ABSTRACT

Title of Dissertation:	THE ASSOCIATION BETWEEN AUDIT COMMITTEE DIRECTORS' POLITICAL SKILL AND AUDIT COMMITTEE QUALITY AND EFFECTIVENESS
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Corporate audit committee (AC) quality and effectiveness have been heavily scrutinized by stakeholders for almost three decades. That scrutiny eventually led to the passage of the Sarbanes-Oxley Act of 2002 (SOX), the most comprehensive piece of business reform legislation since the Securities Act of 1933 and the Securities Exchange Act of 1934. In this dissertation, I use a hybrid resource dependence theory and agency theory underpinning to advance arguments as to why we can expect differences in the behavior of the AC due to the presence of AC directors' political skill. My dissertation is comprised of three essays that investigate the association between AC directors' political skill and AC quality and effectiveness, namely the number of AC meetings (proxy for AC diligence), audit report lag (ARL), and audit fees. The motivation for this dissertation stems from AC quality, effectiveness, and composition concerns of stakeholders (e.g. the Blue Ribbon Committee and the Securities and Exchange Commission), concerns which led to their assertions regarding certain personal characteristics a good AC director should possess to be effective. My first essay

examines and empirically tests the association between AC meeting frequency and AC directors' political skill. I find significant evidence that indicates ACs with at least one politically skilled AC director are more likely to meet regularly (be more diligent). My second essay examines and empirically tests the association between ARL and AC directors' political skill, but I find no evidence to suggest that AC director's political skill impacts ARL. My third essay examines and empirically tests the association between audit fees and AC directors' political skill. I find marginally significant evidence that firms with ACs having at least one politically skilled director are more likely to incur higher fees for the external audit, suggesting that those ACs demand a more comprehensive audit.

THE ASSOCIATION BETWEEN AUDIT COMMITTEE DIRECTORS'

POLITICAL SKILL AND AUDIT COMMITTEE QUALITY AND EFFECTIVENESS

by

Delvin Dwayne Seawright

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DEDICATION

I dedicate this significant achievement to two women who have had a profound influence on my personal and professional development: my maternal grandmother, the late Novella Jones, and one of my mentors, Dr. Jean G. Crawford, retired Alabama State University Professor of Accounting.

ACKNOWLEDGMENTS

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Chapter 1: INTRODUCTION

Corporate audit committee (AC) quality and effectiveness have endured tremendous scrutiny from stakeholders over the years. That scrutiny eventually led to the Securities and Exchange Commission (SEC) adopting rules and requirements related to an AC's composition and activities (SEC 1999a, 1999b, 2003a, 2003b). It also led to the passage of the Sarbanes-Oxley Act of 2002 (SOX), one of the most comprehensive pieces of business reform legislation since the Securities Act of 1933 and the Securities Exchange Act of 1934. In this dissertation, I develop arguments as to why differences in the behavior of the AC due to the presence of AC directors' political skill can be expected. Moreover, I empirically test to find evidence suggesting such differences occur.

The motivation for this dissertation originates from AC quality, effectiveness, and composition concerns of stakeholders (Levitt 1998; BRC 1999; White 2014), concerns which led to their assertions regarding particular personal characteristics they believe a good, effective AC director should possess. While addressing the New York University Center for Law and Business in September 1998 on the adverse impact of earnings management on financial reporting quality and disclosure, SEC chairman Arthur Levitt (1998) asserts that ". . . qualified, committed, independent and tough-minded audit committees represent the most reliable guardians of the public interest." Comprised of a group of private sector bodies seeking to discover ways to improve AC effectiveness, the BRC (1999) also asserts the following on improving AC effectiveness:

Good governance dictates that the board be comprised of individuals with certain personal characteristics, such as a recognition of the importance of the board's

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tasks, integrity, sense of accountability, a history of achievement, and the ability to ask tough questions. (BRC 1999, pg. 21).

Moreover, current SEC chairwoman Mary Jo White (2014) recently echoed very similar sentiments on AC director attributes during a June 2014 speech given at Stanford University's Rock Center for Corporate Governance 20th Annual Stanford Directors' College. During her address, White (2014) asserts that directors are vital "gatekeepers" upon whom investors and the SEC rely, and that AC directors should be "conscientious," "diligent," "engaged," and "committed," as well as able to "ask difficult questions" and "insist on answers when questions arise."

My dissertation is comprised of three essays. In the three essays, I utilize a hybrid resource dependence theory and agency theory underpinning to examine the association between AC directors' political skill and AC diligence, audit report lag (ARL), and audit fees. Hillman and Dalziel (2003) argue that such a hybrid underpinning is appropriate when investigating links between a firm's performance and its board of directors, which serves a two-fold purpose of providing resources (e.g. knowledge, skills, and competencies) to the firm and monitoring management. They argue that using only one theory as a foundation yields an incomplete understanding of how the board performs that two-fold purpose. Also, a call by Cohen, Krishnamoorthy, and Wright (2008) for future studies examining AC characteristics to use a hybrid resource dependence theory and agency theory underpinning underscores the argument of Hillman and Dalziel (2003).

The motivation for essay one stems from the perennial concerns of stakeholders regarding AC diligence. Levitt (1998), BRC (1999), and White (2014) all address AC

diligence and assert that the personal characteristics mentioned above are likely to be found on ACs who meet regularly. Levitt (1998) asserts the need for frequent AC meetings to deter earnings management. BRC (1999) also emphasizes the need for regular meetings of the AC for it to be effective in discharging its duties. Moreover, White (2014) asserts diligent AC directors are critical to ensuring investor and regulator confidence in financial reporting and disclosure.

If the personal characteristics that stakeholders have repeatedly mentioned are qualities of a good AC director and capable of impacting AC activities, then it is plausible there exist differences in the behavior of ACs with and without AC directors who possess those qualities. Such differences may be empirically observed by a comparison of the AC meeting frequency of ACs with and without directors who possess those or similar characteristics. In essay one, I empirically test the assertions of the stakeholders by examining the association between the number of AC meetings and AC directors' political skill[1], a comprehensive system of social competencies (Ferris et al. 2005) that encompasses several of the personal characteristics suggested by Levitt (1998), BRC (1999), and White (2014).

In essay two, I investigate if AC directors' political skill impacts ARL. Preventing prolonged delays in the release of audited financial reports has been a longstanding concern of the SEC (SEC 2002). The timely release of audited financial reports ensures that investors are provided with timely, relevant information with which to use in their decision-making activities. In an effort to ensure investors are provided

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[1] Ferris et al. (2005) defines political skill as a comprehensive system of social competencies that enables an individual to understand others in work-relevant situations and use that knowledge to influence others' actions in ways that heighten one's organizational and/or personal objectives. Researchers believe it can be innate and/or developed or shaped through socialization or training (Ferris, Anthony, Kolodinsky, Gilmore, and Harvey 2002).

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with timely reports, the SEC took actions to shorten the annual report (10-K) filing period from 90 days after a firm's fiscal year-end to 75 days for some[2] firms and 60 days for others[3] (SEC 2002, 2005).

Given the critical oversight role the AC has over the external audit process and the management-auditor relationship (both which affect ARL), it is plausible that AC directors' political skill affects ARL. Turley and Zaman (2007) argue that the ability of AC directors to influence the management-auditor relationship is a function of the quality of AC directors and that the outcomes of corporate governance are influenced significantly by relationships the AC has with other corporate governance participants. BRC (1999) also emphasizes that those (effective) relationships are necessary for quality financial reporting and disclosure, an outcome of the audit process, but Turley and Zaman (2007) state that those relationships are mostly unexplored in AC studies. Given the pressure, in addition to others[4], a firm's management and external auditor face due to having to shorten the portion of the external audit conducted after year-end because of the shortened 10-K filing period, politically skilled AC directors may impact ARL through, among other things, their ability to exert compelling influence on others (Ferris et al. 2007) and through their mastery of conflict resolution and compromise (Hibbing and Theiss-Morse 1995). Therefore, while overseeing the external audit process, I expect differences in the behavior of ACs with and without a politically skilled director. And, I

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[2] Firms categorized as Accelerated Filers, which are public companies with a public float between $75 million and $700 million (SEC 2002, 2005).

[3] Firms categorized as Large Accelerated Filers, which are public companies with a public float of $700 million or more (SEC 2002, 2005).

[4] Dyer and McHugh (1975) identify "normal" auditing and accounting issues that may lead to pressure on management and the external auditor. Such issues include conducting physical inventories, the slow return of confirmations, delays in year-end adjustments, and disagreements with the external auditor concerning reporting extraordinary items, and valuation of accounts. However, SOX and PCAOB actions have been associated with additional pressures such as time pressure from complying with SOX and from auditors' liability fears (Gullapalli 2005; McGee 2005), pressure due to having insufficient audit personnel resources (Behn, Searcy, and Woodruff, 2006), and pressure completing fiscal year-end audit work (Lambert et al. 2013).

empirically test the association between AC directors' political skill and ARL to find whether such differences occur.

In essay three, I investigate if AC directors' political skill impacts audit fees. A recent decline in audit fees garnered the attention of Public Company Accounting Oversight Board (PCAOB) chairman James R. Doty (2014) who expresses concern regarding the decline. In a May 2014 address to attendees of Baruch College's 13th Annual Financial Reporting Conference, chairman Doty (2014) expresses concern about audit fees becoming a declining component of total revenue for audit firms and questions whether those declining fees suggested a decline in the scope of those audits performed. Chairman Doty (2014) goes on to suggest the need to understand the potential impact such a trend in audit fees may have on audit quality. And, such a suggestion seems reasonably valid given the SEC's prior concerns about the association between external auditor independence and the lowballing of audit fees on initial audit engagements (SEC, 2000).

Given that the selection and retention/dismissal of a firm's external auditor falls within the purview of the AC, which must "satisfy itself that the audit fee is sufficient for a comprehensive and complete audit" (Public Oversight Board 1993), it is plausible that AC directors' political skill impacts the audit fees charged by the external auditor. The external auditor selection and retention process involves extensive negotiations between a firm's AC and its current or a prospective external auditor. Politically skilled individuals are, among other things, known for being accountable to others, conscientious, and skilled at negotiations and making deals (Ferris et al. 2007). Also, AC directors with such attributes and skills are, arguably, more likely to agree to audit fees of an audit

engagement viewed as being comprehensive and complete. Therefore, during audit engagement contract negotiations, I expect ACs with at least one politically skilled director to behave differently than those without such a director. And, I empirically test the association between AC directors' political and external audit fees to find whether such differences occur.

Organization of the Succeeding Sections

The remaining sections of my dissertation are as follows. Chapter 2 begins by outlining the concerns of stakeholders regarding AC diligence, which researchers generally measure as the number of AC meetings (DeZoort et al. 2002). Using archival data from 2012, I empirically test the association between the number of AC meetings and AC directors' political skill by estimating a multivariate OLS regression model. I find significant evidence that AC directors' political skill is more likely to lead to more frequent AC meetings. Chapter 3 begins by outlining the SEC's concern about the impact a prolonged delay in the release of audited financial reports has on the value and relevance of the information contained in those reports. I use archival data and OLS regression to test the association between ARL and AC directors' political skill, but find no evidence suggesting an association. Chapter 4 begins by outlining the concern of the chairman of PCAOB regarding a noticeable decline in audit fees between 2006 and 2011. Using archival data from 2012 and an OLS regression model comprised of variables used in traditional audit fee models, I test the association between audit fees and AC directors' political skill. I find marginally significant evidence suggesting that ACs with at least one politically skilled director demand a more comprehensive external audit as evidenced by higher audit fees paid.

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Chapter 2: POLITICAL SKILL AND AUDIT COMMITTEE DILIGENCE

2.1 Motivation

The motivation for this essay stems from stakeholders' ongoing concerns regarding AC diligence and their contention that there are certain personal characteristics that a quality AC director should possess (Levitt 1998; BRC 1999; White 2014). While speaking on the topic of earnings management and financial reporting quality, SEC chairman Arthur Levitt (1998) asserts that ACs that are more likely to meet regularly are those that, among other things, are "independent," "committed," and "tough-minded." Shortly thereafter, the BRC (1999) asserts that, among other things, AC directors who have a "sense of accountability" and "the ability to ask tough questions" make for a quality AC with good governance. Moreover, while addressing attendees of a corporate governance conference, SEC chairman Mary Jo White (2014) asserts that, among other things, AC directors should be "diligent," "conscientious," "committed," and able "to ask the difficult questions."

Some of the characteristics asserted by Levitt (1998), BRC (1999), and White (2014) have been argued and/or documented in the political skill and organizational politics literatures to be associated with politically skilled individuals. Based on those stakeholders assertions, I investigate whether the presence of politically skilled individuals on the AC will lead to differences in AC behavior that impacts AC diligence as measured by the number of AC meetings held during the year.

2.2 Background

Given the AC's critical role of overseeing the financial reporting and disclosure and external audit function of public firms, AC diligence has been of grave concern to

stakeholders for many years. After being formed by private sector bodies in 1985 to identify causal factors of fraudulent financial reporting as well as identify steps to reduce fraud occurrences, the National Commission on Fraudulent Financial Reporting (NCFFR), also known as the Treadway Commission, recommended the need for regular meetings of the corporate governance participants (e.g. AC and senior management) was necessary (NCFFR 1987). In his September 1998 address to New York University's Center for Law and Business on the detrimental impact of earnings management on financial reporting quality in America, SEC chairman Arthur Levitt (1998) asserts the need for regular meetings of the AC to combat earnings management. After being formed in the latter part of 1998 by private sector bodies to investigate ways to improve corporate AC effectiveness, the BRC (1999) asserts the need for regular meetings of the AC for the AC to be effective in executing its duties. And, SEC chairwoman Mary Jo White (2014) informs attendees of a Stanford University corporate governance conference that diligent AC directors need not fear the risk of an enforcement action being imposed by her agency (White 2014).

Generally, the number of AC meetings is used by researchers to proxy for AC diligence since it the sole publicly available and quantifiable signal of it (DeZoort et al. 2002). Given the important role the AC has, regular meetings of the AC are of the utmost importance. Such meetings allow for continuous review of controls established by management to safeguard the integrity of quarterly financial reporting (NCFFR 1987). Regular meetings present opportunities for better communication and relationships between the AC and a firm's management, internal audit function, and external auditor (BRC, 1999; POB, 1993). Furthermore, regular meetings of the AC have also been

documented in the accounting and auditing literature (e.g. McMullen and Raghunandan 1996; Xie, Davidson, and DaDalt 2003; Abbott, Parker, and Peters 2004; Farber 2005) as being associated with several positive financial reporting outcomes, and some determinants of AC diligence have been documented as well (e.g. Raghunandan and Rama 2007; Thiruvadi 2012).

2.3 Related Literature

AC Diligence

Menon and Williams (1994) investigate whether voluntarily formed ACs are relied upon for monitoring as indicated by the number of AC meetings and AC composition. The authors find that many ACs either meet once or not at all and that as the proportion of outside directors increases, the probability of the AC meeting more also increases. McMullen and Raghunandan (1996) use a sample of firms with and without financial reporting issues (SEC enforcement actions and restatements of earnings) to examine differences in AC composition and meeting habits of such firms in an effort to discover clues about AC effectiveness. The authors find that the AC of firms with a financial reporting issue is less likely to meet regularly, be comprised solely of outside directors, or have a certified public accountant as a director. Scarbrough, Rama, and Raghunandan (1998) use a sample of Canadian manufacturing firms to investigate the association between AC composition and communication with the internal audit function. They find that frequent meetings of the AC with the internal audit chief are more likely when the AC is comprised solely of independent directors. Beasley, Carcello, and Hermanson (1999) provide a comprehensive analysis of incidences of fraudulent financial reporting since the report issued by the Treadway Commission in 1987. With a

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threefold objective of (1) identifying SEC alleged incidences of fraudulent financial reporting, (2) examining certain firm and management attributes of a sample of firms identified as having an alleged SEC incidence of fraudulent financial reporting, and (3) providing recommendations for corporate financial reporting improvements, Beasley et al. (1999) find that the ACs of firms that comprise their sample appear weak, rarely meet, lack a director with accounting or finance expertise, and the boards of those firms have a heavy presence of inside directors on average. Xie et al. (2003) investigate the role of corporate governance mechanisms (board of directors, AC, and executive committee) in restraining earnings management and find smaller levels of discretionary accruals are associated with boards and ACs that meet regularly. Using a matched-pairs sample of firms with and without a non-fraud restatement of financials, Abbott et al. (2004) examine the association between of AC characteristics and the likelihood of restatement and find a significant, negative relationship between the number of AC meetings and restatements and between restatements and ACs with at least one director with financial expertise. Using a sample of firms with and without an occurrence of fraud as determined by the SEC, Farber (2005) investigates the association between the quality of a firm's corporate governance mechanisms and the integrity of its financial reporting system and finds that firms not identified by the SEC as having fraudulently manipulated their financial statements have more frequent AC meetings compared to similar firms with a fraud occurrence. Although AC diligence, measured as AC meeting frequency, has been documented in prior studies as being associated with positive financial reporting outcomes, studies on the determinants of AC diligence have been scarce.

To add to the scant literature on the determinants of AC diligence, Raghunandan and Rama (2007) examine the association between the number of AC meetings and characteristics of the firm, and Thiruvadi (2012) investigates the impact of AC director gender on AC diligence. Using a sample of S&P SmallCap Index firms with a fiscal year-end of December 31, 2003, Raghunandan and Rama (2007) find that firms that are larger, have a higher level of block-holders, in industries prone to litigation, and have more board meetings are more likely to have to have a higher AC meeting frequency. The authors also document a significant positive relationship between the AC meeting frequency and the proportion of directors considered accounting experts. Also using a sample of S&P SmallCap Index firms with a fiscal year-end of December 31, 2003, Thiruvadi (2012) investigates the impact of behavioral differences due to AC director gender on AC diligence. She argues and posits that gender differences should be expected to lead to differences in the behavior (meeting frequency) of ACs with and without at least one female AC director. Her sample documents a mean number of 8.06 AC meetings for ACs with at least one female AC director and a mean number of 6.80 AC meetings for ACs comprised solely of males. Moreover, she finds marginally significant evidence to support her hypothesis that ACs with at least one female director are likely to meet more often than ACs comprised of all males.

In short, our knowledge and understanding of the impact of AC diligence on AC quality and effectiveness have been enhanced greatly. However, given that AC diligence remains a grave concern of many stakeholders, identifying possible additional determinants of AC diligence is important.

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2.4 Theory Development

Political Skill

Political skill is defined as a system of social competencies that enables an individual to understand others in work-relevant situations and use that knowledge to influence others' actions in ways that heightens one's organizational and/or personal objectives (Ferris et al. 2005). Researchers view political skill as a social competency that can be innate or significantly developed or shaped through socialization or training (Ferris et al. 2002). Many researchers agree that organizations are inherently political to some degree (Mintzberg 1985), and some argue that political skill is necessary for success in organizations (Pfeffer 1981).

After conducting a survey of the political skill and organizational politics literature, Ferris et al. (2007) conceptualize political skill as being comprised of four dimensions: (1) social astuteness, (2) interpersonal influence, (3) networking ability, and (4) apparent sincerity. Socially astute individuals are considered keen observers of others (Ferris et al. 2007). They are viewed as possessing a high self-awareness and self-confidence, though not self-centered (Ferris et al. 2007). They are also argued to be accountable to others (Ferris et al. 2007) and conscientious (Treadway, Hochwarter, Kacmar, and Ferris 2005). The interpersonal influence dimension of political skill encompasses the influence ability and adaptability of politically skilled individuals (Ferris et al. 2007). Politically skilled individuals are able to exert compelling influence on others and that influence allows them to adapt to different environments and situations to bring about responses desired of others (Ferris et al. 2007). Also, Liu et al. (2007) and Thompson (2005) provide evidence on significant positive relationships between political

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skill's interpersonal influence dimension and proactive personality. The networking

ability dimension of political skill captures a politically skilled individual's ability to

indentify, develop, and maintain diverse and extensive contacts and networks (Ferris et

al. 2007). The networking ability dimension also captures a politically skilled

individual's ability to build and maintain beneficial coalitions and alliances (Ferris et al.

2007). Also, Ferris et al. (2007) argue that due to political skilled individuals' ability to

develop and maintain diverse and extensive contacts and networks, they are more likely

to be assertive. Lastly, the apparent sincerity dimension captures the ability of a

politically skilled individual to appear genuine and sincere (Ferris et al. 2007). This

dimension also captures a politically skilled individual's ability to appear to possess a

high degree of integrity and to produce confidence and trust within others around them

(Ferris et al. 2007).

In short, from conscientiousness to proactive personality, political skill enables

individuals to be very effective at work and in various types of organizations (Ferris et al.

2007). And, given that political skill encompasses similar personal characteristics

asserted in Levitt (1998), BRC (1999), White (2014), the presence of politically skilled

directors may be a good addition to corporate ACs.

Resource Dependence Theory and Agency Theory

Hillman and Dalziel (2003) argue that because the purpose of the board of

directors is to provide resources to the firm and to monitor management, this two-fold

purpose warrants the use of a hybrid resource dependence theory and agency theory

underpinning when exploring links between a firm's board of directors and firm

performance. They argue that the human and social capital directors bring to the board

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affect the board's ability to provide resources as well as effectively monitor management. Hillman and Dalziel (2003) state that too many prior studies have used only one perspective (primarily agency theory), and such use yields an incomplete understanding of how a board executes its two-fold purpose and that a hybrid theoretical underpinning is more appropriate.

Providing resources or access to resources is central to the resource dependence perspective in which researchers argue that firms are dependent upon outside organizations that operate within the external environment (Pfeffer and Salancik 1978). Such a dependency on those external organizations (e.g. government) gives rise to uncertainty and risk which affect the performance of firms (Hillman 2005). To protect against or minimize that uncertainty and risk, firms form linkages with those external organizations (Pfeffer and Salancik 1978), oftentimes by using the board of directors as its primary means of extracting and absorbing crucial components of environmental uncertainty and risk into the firm (Hillman 2005). Once appointed to corporate boards, those former affiliates or employees of external organizations provide firms with resources (e.g. knowledge, skills, and competencies) that have been accumulated from and about the external environment.

Monitoring management is central to agency theory which seeks to minimize agency costs of a firm (Jensen and Meckling 1976). Such costs arise due to the separation of a firm's ownership and management (Jensen and Meckling 1976). Such a separation leads to information asymmetry and conflicting interests between a firm's shareholders and management (Jensen and Meckling 1976; Dey 2008). Because of that information asymmetry and those conflicting interests, agency scholars argue that

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managers of the firm are likely inclined to engage in activities that maximize their own utility at the expense of maximizing the wealth of shareholders (Jensen and Meckling 1976; Dey 2008). So, to deter or minimize those activities by resolving or mitigating conflicts of interests, corporate governance mechanisms and controls are established (Dey, 2008), of which monitoring a firm's management is a critical role of a firm's AC.

The argument of Hillman and Dalziel (2003) in support of a hybrid resource dependence theory and agency theory underpinning when examining links between a firm's board of directors and firm performance has garnered the attention of some researchers. It has also led to a call for such a hybrid theoretical framework for future studies investigating AC characteristics (Cohen et al. 2008).

2.5 Research Question Development

The U.S. government is one external organization that impacts corporate firms in some way or another. Whether through the promulgation of corporate tax policy and law or regulating certain industries, the government's role as a policy maker, regulator, and enforcer impacts corporate firms. From a resource dependence perspective, such an impact creates a dependence on the government and gives rise to uncertainty and risk which affect the performance of firms and lead to the forming of linkages with the government in an effort to protect against or minimize that uncertainty and risk (Hillman 2005). The appointment of former political and government officials to corporate boards is one way those linkages are formed, and over the last four decades corporate boards have seen an influx of former political and government officials (Lester, Hillman, Zardkoohi, and Cannella 2008; Goldman et al. 2009). Lester et al. (2008) document former federal government cabinet members and senators comprise a large number of

outside directorships. Since subcommittees are subsets of the full board, it's plausible that some of those public officials have been appointed to the AC. Moreover, it is also plausible that those individuals on the AC may be using the resources (e.g. knowledge, skills, and competencies) acquired or developed while in the public sector to carry out their director duties (e.g. monitor management) while currently in the private sector.

Prior research indicates that former political and government officials possess political skill because of the training (implicit and explicit) they received upon occupying their respective public office or capacity (Parker, Parker, and Dabros 2012). Parker et al. (2012) suggest such training enables those officials to develop policy expertise, extensive contacts and networks, and experience formulating and maneuvering legislation. Morrell and Hartley (2006) and Simpson (2008) suggest public officials are self-motivated and persistent individuals because of the ambiguous, intricate environments they must navigate and opposition they must overcome. Mondak and Halperin (2008) suggest public officials possess a strong sense of duty which is often associated with individuals being ethical, accountable, and conscientious. Furthermore, due to public officials developing and maintaining extensive networks and contacts (Kotter 1982; Lester et al. 2008), such activities suggest those individuals must be assertive (Ferris et al. 2007).

Given the importance of AC diligence to stakeholders and the integrity of financial reporting and disclosure, identifying factors that are associated with AC diligence is essential. Since politically skilled individuals (e.g. former public officials) are argued and suggested to possess personal characteristics similar to those of a good AC director as asserted in Levitt (1998), BRC (1999), and White (2014), it is plausible that the presence of at least one politically skilled AC director may lead to differences in

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the behavior of the AC that may impact AC diligence. Therefore, I put forth the following research question:

RQ1: Is AC directors' political skill associated with the number of AC meetings?

2.6 Methodology

Multivariate Regression Model

As believed and/or documented in prior studies (e.g. Rahunandan and Rama 2007; Thiruvadi 2012), AC meetings frequency could be associated with certain firm and/or director characteristics, therefore I control for such associations. I use a modified version of the ordinary least squares (OLS) regression models found in Raghunandan and Rama (2007) and Thiruvadi (2012) to test the association between the number of AC meetings and the political skill variable of interest. That modified OLS model is as follows:

$$LNACMTGS = \beta_0 + \beta_1 LNAT + \beta_2 INSIDER + \beta_3 BLOCK + \beta_4 LEV + \beta_5 ROA$$
$$+ \beta_6 MTB + \beta_7 LTGN + \beta_8 ACSIZE + \beta_9 ACCEXP + \beta_{10} OTH$$
$$+ \beta_{11} FEM + \beta_{12} CHRCEO + \beta_{13} LNBDSIZE + \beta_{14} BDIND$$
$$+ \beta_{15} BDMTGS + \beta_{16} BIG4 + \beta_{17} PSKILL + \varepsilon$$

Where:

LNACMTGS =	The natural log of the number of AC meetings held in fiscal year 2012.
LNAT=	The natural log of total assets as of December 31, 2012.
INSIDER=	The percent of common shares held by officers and directors.

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BLOCK=	The percent of common shares held by outside block-holders of 5% or more of shares outstanding.
LEV=	The ratio of long-term debt-to-assets as of December 31, 2012.
ROA=	The earnings before interest and taxes (EBIT) divided by total assets.
MTB=	The ratio of market value to book value as of December 31, 2012.
LTGN=	1 if firm is in litigious sectors Pharmaceuticals (SIC 2833-2836), Computers (3570-3577), Electronics (3600-3674), Retail (5200-5961), or Software (7370), otherwise 0.
ACSIZE=	The number of AC directors.
ACCEXP=	The proportion of AC directors who are accounting experts (e.g., CPA, auditor, CAO, CFO, or controller).
OTH=	The proportion of directors who are designated AC financial experts, but are not accounting experts as defined for ACCEXP.
FEM=	1 if at least one female AC director, otherwise 0.
CHRCEO=	1 if CEO is also the board chairman, otherwise 0.
LNBDSIZE=	The natural log of the number of directors on the board.
BDIND=	The proportion of independent directors on the board.
BDMTGS=	The number of board meetings held in 2012.

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BIG4=	1 if external auditor a Big Four firm (Deloitte, PricewaterhouseCoopers, Ernst & Young, or KPMG), otherwise 0.
PSKILL=	1 if at least one politically skilled director on the AC, otherwise 0.

2.7 Data and Sample

Several factors influenced the sample selection for this essay. First, due to the necessity of hand-collecting AC data from proxy statements (DEF 14A) filed with the SEC, I desired to keep a manageable sample size. Second, I wanted to direct my attention on firms where other monitoring mechanisms would be reduced in strength so that the significance of the AC would be greater. Since large firms are more likely to have alternative monitoring mechanisms (e.g. securities analysts), I decided to focus on smaller firms. Third, due to changes in regulations, I desired to limit my analysis to firms having a fiscal year-end of December 31. Using the criteria above, I limit my analysis to all S&P SmallCap 600 firms with a fiscal year-end of December 31, 2012.

Table 1.1 presents sample selection information as well as information on the industry distribution of firms in the sample. The initial sample of S&P 600 SmallCap firms was identified from the COMPUSTAT EXECUCOMP database. The tickers of those firms were then used to search for and extract COMPUSTAT financial data on those firms. Firms with missing COMPUSTAT data were excluded, followed by the exclusion of financial firms (SIC codes 6000-6999), firms missing proxy statements, and firms with a fiscal year-end other than December 31, 2012. Then, the background description of AC directors found in the proxy statements was reviewed to determine

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whether an AC director possessed political skill as determined by a modified version of the political connection classification scheme developed in Goldman et al. (2009), which classifies a politically connected board member as one who previously held certain high level positions at the international or federal level of government or politics.[5] Those AC directors not meeting my modified political connection classification criteria were excluded from the sample.[6]

The final sample includes 270 firms, of which 213 have at least one politically skilled AC director and the remaining 57 firms have no such AC director.

Descriptive Statistics

Table 1.2 presents the descriptive statistics for the sample used in this essay. The sample firms are categorized by ACs having an absence (*PSKILL*=0; n=213) or a presence (*PSKILL*=1; n=57) of a politically skilled AC director. Compared to the sample where *PSKILL*=1, the mean (median) of the number of AC meetings (*ACMTGS*) is greater than that of the sample where *PSKILL*=0. The mean (median) number of *ACMTGS* where *PSKILL*=1 is 7.67 (8.00), whereas it is 6.87 (6.00) where *PSKILL*=0. Table 1.3 presents additional AC meetings frequency descriptive data and Figure 1.1 presents, in graph form, the same information contained in Table 1.3. Firms where

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[5] Goldman et al. (2009) uses an extensive classification scheme to classify a board member as being politically connected. That scheme includes some of the following positions: U.S. president, presidential candidate, senator, representative; presidential cabinet secretary or assistant, deputy, deputy assistant, or undersecretary; ambassador; representative to the United Nations; state governor; and mayor. See Goldman et al. (2009) for the complete list. and city mayors. Firms in which no AC director possessed a political connection comprise the *PSKILL=0* sample.

[6] My sample includes all politically connected AC directors who held previous positions at the international and federal level, as well as state governor and city mayor. Observations in which the AC director was a military soldier only, or held a position at the state or local level of government or politics lower than governor or mayor, were excluded in accordance with prior literature investigating political connections on corporate boards. Such observations were excluded due to the lower public visibility, smaller constituency served, and/or less influence of military personnel and lower-level state and city public officials when compared to public officials such as U.S. vice-presidents or senators, presidential cabinet members, presidential council/committee members, directors/commissioners of federal agencies, state governors, and city mayors.

PSKILL=1 are larger in size (total assets, *AT*) than firms where *PSKILL*=0. The mean (median) amount of *AT* is $1.47 ($1.05) billion dollars where *PSKILL*=1, compared to $952.24 ($672.23) million where *PSKILL*=0. Firms where *PSKILL*=1 are more leveraged (*LEV*) than firms where *PSKILL*=0. The mean (median) *LEV* is 0.24 (0.24) percent where *PSKILL*=1 compared to 0.15 (0.10) percent where *PSKILL*=0. Firms where *PSKILL=1* have a larger AC (*ACSIZE*) than those where *PSKILL*=0. Mean (median) *ACSIZE* is 4.12 (4.00) directors compared to 3.52 (3.00) directors where *PSKILL*=0. A larger proportion of AC directors considered accounting experts (*ACCEXP*) is found in firms where *PSKILL=0* compared to those where *PSKILL=1*. Mean (median) *ACCEXP* is 0.36 (3.00) where *PSKILL*=0 and 0.26 (0.29) where *PSKILL*=1. Lastly, at least one female AC directors (*FEM*) is more likely to be found in firms where *PSKILL*=1 compared to those where *PSKILL=0*. Mean (median) *FEM* value is 0.56 (1.00) where *PSKILL*=1 compared to 0.32 (0.00) for the *PSKILL=0* sample.

Pearson Correlation Analysis

Table 1.4 presents a Pearson correlation matrix which documents correlations between the variables analyzed in this essay. Multicollinearity appears not to be an issue as evidenced by only five correlations having a coefficient in excess of 0.30. An assessment of the *p*-values of the correlations indicates a statistically significant (*p*-value = 0.04; 5% significance level) correlation between the *PSKILL* variable of interest and the dependent variable *LNACMTGS*.

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2.8 Results

Univariate Analysis

Table 1.5 presents information resulting from performing univariate analysis of the data based on whether an AC had at least one politically skilled director (*PSKILL=1*) or not (*PSKILL=0*). An assessment of the *p*-values of the variables documents a statistically significant difference in means for the dependent variable *LNACMTGS* and seven control variables. A few variables of interest are mentioned below.

Analysis of *LNACMTGS* documents a statistically significant (*t*-statistic = -2.08; *p*-value = .038; 5% significance level) difference in the means of the *PSKILL=0* and *PSKILL=1* samples. This finding suggests firms with at least one politically skilled director on the AC are likely to meet more than firms without a politically skilled AC director. Analysis of the control variable *LEV* documents a statistically significant (*t*-statistic= -3.29; *p*-value= <.01; 1% significance level) difference in the means of the two samples. This finding is consistent with prior research (Faccio, Masulis, & McConnell, 2006) that finds that politically connected firms are often larger in size and likely to be more leveraged, but also suggests politically connected firms may have easier access to credit markets. Analysis of the control variable *ACSIZE* documents statistically significant (*t*-statistic= -3.71; *p*-value = <.01; 1% significance level) difference in means of the *PSKILL=0* and *PSKILL=1* samples. This finding suggests firms with large ACs are more likely to have a politically skilled AC director. Analysis of the *ACCEXP* variable yields a statistically significant (*t*-statistic= 3.56; *p*-value= <.01; 1% significance level) difference in means of the two samples. This finding suggests that AC directors with accounting expertise are more likely to be on ACs lacking a politically skilled

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director. Analysis of the FEM variable yields a statistically significant (*t*-statistic= -3.42; p-value = <.01; 1% significance level) differences in means of the two samples. This finding suggests that politically skilled AC directors wield influence that overshadows the influence of female AC directors.

Regression Results

Table 1.6 presents the results from estimating the multiple regression model for this essay. The overall regression model is significant (*F*=3.33, *p* < .01). The model's adjusted r-squared (Adj. R^2) value is .13. This value falls within the Adj. R^2 values range of prior studies investigating determinants of AC diligence (Raghunandan and Rama 2007; Adjusted R^2 = .08) and gender's impact on AC meeting frequency (Thiruvadi 2012; Adj. R^2 = .15). The *LEV* variable coefficient is positive and marginally significant (*t*-statistic = -1.68; *p*-value = .09; 10% significance level) and suggests firms with more leverage are likely to have ACs that meet more. The *ROA* variable coefficient (-0.38) is negative and statistically significant (*t*-statistic = -1.97; *p*-value = .05; 5% significance level) and suggests firms with an earnings loss are likely to have ACs that meet more. The *OTH* variable coefficient (0.11) is positive and marginally significant (*t*-statistic = 1.90; *p*-value = .06; 10% significance level) and suggests firms with non-accounting AC directors are likely to have ACs that meet more. The *ACCEXP* variable is positive (0.06) but insignificant (*t*-statistic = 2.89; *p*-value = .53). The *BDIND* variable coefficient (0.66) is positive and statistically significant (*t*-statistic = 2.89; *p*-value = <.00; 1% significance level) and suggests firms with a board of directors with a larger proportion of outside directors are likely to have ACs that meet more. The *BDMTGS* variable coefficient (0.01) is positive and marginally significant (*t*-statistic = 1.89; *p*-value = .06;

10% significance level) and suggests firms which board of directors meet regularly are likely to have ACs that meet regularly. The *BIG4* variable coefficient (0.18) is positive and statistically significant (*t*-statistic = 3.11; *p*-value = <.01; 1% significance level) and suggests firms with a high quality external auditor are likely to have ACs that meet more. Lastly, the coefficient (0.10) of *PSKILL*, the variable of primary interest, is positive and statistically significant (*t*-statistic = 1.99; *p*-value = .05; 5% significance level) and suggests firms with at least one politically skilled AC director are more likely to have an AC that meets more frequently than firms without such a director. **Thus, my finding provides evidence that the presence of an AC director's political skill impacts AC diligence as measured by the number of AC meetings.**

Sensitivity Analysis

Raghunandan and Rama (2007) suggest there may be differences in AC meetings frequency between firms listed on the New York Stock Exchange (NYSE) and firms listed on others due to differing requirements of the exchanges. Firms listed on the NYSE are required to have an internal audit function, whereas other exchanges may not. Also, the NYSE has some thresholds that differ from the NASDAQ that are used in determining the independence of directors on the board (Raghunandan and Rama 2007). Of the 270 firms in the full sample, 123 (46%) are NYSE firms. I include a NYSE dummy variable (1 if a NYSE firm, 0 otherwise) in the model, but it is insignificant (*t*-statistic = 0.83; *p*-value = .41).

To assess sensitivity of the firm size variable *LNAT*, I substitute the natural log of market value of equity for it in the model, but it is insignificant (*t*-statistic = 0.60; *p*-value = .55) and doesn't improve the model fit (Adj. R^2 = .12) any.

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To assess sensitivity of the leverage variable (*LEV*), I substitute another leverage proxy for it in the model. The *LEV* variable in the original model is defined as the ratio of long-term debt to total assets, whereas the substitute leverage model is defined as the ratio of current and long-term debt. In the model, the substitute leverage proxy is insignificant (*t*-statistic = -1.33; *p*-value = .18).

Lastly, sensitivity of the return on assets variable (*ROA*) is assessed by substituting a dummy variable (1 if negative earnings, 0 otherwise) for it in the model. This substitute profitability variable is insignificant (*t*-statistic = 0.43; *p*-value = .67).

Chapter 3: POLITICAL SKILL AND AUDIT REPORT LAG

3.1 Motivation

The motivation for this essay originates from the concerns of stakeholders regarding the issuance of timely audited financial reports (SEC 2002), a consequence of audit efficiency. Shortly after the passage of SOX, and in an effort to provide investors with timely and relevant audited financial reports by preventing prolonged delays prior to the release of earnings information, the SEC took actions to shorten the annual report (10-K) filing period for certain[7] firms (SEC 2002). Several studies have investigated audit report lag (ARL), also known as audit delay (Ashton, Willingham, and Elliott 1987; Bamber, Bamber, and Schoderbek 1993; Ettredge, Li, and Sun 2006). And, several determinants of ARL have been discovered as well.

The AC plays an important role in the audit process, and Zaman and Turley (2007) argue that outcomes of corporate governance are influenced significantly by relationships and informal processes involving the AC, management, and the external auditor. The authors argue that the AC's influence on management and the external auditor is a function of its quality, standing, and experience. Levitt (1998), BRC (1999), and White (2014) assert several personal characteristics of a quality AC and AC director. Those characteristics include being tough-minded, committed, accountable, and being able to ask difficult questions (Levitt 1998; BRC 1999). Similar characteristics are argued to be associated with individuals who are politically skilled. Given that the AC acts as a liaison (Knapp 1987) or communications bridge (Carcello, Hermanson, and Neal

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[7] Public companies with a public float between $75 million and $700 million (Accelerated Filers) had their 10-K filing period reduced from 90 days after year-end to 75 days, and public companies with a public float of $700 million or more (Large Accelerated Filers) had their 10-K filing period reduced from 90 days after fiscal year-end to 60 days (SEC, 2005).

2002) between management and the external auditor, I investigate whether possible differences in the behavior of ACs with and without a politically skilled director impact a firm's ARL.

3.2 Background

The timely issuance of audited financial reports has been a perennial concern of stakeholders (Givoly and Palmon 1982; Bamber et al. 1993; Krishnan and Yang 2009; Abbott, Parker, and Peters 2012), especially regulators since the accounting and auditing scandals and corporate failures that led to the passage of SOX. Seeking to enhance the value and relevance of audited financial reports to investors, the SEC (2002, 2005) took actions which shortened the 10-K filing period from 90 days after a company's fiscal year-end to 75 days for companies it labeled accelerated filers (public companies with a public float between $75 million and $700 million) and 60 days for companies labeled large accelerated filers (public companies with a public float of $700 million or more). Companies not considered accelerated or large accelerated filers are considered non-accelerated filers and must adhere to the original 90 day 10-K filing period. Such actions were controversial and were not received well by the companies affected (Lambert et al. 2013), especially given that, during the same period of time, the PCAOB issued several auditing standards that increased audit scope and the reporting requirements of the external auditor[8] (Whitworth and Lambert 2014). Furthermore, the actions of the SEC and PCAOB highlighted the importance of identifying determinants of ARL (Abbott et al. 2012).

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[8] For example, Auditing Standard No. 2 (AS2) mandates an internal controls audit and AS No. 3 increased the requirements pertaining to audit documentation (PCAOB 2004, 2007). AS No. 2 was later superseded by AS No. 5 requiring an integrated audit of internal control and the financial statements (PCAOB 2007).

Measured as the number of calendar days between the fiscal year-end of a firm and the audit report date (Ashton et al. 1987), ARL is one of a few variables, externally observable, that is likely associated with audit efficiency (Bamber et al. 1993). Prior studies investigating ARL have discovered several of its determinants. Ashton et al. (1987), considered the first study on ARL (Bamber et al. 1993), document a mean ARL of 62.5 days and longer ARL for firms with a fiscal year-end other than December. Bamber et al. (1993) investigates the association between ARL and audit structure and documents a mean ARL of 40 days and a longer ARL for audit firms using more structured audit technologies. Knechel and Payne (2001) find ARL to be positively related to audit effort, controversial tax issues, and using unseasoned audit personnel. Furthermore, Whitworth and Lambert (2014) find ARL to be negatively associated with office-specific industry expertise. Though many determinants of ARL have been discovered, there is likely to be others that remain undiscovered. And, one such determinant may involve the management-auditor relationship.

SEC actions taken shortly after the passage of SOX to shorten 10-K filing periods, and PCAOB actions taken that increased audit scope and audit reporting requirements during the same period of time, were controversial and not received well by the firms affected (Lambert et al. 2013). Such actions imposed additional pressure on companies and their external auditor to perform a timely audit (Ettredge et al. 2006; Bronson, Hogan, Johnson, and Ramesh 2011). Such pressure may lead to increased conflict between the auditor and auditee, and that increased conflict may have significant implications for ARL. Given the important oversight role the AC has over the audit process and the management-auditor relationship, it is critical that the AC attempts to

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mitigate such pressure and conflict in an effort to minimize its impact on audit efficiency and the timely issuance of audited financial reports. And, such efforts on part of the AC may potentially impact ARL.

3.3 Related Literature

Determinants of ARL (Audit Delay)

Motivated by the impact of audit delay on the timely issuance of financial reports and the decision making processes of securities market participants, Ashton et al. (1987) is known as the first study to investigate possible determinants of audit delay (Bamber et al. 1993), also known as ARL. Using data collected from questionnaires completed by Peat Marwick Mitchell engagement partners regarding the audit most recently completed for a client, Ashton et al. (1987) test the association between audit delay and fourteen variables of interest which describe those clients, their external auditor, and the types of interactions they have with one another. They find, among other things, that audit delay is significantly associated with private firms, firm size (as measured by total revenue), and the quality of internal controls. Motivated by the desire to obtain a better understanding of audit delay determinants, Ashton, Graul, and Newton (1989) investigate determinants of audit delay using a sample of firms listed on Canada's Toronto Stock Exchange and audited by Canadian audit firms. Like Ashton et al. (1987), Ashton et al. (1989) find a negative relationship between audit delay and firm size (measured as total assets). They also find negative relationships between ARL and auditor size (Canadian Big Nine or not) and firms in the financial services industry. Bamber et al. (1993) examines the association between audit structure and ARL, as well as other determinants of ARL. Like Ashton et al. (1987, 1989), they find that ARL is negatively associated

with larger auditees. They also find ARL is positively associated with external auditors which use a structured audit approach. Knechel and Payne (2001) uses proprietary data obtained from a survey completed by an international public accounting firm in an effort to enhance our understanding of ARL determinants. They find that ARL is positively related to incremental audit effort and contentious tax issues, and negatively related to the supplying of management advisory services and the use of seasoned audit staff. Ettredge et al. (2006) examines the association between audit delay and internal control quality after SOX. Using Audit Analytics data from external auditor assessments, the authors find that longer ARL are associated with internal control material weaknesses, as well as with complying with SOX's 404 internal control assessment requirement. Lee, Mande, and Son (2009) examine the association between ARL and external auditor tenure and non-audit services. Using Audit Analytics data, they find a significant negative relationship between ARL and auditor tenure, and unlike Knechel and Payne (2001) who find a positive relationship, Lee et al. (2009) find a significant negative relationship between ARL and non-audit services (tax services). Abbott et al. (2012) investigate the association between audit delay and assistance provided to the external auditor by the auditee's internal audit function. Using data obtained from surveys completed by chief audit executives of Fortune 1000 firms, the authors find that audit delay is negatively associated with external audit assistance provided by an auditee's internal audit function. Lastly, Whitworth and Lambert (2014) investigate the association between audit delay and office-level characteristics of Big Four audit firms and find that audit delay is negatively associated with office-specific industry expertise.

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Our knowledge of the determinants of ARL has been greatly enhanced by prior studies, however, ARL remains an important concern to stakeholders. And, that concern warrants continual efforts devoted to identifying additional factors associated with ARL.

3.4 Theory Development

Political Skill

Defined as a system of social competencies, political skill enables an individual to understand others in work-relevant situations and use that knowledge to influence others' actions in ways that heightens one's personal and/or organizational objectives (Ferris et al. 2005). Researchers believe it can be intrinsic or developed or shaped significantly through training and/or socialization (Ferris et al. 2002). Political skill is argued to be necessary to be successful in organizations (Pfeffer 1981) since many researchers agree that organizations are, to some degree, inherently political (Mintzberg 1985).

Ferris et al. (2007) survey the political skill and organizational politics literature and conceptualize political skill as encompassing four dimensions: (1) social astuteness, (2) interpersonal influence, (3) networking ability, and (4) apparent sincerity. Socially astute individuals are argued to be keen observers of others (Ferris et al. 2007). Ferris et al. (2007) suggest socially astute individuals possess a high self-confidence and self-awareness and are accountable to others. Treadway et al. (2005) document significant positive relationships between conscientiousness and social astuteness. Political skill's interpersonal influence dimension encompasses an individual's ability to influence others and adapt to various environments and situations (Ferris et al. 2007). Ferris et al. (2007) suggest that politically skilled individuals have the ability to exert compelling influence on others. The authors suggest that influence allows politically skilled individuals to

adapt to different environments and situations to bring about behavior desired of others. Political skill's networking ability dimension captures an individual's ability to identify, develop, and maintain diverse, extensive networks and contacts, as well as build and maintain alliances and coalitions (Ferris et al. 2007). Ferris et al. (2007) argue that individuals who possess a high degree of networking ability are often skilled at conflict management and resolution, as well as negotiating and making deals. The apparent sincerity dimension of political skill captures an individual's ability to appear genuine and sincere (Ferris et al. 2007). This dimension also encompasses an individual's ability to appear to have a high degree of integrity (Ferris et al. 2007). Individuals with apparent sincerity are argued to produce trust and confidence within others around them which enables them to successfully influence others (Ferris et al. 2007).

Summarizing, politically skilled individuals possess social competencies that enable them to be very effective and successful at work. And, given that the relationships between corporate governance participants is often rife with conflicting interests (Dey 2008) and divergent beliefs (Dye 1991), corporate boards of directors and subcommittees could potentially benefit from the appointment of such individuals.

Resource Dependence Theory and Agency Theory

It is argued that the board of directors of a firm serves a two-fold purpose: (1) providing resources to firms and (2) monitoring management (Hillman and Dalziel 2003). Hillman and Dalziel (2003) argue that the human and social capital directors possess affect the board's ability to provide resources and monitor management. The provision of resources is key to the resource dependence perspective, and monitoring management is key to the agency perspective.

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Resource dependence scholars argue that firms are dependent upon outside organizations that operate within the external environment (Pfeffer and Salancik 1978). That dependency gives rise to uncertainty and risk which affect the performance of firms (Hillman 2005). To protect against or mitigate that uncertainty and risk, firms create linkages with those external organizations (Pfeffer and Salancik 1978), oftentimes by extracting human resources (former employees or affiliates) from the external environment (Pfeffer 1972). The board of directors is argued to be the primary means of extracting and absorbing critical components of environmental uncertainty and risk into the firm. Once directors, those former employees or affiliates provide firms with resources that have been accumulated from and about the external environment. Unique knowledge, skills, and competencies are a few examples of the resources those individuals are able to provide (Hillman, Zardkoohi, and Bierman 1999).

Central to agency theory is the monitoring of a firm's management in an effort to minimize agency costs of the firm (Jensen and Meckling 1976). Such costs result from the separation of a firm's ownership and management (Jensen and Meckling 1976). Due to information asymmetry and conflicting interests, agency scholars argue that managers of the firm are likely inclined to engage in behavior that maximizes their own utility at the expense of maximizing the wealth of shareholders (Jensen and Meckling 1976; Dey 2008). In an effort to deter or minimize that behavior, corporate governance controls and mechanisms are established to help resolve or mitigate conflicts of interest, of which monitoring management is critical. And, a firm's AC has a critical role in effective monitoring.

In short, it is argued that a hybrid resource dependence theory and agency theory underpinning is warranted when examining links between a firm's board of directors and firm performance (Hillman and Dalziel 2003). Most previous studies examining such links have used only an agency theory underpinning (Hillman and Dalziel 2003). Hillman and Dalziel (2003) argue that using a hybrid underpinning is more appropriate because using only the agency theory perspective as a foundation yields an incomplete understanding of how a board executes its two-fold purpose. Such an argument is supported by a call for the use of a hybrid resource dependence theory and agency theory underpinning for studies investigating AC characteristics (Cohen et al. 2008).

3.5 Research Question Development

The U.S. government is an external organization that affects the operations of corporate firms. Whether through such things as the regulation of certain industries or the corporate taxation, the government's role as a regulator and enforcer impacts corporate firms. From a resource dependence perspective, that influence leads to dependence upon the government and gives rise to uncertainty and risk that impact the performance of firms (Hillman 2005). Such a dependence and may lead to the forming of linkages with the government to mitigate that uncertainty and risk (Hillman 2005), and the appointment of former public officials to corporate boards is a plausible means of forming those linkages, given that corporate boards have experienced an influx of former public officials over the last four decades (Lester et al. 2008; Goldman et al. 2009). Since board committees are subsets of the full board, it is plausible that some of those former public officials have been appointed to the AC and may be using their human and social capital to provide resources and monitor management.

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Former government and political officials possess political skill because of the training received upon entering public office or assuming a public position (Parker et al. 2012). Such training enables those officials to acquire and/or develop human and social capital such as policy expertise, extensive networks and contacts, and experience formulating and maneuvering legislation (Parker et al. 2012). Public officials are argued to be self-motivated and persistent individuals because of opposition they must overcome and the complex, ambiguous environments they must navigate (Morrell and Hartley 2006; Simpson, 2008). Public officials are argued to possess a strong sense of duty, which is often associated with ethical, accountable, and conscientious individuals (Mondak and Halperin 2008). Due to developing and maintaining extensive networks and contacts (Kotter 1982; Lester et al. 2008), individuals such as public officials are likely o be assertive (Ferris et al. 2007). Furthermore, public officials are argued to be adept at conflict and compromise (Hibbing and Theiss-Morse 1995).

Providing investors with timely audited financial reports is an ongoing concern of stakeholders, and the issuance of those reports falls within the purview of the AC's oversight of the audit process and the management-auditor relationship. Zaman and Turley (2007) argue that the quality of AC directors impacts the AC's ability to influence the management-auditor relationship. Levitt (1998), BRC (1999), and White (2014) assert that a good AC director is one who possesses certain personal attributes such being accountable, committed, tough-minded, and able to ask difficult questions. Since politically skilled individuals (former public officials) are argued to possess some of those personal attributes and are adept at conflict and compromise (Hibbing and Theiss-Morse 1995), politically skilled AC directors may impact ARL by mitigating pressure

and conflict involving management and the external auditor that may arise during the external audit. Thus, I pose the following research question:

RQ2: Is AC directors' political skill associated with audit report lag?

3.6 Methodology

Multivariate Regression Model

Many prior studies have investigated the determinants of ARL and have suggested that ARL may be associated with a few things including certain firm and external auditor characteristics, therefore I control for such associations. OLS regression is used to test the association between ARL and the political skill variable of interest. That OLS regression model is as follows:

$$LNARL = \beta_0 + \beta_1 OWNC + \beta_2 LNMV + \beta_3 LEV + \beta_4 MTB + \beta_5 INVTA + \beta_6 SUBS$$
$$+ \beta_7 ENEWS + \beta_8 LOSS + \beta_9 BIG4 + \beta_{10} NEWAUD + \beta_{11} LNNAFEES$$
$$+ \beta_{12} ICMW + \beta_{13} PSKILL + \varepsilon$$

Where:

LNARL=	The natural log of the number of calendar days between the firm's fiscal year-end and audit report date.
OWNC=	The ratio of common shares outstanding to number of common shareholders.
LNMV=	The natural log of market value as of 12/31/2012.
LEV=	The ratio of long-term debt to assets as of 12/31/2012.
MTB=	The ratio of market value of equity to book value as of 12/31/2012.
INVTA=	The ratio of total inventory to total assets.
SUBS=	The number of subsidiaries.

ENEWS= The difference between current year's and prior year's EPS, divided by the

     absolute value of the prior year's EPS.

LOSS=   1 if negative earnings reported, otherwise 0.

BIG4=   1 if external auditor a Big Four firm (Deloitte, PricewaterhouseCoopers,

     Ernst & Young, or KPMG), otherwise 0.

NEWAUD= 1 if external auditor tenure equal to 3 or less years, otherwise 0.

LNNAFEES= The natural log of non-audit fees as of 12/31/2012.

ICMW=   1 if an internal control material weakness reported, otherwise 0.

PSKILL=   1 if at least one politically skilled director on the AC, otherwise 0.

3.7 Data and Sample

  The sample selection for this essay was influenced by several factors. First, because hand-collecting AC data from proxy statements filed with the SEC was necessary, keeping the sample size manageable was desirable. Second, I desired to direct my attention on firms where other monitoring mechanisms would be reduced in strength so that the significance of the AC would be greater. Because large firms are more likely to have alternative monitoring mechanisms such as large analyst following, I decided to direct my attention on smaller firms. Third, due to changes in regulations, I desired to limit my analysis to firms having a fiscal year-end of December 31. Using the sample selection criteria above, I limit my analysis to S&P SmallCap 600 firms with a fiscal year-end of December 31, 2012.

  Table 2.1 provides sample selection and industry distribution information. The COMPUSTAT EXECUCOMP database was used to identify the initial sample of S&P 600 SmallCap firms. The tickers of those firms were then used to identify and extract

financial data from the COMPUSTAT Industrial Annual database and audit information from the Audit Analytics database. Firms missing COMPUSTAT data were excluded, followed by the exclusion of financial firms (SIC codes 6000-6999), firms missing Audit Analytics data, firms missing proxy statements, firms with a fiscal year-end other than December 31, 2012, firms with military-only politically skilled AC directors, and firms with politically skilled AC directors from state and local government and political levels lower than governor or mayor.

Proxy statements provided background descriptions on AC directors and that information was reviewed to determine whether an AC director possessed political skill as determined by a modified version of the political connection classification scheme used in Goldman et al. (2009). Following that modified version, firms with at least one AC director who held a previous position at the international or federal level of politics or government, as well as the position of state governor or city mayor, were included in the sample *PSKILL=1*. Observations in which the AC director was a military soldier only, or held a position at the state or local level of politics or government lower than governor or mayor, were excluded in accordance with prior literature investigating political connections on corporate boards. Those observations were excluded because of the lower public visibility, smaller constituency served, and/or less influence of military personnel and lower-level state and city public officials when compared to positions such as U.S. senators, representatives, and presidential cabinet members. Firms in which no AC director held a political or government position described above make up the *PSKILL=0* sample. The final full sample is comprised of 262 firms, of which 205 have at least one politically skilled AC director and the remaining 57 firms do not.

Descriptive Statistics

Table 2.2 provides descriptive statistics for this essay's sample. Those firms are categorized by ACs without a politically skilled AC director (*PSKILL=0*) and firms with a politically skilled AC director (*PSKILL=1*). Mean (median) ARL for the *PSKILL=0* sample is 61 (59) days and 60 (59) days for the *PSKILL=0* sample. Table 2.3 provides additional ARL descriptive data, and Figure 2.1 presents in graph form the information contained in Table 2.3. A few control variables of particular interest are discussed below.

Firms where *PSKILL*=0 are smaller in size (market value, *MV*) than firms where *PSKILL*=1. The mean (median) amount of MV is $783.92 ($677.01) million dollars for the *PSKILL=0* sample, compared to $916.70 ($753.00) for the *PSKILL=1* sample. Firms in the *PSKILL=0* sample are less leveraged than firms where *PSKILL=1*. The mean (median) leverage ratio is 0.35 (0.34) for the *PSKILL=0* samples, compared to 0.43 (0.42) for the *PSKILL=1* sample. Also, data for the *SUBS* variable (proxy for firm and audit complexity) suggest that the firms in the *PSKILL=0* sample are less complex than those firms in the *PSKILL=1* sample as reflected by the mean (median) number of subsidiaries for the *PSKILL=0* sample, 28.80 (14.00), compared to 38.21 (27.00) for the sample *PSKILL=1*.

Pearson Correlation Analysis

Table 2.4 presents a Pearson correlation matrix documenting correlations between the variables analyzed in this essay. Multicollinearity appears not to be a problem as reflected by only two correlations coefficients that exceed 0.30. In regards to the *PSKILL* variable, it is statistically significantly correlated with three variables, *LNMV* (p-value = .05; 5% significance level), *LEV* (p-value = <.01; 1% significance level), and *SUBS* (p-

value = .05; 5% significance level). *PSKILL* is also marginally significantly correlated with *ENEWS* (*p*-value = .09; 10% significance level) and *LNNAF* (*p*-value = .06; 10% significance level).

3.8 Results

Univariate Analysis

Table 2.5 provides information resulting from univariate analysis of the data. The data were grouped into two groups based on whether a least one politically skilled director was on the AC (*PSKILL*=1) or not (*PSKILL*=0). After assessing the *p*-values of the variables, I find no statistical difference in means for the dependent variable *LNARL*. I do find statistically significant (at the 1% and 5% significance levels) differences in means for three control variables (*LNMV*, *LEV*, and *SUBS*) and a marginally significant (at the 10% level) difference in means for another control variable (*LNNAF*). Analysis of *LNMV* documents a statistically significant (*t*-statistic = -2.01; *p*-value = .05; 5% significance level) difference in means of the *PSKILL=0* and *PSKILL=1* samples. This finding suggests larger firms are more likely to have a politically skilled director on their AC. Analysis of *LEV* documents a statistically significant (*t*-statistic = -2.90; *p*-value = <.01; 1% significance level) difference in means of the *PSKILL=0* and *PSKILL=1* samples. Such a finding suggests that firms with politically skilled individuals (former public officials) on their AC are often larger in size, more leveraged, and may have easier access to credit markets. Analysis of *SUBS* shows a statistically significant (*t*-statistic = -1.95; *p*-value = .05; 5% significance level) difference in means of the *PSKILL=0* and *PSKILL=1* samples. This finding suggests politically skilled AC directors are more likely to be on the boards of firms with complex operations. Lastly, an analysis of

LNNAF variable documents a marginally significant (*t*-statistic = -1.89; *p*-value = .06; 10% significance level) difference in means of the *PSKILL=0* and *PSKILL=1* samples. Such a finding suggests that firms with at least one politically skilled AC director may enjoy knowledge spillovers due to the acquiring of firm-specific information while providing non-audit services.

Regression Results

Results of estimating the regression model for this essay are presented in Table 2.6. The overall regression model is significant (F=6.37, p<.01). The adjusted r-squared (Adj. R^2) value for the model is .21. Five control variables are statistically significant in the model, and two are marginally significant. Consistent with prior studies, the *LNMV* coefficient (-0.10) is negative and highly significant (*t*-statistic = -6.12; *p*-value = <.01; 1% significance level) and suggests that larger firms have more of an incentive to issue audited financial reports quicker than smaller firms. Inconsistent with prior studies, the *LEV* variable coefficient (-0.10) is negative and marginally significant (*t*-statistic = -1.79; *p*-value = .07; 10% significance level) and suggests that more highly leveraged firms have a shorter ARL. The *SUBS* coefficient (0.02) is positive and significant (*t*-statistic = 2.20; *p*-value = .03; 5% significance level) and suggests that audit complexity is a function of a client's operations complexity. The *BIG4* coefficient (-0.05) is negative and marginally significant (*t*-statistic = -1.67; *p*-value = .10; 10% significance level). Such a finding suggests the clients of Big Four audit firms have shorter ARLs, which could be due to several reasons including the audit technologies and procedures used, or the vast resources large audit firms tend to possess. The *NEWAUD* coefficient (0.09) is positive and significant (*t*-statistic = 2.46; *p*-value = .02; 5% significance level) and suggests that

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an external auditor with three or less years auditing a client needs more time to familiarize themselves with a client's operations. Inconsistent with prior studies, the *LNNAF* coefficient (0.01) is positive and highly significant (*t*-statistic = 2.99; *p*-value = <.01; 1% significance level). This finding suggests that audit firms do not experience a knowledge spillover benefit from providing non-audit and audit services. The *ICMW* variable coefficient (0.16) is positive and highly significant (*t*-statistic = 3.99; *p*-value = <.01; 1% significance level). This finding suggests that the external auditor may need to exert additional effort and conduct additional audit work when an internal control material weakness has been reported. Lastly, the primary variable of interest, *PSKILL*, is insignificant (*t*-statistic = 0.38; *p*-value = .70). **Therefore, I find no evidence to suggest that AC directors' political skill impacts ARL.**

Sensitivity Analysis

Sensitivity analysis was conducted on the following four variables: (1) firm size [*LNMV*], (2) leverage [*LEV*], (3) number of subsidiaries [*SUBS*], and (4) earnings loss [*LOSS*].

To assess the sensitivity of *LNMV*, I substitute the natural log of total assets for it in the regression model. Although the natural log of total assets is significant (*t*-statistic = -4.59; *p*-value = <.01) in the model, the overall fit of the model decreases as evidenced from a drop in Adj. R^2 from the initial .21 to .16.

To assess the sensitivity of *LEV*, I substitute another leverage proxy for it in the model. The substitute leverage proxy is measured as the ratio of total (current and long-term) debt to assets, whereas the numerator for *LEV* only consists of long-term debt. The substitute leverage proxy is found to be insignificant (*t*-statistic = -0.55; *p*-value = .58).

To assess the sensitivity of *SUBS*, I substitute the number of segments for it in the regression model. The number of segments proxy is found to be insignificant (t-statistic = -1.11; *p*-value = .27).

Lastly, to assess the sensitivity of *LOSS*, I substitute return on assets for it in the model. The return on assets proxy is measured as the earnings before interest and taxes divided by total assets. The return on assets proxy is found to be insignificant (*t*-statistic = -0.59; *p*-value = .56).

Chapter 4: POLITICAL SKILL AND AUDIT FEES

4.1 Motivation

The motivation for this essay arises from the concerns of PCAOB chairman James Doty regarding a decline in audit fees from 2006 to 2011 (Doty 2014). In a May 2014 address to attendees of Baruch College's Zicklin School of Business 13th Annual Financial Reporting Conference, Chairman Doty expresses his concerns about the impact that the decline in audit fees may have on audit quality. The logic behind his concern is that a reduction in audit fees charged may suggest an impairment or reduction in an external audit's scope. After posing a few questions to the conference attendees in that regards, Chairman Doty tells attendees that "Whatever the answers are in particular cases, the emerging reality for all of us is the need to understand the effect of these trends and pressures on audit quality" (Doty 2014). Moreover, given the SEC's prior concerns regarding the practice of lowballing audit fees and its association with external auditor independence (SEC 2000), the chairman's concerns are reasonably valid.

Levitt (1998), BRC (1999), and White (2014) assert several personal characteristics that a good AC and AC director should possess for good governance. Given that the AC is responsible for hiring the external auditor and overseeing the audit process and the management-auditor relationship, I investigate whether the AC of firms with AC directors possessing similar personal characteristics behave differently than the AC of firms without directors deemed not to possess those characteristics.

4.2 Background

Using an economic framework to underpin their studies, Simunic and Stein (1996) and Carcello et al. (2002) argue that audit fees represent efficient auditors'

economic costs which consist of resource costs (costs attributed to doing additional audit work) and expected future losses (attributed to legal liability). According to Simunic and Stein (1996), those costs are recognized to differ significantly with certain characteristics (e.g. size, riskiness, complexity) of the auditee. Carcello et al. (2002) argue that auditors look to minimize an audit's total cost by finding an optimal balance between resource costs and expected future losses resulting from legal liability. As additional audit effort is rendered, the probability of suffering a liability loss decreases (Carcello et al. 2002), and audit fees charged are likely to increase. Simunic and Stein (1996) argue that the AC can demand a significant quantity of audit effort. Furthermore, the authors provide evidence that suggests when an auditor faces a higher level of legal liability exposure, that auditor makes adjustments in audit fees nearly exclusively through rendering higher degrees of audit effort, as opposed to simply levying a price premium.

During the years 2006 to 2011, a noticeable decrease in audit fees in general and as a component of a firm's total revenues garnered the attention of PCAOB chairman James Doty[9] (2014). Though PCAOB doesn't regulate audit fees, Chairman Doty found the trend alarming and wondered if the decline in audit fees suggested a decline in an external audit's scope (Doty 2014). Given that auditor effort during an external audit is unobservable to investors, Chairman Doty (2014) believes such a trend in audit fees may not help to improve public confidence in the external audit, which has been adversely affected due to The Great Recession[10] (Doty 2014). Such a belief on part of the

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[9] Analyzing statistics regarding changes in external auditors of 418 Russell 3000 firms from 2006 to 2011, Chairman Doty's concern was due to an 11.5% decrease in the audit fees those firms reported and 62% of those firms reported a reduction in fees during an engagement's first year (Doty 2014). Also, the reduction in fees was more pronounced for sizable engagements of at least $3 million, of which 83% of those firms reported reduced audit fees in the external auditor's first year, a 15.7% median reduction (Doty 2014).

[10] The period of economic turmoil world markets experienced from December 2007 through June 2009.

chairman is not unreasonable given the SEC's longstanding concerns about the association between the practice of lowballing of audit fees for initial external audit engagements and external auditor independence (SEC 2000). Therefore, his assertion that an understanding of the impact of such a trend and pressure on audit quality is needed (Doty 2014) has merit.

The AC is responsible for effectively executing the critical oversight role over the financial reporting and disclosure function of a firm, as well as the external audit process and the management-external auditor relationship. It is crucial that the AC selects and retains a qualified external auditor capable of providing a quality client-specific audit, for not doing so may lead to significant consequences that can adversely affect the firm, its shareholders, and other stakeholders. And, it is because of those potential consequences that the recent trend (decline) in audit fees warrants the need for the continued engagement in studies that investigate the determinants of audit fees.

4.3 Related Literature

Determinants of Audit Fees

Carcello et al. (2002) investigates the association between characteristics (independence, expertise, and diligence) of the board of directors and audit fees (Big Six) for a sample of Fortune 1000 firms. They find significant positive associations for all three board characteristics, but additional analyses document that similar AC characteristics of the firms are insignificant in the regression model while in the company of the board variables. Abbott, Parker, Peters, and Raghunandan (2003) investigate the association between audit fees and AC characteristics and find evidence that contradicts the findings of Carcello et al. (2002). Abbott et al. (2003) find evidence that in the

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presence of variables that represent board characteristics, AC independence and financial expertise are positively and significantly related to audit fees. Lee and Mande (2005) investigate the relation between audit fees and AC independence and diligence and provide evidence (both single equation and simultaneous equations) that both are positively related to audit fees. Using a sample of public Australian firms, Goodwin-Stewart and Kent (2006) investigate the relation between audit fees, AC characteristics (including independence and financial expertise, and number of meetings), and the internal audit function. They find that audit fees are positively and significantly associated with AC meeting frequency, but not significantly related to AC independence and financial expertise. Their finding contradicts Abbott et al. (2003) who provide evidence of a positive and significant association between audit fees and AC independence and financial expertise. Using a sample of Fortune 500 firms, Vafeas and Wagelein (2007) investigate the relationship between AC characteristics and audit fees and find that audit fee levels are positively associated with AC size, independence, and financial expertise. Rainsbury, Bradbury, and Cahan (2009) use a sample of unregulated New Zealand firms to investigate the association between AC quality (including AC independence and accounting expertise) and find no significance among all AC quality proxies used. Ittonen, Miettinen, and Vahamaa (2010) use a sample of S&P 500 Index firms to investigate the relation between audit fees and female representation on the AC and provide evidence that lower audit fees are likely when a female is the chair of the AC. Lastly, Zaman, Hudaib, and Haniffa (2011) uses a sample of United Kingdom (UK) Financial Times Stock Exchange (FTSE) 350 firms to examine the association between audit committee effectiveness and audit and non-audit fees using a composite measure to

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capture AC size, independence, diligence, and financial expertise. They provide evidence of a positive relation between audit fees and their AC effectiveness composite measure only for clients that are larger.

4.4 Theory Development

Political Skill

Political skill, a system of social competencies, enables an individual to understand others in work-relevant circumstances and use that acquired knowledge to influence others' behavior in ways that enhances one's personal and/or organizational objectives (Ferris et al. 2005). Researchers believe it can be innate or developed considerably through training or socialization (Ferris et al. 2002). Also, many researchers believe that organizations are inherently political to some degree (Mintzberg 1985) and that political skill is necessary to be successful in them (Pfeffer 1981).

A survey of the political skill and organizational politics literature by Ferris et al. (2007) leads the authors to conceptualize political skill as being made up of four dimensions: (1) social astuteness, (2) interpersonal influence, (3) networking ability, and 94) apparent sincerity. The social astuteness dimension encompasses the ability of an individual to be a keen observer of others (Ferris et al. 2007). Socially astute individuals are viewed by others as having a high self-awareness and self confidence, as well as being accountable to others (Ferris et al. 2007). The interpersonal influence dimension captures an individual's ability to influence others and adapt to different settings and situations (Ferris et al. 2007). Ferris et al. (2007) suggest that this influence enables politically skilled individuals to bring about desired behavior of others. The networking ability dimension encompasses an individual's ability to recognize, develop, and maintain

networks that are diverse and extensive (Ferris et al. 2007). This dimension also captures an individual's ability to manage and resolve conflict, negotiate and make deals, as well as to form and maintain coalitions and alliances (Ferris et al. 2007). Lastly, the apparent sincerity dimension captures an individual's ability to seem to possess a high degree of integrity, as well as produce confidence and trust within others around them.

In short, politically skilled individuals are able to be very successful and effective in work-relevant situations. And, considering that divergent beliefs (Dye 1991) and conflicting interests (Dey 2008) are common among corporate governance participants, the appointment of politically skilled individuals to corporate boards may improve corporate governance quality.

Resource Dependence Theory and Agency Theory

The board of directors is said to serve a two-fold purpose of providing resources to the firm and monitoring management (Hillman and Dalziel 2003). Hillman and Dalziel (2003) argue that the social and human capital directors possess impact the board's ability to provide resources and monitor a firm's management. Providing resources is central to resource dependence theory, whereas monitoring management is central to agency theory.

Scholars of resource dependence theory argue that firms depend upon external organizations that operate within the external environment (Pfeffer and Salancik 1978). That dependency is argued to give rise to uncertainty and risk which impact the performance of firms (Hillman 2005). In an effort to mitigate or protect against that uncertainty and risk, firms form linkages with those external organizations (Pfeffer and Salancik 1978). Hillman (2005) argues that the board of directors is the primary method

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of extracting and absorbing essential components of environmental uncertainty and risk into the firm. Once on the board, those former affiliates and employees of the external organizations provide firms with resources (e.g. skills and competencies) that have been collected about and from the external environment.

Monitoring a firm's management in an effort to mitigate agency costs of the firm is central to agency theory (Jensen and Meckling 1976). Such costs stem from the separation of ownership and management of a firm (Jensen and Meckling 1976). Scholars of agency theory argue that, due to conflicting interests and information asymmetry, a firm's management is likely inclined to participate in behavior that maximizes its own utility at the expense of the firm's shareholders (Jensen and Meckling 1976; Dey 2008). To deter or minimize that behavior, corporate governance mechanisms are instituted to help mitigate or resolve conflicts of interests. And, the board of directors and its subcommittees are critical to effective corporate governance.

Hillman and Dalziel (2003) argue that studies investigating links between a firm's board of directors and firm performance warrants a hybrid resource dependence theory and agency theory underpinning because of the board's two-fold purpose of providing resources and monitoring management. They argue that using only one theory is inappropriate because doing so provides an incomplete understanding of how that two-fold purpose is carried out by the board. And, a call for a hybrid resource dependence theory and agency theory underpinning for studies examining AC characteristics (Cohen et al., 2008) lends credibility to that argument.

4.5 Research Question Development

One external organization that impacts corporate firms is the U.S. government. Whether through corporate taxation or industry regulation, the government's operations affect corporate firms. From a resource dependence perspective, such an impact creates a reliance on the government and gives rise to risk and uncertainty that affect a firm's performance and may lead to the formation of linkages (appointment of former public officials to the board of directors) with the government to reduce that risk and uncertainty (Hillman 2005). Corporate boards have experienced an influx of former government and political officials as directors over the last forty years (Lester et al. 2008; Goldman et al. 2009), and it is reasonable to believe that some of those officials may be serving on the AC.

Due to the training they received after entering a public office or assuming a public capacity, political and government officials are argued to possess political skill (Parker et al. 2012). That training is believed to have provided those public officials with the opportunity to acquire and/or develop social and human capital such as extensive contacts and networks, policy expertise, and experience formulating as well as maneuvering legislation (Parker et al. 2012). Morrell and Hartley (2006) and Simpson (2008) argue that public officials must be persistent and self-motivated individuals due to opposition they must overcome and the intricate, ambiguous environments they have to navigate. Hibbing and Theiss-Morse (1995) suggest public officials are skillful at conflict resolution and compromise. Furthermore, public officials are argued to have a strong sense of duty to others and are likely to be ethical and conscientious (Mondak and Halperin 2008).

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Providing effective oversight over the external audit process and the management-auditor relationship is critical to the integrity of the financial reporting and disclosure function of a firm and is the primary responsibility of the AC. However, the effectiveness of the AC is a function of the quality of its directors (Turley and Zaman 2007). Turley and Zaman (2007) argue that an AC's ability to influence the relationship between management and the external auditor depends on the quality of AC directors. BRC (1999), Levitt (1998), and White (2014) assert that accountable, tough-minded, committed individuals who are able to ask difficult questions make good AC directors. Similar personal characteristics are associated with politically skilled (public officials) individuals. Public officials have been argued to possess a strong sense of duty and accountability to others (Mondak and Halperin 2008) and are skilled at conflict resolution and compromise (Hibbing and Theiss-Morse 1995). Politically skilled AC members may communicate with management prior to negotiating the external audit engagement contract with the firm's audit firm. It is plausible that the politically skilled AC uses that information provided by management during those communications to demand a more comprehensive (quality) external audit during the audit engagement contract negotiations. So, it is likely such a demand may impact the amount of audit fees levied by the external auditor. Therefore, I put forth the following research question:

RQ3: Is AC directors' political skill associated with audit fees?

4.6 Methodology

Multivariate Regression Model

The extant auditing literature is filled with prior studies investigating the association between audit fees and other variables of interest, and those studies have

enhanced our knowledge and understanding. Hay, Knechel, Wong (2006) conduct a meta-analysis to analyze and summarize the extant auditing literature that investigates the determinants of audit fees. It is from that meta-analysis that this essay's OLS regression model is constructed to test the association between audit fees and the political skill variable of interest, while controlling for other associations. That model is as follows:

$$LNAFEES = \beta_0 + \beta_1 LNAT + \beta_2 SUBS + \beta_3 INVTA + \beta_4 ROA + \beta_5 LEV + \beta_6 BIG4$$
$$+ \beta_7 NEWAUD + \beta_8 ARL + \beta_9 ICMW + \beta_{10} PSKILL + \varepsilon$$

Where:

LNAFEES=	The natural log of audit fees.
LNAT=	The natural log of total assets as of 12/31/2012.
SUBS=	The number of subsidiaries.
INVTA=	The ratio of inventory to total assets.
ROA=	Return on assets measured as earnings before interest and taxes divided by total assets.
LEV=	The ratio of long-term debt to total assets as of 12/31/2012.
BIG4=	1 if external auditor a Big Four firm (Deloitte, PricewaterhouseCoopers, Ernst & Young, or KPMG), otherwise 0.
NEWAUD=	1 if external auditor tenure equal to 3 or less years, otherwise 0.
ARL=	The number of calendar days between the firm's fiscal year-end and audit report date.
ICMW=	1 if an internal control material weakness reported, otherwise 0.
PSKILL=	1 if at least one politically skilled director on the AC, otherwise 0.

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4.7 Data and Sample

A few factors influenced the sample selection for this essay. First, I wanted to keep a manageable sample size due to having to hand-collect data from proxy statements filed with the SEC. Second, due to their size, smaller firms tend to have less alternative monitoring mechanisms (e.g. analysts) than larger firms; therefore the significance of the AC should be greater for smaller firms, and I direct my attention on those firms. Lastly, due to changes in regulations, I wished to limit my analysis to firms having a fiscal year-end of December 31. And, using the sample selection criteria outlined above, I limit my analysis to S&P SmallCap 600 firms with a fiscal year-end of December 31, 2012.

Table 3.1 presents sample selection information and information pertaining to the industry distribution of the firms that comprise the sample. COMPUSTAT's EXECUCOMP database was utilized to identify the initial sample of S&P 600 SmallCap firms. Firms with a fiscal year-end other than December 31, 2012 were excluded immediately. Using the tickers of the remaining firms, financial data for the firms were extracted from the COMPUSTAT Industrial Annual database and Audit Analytics, then merged. Firms with missing COMPUSTAT and Audit Analytics data were excluded, followed by the exclusion of firms with missing proxy statements (DEF 14A), firms with military-only politically skilled AC directors, and firms having politically skilled AC directors having previously held state and local government positions lower than governor or mayor. The proxy statements provided background descriptions of the AC directors, and those descriptions were used to determine if an AC director possessed political skill. Such a determination was made using a modified version of the political connection classification scheme developed in Goldman et al. (2009). Adhering to that

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modified version, I determine that an AC director is politically skilled if he or she previously held a government or political position at the international or federal level, or as a state governor or city mayor. AC directors who do not meet that criteria are excluded from the sample in line with prior literature that investigated political connections on corporate boards. The final sample is comprised of 258 firms, of which 202 have at least one politically skilled AC director (*PSKILL=1*) and 56 have no such director (*PSKILL=0*).

Descriptive Statistics

Table 3.2 presents descriptive statistics for the sample. Statistics are provided according to groupings based on whether a firm has a politically skill director on the AC (*PSKILL=1*) or not (*PSKILL=0*). Mean (median) audit fees (*AFEES*) for the *PSKILL*=0 and *PSKILL*=1 samples are $1.28 ($1.06) million and $1.57 ($1.44) million, respectively. Firms where *PSKILL*=1 are larger than firms where *PSKILL*=0 as reflected in mean (median) AT of $1.472 ($1.02) billion and $999.27 ($700.76) million, respectively. Also, firms where *PSKILL*=1 are more leveraged than firms where *PSKILL*=0 as reflected in mean (median) *LEV* ratio of 0.24 (0.25) and 0.16 (0.11), respectively.

Pearson Correlation Analysis

Table 3.3 provides the Pearson correlation matrix used to assess the correlation between the variables in this essay. Given that only five variables have correlation coefficients that exceed 0.30, multicollinearity doesn't appear to be an issue. After assessing the p-values of the correlations, three variables (*LNAFEES*, *LNAT*, and *LEV*) are found to be statistically significant at the 1% significance level to this essay's variable of interest, *PSKILL*.

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4.8 Results

Univariate Analysis

Table 3.4 presents univariate analysis information according to grouping pertaining to whether a firm has at least one politically skill AC director (*PSKILL=1*) or not (*PSKILL=0*). An assessment of the *p*-values for the variables indicates a statistically significant (at the 1% significance level) difference in means for the dependent variable *LNAFEES* and two control variables, *LNAT* and *LEV*. Analysis of *LNAFEES* indicates a statistically significant (*t*-statistic = -2.77; *p*-value = <.01) difference in means for the *PSKILL=0* and *PSKILL=1* samples. This finding suggest that firms with ACs that have at least one politically skilled director pay more in audit fees because they demand a more thorough, quality audit which may involve more audit work, thus driving fees higher. Analysis of the firm size variable *LNAT* indicates a statistically significant (*t*-statistic = -2.97; *p*-value = <.01) difference in means for the two samples. This finding suggests that politically skilled directors are more likely to be found on the AC of large firms. Lastly, analysis of *LEV* indicates a statistically significant (*t*-statistic = -3.03; *p*-value = <.01) difference in means for the *PSKILL=0* and *PSKILL=1* samples. This finding suggests that easy or preferential access to credit markets is more likely to be afforded to firms with a politically skilled individual on the AC.

Regression Results

Table 3.5 presents results from estimating the OLS regression model for this essay. The overall regression model is significant (*F*=24.57, *p*<.01), and the adjusted r-squared (Adj. R^2) value is .48. An assessment of those values indicates the model has a good fit and explains much of the variation in the dependent variable, *LNAFEES*. The

coefficient of the firm size control variable *LNAT* is positive (0.39) and highly significant (*t*-statistic = 8.70; *p*-value = <.01). This finding suggests that larger firms are more likely to pay higher audit fees. The coefficient of the control variable *SUBS* is positive (0.00) and highly significant (*t*-statistic = 4.41; *p*-value = <.01). This finding suggests that firms that are more complex, as measured by the number of subsidiaries, require a more thorough external audit that may require additional audit work and effort on part of the external auditor. The coefficient of the control variable *LEV* is negative (-0.63) and highly significant (*t*-statistic = -3.17; *p*-value = <.01) and suggests that firms that are more leveraged are more likely to pay higher audit fees as a result of the need to conduct a more thorough audit due to the financial condition of the firms. The coefficient of the control variable *BIG4* is positive (0.22) and highly significant (*t*-statistic = 2.73; *p*-value = <.01) and suggests that higher quality audit firms are more likely to charge more in fees for conducting an external audit. The coefficient of the control variable *NEWAUD* is negative (-0.27) and highly significant (*t*-statistic = -2.51; *p*-value = .01) and suggests that auditors with less tenure (3 or less years with the auditee) are more likely to charge less fees for conducting the external audit. The coefficient of the control variable *ARL* is positive (0.01) and highly significant (*t*-statistic = 3.46; *p*-value = <.01) and suggest that firms that experience a longer audit report lag are more likely to incur higher external audit fees. The control variables *INVTA*, *ROA*, and *ICMW* are found to be insignificant. Lastly, the coefficient (0.12) for the primary variable of interest *PSKILL* is positive and marginally significant (*t*-statistic = 1.68; *p*-value = .10). This finding suggests that firms with at least one politically skilled director on the AC require a more thorough, quality audit and incur higher external audit fees more than likely due to necessity of additional

audit work to satisfy the auditee. **Therefore, I find marginally significant evidence that suggests the presence of AC directors' political skill impacts audit fees.**

Sensitivity Analysis

Sensitivity analysis was performed on three control variables: (1) *LNAT*, (2) *ROA*, and (3) *LEV*. According to Hay et al. (2006), more than twenty prior studies on audit fees found positive and significant results using sales to proxy for firm size, so I substituted the natural log of sales in the regression model. Though the sales proxy is found to be positive and significant at the 1% significance level, the fit of the model declines from an adjusted r-squared (Adj. R^2) of .48 to .44. I also substitute the natural log of the market value of equity in the model as a firm size proxy, and find the variable to be positive and significant at the 1% significance level, but model fit diminishes further (from Adj. R^2 of .48 to .39). Both variables are excluded from the model. And, my substitution of the presence of an earnings loss dummy variable for *ROA* and a different leverage proxy (total debt to total assets, rather than long-term debt to total assets) for *LEV* in the model results in no significance or improvement to model fit.

Chapter 5: DISCUSSION & CONCLUSION

In this section of my dissertation, I discuss the contributions and limitations of each essay, as well as provide directions for future research. However, there are a few contributions, limitations, and directions for future research that all three essays share, and those items are as follows.

There are at least four contributions of my dissertation. First, though there have been several studies to examine the impact of AC director characteristics such as independence (Klein 2002), accounting/financial expertise (Dhaliwal, Naiker, and Navissi 2010) and gender (Thiruvadi and Huang 2011; Thiruvadi 2012) on AC quality and effectiveness, there appears to be no prior studies examining this topic. Therefore my dissertation fills a gap in the literature. Second, this dissertation contributes to the accounting and auditing literature by investigating an unexplored, non-accounting AC characteristic that has been added to the AC voluntarily, unlike the financial expert characteristic which is a requirement of SOX. Third, this dissertation answers the call for studies to use a hybrid resource dependence theory and agency theory underpinning when examining AC characteristics (Cohen et al. 2008). Lastly, this study contributes to two ongoing debates, the corporate governance debate and the "revolving door" debate which centers on government and political officials who leave the public sector for the private sector.

There are at least four limitations and directions for future research that result from my dissertation. First, the AC directors' political skill proxy used is an imperfect one. Using prior experience in a high level political or governmental capacity as a proxy may not best capture an AC director's political skill, but I reasonably believe it to be

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given the time constraints of this dissertation, as well as the consistent evidence and logical arguments presented in prior studies in the political skill, organizational politics, and management literatures. Future research examining similar associations can use a well developed survey or questionnaire instrument to obtain data for testing associations of interest. Second, my inability to discriminate between the political skill of AC directors who are former public officials and those who have no such prior experience is a possible limitation of this dissertation. It is a possible limitation because political skill can be innate as well as learned and developed within any organization; therefore, my inability to discriminate does not allow for a determination of the possible impact of the political skill of AC directors who are not former public officials. A well developed questionnaire or survey instrument can possibly be used in future research to overcome this limitation. Third, my samples are comprised of U.S. firms, therefore, my findings may not be able generalizable to other settings, especially settings in which government-owned firms are common. Future research can investigate how ACs function across countries. Lastly, the time period of my dissertation is only one year and uses cross-sectional regression analysis, and this makes it impossible to infer causation. Future research could examine this topic over a span of a few years while using a research methodology (e.g. difference in difference(s)) that can lend to inferring causation.

Essay 1: Contribution, Limitations, and Future Research

AC diligence and its impact on financial reporting and disclosure has been an ongoing concern of stakeholders, including the SEC and private sector bodies, for many years (Levitt 1998; BRC 1999; White 2014). Generally, the number of AC meetings is utilized by researchers to proxy for AC diligence since it is the sole publicly available

quantifiable signal of AC diligence (DeZoort et al. 2002). BRC (1999), Levitt (1998), and White (2014) assert that certain personal attributes of an AC director are good for corporate governance, and several of the attributes mentioned are associated with politically skilled individuals (Ferris et al. 2007). Given that AC diligence remains a concern of stakeholders, it is important and useful to investigate possible unexplored determinants of AC diligence such as AC directors' political skill.

In Chapter 2, I use archival data from 2012 to examine and empirically test the association between the number of AC meetings and AC directors' political skill. I find significant evidence from estimating the OLS regression model of essay one that suggests that firms with ACs that have at least one politically skill AC director is more likely to meet regularly. Also, univariate analysis provides evidence of a statistically significant difference in the means of the natural log of the number of AC meetings of firms with and without at least one politically skilled director. These finding also suggests that the presence of a politically skilled director on the AC is more likely to be associated with ACs that are more conscientious in carrying out its duties.

The AC diligence proxy used in Chapter 2 presents at least one possible limitation of the chapter's findings. The number of AC meetings is an imperfect proxy for AC diligence, but it is generally used by researchers (DeZoort et al. 2002). Using the number of meetings makes it impossible to determine the duration of meetings and what is being discussed. Future research examining this topic may be able to overcome this limitation by obtaining AC meetings data from minutes of the AC meetings and/or through the use of a questionnaire or survey instrument.

Essay 2: Contribution, Limitations, and Future Research

Issuing audited financial reports in a timely manner has been a longstanding concern of the SEC (Givoly and Palmon 1982; Abbott et al. 2012), particularly since the accounting and auditing improprieties and corporate failures that proceeded SOX. Given the adverse impact untimely reports can have on the value and relevance of the information contained in those reports, the SEC (2002, 2005) acted to shorten the annual report (10-K) filing period for certain firms while during the same period the PCAOB (2004, 2007) increased the scope of the audit as well as increased auditor reporting requirements. ARL is one of a small number of variables, externally observable, that is likely related to audit efficiency (Bamber et al. 1993). Given that the AC oversees the external audit process, audit efficiency affects the timely issuance of audit financial reports, and the timely issuance of those reports remains a concern of stakeholders, it is important and useful to examine potential unexplored determinants of ARL such as AC directors' political skill.

In Chapter 3, I use archival data and OLS regression to examine and empirically test the association between ARL and AC directors' political skill. I find no evidence to suggest that AC directors' political skill affects ARL. The results of univariate analysis and estimating essay two's regression model yields no significant evidence.

The ARL proxy used for in Chapter 3 presents at least one possible limitation of this chapter's findings. Though ARL is a proxy commonly used by researchers (Bamber, et al. 1993), its use as measured by the difference in calendar days between the fiscal year-end of a firm and the audit report date (Ashton et al. 1987) is a rough proxy for audit efficiency. ARL does not afford me with the ability to determine how much actual effort

or audit work put into conducting the external audit. Future research examining this topic can possibly overcome this limitation by acquiring and using proprietary firm data documenting the number of hours the external auditor worked while conducting the audit.

Essay 3: Contribution, Limitations, and Future Research

A recent trend of declining audit fees as a segment of the total revenues of an audit firm presented a cause for alarm for PCAOB chairman James Doty (2014) who questioned if a decrease in audit fees suggested a decrease in audit scope. Audit fees represent the economic costs (resource costs and expected future legal liability) of efficient external auditors, and those auditors look to find a balance between those costs in an effort to minimize the total cost of conducting an external audit (Simunic and Stein 1996). Although those economic costs can differ greatly due to certain auditee characteristics (e.g. size and complexity), the trend noticed by chairman Doty (2014) leads him to inquire if such a trend impacts audit quality. He also suggests the need to understand such a trend. Given the importance of the role of the AC in selecting and retaining the external auditor and the importance of responding to suggestions of key stakeholders like PCAOB, it is important and useful to examine possible undiscovered determinants of audit fees such as AC directors' political skill.

In Chapter 4, I use archival data from 2012 to examine and empirically test the association between audit fees and AC directors' political skill. I find highly statistically significant univariate evidence and marginally significant evidence from estimating the OLS regression model. These findings suggest that ACs with at least one politically skilled director demand a more comprehensive external audit. A more comprehensive audit should lead to additional audit work which should lead to higher audit fees. It is

plausible that the AC places such a demand on the external auditor because of heightened scrutiny from external stakeholders (e.g. the media and political watchdog groups) that are more interested in following the career of a public official from the public sector to the private sector. Many consider such links between politics/government and business to be taboo (Fisman 2001). And, that widely held sentiment could lead to heightened scrutiny by those external stakeholders which may lead to additional audit work being performed and higher audit fees.

The audit fees proxy used in Chapter 4 presents at least one possible limitation of this chapter's findings. Although an audit fees proxy is commonly used in the auditing literature, it is an imperfect proxy when attempting to capture the quality of the external audit. Using audit fees doesn't provide me with the ability to determine the actual scope of the audit or the effort put forth by the external auditor during the audit. This limitation can possibly be overcome in future research examining this topic by obtaining and using proprietary firm data that document the scope of the audit and the number of hours rendered by the external auditor while conducting the audit.

Figure 1.1
FY 2012 AC Meetings Frequency Descriptive Data Graph
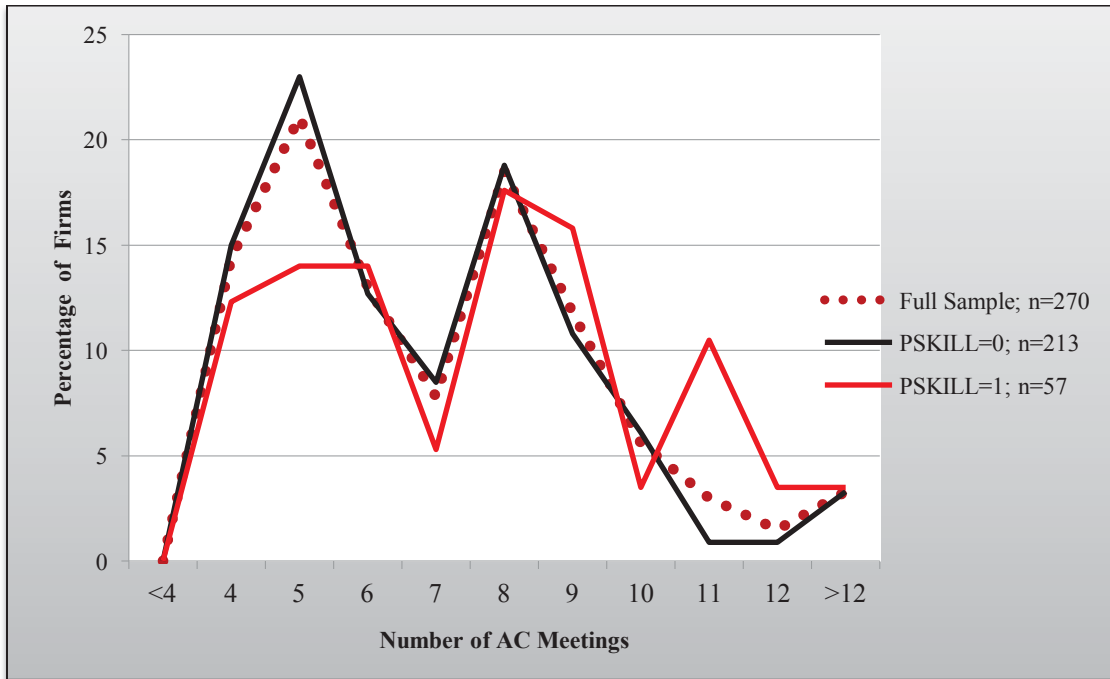
Figure 2.1
FY 2012 ARL Descriptive Data Graph
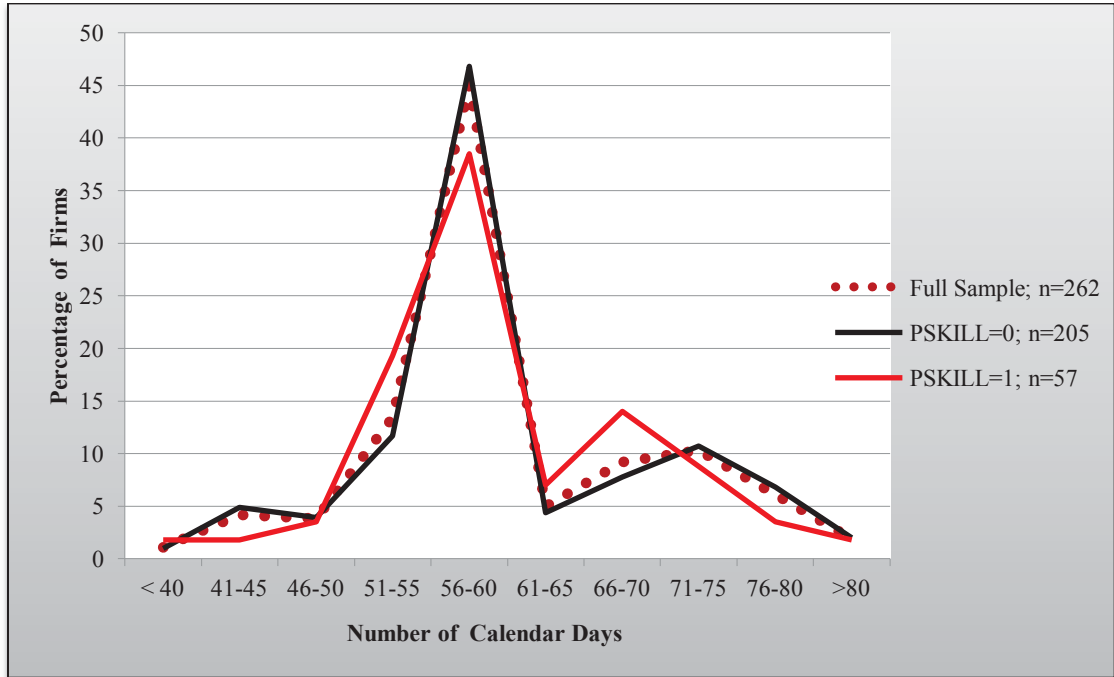
TABLE 1.1
Sample Selection* and Industry Distribution

PANEL A: Sample Selection

Initial sample of S&P 600 firms in 2012 per COMPUSTAT EXECUCOMP	600
LESS: Firms missing COMPUSTAT data	-121
LESS: Financial industry firms (SIC codes 6000-6999)	-15
LESS: Firms missing proxy statements (DEF 14A)	-7
LESS: Firms with fiscal year end other than 12/31/2012	-159
LESS: Firms with military-only[1] politically skilled AC directors	-15
LESS: Firms with politically skilled AC directors from state and local governmental/political levels lower than governor or mayor[1]	-13
Final Sample	**270**

PANEL B: Industry Distribution of Sample

Industry	Full Sample	*PSKILL*=0	*PSKILL*=1
Mining and Construction (1000–1999, excl. 1300–1399)	8	7	1
Extractive (1300–1399 and 2900–2999)	14	11	3
Food and Kindred Products (2000–2111)	3	3	0
Textiles and Printing (2200–2799)	11	7	4
Chemicals and Pharmaceuticals (2800–2899)	22	20	2
Durable Manufactures (3000–3999, excl. 3570–3579 and 3670–3679)	55	40	15
Computers (3570–3579, 3670–3679, and 7370–7379)	80	66	14
Transportations and Telecommunications (4000–4899)	18	15	3
Utilities (4910–4999)	7	4	3
Retail (5000–5999)	28	21	7
Services (7000–8999, excl. 7370–7379)	24	19	5
Total	**270**	**213**	**57**

*The initial sample of 600 S&P 600 firms was identified from the COMPUSTAT EXECUCOMP database. The tickers of those firms were then used to search for and extract COMPUSTAT financial data on those firms. Firms with missing COMPUSTAT data were excluded, followed by the exclusion of financial firms (SIC codes 6000-6999), firms missing proxy statements (DEF 14A), and firms with fiscal year end other than 12/31/2012.

[1] The background description of audit committee (AC) directors found in the proxy statements was reviewed to determine whether an AC director had a political connection as determined by a modified version of the political connection classification scheme used in Goldman, Rocholl, and So (2009). Firms with at least one AC director who held a former position at the international or federal level of government or politics, as well as state governor or city mayor, were included in the sample *PSKILL*=1. Observations in which the AC director was a military solider only or held a position at the state or local level of government or politics lower than governor or mayor were excluded in accordance with prior literature investigating political connections on corporate boards. Such observations were excluded due to the lower public visibility, smaller constituency served, and/or less influence of military personnel and lower level state and city positions when compared to government or political officials such as U.S. vice-presidents or senators, presidential cabinet members, presidential council/committee members, directors/commissioners of federal agencies, state governors, and city mayors. Firms in which no AC director possessed a political connection comprise the sample *PSKILL*=0.

TABLE 1.2
Descriptive Statistics

| | Firms without AC Political Skill (*PSKILL*=0) | | | | | versus | Firms with AC Political Skill (*PSKILL*=1) | | | | |
Variable	n	Mean	Std. Dev.	25th Percentile	Median	75th Percentile	n	Mean	Std. Dev.	25th Percentile	Median	75th Percentile
ACMTGS	213	6.871	2.391	5.000	6.000	8.000	57	7.667	2.689	5.000	8.000	9.000
AT ($MM)	213	952.240	1,053.950	366.384	672.230	1,104.160	57	1,468.030	1,236.88	564.230	1,052.220	2,182.300
INSIDER	213	0.106	0.123	0.034	0.063	0.121	57	0.095	0.118	0.026	0.041	0.080
BLOCK	213	0.362	0.142	0.272	0.354	0.458	57	0.336	0.136	0.244	0.327	0.433
LEV	213	0.149	0.173	0	0.096	0.263	57	0.235	0.183	0.103	0.242	0.323
ROA	213	0.099	0.129	0.047	0.086	0.132	57	0.082	0.069	0.044	0.085	0.106
MTB	213	2.442	3.516	1.263	1.774	2.812	57	2.385	2.569	1.271	1.665	2.513
LTGN	213	0.268	0.444	0	0	1.000	57	0.140	0.350	0	0	0
ACSIZE	213	3.519	0.835	3.000	3.000	4.000	57	4.123	1.151	3.000	4.000	5.000
ACCEXP	213	0.359	0.240	0.250	0.333	0.500	57	0.257	0.177	0.167	0.286	0.333
OTH	213	0.540	0.371	0.333	0.333	0.667	57	0.506	0.280	0.250	0.400	0.667
FEM	213	0.319	0.467	0	0	1.000	57	0.561	0.501	0	1.000	1.000
CHRCEO	213	0.409	0.493	0	0	1.000	57	0.491	0.504	0	0	1.000
BDSIZE	213	7.944	1.565	7.000	8.000	9.000	57	8.754	1.704	8.000	9.000	10.000
BDIND	213	0.803	0.087	0.750	0.833	0.875	57	0.808	0.117	0.750	0.857	0.889
BDMTGS	213	7.770	3.522	5.000	7.000	9.000	57	7.860	2.900	6.000	7.000	10.000
BIG4	213	0.826	0.380	1.000	1.000	1.000	57	0.877	0.331	1.000	1.000	1.000

The full sample includes 270 observations from non-financial S&P 600 firms with a December 31, 2012 fiscal year end. Refer to Table 1.1 for sample selection information. Definitions of variables are as follows: *PSKILL* – 1 if at least one former politically skilled director on the AC; *ACMTGS* – number of AC meetings held in fiscal year 2012*;AT* – total assets as of 12/31/2012; *INSIDER* – percent of common shares held by officers and directors; *BLOCK* – percent of common shares held by outside block-holders of 5% or more of shares outstanding; LEV – ratio of long-term debt-to-assets as of 12/31/2012; *ROA* – EBIT divided by total assets, otherwise 0; *MTB* – ratio of market value to book value as of 12/31/2012; *LTGN* – 1 if firm is in litigious sectors Pharmaceuticals (SIC 2833-2836), Computers (3570-3577), Electronics (3600-3674), Retail (5200-5961), or Software (7370), otherwise 0; *ACSIZE* – number of AC directors; *ACCEXP* – proportion of directors who are accounting experts (e.g., CPA, auditor, CAO, CFO, or controller); *OTH* – proportion of directors who are designated AC financial experts, but are not accounting experts as defined for ACCEXP; *FEM* – 1 if at least one female AC director, otherwise 0; *CHRCEO* – 1 if CEO is also the board chairman, otherwise 0; *BDSIZE* – number of directors on the board; *BDIND* – proportion of independent directors on the board; *BDMTGS* – number of board meetings held in 2012; and, *BIG4* – 1 if external auditor a Big 4 firm, otherwise 0.

TABLE 1.3
FY 2012 AC Meetings Frequency Descriptive Data

No. of AC Meetings	No. of Companies (%) [Full Sample; n=270]	No. of Companies (%) [*PSKILL*=0; n=213]	No. of Companies (%) [*PSKILL*=1; n=57]
Less than 4	0 (0.0%)	0 (0.0%)	0 (0.0%)
4	39 (14.4%)	32 (15.0%)	7 (12.3%)
5	57 (21.1%)	49 (23.0%)	8 (14.0%)
6	35 (13.0%)	27 (12.7%)	8 (14.0%)
7	21 (7.8%)	18 (8.5%)	3 (5.3%)
8	50 (18.5%)	40 (18.8%)	10 (17.6%)
9	32 (11.8%)	23 (10.8%)	9 (15.8%)
10	15 (5.6%)	13 (6.1%)	2 (3.5%)
11	8 (3.0%)	2 (0.9%)	6 (10.5%)
12	4 (1.5%)	2 (0.9%)	2 (3.5%)
More than 12	9 (3.3%)	7 (3.3%)	2 (3.5%)
	270 (100%)	**213** (100%)	**57** (100%)

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TABLE 1.4
Pearson Correlation Matrix

	LNACMTGS	LNAT	INSIDER	BLOCK	LEV	ROA	MTB	LTGN	ACSIZE	ACCEXP	OTH	FEM	CHRCEO	LNBDSIZE	BDIND	BDMTGS	BIG4	PSKILL
LNACMTGS	1.00	0.14	-0.14	0.02	0.03	-0.17	-0.05	-0.05	-0.08	0.07	0.14	0.10	-0.07	0.20	0.22	0.10	0.29	0.13
		.020	.818	.811	.600	.005	.365	.594	.182	.273	.021	.106	.264	.000	.000	.096	.000	.038
LNAT		1.00	-0.14	0.06	0.62	-0.28	-0.36	-0.27	0.23	-0.05	0.00	0.21	-0.11	0.36	0.06	0.12	0.28	0.21
			.022	.577	.000	.000	.000	.000	.000	.404	.958	.000	.083	.000	.362	.057	.000	.000
INSIDER			1.00	-0.35	-0.07	0.06	0.07	-0.04	-0.01	-0.10	-0.07	-0.05	0.09	-0.04	-0.29	-0.06	-0.03	-0.04
				.000	.278	.347	.253	.561	.918	.118	.230	.466	.141	.561	.000	.313	.587	.514
BLOCK				1.00	0.17	-0.06	0.06	-0.01	-0.05	0.09	0.06	-0.07	-0.16	0.06	0.06	0.06	0.10	-0.08
					.007	.350	.304	.829	.385	.140	.296	.241	.007	.337	.356	.307	.116	.219
LEV					1.00	-0.19	-0.18	-0.26	0.08	-0.01	0.03	0.20	-0.19	0.20	0.02	0.15	0.18	0.20
						.002	.003	.000	.205	.907	.665	.001	.002	.001	.726	.085	.004	.001
ROA						1.00	0.48	0.02	-0.06	-0.00	0.08	-0.10	0.05	-0.12	-0.05	-0.12	-0.22	-0.06
							.000	.709	.361	.943	.188	.118	.445	.059	.411	.042	.000	.337
MTB							1.00	0.16	-0.05	-0.10	0.04	-0.04	-0.01	-0.06	-0.01	-0.10	-0.12	-0.01
								.010	.463	.098	.561	.557	.903	.304	.828	.102	.048	.910
LTGN								1.00	-0.07	-0.01	-0.05	-0.00	0.01	-0.19	0.07	0.05	-0.03	-0.12
									.290	.838	.441	.983	.928	.002	.256	.386	.589	.046
ACSIZE									1.00	-0.18	-0.21	0.29	-0.00	0.40	0.18	0.06	0.13	0.26
										.004	.966	.000	.966	.000	.003	.372	.029	.000
ACCEXP										1.00	0.20	0.10	-0.07	-0.04	0.17	0.03	0.06	-0.18
											.001	.114	.264	.534	.006	.686	.312	.003
OTH											1.00	0.11	-0.07	0.08	0.07	-0.06	0.12	-0.04
												.070	.243	.205	.276	.295	.041	.516
FEM												1.00	-0.03	0.26	0.22	0.10	0.21	0.21
													.686	.000	.000	.087	.000	.000
CHRCEO													1.00	-0.11	-0.03	-0.07	-0.11	0.07
														.085	.627	.282	.080	.263
LNBDSIZE														1.00	0.20	-0.05	0.29	0.19
															.001	.377	.000	.002
BDIND															1.00	-0.01	0.17	0.02
																.861	.004	.743

TABLE 1.4 (continued)
Pearson Correlation Matrix

	LNACMTGS	LNAT	INSIDER	BLOCK	LEV	ROA	MTB	LTGN	ACSIZE	ACCEXP	OTH	FEM	CHRCEO	LNBDSIZE	BDIND	BDMTGS	BIG4	PSKILL
BDMTGS																1.00	0.03	0.01
																	.638	.860
BIG4																	1.00	0.06
																		.357
PSKILL																		1.00

Refer to Table 1.1 for sample selection information. Definitions of variables are as follows: *LNACMTGS* – natural log of the number of AC meetings held in fiscal year 2012*;LNAT* – natural log of total assets as of 12/31/2012; *INSIDER* – percent of common shares held by officers and directors; *BLOCK* – percent of common shares held by outside block-holders of 5% or more of shares outstanding; LEV – ratio of long-term debt-to-assets as of 12/31/2012; *ROA* – EBIT divided by total assets; *MTB* – ratio of market value to book value as of 12/31/2012; *LTGN* – 1 if firm is in litigious sectors Pharmaceuticals (SIC 2833-2836), Computers (3570-3577), Electronics (3600-3674), Retail (5200-5961), or Software (7370), otherwise 0; *ACSIZE* – number of AC directors; *ACCEXP* – proportion of directors who are accounting experts (e.g., CPA, auditor, CAO, CFO, or controller); *OTH* – proportion of directors who are designated AC financial experts, but are not accounting experts as defined for ACCEXP; *FEM* – 1 if at least one female AC director, otherwise 0; *CHRCEO* – 1 if CEO is also the board chairman, otherwise 0; *LNBDSIZE* – natural log of the number of directors on the board; *BDIND* – proportion of independent directors on the board; *BDMTGS* – number of board meetings held in 2012; *BIG4* – 1 if external auditor a Big 4 firm, otherwise 0; and, *PSKILL* – 1 if at least one former politically skilled director on the AC.

TABLE 1.5
Univariate Analysis

Variable	Firms without AC Political Skill (*PSKILL*=0; *n*=213)			*versus*	Firms with AC Political Skill (*PSKILL*=1; *n*=57)			Diff. in Means	*t*-statistic	Pr>|t|
	Mean	Std. Dev.	Median		Mean	Std. Dev.	Median			
LNACMTGS	1.871	0.332	1.792		1.976	0.356	2.079	-0.105	-2.080	.038**
LNAT	6.482	0.851	6.531		6.924	0.922	6.697	-0.442	-3.420	.000***
INSIDER	0.106	0.123	0.063		0.095	0.118	0.041	0.011	0.650	.514
BLOCK	0.362	0.142	0.354		0.336	0.136	0.327	0.026	1.230	.219
LEV	0.149	0.173	0.096		0.235	0.183	0.242	-0.086	-3.290	.001***
ROA	0.099	0.129	0.086		0.082	0.069	0.085	0.017	1.340	.181
MTB	2.442	3.517	1.774		2.385	2.569	1.665	0.057	0.140	.893
LTGN	0.268	0.444	0		0.140	0.350	0	0.128	2.290	.024**
ACSIZE	3.519	0.835	3.000		4.123	1.151	4.000	-0.604	-3.710	.000***
ACCEXP	0.359	0.240	0.333		0.257	0.177	0.286	0.102	3.560	.000***
OTH	0.540	0.371	0.333		0.506	0.280	0.400	0.034	0.760	.447
FEM	0.319	0.467	0		0.561	0.501	1.000	-0.242	-3.420	.001***
CHRCEO	0.409	0.493	0		0.491	0.504	0	-0.082	-1.120	.263
LNBDSIZE	2.052	0.207	2.079		2.149	0.213	2.197	-0.097	-3.120	.002***
BDIND	0.803	0.087	0.833		0.808	0.117	0.857	-0.005	-0.280	.782
BDMTGS	7.770	3.522	7.000		7.860	2.900	7.000	-0.090	-0.200	.844
BIG4	0.826	0.380	1.000		0.877	0.331	1.000	-0.051	-0.920	.357

***, **, * Denotes significant p-value at the 1%, 5%, and 10% levels, respectively. The t-test of means uses the pooled method when the underlying variances are equal and the Satterthwaite method when they are unequal. Refer to Table 1.1 for sample selection information. Definitions of variables are as follows: *PSKILL* – 1 if at least one former politically skilled director on the AC; *LNACMTGS* – natural log of the number of AC meetings held in fiscal year 2012*;LNAT* – natural log of total assets as of 12/31/2012; *INSIDER* – percent of common shares held by officers and directors; *BLOCK* – percent of common shares held by outside block-holders of 5% or more of shares outstanding; LEV – ratio of long-term debt-to-assets as of 12/31/2012; *ROA* – EBIT divided by total assets; *MTB* – ratio of market value to book value as of 12/31/2012; *LTGN* – 1 if firm is in litigious sectors Pharmaceuticals (SIC 2833-2836), Computers (3570-3577), Electronics (3600-3674), Retail (5200-5961), or Software (7370), otherwise 0; *ACSIZE* – number of AC directors; *ACCEXP* – proportion of directors who are accounting experts (e.g., CPA, auditor, CAO, CFO, or controller); *OTH* – proportion of directors who are designated AC financial experts, but are not accounting experts as defined for *ACCEXP*; *FEM* – 1 if at least one female AC director, otherwise 0; *CHRCEO* – 1 if CEO is also the board chairman, otherwise 0; *LNBDSIZE* – natural log of the number of directors on the board; *BDIND* – proportion of independent directors on the board; *BDMTGS* – number of board meetings held in 2012; and, *BIG4* – 1 if external auditor a Big 4 firm, otherwise 0.

TABLE 1.6
Multiple Regression Results

PANEL A: Regression Model

$$LNACMTGS = \beta_0 + \beta_1 LNAT + \beta_2 INSIDER + \beta_3 BLOCK + \beta_4 LEV + \beta_5 ROA + \beta_6 MTB$$
$$+ \beta_7 LTGN + \beta_8 ACSIZE + \beta_9 ACCEXP + \beta_{10} OTH + \beta_{11} FEM + \beta_{12} CHRCEO$$
$$+ \beta_{13} LNBDSIZE + \beta_{14} BDIND + \beta_{15} BDMTGS + \beta_{16} BIG4 + \beta_{17} PSKILL + \varepsilon$$

PANEL B: Estimation of Regression Model ($F=3.33$, $p < .01$, $R^2 = .18$, Adjusted $R^2 = .13$)

Variable	Predicted Sign	Coefficient	*t*-Statistic	*p*-Value
Intercept		0.647	2.070	.040
LNAT	+	0.033	1.020	.308
INSIDER	-	0.213	1.180	.239
BLOCK	+	-0.021	-0.130	.893
LEV	+	-0.246	-1.680	.093*
ROA	-	-0.379	-1.970	.050**
MTB	+	0.006	0.810	.416
LTGN	+	-0.032	-0.660	.510
ACSIZE	+	-0.007	-0.260	.794
ACCEXP	+	0.056	0.620	.533
OTH	+/-	0.112	1.900	.058*
FEM	+	-0.038	-0.840	.403
CHRCEO	-	-0.029	-0.700	.483
LNBDSIZE	+/-	0.128	1.150	.251
BDIND	+	0.662	2.890	.004***
BDMTGS	+	0.011	1.890	.059*
BIG4	+	0.180	3.110	.002***
PSKILL	+	0.103	1.990	.048**

***, **, * Denotes significant p-value at the 1%, 5%, and 10% levels, respectively. Refer to Table 1.1 for sample selection information. Definitions of variables are as follows: *LNACMTGS* – natural log of the number of AC meetings held in fiscal year 2012*;LNAT* – natural log of total assets as of 12/31/2012; *INSIDER* – percent of common shares held by officers and directors; *BLOCK* – percent of common shares held by outside block-holders of 5% or more of shares outstanding; LEV – ratio of long-term debt-to-assets as of 12/31/2012; *ROA* – EBIT divided by total assets, otherwise 0; *MTB* – ratio of market value to book value as of 12/31/2012; *LTGN* – 1 if firm is in litigious sectors Pharmaceuticals (SIC 2833-2836), Computers (3570-3577), Electronics (3600-3674), Retail (5200-5961), or Software (7370), otherwise 0; *ACSIZE* – number of AC directors; *ACCEXP* – proportion of directors who are accounting experts (e.g., CPA, auditor, CAO, CFO, or controller); *OTH* – proportion of directors who are designated AC financial experts, but are not accounting experts as defined for ACCEXP; *FEM* – 1 if at least one female AC director, otherwise 0; *CHRCEO* – 1 if CEO is also the board chairman, otherwise 0; *LNBDSIZE* – natural log of the number of directors on the board; *BDIND* – proportion of independent directors on the board; *BDMTGS* – number of board meetings held in 2012; *BIG4* – 1 if external auditor a Big 4 firm, otherwise 0; and, *PSKILL* – 1 if at least one former politically skilled director on the AC.

TABLE 2.1
Sample Selection* and Industry Distribution

PANEL A: Sample Selection

Initial sample of S&P 600 firms in 2012 per COMPUSTAT EXECUCOMP	600
LESS: Firms missing COMPUSTAT data	-122
LESS: Financial industry firms (SIC codes 6000-6999)	-15
LESS: Firms missing proxy statements (DEF 14A)	-7
LESS: Firms missing Audit Analytics data	-7
LESS: Firms with fiscal year end other than 12/31/2012	-159
LESS: Firms with military-only[1] politically skilled AC directors	-15
LESS: Firms with politically skilled AC directors from state and local governmental/political levels lower than governor or mayor[1]	<u>-13</u>
Final Sample	**<u>262</u>**

PANEL B: Industry Distribution of Sample

Industry	Full Sample	$PSKILL=0$	$PSKILL=1$
Mining and Construction (1000–1999, excl. 1300–1399)	7	6	1
Extractive (1300–1399 and 2900–2999)	14	11	3
Food and Kindred Products (2000–2111)	3	3	0
Textiles and Printing (2200–2799)	11	7	4
Chemicals and Pharmaceuticals (2800–2899)	20	18	2
Durable Manufactures (3000–3999, excl. 3570–3579 and 3670–3679)	55	40	15
Computers (3570–3579, 3670–3679, and 7370–7379)	76	62	14
Transportations and Telecommunications (4000–4899)	17	14	3
Utilities (4910–4999)	7	4	3
Retail (5000–5999)	28	21	7
Services (7000–8999, excl. 7370–7379)	<u>24</u>	<u>19</u>	<u>5</u>
Total	<u>262</u>	<u>205</u>	<u>57</u>

*The initial sample of 600 S&P 600 firms was identified from the COMPUSTAT EXECUCOMP database. The tickers of those firms were then used to search for and extract COMPUSTAT financial data and Audit Analytics data on those firms. Firms with missing COMPUSTAT and Audit Analytics data were excluded. Financial firms (SIC codes 6000-6999), firms missing proxy statements (DEF 14A), and firms with fiscal year end other than 12/31/2012 were also excluded.

[1] The background description of audit committee (AC) directors found in the proxy statements was reviewed to determine whether an AC director had a political connection as determined by a modified version of the political connection classification scheme used in Goldman, Rocholl, and So (2009). Firms with at least one AC director who held a former position at the international or federal level of government or politics, as well as state governor or city mayor, were included in the sample $PSKILL=1$. Observations in which the AC director was a military solider only or held a position at the state or local level of government or politics lower than governor or mayor were excluded in accordance with prior literature investigating political connections on corporate boards. Such observations were excluded due to the lower public visibility, smaller constituency served, and/or less influence of military personnel and lower level state and city positions when compared to government or political officials such as U.S. vice-presidents or senators, presidential cabinet members, presidential council/committee members, directors/commissioners of federal agencies, state governors, and city mayors. Firms in which no AC director possessed a political connection comprise the sample $PSKILL=0$.

TABLE 2.2
Descriptive Statistics

| | | Firms without AC Political Skill (*PSKILL*=0) | | | | | | | | | | |
| | *versus* | | | | Firms with AC Political Skill (*PSKILL*=1) | | | | | | | |
Variable	n	Mean	Std. Dev.	25th Percentile	Median	75th Percentile	n	Mean	Std. Dev.	25th Percentile	Median	75th Percentile
ARL	205	61.361	14.370	56.000	59.000	67.000	57	60.193	8.802	53.000	59.000	66.000
OWNC	205	249.750	594.682	10.310	54.088	197.196	57	169.616	253.334	10.759	46.500	259.550
MV ($MM)	205	783.923	447.572	437.076	677.006	1,066.690	57	916.702	503.289	520.019	753.001	1,217.380
LEV	205	0.354	0.184	0.201	0.340	0.466	57	0.433	0.188	0.372	0.421	0.550
MTB	205	2.397	3.534	1.251	1.760	2.804	57	2.385	2.569	1.271	1.665	2.513
INVTA	205	0.096	0.112	0.002	0.067	0.150	57	0.104	0.104	0.009	0.096	0.145
SUBS	205	28.790	46.777	7.000	14.000	30.000	57	38.211	43.022	14.000	27.000	44.000
ENEWS	205	-0.482	6.551	-0.388	0.081	0.471	57	-4.778	34.249	-0.360	0.035	0.305
LOSS	205	0.093	0.291	0	0	0	57	0.088	0.285	0	0	0
BIG4	205	0.824	0.381	1.000	1.000	1.000	57	0.877	0.331	1.000	1.000	1.000
NEWAUD	205	0.078	0.269	0	0	0	57	0.053	0.225	0	0	0
LNNAF ($KK)	205	240.687	340.272	30.500	130.426	307.794	57	426.084	531.189	88.000	239.378	537.718
ICMW	205	0.063	0.244	0	0	0	57	0.053	0.225	0	0	0

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The full sample includes 262 observations from non-financial S&P 600 firms with a December 31, 2012 fiscal year end. Refer to Table 2.1 for sample selection information. Definitions of variables are as follows: *PSKILL* – 1 if at least one former politically skilled director on the AC; *ARL* – number of calendar days between the firm's fiscal year end and audit report date; *OWNC* – ratio of common shares outstanding to number of common shareholders; *MV* – market value as of 12/31/2012; *LEV* – ratio of total debt to assets as of 12/31/2012; *MTB* – ratio of market value to book value as of 12/31/2012; *INVTA* – ratio of total inventory to total assets; *SUBS* – number of subsidiaries; *ENEWS* – difference between current year's and prior year's EPS, divided by the absolute value of the prior year's EPS; *LOSS* – 1 if negative earnings reported, otherwise 0; *BIG4* – 1 if external auditor a Big 4 firm, otherwise 0; *NEWAUD* – 1 if external auditor tenure equal to 3 or less years, otherwise 0; *LNNAF* – natural log of non-audit fees as of 12/31/2012; and, *ICMW* – 1 if an internal control material weakness reported, otherwise 0.

TABLE 2.3
Fiscal Year 2012 ARL Descriptive Data

No. of Calendar Days	No. of Companies (%) [Full Sample; n=262]	No. of Companies (%) [*PSKILL*=0; n=205]	No. of Companies (%) [*PSKILL*=1; n=57]
Less than 40	3 (1.1%)	2 (1.0%)	1 (1.8%)
41-45	11 (4.2%)	10 (4.9%)	1 (1.8%)
46-50	10 (3.8%)	8 (3.9%)	2 (3.5%)
51-55	35 (13.4%)	24 (11.7%)	11 (19.3%)
56-60	118 (45.0%)	96 (46.8%)	22 (38.5%)
61-65	13 (5.0%)	9 (4.4%)	4 (7.0%)
66-70	24 (9.2%)	16 (7.8%)	8 (14.0%)
71-75	27 (10.3%)	22 (10.7%)	5 (8.8%)
76-80	16 (6.1%)	14 (6.8%)	2 (3.5%)
More than 80	5 (1.9%)	4 (2.0%)	1 (1.8%)
	262 (100%)	**205** (100%)	**57** (100%)

TABLE 2.4
Pearson Correlation Matrix

	LNARL	OWNC	LNMV	LEV	MTB	INVTA	SUBS	ENEWS	LOSS	BIG4	NEWAUD	LNNAF	ICMW	PSKILL
LNARL	1.000	0.082	-0.316	-0.154	0.010	0.072	0.036	-0.031	0.081	-0.147	0.163	0.010	0.227	-0.027
		.188	.000	.811	.868	.243	.565	.623	.191	.017	.008	.107	.000	.668
OWNC		1.000	0.118	-0.140	0.026	-0.008	-0.079	0.013	-0.016	-0.032	0.050	0.093	0.075	-0.061
			.056	.024	.671	.893	.200	.831	.796	.612	.417	.132	.224	.322
LNMV			1.000	0.168	0.090	-0.001	0.178	0.071	-0.334	0.099	0.005	0.213	-0.001	0.124
				.006	.146	.982	.004	.250	.000	.110	.983	.000	.992	.045
LEV				1.000	0.050	0.029	0.262	-0.168	-0.089	0.193	-0.140	0.086	0.028	0.177
					.423	.645	.000	.006	.153	.002	.024	.163	.650	.004
MTB					1.000	-0.017	-0.131	0.043	-0.208	-0.106	-0.010	0.017	0.074	-0.002
						.785	.034	.484	.000	.087	.878	.791	.231	.981
INVTA						1.000	0.094	0.063	-0.039	-0.062	0.062	-0.017	0.099	0.028
							.128	.308	.530	.317	.318	.782	.110	.638
SUBS							1.000	-0.055	-0.046	0.161	-0.103	0.178	0.005	0.120
							.	.377	.458	.009	.097	.004	.932	.052
ENEWS								1.000	-0.119	-0.002	0.018	-0.055	-0.028	-0.105
									.054	.971	.770	.374	.650	.091
LOSS									1.000	-0.074	-0.038	-0.033	0.030	-0.007
										.235	.542	.593	.634	.909
BIG4										1.000	-0.154	0.141	-0.059	0.059
											.012	.022	.340	.343
NEWAUD											1.000	0.033	-0.009	-0.040
												.596	.874	.515
LNNAF												1.000	-0.045	0.116
													.471	.061
ICMW													1.000	-0.019
														.765
PSKILL														1.000

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Refer to Table 2.1 for sample selection information. Definitions of variables are as follows: *LNARL* – natural log of the number of calendar days between the firm's fiscal year end and audit report date; *OWNC* – ratio of common shares outstanding to number of common shareholders; *LNMV* – natural log of market value as of 12/31/2012; *LEV* – ratio of total debt to assets as of 12/31/2012; *MTB* – ratio of market value to book value as of 12/31/2012; *INVTA* – ratio of total inventory to total assets; *SUBS* – number of subsidiaries; *ENEWS* – difference between current year's and prior year's EPS, divided by the absolute value of the prior year's EPS; *LOSS* – 1 if negative earnings reported, otherwise 0; *BIG4* – 1 if external auditor a Big 4 firm, otherwise 0; *NEWAUD* – 1 if external auditor tenure equal to 3 or less years, otherwise 0; *LNNAF* – natural log of non-audit fees as of 12/31/2012; *ICMW* – 1 if an internal control material weakness reported, otherwise 0; and, *PSKILL* – 1 if at least one politically skilled director on the AC.

TABLE 2.5
Univariate Analysis

Variable	Firms without AC Political Skill (PSKILL=0; n=205)			versus	Firms with AC Political Skill (PSKILL=1; n=57)					
	Mean	Std. Dev.	Median		Mean	Std. Dev.	Median	Diff. in Means	t-statistic	Pr>|t|
LNARL	4.098	0.181	4.078		4.087	0.147	4.078	0.110	0.430	.668
OWNC	249.750	594.682	54.088		169.193	253.334	46.500	80.557	1.500	.135
LNMV	6.483	0.643	6.520		6.671	0.564	6.624	-0.188	-2.010	.045**
LEV	0.353	0.184	0.340		0.434	0.188	0.421	-0.081	-2.900	.004***
MTB	2.397	3.533	1.759		2.385	2.569	1.665	0.012	0.003	.978
INVTA	0.096	0.113	0.067		0.104	0.104	0.096	-0.008	-0.460	.648
LNSUBS	2.642	1.230	2.639		3.008	1.340	3.296	-0.366	-1.950	.052**
ENEWS	-0.482	6.551	0.081		-4.778	34.249	0.035	4.296	0.940	.350
LOSS	0.093	0.291	0		0.088	0.285	0	0.005	0.110	.909
BIG4	0.824	0.381	1.000		0.877	0.331	1.000	-0.053	-0.950	.343
NEWAUD	0.078	0.269	0		0.052	0.225	0	0.026	0.650	.515
LNNAF	10.422	3.957	11.779		11.510	3.453	12.386	-1.088	-1.890	.061*
ICMW	0.063	0.244	0		0.053	0.225	0	0.010	0.300	.765

***, **, * Denotes significant p-value at the 1%, 5%, and 10% levels, respectively. The t-test of means uses the pooled method when the underlying variances are equal and the Satterthwaite method when they are unequal. Refer to Table 2.1 for sample selection information. Definitions of variables are as follows: *PSKILL* – 1 if at least one politically skilled director on the AC; *LNARL* – natural log of the number of calendar days between the firm's fiscal year end and audit report date; *OWNC* – ratio of common shares outstanding to number of common shareholders; *LNMV* – natural log of market value as of 12/31/2012; *LEV* – ratio of total debt to assets as of 12/31/2012; *MTB* – ratio of market value to book value as of 12/31/2012; *INVTA* – ratio of total inventory to total assets; *LNSUBS* – natural log of number of subsidiaries; *ENEWS* – difference between current year's and prior year's EPS, divided by the absolute value of the prior year's EPS; *LOSS* – 1 if negative earnings reported, otherwise 0; *BIG4* – 1 if external auditor a Big 4 firm, otherwise 0; *NEWAUD* – 1 if external auditor tenure equal to 3 or less years, otherwise 0; *LNNAF* – natural log of non-audit fees as of 12/31/2012; and, *ICMW* – 1 if an internal control material weakness reported, otherwise 0.

TABLE 2.6
Multiple Regression Results

PANEL A: Regression Model

$LNARL = \beta_0 + \beta_1 OWNC + \beta_2 LNMV + \beta_3 LEV + \beta_4 MTB + \beta_5 INVTA + \beta_6 SUBS + \beta_7 ENEWS$
$\qquad + \beta_8 LOSS + \beta_9 BIG4 + \beta_{10} NEWAUD + \beta_{11} LNNAF + \beta_{12} ICMW$
$\qquad + \beta_{13} PSKILL + \varepsilon$

PANEL B: Estimation of Regression Model (F=6.37, p < .01, R^2 = .25, Adjusted R^2 = .21)

Variable	Predicted Sign	Coefficient	*t*-Statistic	*p*-Value
Intercept		4.689	42.890	.000***
OWNC	+	0.000	1.390	.167
LNMV	+	-0.104	-6.120	.000***
LEV	+/-	-0.101	-1.790	.074*
MTB	+	0.002	0.490	.625
INVTA	+	0.044	0.500	.615
SUBS	+	0.018	2.200	.029**
ENEWS	-	-0.000	-0.150	.880
LOSS	+	-0.027	-0.730	.464
BIG4	+/-	-0.046	-1.670	.096*
NEWAUD	+	0.093	2.460	.015**
LNNAF	-	0.008	2.990	.003***
ICMW	+	0.161	3.990	.000***
PSKILL	-	0.009	0.380	.703

    ***, **, * Denotes significant p-value at the 1%, 5%, and 10% levels, respectively. Refer to Table 2.1 for sample selection information. Definitions of variables are as follows: *LNARL* – natural log of the number of calendar days between the firm's fiscal year end and audit report date; *OWNC* – ratio of common shares outstanding to number of common shareholders; *LNMV* – natural log of market value as of 12/31/2012; *LEV* – ratio of total debt to assets as of 12/31/2012; *MTB* – ratio of market value to book value as of 12/31/2012; *INVTA* – ratio of total inventory to total assets; *SUBS* – number of subsidiaries; *ENEWS* – difference between current year's and prior year's EPS, divided by the absolute value of the prior year's EPS; *LOSS* – 1 if negative earnings reported, otherwise 0; *BIG4* – 1 if external auditor a Big 4 firm, otherwise 0; *NEWAUD* – 1 if external auditor tenure equal to 3 or less years, otherwise 0; *LNNAF* – natural log of non-audit fees as of 12/31/2012; *ICMW* – 1 if an internal control material weakness reported, otherwise 0; and, *PSKILL* – 1 if at least one politically skilled director on the AC.

TABLE 3.1
Sample Selection* and Industry Distribution

PANEL A: Sample Selection

Initial sample of S&P 600 firms in 2012 per COMPUSTAT EXECUCOMP	600
LESS: Firms with fiscal year end other than 12/31/2012	-170
LESS: Financial industry firms (SIC codes 6000-6999)	-113
LESS: Firms missing COMPUSTAT data	-10
LESS: Firms missing Audit Analytics data	-7
LESS: Firms missing proxy statements (DEF 14A)	-14
LESS: Firms with military-only[1] politically skilled AC directors	-15
LESS: Firms with politically skilled AC directors from state and local governmental/political levels lower than governor or mayor[1]	-13
Final Sample	**258**

PANEL B: Industry Distribution of Sample

Industry	Full Sample	PSKILL=0	PSKILL=1
Mining and Construction (1000–1999, excl. 1300–1399)	8	7	1
Extractive (1300–1399 and 2900–2999)	14	11	3
Food and Kindred Products (2000–2111)	3	3	0
Textiles and Printing (2200–2799)	11	7	4
Chemicals and Pharmaceuticals (2800–2899)	20	18	2
Durable Manufactures (3000–3999, excl. 3570–3579 and 3670–3679)	52	38	14
Computers (3570–3579, 3670–3679, and 7370–7379)	79	64	15
Transportations and Telecommunications (4000–4899)	17	14	3
Utilities (4910–4999)	7	4	3
Retail (5000–5999)	24	17	7
Services (7000–8999, excl. 7370–7379)	23	19	4
Total	258	202	56

* The initial sample of 600 S&P 600 firms was identified from the COMPUSTAT EXECUCOMP database. The tickers of those firms were then used to search for and extract COMPUSTAT financial data and Audit Analytics data on those firms. Firms with missing COMPUSTAT and Audit Analytics data were excluded. Financial firms (SIC codes 6000-6999), firms missing proxy statements (DEF 14A), and firms with fiscal year-end other than 12/31/2012 were also excluded.

[1] The background description of audit committee (AC) directors found in the proxy statements was reviewed to determine whether an AC director had a political connection as determined by a modified version of the political connection classification scheme used in Goldman, Rocholl, and So (2009). Firms with at least one AC director who held a former position at the international or federal level of government or politics, as well as state governor or city mayor, were included in the sample PSKILL=1. Observations in which the AC director was a military solider only or held a position at the state or local level of government or politics lower than governor or mayor were excluded in accordance with prior literature investigating political connections on corporate boards. Such observations were excluded due to the lower public visibility, smaller constituency served, and/or less influence of military personnel and lower level state and city positions when compared to government or political officials such as U.S. vice-presidents or senators, presidential cabinet members, presidential council/committee members, directors/commissioners of federal agencies, state governors, and city mayors. Firms in which no AC director possessed a political connection comprise the sample PSKILL=0.

TABLE 3.2
Descriptive Statistics

Variable	n	Mean	Std. Dev.	25th Percentile	Median	75th Percentile		n	Mean	Std. Dev.	25th Percentile	Median	75th Percentile
		Firms without AC Political Skill (*PSKILL*=0)					*versus*	Firms with AC Political Skill (*PSKILL*=1)					
AFEES ($KK)	202	1,275.995	916.331	662.300	1,063.045	1,620.360		56	1,566.237	821.500	1,091.280	1.442.555	1,925.205
AT ($MM)	202	996.267	1,081.54	394.468	700.762	1,163.790		56	1,472.610	1,247.580	540.808	1,023.380	2,294.350
SUBS	202	29.381	46.992	7.000	15.000	32.000		56	38.893	43.099	14.000	27.000	44.500
INVTA	202	0.096	0.115	0.001	0.067	0.150		56	0.105	0.105	0.006	0.098	0.147
ROA	202	0.090	0.097	0.047	0.084	0.125		56	0.082	0.070	0.044	0.081	0.106
LEV	202	0.156	0.176	0	0.107	0.274		56	0.237	0.184	0.098	0.246	0.326
BIG4	202	0.827	0.379	1.000	1.000	1.000		56	0.875	0.334	1.000	1.000	1.000
NEWAUD	202	0.079	0.271	0	0	0		56	0.054	0.227	0	0	0
ARL	202	62.614	22.513	56.000	59.000	67.000		56	60.321	8.828	54.500	59.000	66.000
ICMW	202	0.064	0.245	0	0	0		56	0.036	0.187	0	0	0

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The full sample includes 258 observations from non-financial S&P 600 firms with a December 31, 2012 fiscal year end. Refer to Table 3.1 for sample selection information. Definitions of variables are as follows: *PSKILL* – 1 if at least one former politically skilled director on the AC; *AFEES* – total amount of audit fees; *AT* – total assets as of 12/31/2012; *SUBS* – number of subsidiaries; *INVTA* – ratio of inventory to total assets; *ROA* – EBIT divided by total assets; *LEV* – ratio of long-term debt to total assets as of 12/31/2012; *BIG4* – 1 if external auditor a Big 4 firm, otherwise 0; *NEWAUD* – 1 if external auditor tenure equal to 3 or less years, otherwise 0; *ARL* – number of calendar days between the firm's fiscal year end and audit report date; and, *ICMW* – 1 if an internal control material weakness reported, otherwise 0.

TABLE 3.3
Pearson Correlation Matrix

	LNAFEES	LNAT	SUBS	INVTA	ROA	LEV	BIG4	NEWAUD	ARL	ICMW	PSKILL
LNAFEES	1.000	0.597	0.449	0.093	-0.245	0.240	0.302	-0.177	0.091	0.026	0.171
		.000	.000	.138	.000	.000	.000	.005	.147	.684	.006
LNAT		1.000	0.392	0.020	-0.284	0.615	0.289	-0.104	-0.118	-0.047	0.182
			.000	.744	.000	.000	.000	.095	.058	.454	.003
SUBS			1.000	0.042	-0.076	0.169	0.143	-0.106	-0.029	0.009	0.085
				.501	.223	.007	.022	.091	.640	.889	.174
INVTA				1.000	-0.025	-0.062	-0.061	-0.060	0.048	0.093	0.030
					.690	.323	.334	.336	.446	.136	.631
ROA					1.000	-0.182	-0.147	0.049	-0.019	-0.019	-0.035
						.003	.018	.430	.222	.768	.579
LEV						1.000	0.179	-0.134	-0.116	-0.017	0.186
							.004	.031	.063	.783	.003
BIG4							1.000	-0.157	-0.095	-0.070	0.054
						.		.012	.129	.263	.389
NEWAUD								1.000	0.124	-0.007	-0.041
									.047	.916	.518
ARL									1.000	0.125	-0.047
										.045	.457
ICMW										1.000	0.051
											.420
PSKILL											1.000

Refer to Table 3.1 for sample selection information. Definitions of variables are as follows: *LNAFEES* – natural log of audit fees; *LNAT* – natural log of total assets as of 12/31/2012; *SUBS* – number of subsidiaries; *INVTA* – ratio of inventory to total assets; *ROA* – EBIT divided by total assets; *LEV* – ratio of long-term debt to total assets as of 12/31/2012; *BIG4* – 1 if external auditor a Big 4 firm, otherwise 0; *NEWAUD* – 1 if external auditor tenure equal to 3 or less years, otherwise 0; *ARL* – number of calendar days between the firm's fiscal year end and audit report date; *ICMW* – 1 if an internal control material weakness reported, otherwise 0; and, *PSKILL* – 1 if at least one former politically skilled director on the AC.

TABLE 3.4
Univariate Analysis

Variable	Firms without AC Political Skill (*PSKILL*=0; *n*=202)			versus	Firms with AC Political Skill (*PSKILL*=1; *n*=56)			Diff. in Means	*t*-statistic	Pr>|t|
	Mean	Std. Dev.	Median		Mean	Std. Dev.	Median			
LNAFEES	13.867	0.612	13.877		14.120	0.576	14.182	-0.253	-2.770	.006***
LNAT	6.533	0.846	6.552		6.921	0.930	6.931	-0.388	-2.970	.003***
SUBS	29.381	46.992	15.000		38.893	43.099	27.000	-9.512	-1.360	.174
INVTA	0.096	0.115	0.067		0.105	0.105	0.098	-0.009	-0.480	.631
ROA	0.090	0.097	0.084		0.082	0.070	0.081	0.008	0.670	.505
LEV	0.156	0.176	0.107		0.237	0.184	0.246	-0.081	-3.030	.003***
BIG4	0.827	0.380	1.000		0.875	0.334	1.000	-0.048	-0.860	.389
NEWAUD	0.080	0.271	0		0.054	0.227	0	0.026	0.650	.518
ARL	62.614	22.513	59.000		60.321	8.828	59.000	2.293	1.160	.247
ICMW	0.064	0.246	0		0.036	0.187	0	0.028	0.940	.349

***, **, * Denotes significant p-value at the 1%, 5%, and 10% levels, respectively. The t-test of means uses the pooled method when the underlying variances are equal and the Satterthwaite method when they are unequal. The full sample includes 258 observations from non-financial S&P 600 firms with a December 31, 2012 fiscal year end. Refer to Table 3.1 for sample selection information. Definitions of variables are as follows: *PSKILL* – 1 if at least one former politically skilled director on the AC; *LNAFEES* – natural log of audit fees; *LNAT* – natural log of total assets as of 12/31/2012; *SUBS* – number of subsidiaries; *INVTA* – ratio of inventory to total assets; *ROA* – EBIT divided by total assets; *LEV* – ratio of long-term debt to total assets as of 12/31/2012; *BIG4* – 1 if external auditor a Big 4 firm, otherwise 0; *NEWAUD* – 1 if external auditor tenure equal to 3 or less years, otherwise 0; *ARL* – number of calendar days between the firm's fiscal year end and audit report date; and, *ICMW* – 1 if an internal control material weakness reported, otherwise 0.

TABLE 3.5
Multiple Regression Results

PANEL A: Regression Model

$LNAFEES = \beta_0 + \beta_1 LNAT + \beta_2 SUBS + \beta_3 INVTA + \beta_4 ROA + \beta_5 LEV + \beta_6 BIG4 + \beta_7 NEWAUD$
$\qquad + \beta_8 ARL + \beta_9 ICMW + \beta_{10} PSKILL + \varepsilon$

PANEL B: Estimation of Regression Model (F=24.57, $p < .01$, $R^2 = .50$, Adjusted $R^2 = .48$)

Variable	Predicted Sign	Coefficient	*t*-Statistic	*p*-Value
Intercept		10.850	36.270	.000***
LNAT	+	0.393	8.700	.000***
SUBS	+	0.003	4.410	.000***
INVTA	+	0.332	1.340	.183
ROA	+	-0.399	-1.250	.211
LEV	+	-0.626	-3.170	.002***
BIG4	+/-	0.217	2.730	.007***
NEWAUD	+/-	-0.272	-2.510	.013**
ARL	+	0.005	3.460	.001***
ICMW	+	0.084	0.700	.484
PSKILL	+	0.115	1.680	.095*

***, **, * Denotes significant p-value at the 1%, 5%, and 10% levels, respectively. Refer to Table 3.1 for sample selection information. Definitions of variables are as follows: *LNAFEES* – natural log of audit fees; *LNAT* – natural log of total assets as of 12/31/2012; *SUBS* – number of subsidiaries; *INVTA* – ratio of inventory to total assets; *ROA* – EBIT divided by total assets; *LEV* – ratio of long-term debt to total assets as of 12/31/2012; *BIG4* – 1 if external auditor a Big 4 firm, otherwise 0; *NEWAUD* – 1 if external auditor tenure equal to 3 or less years, otherwise 0; *ARL* – number of calendar days between the firm's fiscal year end and audit report date; *ICMW* – 1 if an internal control material weakness reported, otherwise 0; and, *PSKILL* – 1 if at least one former politically skilled director on the AC.

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