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Corporate Political Activity, CEO Hubris, and Earnings Management

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Abstract

In this study, I examine the relation between corporate political activity and earnings management. I propose and test a hypothesis that CEO hubris moderates this relation. Consistent with the view that CEOs with relatively higher levels of hubris are more likely to expect that corporate political activity shields them from the costs of earnings management, I expect earnings management to be highest for firms with higher levels of corporate political activity that are run by CEOs possessing relatively high levels of hubris. My results suggest that earnings management is only more likely to occur in firms that have both corporate political activity and CEOs with high levels of hubris present. Having only one of variables present does not lead to increased earnings management.

1. Introduction

My study examines the moderating effect of CEO hubris on the relation between corporate political activity (CPA) and earnings management. CPA encompasses the political involvement of a firm and typically includes money spent on lobbying and donations to Political Action Committees (PACs). Recent research suggests that firms engaging in more CPA face reduced regulatory enforcement from the Securities and Exchange Commission (SEC). CEO hubris is a construct that comes from research that examines the impact of idiosyncratic CEO characteristics on corporate outcomes. Hubris is broadly defined as excessive self-pride, self-confidence, egotism, and superiority. Consequently, CEOs with higher levels of hubris are more likely to engage in potentially unethical or "suspect" corporate activities (Biggerstaff et al. 2014). I test the related hypotheses that earnings management increases with increased CPA and that CEO hubris moderates this relation. Evidence in support of my hypotheses would be consistent with the proposition that CEOs with higher levels of hubris are more likely to believe that CPA is effective in regulators implicitly granting them more latitude to manage earnings.

Past research has found links between CPA and regulatory enforcement levels (Correia, 2014, and Fulmer and Knill, 2012) as well as CPA and firm performance (Lux et al., 2011), but researchers have yet to document a direct relation between CPA and earnings management. Other research, as seen in Biggerstaff et al. (2014) and Hribar and Yang (2010), has found a relation between measures of CEO hubris and earnings management but has not investigated the role CPA plays in this relation. While the relation between earnings management and CEO hubris could hold on average, it is possible that this relation only holds for firms with high CPA. Consequently, the results of my tests help to inform and extend recent research that examines corporate outcomes related to CPA and CEO hubris.

Per the Center for Responsive Politics, in 2016 PACs, the mechanism through which corporations are permitted to make political donations, contributed more than 470 million dollars to candidates. Rational managers would not spend money unless it was of financial benefit to the company. Why then do corporations make donations to political candidates? Correia (2014) shows that companies who engage in CPA through lobbying and donations to PACs are less likely to face enforcement actions from the SEC than non-CPA engaging firms. These results indicate the costs of managing earnings is likely to decrease as CPA is higher, which could be a motivating factor for many firms. Another possible motivation for CPA can be seen in Lux et al. (2011). This study finds that firms with higher levels of CPA will exhibit better financial performance. They attribute this finding to the influence that CPA has on policymakers taking or not taking certain actions that benefit the firm, such as rate increases and import tariffs. However, the study did not control for earnings management, which in most cases increases a firm's financial performance. Consequently, to the extent that some of the increased performance associated with CPA documented in prior literature was due to earnings management, the results of my study could provide another explanation for CPA's positive effect on firm performance.

Several recent related studies motivate my hypotheses and help me to identify proxies for CEO hubris. Biggerstaff et al. (2014) shows that CEOs who engage in potentially unethical behavior (i.e. stock option backdating) are more likely to manage earnings than CEOs who do not display unethical behaviors. Hribar and Yang (2010), Hsieh et al. (2014), and Li and Hung (2013) find that CEOs who are overconfident are more likely to manage earnings. For my study, I allow CEO hubris to be captured by the measures of unethical CEO conduct and CEO overconfidence used in this related research. I predict that CEO hubris will have a moderating effect on the relation between CPA and earnings management. Specifically, I expect the predicted positive relation

between CPA and earnings management to strengthen (i.e. become more positive) when CEOs with higher levels of hubris are present. Because I capture CEO hubris with related but still different measures, it is possible that I will not document support for my hypotheses across all measures that proxy for CEO hubris.

My study should be of interest to both policymakers and investors because CPA has been shown to impact the success of a firm; however, corporations are not required to disclose any of the money they spend on political contributions or lobbying directly in their financial statements. In 2011, a petition was filed with the SEC asking that they require public companies who use corporate resources for political activities to disclose that information to shareholders (Bebchuck et al. 2011). This petition received over 1 million generally favorable public comments—the most of any petition filed with the SEC—but the SEC has yet to take a definitive stance on the matter (ElBoghdady, 2013, May 16). Firms and CEOs (and even some politicians) have been reluctant to support the disclosure of CPA in firm financial statements.[1]

This reluctance is troubling for investors because of the difficulty in getting CPA information in a clear, concise manner. As mentioned earlier, corporations can only make political contributions through a registered PAC, and PACs are required to file reports with the Federal Election Commission (FEC). However, retrieving that information requires multiple searches and filters. Researchers and shareholders obtaining CPA data from the FEC do so with great time and effort. Obtaining lobbying expense data also requires significant effort on the part of researchers and shareholders who must sift through and compile information from both House and Senate databases to understand the extent of a firm's expenditures in this area.

[1] The debate over the required disclosure is still ongoing and has impacted things such as the 2016 federal budget and the approval of new SEC commissioners (Ackerman, 2015, Dec. 16 and Ackerman, 2016, Apr. 7).

Shareholders want access to reliable financial statements in order to make well-informed investment decisions. However, if earnings management is more likely to occur with increased CPA, then the financial statements of highly politically active firms are potentially less reliable. Accordingly, the lack of appropriate disclosure means investors are unable to identify and to discount the information contained in the financial statement of politically active firms.

Prior research has investigated some of the implications of CPA, but not all the consequences of CPA, either positive or negative, are well understood. If CPA did not have any economic benefits, it seems unlikely firms would expand resources towards it. CEOs likely control how much CPA their firms undertake and could be afraid that financial statement disclosure will create investor backlash for supporting one candidate or cause over another. Currently however, the complete costs of CPA are artificially low because CEOs can make CPA decisions without the need to disclose these decisions transparently to investors.

Finally, the results of my study add to the work in behavioral financial literature that attempts to examine links between firms and their CEO's personality traits. Some of the existing research directly related to by study includes Biggerstaff et al. (2014), Hribar and Yang (2010), Hsieh et al. (2014), and Li and Hung (2013). Other research, among many others, includes Peterson et al. (2003) which studies the impact of CEO personality traits on the dynamics of top management teams and overall organizational performance, and Cain and McKeon (2014) which studies the impact risk-taking CEOs have on their firm's policy decisions.

My sample consists of large firms—some of whom engage in CPA—that were currently or formerly included in the S&P 500 from 1998 to 2005. I use well-known measures for CPA, CEO hubris, and earnings management and perform an ordinary least squares regression analysis to evaluate the relationships among the three variables while controlling for other variables such

as size, industry, and profitability. My results provide mixed support for my three hypotheses. I find no substantial evidence that CPA alone is correlated with earnings management. Confirming results found in related research, I document some evidence of a positive relation between CEO hubris and earnings management. However, I find the most consistent support for my hypothesis that the combined presence of CPA and CEO hubris positively relates to earnings management.

2. Literature Review

Corporate political activity. Most studies relating to CPA use PAC contribution information from the FEC and the Center for Responsive Politics as a proxy for political contributions. Although corporations are not required by law to disclose their PAC contributions to investors in their financial statements, PACs themselves are required to report their receipts and expenditures to the FEC throughout the year. Additionally, a corporation is only allowed to contribute to a PAC through their own PAC. For example, Aflac, Inc. had to create an Aflac PAC to make PAC contributions. The FEC then reports all the data they receive on their website (fec.gov), which is the primary source of data for researchers.

Lobbying expenditures, the other main component of CPA, do not have a financial statement disclosure requirement either. However, under the Lobbying Disclosure Act of 1995, federal lobbyists must register and file quarterly activity reports with both the House and the Senate. The Center for Responsive Politics compiles this congressional data in a more readable format on their website (opensecrets.org), which serves as the primary source of lobbying data for researchers. However, as discussed earlier, the process of searching for CPA data is complicated and tedious for shareholders because they have to compile the data themselves from various

sources and cannot directly search in one database for all pertinent information on a specific corporation.

Correia (2014) uses PAC contributions and lobbying expenditures as proxies for political connections and examines the relationship between political connections and enforcement actions from the SEC. Correia (2014) finds there is a negative relation between political connections—what I am calling CPA—and the likelihood of SEC enforcement. Additionally, Correia (2014), finds that when CPA engaging firms actually have enforcement actions brought up against them, their monetary fines are lower than non-CPA engaging firms. Fulmer and Knill (2012) uses a combination of PAC contributions and CEO contributions as proxies for political contributions and documents a negative relation with SEC enforcement. Collectively, the results of these studies indicate a desire to reduce the costs of SEC enforcement as one potential motivation for CPA. In other words, companies consciously engage in CPA to reap benefits, such as decreased regulatory enforcement. This decreased risk of enforcement could increase the likelihood of earnings management as regulatory bodies are normally tasked with preventing and disciplining this type of activity.

CEO hubris. Hubris is a personality trait that is characterized by excessive self-pride, self-confidence, egotism and superiority. Prior literature including Biggerstaff et al. (2014) and Malmendier and Tate (2005) has aimed to capture variation in this broad idiosyncratic personality trait among CEOs with different approaches. Biggerstaff et al. (2014) quantifies the ethical values of CEOs by analyzing their stock option backdating practices. If more than 30% of the CEOs options activities are considered "likely-backdated," the CEO is characterized as being "suspect". The study also included CEOs who were involved in a related enforcement action or backdating settlement even if they did not meet the 30% threshold. The study found that the firms of these

suspect CEOs are more likely to engage in other corporate misbehaviors—one of them being fraudulent overstatement of earnings—because of the culture fostered by the unethical CEO. These suspect CEOs and their suspect firms are also more likely than their non-suspect counterparts to be involved in shareholder lawsuits.

Malmendier and Tate (2005) captures CEO overconfidence using stock option exercise behavior. This approach has been used frequently in subsequent research including Hsieh et al. (2014), a study related to mine. Consistent with Malmendier and Tate (2005), Hsieh et al. (2014) classifies CEOs as overconfident if they hold stock options when they are more than 67% in-the-money at least twice during a 10-year sampling period. Their study finds more evidence of earnings management from these overconfident CEOs before the Sarbanes Oxley Act of 2002 (SOX) was passed than they do after it was passed; however, they also find, even after SOX, overconfident CEOs continue to manage earning more than less confident CEOs.

Another study related to mine, Li and Hung (2013), reconfirms the positive relation found between managerial overconfidence and earnings management. In addition, their study documents the moderating effect of family control on this relation. Li and Hung (2013) define family control as a firm in which more than 50% of the directors are controlling shareholders who have control rights that exceed a 10% threshold. The study finds that family control has a negative moderating effect on the relation between overconfidence and earnings management consistent with the proposition that family members care more about the long-term reputation of the firm as opposed to the short-term benefits that earnings management can provide. The study also finds that this negative moderating effect of family control mainly results from family CEOs as opposed to non-family CEOs. Instead of looking at the moderating effect of family control on earnings management, my study is evaluating the moderating effect of CEO hubris on earnings

management. Collectively, these studies indicate that the proposed positive relationship between CPA and earnings management would strengthen if CEO hubris was present.

Earnings management. Consistently defining earnings management and creating measures that effectively capture earnings management has presented a number of challenges for researchers. Ball (2013) is critical of the common earnings management proxies and cautions that some common measures have likely led to faulty results and conclusions. However, as seen in Dechow et al. (2010), there are numerous ways to measure earnings management that lead to reliable inferences. If we assume studies relating to earnings management capture the construct, albeit with some error, I argue that traditional proxies for earnings management, like abnormal accruals and abnormal cashflows, can still be used.

3. Hypotheses Development

CPA has been shown in both Correia (2014) and Fulmer and Knill (2012) to be negatively related to regulatory enforcement. Additionally, the findings of Hayn (1995), Burgtahler and Dichev (1997), and Dechow and Skinner (2000) indicate the majority of firms are already participating in earnings management to some degree. If these firms know they can garner regulatory favor through CPA, I suspect they would be even more likely to increase their levels of earnings management if they simultaneously increase their CPA. I propose in H1 that companies who engage in CPA are aware of their regulatory favorability and would thus be more likely to engage in activities, like earnings management, that would normally put them at risk of regulatory enforcement.

H1*: CPA is positively related to earnings management.*

However, CPA might not actually impact earnings management. Most firms know they cannot egregiously manage earnings because of independent audits, whistleblowers, etc. Consequently, even if they believe CPA creates regulatory favorability, the protections against earnings management could outweigh those advantages gained through CPA. Lastly, despite the likelihood that firms with higher CPA faced reduced regulatory costs, CPA could increase the visibility and profile of the firm thus increasing the costs of earnings management.

Biggerstaff et al. (2014) shows CEOs who engage in unethical behavior are more likely to manage earnings, and Hribar and Yang (2010) and Hsieh et al. (2014) show that CEOs who are characterized as overconfident are also more likely to manage earnings. Based on this prior research, I propose in H2 that these idiosyncratic CEO traits and characteristics that I collectively refer to as hubris are positively related to earnings management.

H2*: CEO hubris is positively related to earnings management.*

Since I am measuring CEO hubris using two different methods from prior research, there is a possibility that one measure holds true with my hypothesis while the other measure does not, which would create difficulty in confirming or disproving H2.

My final hypothesis (H3) focuses on the moderating role of CEO hubris on the relation between CPA and earnings management. I propose CEOs with higher levels of hubris are more likely to believe that CPA represents a sort of "payment" to garner regulatory favor thus providing them additional license to manage earnings. In comparison, CEOs with lower levels of hubris are either less confident in their ability to manage earnings despite the regulatory favor provided from CPA or are more ethical and therefore less likely to perceive CPA as a form of payment to garner favor with regulatory agencies. If this view is descriptive, the interaction between CEO hubris and earnings management will be positive while the main effect of CPA will be insignificant (i.e. H1

will not hold) because the positive relation between CPA and earnings management would exist only in the presence of CEO hubris.

Another explanation for the moderating effect of CEO hubris would be that CEOs with higher levels of hubris believe that $1 spent on CPA is more effective in providing regulatory cover than CEOs with lower levels of hubris. In this scenario both CEOs believe money spent on CPA provides some degree of regulatory cover and allows some degree of earnings management to safely occur. If this view is descriptive, the interaction between CEO hubris and earnings management will be positive and the main effect of CPA on earnings management will still be significant (i.e. H1 will hold). In other words, the presence of CEO hubris would amplify the relation between CPA and earnings management, but the relation would still exist without the presence of CEO hubris.

H3: CEO hubris moderates the relation between CPA and earnings management.

4. Data and Measures

Corporate political activity. The data set and measure for overall CPA were taken from Lux et al. (2011). The overall measure is comprised primarily of PAC contributions and lobbying expenses as well as miscellaneous measures of CPA such as expenses relating to offices in Washington, D.C. and government relations employees (Lux et al. 2011). This data set was created using publicly available information for both PAC contributions and lobbying expenditures. PAC contribution data is available from 1974 forward through the FEC (fec.gov) and federal lobbying expenditures from 1999 forward through the Center for Responsive Politics (opensecrets.org). For this study, I create an overall CPA measure that captures all PAC contributions and expenses and internal and external lobbying expenditures.

CEO hubris. I measure CEO hubris using two different methods, both of which are consistent with prior research. The first measure from Biggerstaff et al. (2014) captures unethical CEO behavior. Biggerstaff et al. (2014) infers the presence of unethical CEOs through stock option backdating practices (*HUBRIS SUSPECT)*. The second way I capture CEO hubris is with the options-based measure of overconfidence (*HUBRIS OVERCONF*) as seen in Malmendier and Tate (2005). The options-based measure classifies CEOs as overconfident based upon their stock option holding practices. The data for the options-based measure is from Execucomp.

Earnings management. I use two different measures for earnings management. The first being positive abnormal accruals (*EM POS ABACC*) and the second positive abnormal cash flows (*EM POS ABCF*). The abnormal accruals model is based off the modified Jones Model (Jones, 1991) as seen in Dechow et al. (1995), Cohen and Zarowin (2008), and Zang (2012). The abnormal cash flow model is based off the Ye Model (Ye, 2006), which is derived from the Jones Model, as seen in Zhang (2016). Data for both measures is from Compustat.

5. Research Design

I test my hypotheses by performing an ordinary least squares regression with earnings management (EM) as the dependent variable. CPA, CEO Hubris, and the combined interaction of CPA and CEO Hubris are the primary independent variables.

$$EM_{it} = \alpha_0 + \beta_1 CPA_{it} + \beta_2 CEOH_{it} + \beta_3 CPA_{it} \times CEOH_{it} + \beta_4 mktshare_{it} + \beta_5 Zscore_{it} + \beta_6 BigN_{it} + \beta_7 tenure_{it} + \beta_8 ROA_{it} + \beta_9 logat_{it} + \beta_{10} MTB_{it} + \beta_{11} cfo_{it} + \beta_{12} loss_{it} + \sum Industries + \sum Years + e_{it}$$

Where:

EM_{it} = earnings management. Measured using positive abnormal accruals and positive abnormal cash flows

CPA_{it} = corporate political activity. Measured as total lobbying and political action committee donations made by the firm divided by the total assets of the firm

$CEOH_{it}$	= CEO hubris. Measured using the suspect method from Biggerstaff et al. (2014) and the overconfidence method from Hsieh et al. (2010)
CPA_{it} x $CEOH_{it}$	= CPA and CEO hubris interaction
$mktshare_{it}$	= Market share
$Zscore_{it}$	= Standard score
$BigN_{it}$	= Big N accounting firm. Indicates whether the public company is audited by a large accounting firm (today it would be the Big 4)
$tenure_{it}$	= Audit firm tenure
ROA_{it}	= Return on assets
$logat_{it}$	= Natural log of assets
MTB_{it}	= Market to book ratio
cfo_{it}	= Other commissions and fees
$loss_{it}$	= Net operating losses

H1 predicts a positive relation between earnings management and CPA, which would be supported by a positive $\beta 1$ coefficient. H2 predicts a positive relation between earnings management and CEO hubris, which would be supported by a positive $\beta 2$ coefficient. H3 predicts a positive relationship between earnings management and the interaction between CPA and CEO hubris, which would be supported by a positive $\beta 3$ coefficient. The other variables in the regression are control variables commonly seen in CPA and earnings management literature. Additionally, I included industry and fixed year effects as controls to be consistent with prior literature.

The firms in my sample were selected from the S&P500, and if a firm fell out of the S&P500 at any point during the sample period, data for that firm was still collected and included in my analysis. Firms missing data for any of the variables of interest or control variable were eliminated. My final sample consists of 5,479 firm years covering the period from 1998 to 2005. Table 1, Panel A presents descriptive statistics for the firms in my sample. Table 1, Panel B shows a comparison in the descriptive statistics for CEOs classified as suspect and non-suspect consistent with Biggerstaff et al. (2014). Table 1, Panel C shows a comparison in the descriptive statistics for CEOs classified as overconfident and not overconfident consistent with Hsieh et al. (2010).

6. Empirical Results

Table 2 presents the correlations between my earnings management proxies and primary variables of interest: CPA and CEO Hubris. The two earnings management proxies, *EM POS ABACC* and *EM POS ABCF*, have a statistically significant correlation. The two proxies share about 32% in common variation. The two CEO hubris proxies, *HUBRIS SUSPECT* and *HUBRIS OVERCONF*, also have a statistically significant correlation. They share approximately 9% in common variation. *CPA* is significantly correlated with only one of the proxies for earnings management, *EM POS ABCF*, sharing 5% common variation which provide univariate support for H1. *CPA* is also significantly correlated with *HUBRIS OVERCONF* sharing about 5% in common variation. *HUBRIS OVERCONF* is significantly correlated with both *EM POS ABACC* and *EM POS ABCF* sharing 4% common variation with both proxies. This correlation provides univariate support for H2. *HUBRIS SUSPECT*, however, is not significantly correlated with either earnings management proxy. I am careful not to infer too much from this analysis as it is only univariate. Instead, I focus on multivariate analysis discussed below.

Table 3 presents the results of my ordinary least squares regression. The coefficient on CPA does not have a consistent sign across the two CEO hubris proxies. In addition, coefficient estimates on CPA are never statistically significant using a two-tailed test. As a result, I fail to find support for H1. I find mixed support for H2, but this result appears to be sensitive to the chosen proxy for CEO hubris. For the measure of CEO hubris coming from Biggerstaff et al. (2014) which classified CEOs as being "suspect," no statistically significant relation was found between suspect CEOs and earnings management in my sample of firms. However, when measuring CEO hubris based on the overconfidence measure as seen in Hsieh et al. (2010) I document support for H2 which states that CEO overconfidence is positively associated with earnings management. These

results can be seen in the third and fourth rows of Table 3. Finally, and most importantly, I find significant, consistent evidence that the combined presence of CPA and CEO hubris in a firm does positively relate to earnings management which supports my H3. These results can be seen in rows five and six of Table 3. Combined with my lack of support for H1, this result is consistent with the view that CPA matters with respect to earnings management only in the presence of CEOs with relatively higher levels of hubris.

Table 4 shows additional regression analysis using total abnormal accruals and cash flows instead of only positive accruals and cash flows as seen in Table 3. In my primary regression analysis, I use positive abnormal accruals and cash flows as measurements for earnings management because this is both consistent with prior literature and because I expect that overconfident or suspect CEOs will positively manage earnings. It would be inconsistent with my expectations if CEOs negatively manage the earnings because doing so would hurt firm performance and damage the CEO's reputation. In this way, the tests in Table 4 are a type of placebo analysis where I would expect my results to weaken substantially. This is indeed what I find. I only find evidence supporting H2 in one specification (total accruals and hubris measured with overconfidence). I find no support for H1 or H3. These results underscore the role of CEO hubris in the relation between CPA and earnings management.

7. Conclusions

My study examines the moderating effect of CEO hubris on the relationship between corporate political activity (CPA) and earnings management. I measure CEO hubris in two ways consistent with prior literature and find a significant relation between one of the measures and earnings management. I measure earnings management two different ways consistent with prior

research. CPA is measured using firms' total lobbying and political action committee donations. I do not find significant evidence that CPA alone leads to earnings management. However, I do find significant results when looking at CPA in the presence of CEO hubris. These results indicate that firms who engage in CPA and have a CEO displaying relatively higher levels of hubris are more likely to manage their earnings than either: 1. Firms with CEOs possessing relatively higher levels of hubris but little or no CPA, or 2. Firms with relatively high levels of CPA but without CEOs possessing relatively higher levels of hubris.

My study was initially motivated by the desire to find out if earnings management was a consequence of the decreased likelihood of regulatory enforcement gained through engaging in CPA. Although I do not find a statistically significant association between CPA and earnings management, I do document statistically significant results for one of my hypotheses. Depending on the proxy used, up to 68% of my sample could be classified as overconfident. Consistent with prior research, in at least some settings I find significant evidence that overconfident CEOs are more likely to manage earnings. When I consider the interactive effect of CPA on these CEOs, the association with earnings management only strengthens as noted with my results in Table 3. I think it is safe to assume, given my sample, that the majority of firms have overconfident CEOs and also that the majority of firms engage in some level of CPA. Overall, this indicates that the majority of firms are engaging in some level of earnings management, which misleads shareholders and compromises the market as a whole. My study suggests that regulators, lawmakers, the media, and watchdog groups should consider focusing on the joint combination of CEO hubris and CPA and not just CPA or CEO Hubris in isolation.

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TABLE 1

Descriptive Statistics for CPA, CEO Hubris, Earnings Management, and Control Variables

Panel A: Pooled sample descriptive statistics

Variable	N	Mean	Std. Dev.	Median
EM POS ABACC	5,479	0.0177	0.0441	0
EM POS ABCF	5,479	0.0304	0.0636	0
HUBRIS SUSPECT	5,479	0.0460	0.2095	0
HUBRIS OVERCONF	5,479	0.6810	0.4661	1.00
CPA	5,479	0.0001	0.0002	0
MKTSHARE	5,479	0.0858	0.1472	0.0246
ZSCORE	5,479	5.3531	7.9605	3.5055
BIGN	5,479	0.9797	0.1409	1.00
TENURE	5,479	7.9489	4.0401	8.00
ROA	5,479	0.0631	0.1576	0.0628
LOGAT	5,479	7.4182	1.4638	7.3086
MTB	5,479	4.7322	76.735	2.5427
CFO	5,479	0.1289	0.1055	0.1184
LOSS	5,479	0.1247	0.3304	0

Note: This table reports descriptive statistics for all sample firms used in main regression testing. EM POS ABACC is the earnings management proxy of positive abnormal accruals. EM POS ABCF is the earnings management proxy of positive abnormal cash flows. HUBRIS SUSPECT is the CEO hubris proxy of suspect CEOs. HUBRIS OVERCONF is the CEO hubris proxy of overconfident CEOs. CPA is corporate political activity. MKTSHARE is market share. ZSCORE is standard score. BIGN is Big N accounting firm and serves as an indicator variable for whether the company was audited by one of the large accounting firms at that time (Big 4 in today's world). ROA is return on assets. LOGAT is natural log of assets. MTB is market to book ratio. CFO is other commissions and fees. LOSS is net operating loss.

Panel B: CEO Hubris (Suspect) Descriptive Statistics Comparisons

	HUBRIS SUSPECT=0				*HUBRIS SUSPECT=1*			
Variable	N	Mean	Std. Dev.	Median	N	Mean	Std. Dev.	Median
EM POS ABACC	5,227	0.0177	0.0442	0	252	0.0171	0.0425	0
EM POS ABCF	5,227	0.0302	0.0633	0	252	0.0345	0.0694	0
HUBRIS SUSPECT	5,227	0***	0	0	252	1.00	0	1.00
HUBRIS OVERCONF	5,227	0.6715***	0.4697	1.00	252	0.8770	0.3291	1.00
CPA	5,227	0.0001	0.0002	0	252	0.0001	0.0002	0
MKTSHARE	5,227	0.8767***	0.1489	0.0257	252	0.0461	0.0974	0.0076
ZSCORE	5,227	5.2018***	7.4207	3.4649	252	8.4921	15.037	4.5056
BIGN	5,227	0.9788***	0.1442	1.00	252	1.00	0	1.00
TENURE	5,227	7.8885***	4.0528	8.00	252	9.2024	3.5486	10.00
ROA	5,227	0.0631	0.1585	0.0627	252	0.0625	0.1364	0.0654
LOGAT	5,227	7.4282**	1.4664	7.3091	252	7.2119	1.3964	7.2650
MTB	5,227	4.7784	78.561	2.5227	252	3.7739	2.8595	2.9034
CFO	5,227	0.1284	0.1053	0.1181	252	0.1390	0.1096	0.1250
LOSS	5,227	0.1230	0.3285	0	252	0.1587	0.3662	0

Note: *, **, *** indicate a 10 percent, 5 percent, and 1 percent, respectively, statistically significant difference between the mean values for *HUBRIS SUSPECT*=0 and *HUBRIS SUSPECT*=1. EM POS ABACC is the earnings management proxy of positive abnormal accruals. EM POS ABCF is the earnings management proxy of positive abnormal cash flows. HUBRIS SUSPECT is the CEO hubris proxy of suspect CEOs. HUBRIS OVERCONF is the CEO hubris proxy of overconfident CEOs. CPA is corporate political activity. MKTSHARE is market share. ZSCORE is standard score. BIGN is Big N accounting firm and serves as an indicator variable for whether the company was audited by one of the large accounting firms at that time (Big 4 in today's world). ROA is return on assets. LOGAT is natural log of assets. MTB is market to book ratio. CFO is other commissions and fees. LOSS is net operating loss.

Panel C: CEO Hubris (Overconfidence) Descriptive Statistics Comparisons

	HUBRIS OVERCONF=0				*HUBRIS OVERCONF=1*			
Variable	N	Mean	Std. Dev.	Median	N	Mean	Std. Dev.	Median
EM POS ABACC	1,748	0.0152***	0.3233	0	3,731	0.0189***	0.0486	0
EM POS ABCF	1,748	0.0268***	0.0527	0	3,731	0.0321***	0.6801	0
HUBRIS SUSPECT	1,748	0.0177***	0.1320	0	3,731	0.0592***	0.2361	0
HUBRIS OVERCONF	1,748	0***	0	0	3,731	1.00***	0	1.00
CPA	1,748	0.0001***	0.0001	0	3,731	0.0001***	0.0002	0
MKTSHARE	1,748	0.0991***	0.1619	0.0297	3,731	0.0795***	0.1394	0.0217
ZSCORE	1,748	3.3275***	2.9127	2.6328	3,731	6.3022***	9.2881	3.9716
BIGN	1,748	0.9840	0.1256	1.00	3,731	0.9778	0.1475	1.00
TENURE	1,748	7.8244	4.1522	8.00	3,731	8.0072	3.9858	8.00
ROA	1,748	0.0438***	0.0669	0.0418	3,731	0.7211***	0.1847	0.0758
LOGAT	1,748	7.6538***	1.4529	7.5997	3,731	7.3078***	1.4560	7.1503
MTB	1,748	2.5779**	10.50	1.9795	3,731	5.7415**	92.698	2.9856
CFO	1,748	0.1041***	0.0763	0.0963	3,731	0.1405***	0.1149	0.1310
LOSS	1,748	0.1459***	0.3531	0	3,731	0.1147***	0.3187	0

Note: *, **, *** indicate a 10 percent, 5 percent, and 1 percent, respectively, statistically significant difference between the mean values for *HUBRIS OVERCONF*=0 and *HUBRIS OVERCONF*=1. EM POS ABACC is the earnings management proxy of positive abnormal accruals. EM POS ABCF is the earnings management proxy of positive abnormal cash flows. HUBRIS SUSPECT is the CEO hubris proxy of suspect CEOs. HUBRIS OVERCONF is the CEO hubris proxy of overconfident CEOs. CPA is corporate political activity. MKTSHARE is market share. ZSCORE is standard score. BIGN is Big N accounting firm and serves as an indicator variable for whether the company was audited by one of the large accounting firms at that time (Big 4 in today's world). ROA is return on assets. LOGAT is natural log of assets. MTB is market to book ratio. CFO is other commissions and fees. LOSS is net operating loss.

TABLE 2

Correlation Matrix for Primary Variables of Interest

	EM POS ABACC	EM POS ABCF	HUBRIS SUSPECT	HUBRIS OVERCONF	CPA
EM POS ABACC	1.00	0.3188 <.0001	-0.0031 0.8212	0.0391 0.0038	0.0341 0.115
EM POS ABCF		1.00	0.0142 0.2921	0.0389 0.0039	0.0445 0.0010
HUBRIS SUSPECT			1.00	0.0923 <.0001	-0.0002 0.9907
HUBRIS OVERCONF				1.00	0.0508 0.0002
CPA					1.00

Note: This table reports the correlations above the diagonal for the primary variables of interest. EM POS ABACC is the earnings management proxy of positive abnormal accruals. EM POS ABCF is the earnings management proxy of positive abnormal cash flows. HUBRIS SUSPECT is the CEO hubris proxy of suspect CEOs. HUBRIS OVERCONF is the CEO hubris proxy of overconfident CEOs. CPA is corporate political activity. MKTSHARE is market share. ZSCORE is standard score. BIGN is Big N accounting firm and serves as an indicator variable for whether the company was audited by one of the large accounting firms at that time (Big 4 in today's world). ROA is return on assets. LOGAT is natural log of assets. MTB is market to book ratio. CFO is other commissions and fees. LOSS is net operating loss.

TABLE 3

OLS Regression of Income Increasing Earnings Management on CPA, CEO Hubris, and Control Variables

EM MEASURE	*EM POS ABACC*		*EM POS ABCF*	
CEO HUBRIS MEASURE	*HUBRIS SUPECT*	*HUBRIS OVERCONF*	*HUBRIS SUPECT*	*HUBRIS OVERCONF*
CPA	1.41	-1.27	1.64	-0.24
	(0.1580)	(0.2050)	(0.1005)	(0.8136)
CEO HUBRIS	-0.92	3.22***	0.62	4.44***
	(0.3562)	(0.0004)	(0.5384)	(<.0001)
CPA*CEO HUBRIS	2.38**	1.98**	2.60**	1.15
	(0.0174)	(0.0484)	(0.0095)	(0.2489)
MKTSHARE	-0.15	-0.06	2.61***	2.77***
	(0.8794)	(0.9558)	(0.0093)	(0.0058)
ZSCORE	2.04**	1.91*	1.99**	1.87*
	(0.0413)	(0.0570)	(0.0469)	(0.0625)
BIGN	-1.12	-1.10	-1.15	-1.09
	(0.2638)	(0.2736)	(0.2505)	(0.2770)
TENURE	-0.28	-0.34	-0.38	-0.34
	(0.7799)	(0.7359)	(0.7010)	(0.7315)
ROA	2.52**	2.56**	-0.85	-0.84
	(0.0120)	(0.0106)	(0.3969)	(0.3999)
LOGAT	-3.67***	-3.66***	-5.30***	-5.26***
	(0.0003)	(0.0003)	(<.0001)	(<.0001)
MTB	-0.73	-0.99	1.20	0.77
	(0.4646)	(0.3211)	(0.2299)	(0.4434)
CFO	-7.54***	-7.70***	-6.00***	-6.24***
	(<.0001)	(<.0001)	(<.0001)	(<.0001)
LOSS	-0.37	-0.32	-3.28***	-3.25***
	(0.7078)	(0.7507)	(0.0011)	(0.0012)
Industry Fixed Effects	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes
R-Square	0.1120	0.1137	0.2094	0.2140
N	5,479	5,479	5,479	5,479

Note: For each variable, the t-statistic is reported first with the p-value shown in parentheses below. *, **, ***, represent the 10%, 5%, and 1% levels of statistical significance respectively. All regressions include industry and year fixed effects.

TABLE 4

Additional Analysis: OLS Regression of Income Increasing and Decreasing Earnings Management on CPA, CEO Hubris, and Control Variables

EM MEASURE	*EM ABACC*		*EM ABCF*	
CEO HUBRIS MEASURE	*HUBRIS SUPECT*	*HUBRIS OVERCONF*	*HUBRIS SUPECT*	*HUBRIS OVERCONF*
CPA	0.64	-0.65	1.40	0.33
	(0.5218)	(0.5152)	(0.1620)	(0.7396)
CEO HUBRIS	-0.16	-0.08	0.89	3.76***
	(0.8711)	(0.9369)	(0.3747)	(0.0002)
CPA*CEO HUBRIS	-0.90	0.87	1.50	0.36
	(0.3677)	(0.3858)	(0.1346)	(0.7223)
MKTSHARE	-2.11**	-2.09**	2.32**	2.42**
	(0.0355)	(0.0365)	(0.0206)	(0.0157)
ZSCORE	-2.08**	-2.09**	-2.09**	-2.18**
	(0.0380)	(0.0369)	(0.0372)	(0.0295)
BIGN	-0.62	-0.62	-0.15	-0.10
	(0.5335)	(0.5325)	(0.8805)	(0.9193)
TENURE	-0.30	-0.27	-0.17	-0.13
	(0.7680)	(0.7838)	(0.8612)	(0.8974)
ROA	14.77***	14.77***	0.65	0.67
	(<.0001)	(<.0001)	(0.5141)	(0.5024)
LOGAT	0.43	0.45	-4.30***	-4.24***
	(0.6683)	(0.6500)	(<.0001)	(<.0001)
MTB	0.27	0.26	1.43	1.13
	(0.7879)	(0.7928)	(0.1529)	(0.2583)
CFO	-22.17***	-22.29***	-14.32***	-14.67***
	(<.0001)	(<.0001)	(<.0001)	(<.0001)
LOSS	4.58***	4.59***	-4.87***	-4.86***
	(<.0001)	(<.0001)	(<.0001)	(<.0001)
Industry Fixed Effects	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes
R-Square	0.6740	0.6740	0.3782	0.3808
N	5,479	5,479	5,479	5,479

Note: For each variable, the t-statistic is reported first with the p-value shown in parentheses below. *, **, ***, represent the 10%, 5%, and 1% levels of statistical significance respectively. All regressions include industry and year fixed effects.