**	0.085***	0.015***	0.122***
		[3.22]	[2.55]	[3.23]	[2.81]	[2.97]
SIZE	-	-0.247***	-0.245***	-0.247***	-0.245***	-0.247***
		[-10.14]	[-10.07]	[-10.13]	[-10.11]	[-10.13]
DACC	+	0.008	0.008	0.008	0.008	0.008
		[0.73]	[0.72]	[0.71]	[0.75]	[0.72]
LEV	+	0.214*	0.216*	0.215*	0.214*	0.215*
		[1.93]	[1.94]	[1.94]	[1.93]	[1.94]
ROA	-	-1.107***	-1.110***	-1.110***	-1.111***	-1.105***
		[-12.33]	[-12.40]	[-12.36]	[-12.42]	[-12.29]
LOSS	+	0.858***	0.859***	0.857***	0.857***	0.860***
		[11.57]	[11.62]	[11.56]	[11.59]	[11.57]
BIG4	-	-0.128*	-0.129*	-0.128*	-0.128*	-0.124*
		[-1.80]	[-1.81]	[-1.80]	[-1.80]	[-1.74]
LIT_SHU	+	0.222***	0.222***	0.222***	0.223***	0.222***
		[8.27]	[8.28]	[8.26]	[8.29]	[8.27]
OFFICESIZE	+	0.050**	0.051**	0.050**	0.050**	0.050**
		[2.30]	[2.36]	[2.32]	[2.33]	[2.30]
INFLUENCE	+	0.026	0.029	0.026	0.027	0.024
		[0.33]	[0.36]	[0.33]	[0.34]	[0.30]
NLEADER	+	-0.198	-0.201	-0.200	-0.196	-0.196

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		(1) PC Dummy	(2) PC Directors	(3) PC Rank	(4) PC Tenure	(5) PC Freshness
		[-1.28]	[-1.31]	[-1.29]	[-1.28]	[-1.28]
CLEADER	+	0.044	0.042	0.043	0.041	0.042
		[0.89]	[0.86]	[0.87]	[0.83]	[0.85]
TENURE	+	0.006	0.008	0.007	0.009	0.006
		[0.11]	[0.15]	[0.13]	[0.17]	[0.12]
REPORTLAG	+	0.004***	0.004***	0.004***	0.004***	0.004***
		[6.53]	[6.53]	[6.53]	[6.53]	[6.53]
MB	+	-0.000	-0.000	-0.000	-0.000	-0.000
		[-0.41]	[-0.39]	[-0.40]	[-0.39]	[-0.39]
VOLATILITY	+	0.865***	0.865***	0.868***	0.866***	0.864***
		[5.25]	[5.25]	[5.26]	[5.25]	[5.23]
PROFIT	+	1.745***	1.745***	1.743***	1.746***	1.743***
		[19.93]	[19.97]	[19.94]	[19.99]	[19.94]
Constant		-0.923**	-0.938**	-0.930**	-0.929**	-0.917**
		[-2.03]	[-2.06]	[-2.05]	[-2.04]	[-2.02]
Industry effects		Yes	Yes	Yes	Yes	Yes
Year effects		Yes	Yes	Yes	Yes	Yes
Observations		22,387	22,387	22,387	22,387	22,387
Pseudo-R^2		0.48	0.48	0.48	0.48	0.48

Table 4 (Cont'd.): Political Connections and Audit Opinions

Panel B: Financially distressed sub-sample

		(1) PC Dummy	(2) PC Directors	(3) PC Rank	(4) PC Tenure	(5) PC Freshness
PCON	+	0.270***	0.130***	0.094***	0.016***	0.140***
		[3.46]	[2.63]	[3.28]	[2.83]	[3.18]
Control variables		Yes	Yes	Yes	Yes	Yes
Industry effects		Yes	Yes	Yes	Yes	Yes
Year effects		Yes	Yes	Yes	Yes	Yes
Observations		8,528	8,528	8,528	8,528	8,528
Pseudo-R^2		0.37	0.37	0.37	0.37	0.37

This table reports the results of the probit model, with an indicator variable for going-concern opinions as the dependent variable. Among independent variables; *LIT_SHU* is firm-specific litigation risk, based on Shu [2000]; *OFFICESIZE* is the log value of audit fee revenues for the city-based practice office that provides audit services for the sample firm: *INFLUENCE* is the percentage of total fees (including both audit and non-audit fees) charged to the sample firm relative to the total revenue for the city-based practice office that provides audit services for the firm; *TENURE* equals one if auditor tenure is three years or shorter and zero otherwise; *REPORTLAG* equals the number of days between the fiscal year-end and the earnings announcement date; *VOLATILITY* is the standard deviation of monthly stock returns for 12 months of the current fiscal year; *PRIORGC* equals one if the company received a going-concern audit opinion in the last year and zero otherwise; and *DACC* is unsigned discretionary accruals estimated from the modified cross-sectional Jones model. All other variables are defined in Section 3.2. All continuous variables are winsorized at the 1% and 99% levels. The analysis controls for industry and year fixed effects. All statistics are adjusted by clustering within firms, that is, standard errors are estimated by maximum likelihood under the assumption that residuals are clustered within firms. The superscripts ***, **, and * denote two-tailed significance levels of 0.01, 0.05, and 0.10, respectively.

Table 5: Political Connections and Audit Fees (Before and After the Financial Crisis)

	PC Dummy	
	One year before Oct. 2008	One year after Oct. 2008
	0.062**	0.072***
	[2.30]	[2.79]
	0.010	
	[0.25]	
Control variables	Yes	Yes
Industry effects	Yes	Yes
Observations	3,288	3,020
R-Squared	0.81	0.83

All continuous variables are winsorized at the 1% and 99% levels. All t-statistics reported in brackets are based on standard errors clustered at the firm level. The superscripts ***, **, and * denote two-tailed significance levels of 0.01, 0.05, and 0.10, respectively.