Government Procurement and Financial Reporting Quality

by

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Abstract

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Government spending is essential for the US economy, and the amount of capital that flows from the government to US firms has increased substantially in recent years. Despite the economic importance of the corporate-government contracting relationship, we know little about the firm-level financial outcomes associated with government contracts. In this study, I investigate whether the corporate government contracting relationship affects firm-level financial reporting quality. Using a sample of 58,988 US publicly-traded firms from 2001 through 2017, I find that federal government contracting firms are associated with a lower level of discretionary accruals, lower probability of internal control material weaknesses, and lower probability of restatement and fraud as compared to non-government contractors. However, this association is weaker when industry competition on government contracts are lower, and government switching costs in which the cost to find new suppliers are higher. Collectively, my empirical results

suggest that having the government as a customer has a positive impact on the quality of financial reports.

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Chapter 1 Introduction

The amount of capital that flows from the US Government to US firms has increased substantially in recent years. In 2019, the actual government spending was $4.45 trillion, which represents 21% of the US GDP. This massive amount of spending drives large portions of the US economy and creates millions of jobs for US citizens (Davidson 2018). [1] While government spending is an essential and substantial component of the US economy, to date, we know relatively little about the quality of government suppliers' firm-level financial reports.[2] In this study, I first investigate whether contracting relationships between corporations and governments affect firm-level financial reporting quality. I further consider the incremental effects on the quality of financial reports when government contractors operate in industries with lower market competition for government contracts and when government agencies' costs to switch to new suppliers are higher.

Government contracts account for a large share of contractor revenue. Specifically, Ellis, Thomas, and Fee (2012) report that 13.4% of public firms' major customers are US Government agencies and account for one-third of their respective total

1 US federal government expenditure accounts for about 20% of US GDP for last 40 years (Cohen and Li 2019).

2 The US federal government awards about $500 billion in contracts annually and is the largest buyer of goods and services in the nation (Samuels 2018).

revenue on average. As government contracts provide contractors with a steady stream of revenue, firms have become increasingly government-dependent (Ellis, Thomas, and Fee 2012), which has lowered suppliers' demand uncertainties and resulted in higher profitability (Cohen and Li 2019). This has given corporate managers a strong incentive to maintain strong corporate-government contracting relationships in order to enhance firms' profitability, improve their stock valuation, and lower their cost of capital costs (e.g., Cohen, and Li 2019, Banerjee, Dasgupta, and Kim 2008, and Dhaliwal, Judd, Serfling, and Shaikh 2016). Given this incentive, recent research finds that government suppliers have a higher-quality of voluntary disclosures (Samuels 2018) and produce higher-quality management forecasts (Cheng, Huang, and Zhang 2019) relative to non-government contractors.

Existing literature also provides evidence as to how the commercial supply chain relationship affects firm-level financial reporting quality. However, due to data limitation, this literature largely ignores firms that are government contractors. For example, Raman and Shahrur (2008) provide evidence that firms use earnings management to influence their commercial suppliers' or customers' perceptions of their business prospects. Hui, Klasa, and Yeung (2012) find that a firm recognizes losses more quickly and follows more conservative accounting practices when its commercial suppliers or customers have more rather than less bargaining power. However, having government customers impacts firms' outcomes in a significantly different way than having commercial customers (Cohen and Li 2019). I extend this line of literature by

investigating whether being a government contractor affects the quality of financial reports that suppliers provide to the public.[3]

There are several reasons why I argue that supplier firms' business transactions with US federal agencies are likely to improve the quality of government suppliers' financial reporting. First, the government supplier faces less competition than the typical commercial supplier in the product market and generates static government sales from noncompetitive procurement contracts (Mills, Nutter, and Schwab 2013). The unique nature of government sales motivates government suppliers to increase their relationship-specific investments in order to maximize transaction efficiencies to ensure a competitive position (Cohen and Frazzini 2008) and thereby enhance profitability (Cohen and Li 2019). As a result, corporate managers are less likely to choose an accounting method that involves shifting income from one period to another, resulting in higher financial reporting quality.

Second, government agencies have a low default risk and often offer longer-term procurement contracts relative to commercial contracts. (Dhaliwal, Judd, Serfling, and Shaikh 2016). Thus, firms with government contracts have greater investment efficiency, leading to lower operational uncertainty (Cohen and Li 2019). Low operational and demand uncertainties enhance the forecastability of corporate outcomes and thereby lower corporate managers' opportunism to manage earnings to meet the personal objectives, reducing agency conflicts between managers and shareholders.

[3] Government supplier and governement contractor are used interchangably throughout this dissertation to mean a firm that sells goods or services to the government.

Third, the government procurement process is administered by the Federal Acquisition Regulation (FAR). Individual business units must follow the Federal contracting process to compete for a limited number of contracts, and the Federal Government dictates contract terms in the federal contracting process. More importantly, the government can terminate a contract at any given time (FAR 49.101). These capacities for regulation provide the government agency with greater bargaining and enforcement power to obtain necessary information from its contractors than private-sector customers (Chaney et al., 2011). I therefore expect government contractors will have a strong incentive to ensure that financial reports have the quality needed to mitigate the potential risk of losing government contracts.

To address my research question regarding the association between corporate-government contracting and firm-level financial reporting quality, I regress measures of financial reporting quality on constructs for corporate-government relationship variables and with control variables based on prior research. As discussed above, I expect that the corporate-government contracting relationship is positively associated with the quality of suppliers' firm-level financial reporting. I use two measures of corporate government relationship to capture the existence and/or size of government contracts. I examine whether the presence of a corporate-government contracting relationship enhances the corporate firm's financial reporting quality as well as the dollar amount obligated by the government, which has implications for the contractor firm's reporting. I find a negative association between the size and existence of government contracts and the level of discretionary accruals as well as the probability of material weakness in internal control,

restatements, and fraud. Overall, I find that government contracting is associated with higher financial reporting quality.

Further, I examine whether the corporate-government relationship is affected by industry competition and government switching costs. Referencing the findings of prior studies and the theory of competition. I predict that government contractors are associated with a higher level of financial reporting quality when operating in low government contracting competition industries. However, I find mixed and limited evidence to support this prediction. More specifically, I find that government contractors in high competition industries exhibit a lower level of accruals management, but a higher probability of material weakness in internal control. These inconsistent results do not allow me to conclude that industry competition influences the quality of government contractors' financial reporting.

Furthermore, I hypothesize that government switching costs, which give contractors a competitive advantage over federal government agencies, influence the association between government contracting and financial reporting quality. Building on Porter's (1980) competitive strategy theory, I predict that switching costs allow relative bargaining power to shift from the government agency to contractors. Therefore, I expect government contractors with higher relative bargaining power are associated with a lower level of financial reporting quality. Consistent with my prediction, I find that contractors are associated with a higher level of accruals management and higher probabilities of restatements when switching costs for the federal government agency are high. This finding is consistent with existing empirical evidence suggesting that government agencies become more dependent on government contractors, and the contracting

relationship is not terminated even in the most extreme cases when the contractors are accused of fraud against the government (e.g., Karpoff, Lee, and Vendrzyk 1999; Hesse and Perez-Cavazo 2018).

My study contributes to the stream of literature on customer-supplier relationships and financial reporting in the corporate-government contracting relationship. First, I extend accounting research that examines the impact of customer-supplier relations on accounting choices by investigating the effect of the corporate-government contractual relationship on accounting quality. As a result, this study adds to the stream of research about the effects of bilateral relationships on firm internal decisions and performance, especially studies looking at the consequences of major customer dependency (e.g., Kalwani and Narayandas 1995; Banerjee, Dasgupta, and Kim 2008; Gosman and Kohlbeck 2009).

Additionally, my study responds to Healy and Wahlen's (1999) call for future research to further explain how business factors drive accruals by documenting how firms contracting with federal government agencies exhibit a lower level of accruals management. My study complements earlier work on earnings quality and has important implications for investors, regulators, and other stakeholders who are concerned with corporate earnings quality. My findings should be of interest to investors, as they seek to minimize the risk of investing in government contractors' stocks and make strategic decisions regarding their buy and hold decisions. The findings should also be of interest to regulators (e.g., the Securities and Exchange Commission [SEC]) and other stakeholders (e.g., customers and suppliers) who are interested in understanding the

factors that can improve firm's financial reporting quality, as well as stakeholder groups who care about firms' future growth potential.

Finally, my study adds to financial reporting literature by investigating the financial reporting quality of government contractors. Early studies focus on the relationship between government contracting regulation and contractor firm's accounting outcome (e.g., Pownall 1986; Horwitz and Normolle 1988). Subsequent study has investigated whether government contractors enjoy more subsidies from federal agencies (Callahan, Vendrzyk, and Butler 2012; Cohen and Li 2014); affect by political sensitivity that influence firm outcome (e.g., Karpoff, Lee, and Vendrzyk 1999; Mills, Nutter, and Schwab 2013); or shift costs from commercial to government contracts to extract benefits (e.g., Lichtenberg 1992; McGowan and Vendrzyk 2002; Chen and Gunny 2014). My study therefore adds to the literature by investigating the financial reporting quality of government contractors.

I organize the rest of my dissertation as follows. Chapter 2 reviews prior literature, Chapter 3 develops hypotheses, Chapter 4 describes the research design, Chapter 5 presents the sample selection and descriptive statistics, Chapter 6 discusses the main empirical results, Chapter 7 discusses the result of additional analyses, and Chapter 8 concludes the research.

Chapter 2 Institutional Background And Literature Review

In this section, I provide information on the government contracting process and review literature related to my study. I first discuss the government procurement process and then review the literature on the association between the customer-supplier relationship and corporate outcomes. Finally, I discuss prior literature on the association between corporate government contracting and corporate outcomes.

2.1 Contracting Process with the U.S. Government

The Federal procurement process is initiated when an agency identifies the goods and services it needs and determines the most appropriate method for purchasing them. Then, the agency announces the acquisition on the Federal Business Opportunities website. Prospective contractors submit the necessary documentation along with their offer prices to the agency. Federal Acquisition Regulations (FAR 9.104) state that the agency reviews and determines whether a prospective contractor meets specific criteria to carry out the contract, such as financial and accounting performance, and qualification and prior experience. If the criteria are met, the agency reviews proposed prices and assess their reasonableness and fairness. There is a wide selection of contract types available to meet the needs of both parties with regards to facilitating the sale of goods and services to an agency (FRA 16.101(a)). More importantly, the agency is required to exercise sound judgment in selecting a prospective contractor and determining what type of contract to award (FAR 16.109(a)).

The Federal agency awards prospective contractors one of five types of contracts: fixed-price contracts, cost-reimbursement contracts, incentive contracts, indefinite-delivery contracts, and time-and-material labor-hour and letter contracts (FAR 16). I classify these contracts into two contract groups: 1) fixed-price contracts, indefinite-delivery contracts, and time-and-material labor-hour and letter contracts, and 2) cost-plus contracts that include cost-reimbursement contracts and incentive contracts. In determining which contract type is utilized, federal agencies prefer the fixed-price contract to the cost-plus contract because the risk of incurring additional costs to complete the project falls entirely on the prospective contractor (FAR 16.103). On the contrary, prospective contractors prefer a cost-plus contract since this provides a guaranteed profit (Grant Thornton 2018).

Cost-plus contracts can be further broken down into five different types (FAR 16). In a cost-plus-fixed-fee contract, government contractors receive a designated fee on top of the cost of the contract. When a cost-plus incentive contract is used, there is an incentive for the contractor to keep the contract cost low and meet the project deadline without delay. In the case of a cost-plus award contract, the contractor receives an award when certain pre-determined project metrics are met that have been based on subjective analysis by the government agency. A cost-plus percentage contract allows contractors to claim a higher percentage fee when the project's total cost increases. Finally, in the case of a cost-sharing contract, the government agency only reimburses the contractor for a portion of the total project cost since the contractor will also benefit from the work performed on behalf of the government agency.

After a firm enters into a government contract, annual risk assessments are required to determine the potential risk of non-compliance with the Code of Federal Regulations (CFR). Government contractors are required to submit annual audited financial statements and a compliance report, which includes a single audit report (CFR 200.331). Based on the CFR, the contractors' independent auditor has to identify whether there is a material weakness in internal controls, any instance of material non-compliance with the federal code (i.e., a questionable cost that is related to the federal contract) and whether there are large and unusual amounts of federal contract-related expenses in comparison to total operating costs.

2.2 Customer and Supplier Relationships and Firm Outcomes

Since the mid-1980s, management has come to recognize the role that a close buyer-supplier relationship plays in improving the overall efficiency of both trading parties. As a result of these relationships, firms invest in more specific investments to target their major customers. To date, about 35 percent of Big 4 auditor clients report having major customer/supplier relationships (Hertzel, Li, Officer, and Rodgers 2008). Simultaneously, because of the importance of the supply chain relationship, there is a growing amount of literature investigating the impacts of the costs and benefits of the customer-supplier relationship on firm performance.

One large stream of literature demonstrates the benefits and risks experienced by a firm with a strong customer base. On the one hand, having a concentrated customer base allows firms to improve operating efficiency and reduce the cost of production (e.g., Patatoukas 2012; Ak and Patatoukas 2016). On the other hand, a concentrated customer base might result in greater customer dependence and greater customer power. Powerful

customers might use their power to extract the optimal gain from a weaker supplier (Balakrishnan, Linsmeier, and Venkatachalam 1996; Cooper and Slagmulder 2004; Gosman, Kelly, Olsson, and Warfield 2004; Gosman and Kohlbeck 2009). Moreover, a customer-dependent firm might face a higher risk of losing substantial revenue if its major customers become financially distressed. Finally, the supplier firm might face the risk of losing cash flows due to its inability to collect outstanding receivables when a major customer is financially distressed.

Hertzel, Li, Officer, and Rodgers (2008) examine the impact of a main customer filing bankruptcy on the supplier firm's stock return. The document that customer bankruptcy causes financial distress to the supplier and hurts the supplier's stock price. Similarly, Lian (2017) investigates the impact of the customer-supplier relationship on the supplier's financial distress and shows that the financial distress transfers from a major customer to a supplier, an effect which persists for up to two years subsequent to the major customer's financial distress. Overall, this research highlights the importance of customer-supplier relationships to both trading parties when estimating the probability of financial distress.

Existing research also demonstrates that greater major customer dependence is associated with higher financing costs and greater restriction on loan covenants (Dhaliwal, Judd, Serfling, and Shaikh 2016; Campello and Gao 2017; Albuquerque, Papadakis, and Wysocki 2014). For instance, Dhaliwal, Judd, Serfling, and Shaikh (2016) show that a supplier firm with a more concentrated customer base is associated with a higher cost of capital and that the customer-supplier relationship is stronger when the supplier firm is more likely to lose major customers. Also, Campello and Gao (2017)

investigate the impact that the credit market assessment of a firm's supply chain relationship has on bank loan terms. Their study documents that for a supplier firm, major customer dependency is positively associated with interest rate spreads and a lower number of restrictive covenants.

Another significant stream of accounting and finance literature investigates the impacts that the different aspects of having major customers have on corporate policies and characteristics. Several studies focus on the impact of the supplier-customer relationship on corporate financial policy choices such as firm capital structure (Banerjee, Dasgupta, and Kim 2008; Garcia-Appendini and Montoriol-Garriga 2013; Kale and Shahrur 2007; Petersen and Rajan 1997; Titman and Wessels 1988;

Wang 2012; Wilner 2000), corporate innovations (Krolikowski and Yuan 2017), corporate mergers and acquisitions (Fee and Thomas 2004; Shahrur 2005; Bhattacharyya and Nain 2011; Ahern 2012; Ahern and Harford 2014), predictability of stock returns (Cohen and Frazzini 2008), payout policy (Wang 2012), and cash holdings (Itzkowitz 2013). Overall, this line of research suggests that the corporate supply chain relationship has a significant impact on corporate policies.

Specifically, Banerjee, Dasgupta, and Kim (2008) investigate the manner by which the supply chain affects the financing choice of both trading parties. Their study argues that firms that are major customers tend to maintain lower leverage in order to attract more relationship-specific investments. Consistent with their prediction, Banerjee et al. (2008) find that firms that are major customers maintain lower leverage when they have a large number of dependent suppliers. Further, Krolikowski and Yuan (2017) document that customer concentration is associated with relationship-specific investing.

However, when the key customers become more powerful in this contractual relationship, the supplier firms are less willing to invest in R&D and innovations.

Wang (2012) investigates another corporate policy, the impact of the customer-supplier relationship on firm payout policy. His study suggests that a firm's dependence on the customer-supplier relationship is negatively associated with the dividend payout policy. This study concludes that a firm's relationship with its major customers/suppliers is an key determinant of shareholder's wealth.

Itzkowitz (2013) suggests that a supplier firm's dependence on its major customer is positively associated with the number of additional operating risks. Suppliers that depend on major customers hold more cash on average than suppliers that do not have such a dependence. Itzkowitz (2015) also reports that customer firms have the ability and incentive to monitor suppliers, which mitigates potential agency costs. As a result of this additional monitoring, the supplier firm exhibits higher investment-cash flow sensitivity as well as higher cash-cash flow sensitivity.

In addition, several studies examine the effect that having a major customer has on a supplier's accounting policy choices. Bowen et al. (1995) provide empirical evidence to suggest that income-increasing accounting choices are associated with implicit stakeholder claims. Raman and Shahrur (2008) document that a firm's earnings management in one period is positively associated with a supplier's or customer's relationship-specific investment in the next period, consistent with earnings management being used to opportunistically influence the supplier's and customer's perceptions of the firm. Hui, Klasa, and Yeung (2012) argue that both the supplier and the customer require conservative financial reporting because of the presence of asymmetric information and

the payoff between the trading parties. When a firm recognizes bad news more quickly than good news, managers are able to address the moral hazard problem, which facilitates efficient contracting between the firm and its stakeholders. The results of the study suggest that greater bargaining power for suppliers or customers is associated with greater conservatism in their financial reporting.

Research on supply chains has evolved in recent years to examine the link between customer concentration and opportunistic financial reporting. Kim and Luo (2018) use a quasi-natural experiment based on the implementation of the Sarbanes-Oxley Act of 2003 (SOX) to examine the link between customer concentration and earnings management. Their results suggest that in the post-SOX era, high-customer concentration firms had higher accrual-based earnings management than low-customer concentration firms. Kim and Luo (2018) further demonstrate that subsequent to SOX, operating performance, and earnings informativeness increased to a greater degree among firms with low customer concentration.

Cen, Edward, Zhang, and Zuo (2017) investigate whether a firm works with its customers and suppliers to identify and implement income shifting strategies in order to avoid taxes. Their research findings suggest that firms with closer customer-supplier relationships are more likely to engage in tax strategies that involve income shifting to lower tax jurisdiction subsidiaries and that the tax savings garnered from these strategies appear to benefit both the major customer and dependent supplier firms. Overall, the authors indicate that firms are working with their major customer firms and dependent supplier firms to avoid tax.

In terms of the effect of the customer-supplier relationship on internal control and audit outcomes, Bauer, Henderson, and Lynch (2018) document that the supplier firm's internal control quality is negatively associated with the duration of the supply chain relationship. Their results suggest that customers care about the quality of the supplier firm's internal control, which has significant implications for supply chain relationships.

In summary, existing literature recognizes the impact of supply chain relationships on corporate policies, which can enhance the firm's growth and success. However, these studies do not take into account when the government's role as a customer affects corporate behavior. I now shift the focus of my discussion to this type of supply chain relationship between the government and its suppliers.

2.3 Corporate-Government Contracting Relationships and Firm Outcomes

As indicated in the previous section, extant literature recognizes the importance of supply chain relations and corporate outcomes. However, these studies do not consider relationships in which the government is one of the parties to the contract. The US Federal Government is a major purchaser of goods and services, with purchases exceeding $400 billion each year. This large dollar volume suggests that government-supplier contracting may affect corporate behavior.

A few early studies investigating the profitability of government contractors find that these contractors earned higher profits from government contracts. However, these studies provide mixed evidence as to why government contractors are able to generate abnormally high profits. For instance, Reichelstein's (1992) findings suggest that government contractors earn an abnormally high profit from their government business by shifting and charging the overhead and pension costs from commercial operations to

their government contracts. Lichtenberg (1992) confirms these findings and further suggests that government contractors earn almost three times more profit than commercial contractors. His results indicate that government contractors are also significantly less capital-intensive than non-government contractors.

However, McGowan and Vendrzyk (2002) find no evidence that government contractors' abnormal profits are attributable to cost-shifting. Their study finds that abnormal profits result from price renegotiation with the government agency or cost reimbursement. McGowan and Vendrzyk (2002) argue that the unusually high profitability of government contractors is more likely attributable to non-accounting explanations, such as a lack of industry competition.

Recent literature investigates factors that can influence a government agency's decisions to grant contracts to firms. Flammer (2018) investigates the association between corporate social responsibility (CSR) and the likelihood of gaining government procurement contracts. The author argues that a prospective contractor uses CSR reporting to signal its quality and differentiate itself from other competitors in order to influence a government agency's purchasing decision. His results indicate that CSR firms receive more government contracts where the contractor is in a competitive industry. Further, according to Ferris, Houston, and Javakhadze (2019), firms that make larger political contributions are more likely to receive government contracts with favorable terms.

Other research investigates the effect of the corporate-government contracting relationship on corporate outcomes. This line of research generally finds that firms benefit from having a government agency as their major customer because investors and

creditors view these firms as having a lower risk than firms without government contractors. For example , US government contractors hold significantly less cash and have less volatile future earnings than non-governmental contractors (Cohen and Li 2016). Government contractors also enjoy a lower number of covenants and are less likely to have performance pricing provisions in their loan contracts (Cohen, Li, Li, and Lou 2016). More importantly, government contractors tend to have lower equity capital costs (Dhaliwal, Judd, Serfling, and Shaikh 2016).

Continuing this line of research, Cohen and Li (2019) examine whether customer-base concentration has more of a greater impact on profitability for firms contracting with major government customers than for firms contracting with major commercial customers. Their findings suggest that firm profitability increases with a concentration of major government customers but decreases with a concentration of major corporate customers. Further, this study suggests that major government customers have unique and significant influence on firm outcome which different from major commercial customers.

Alternatively, other research considers whether the government effectively monitors its contractors, which reduces problems that arise from information asymmetry. Samuels (2018) investigates whether the government's monitoring of the contractor's internal information process can strengthen the quality of the firm's external reporting. More specifically, she examines whether government contractors have provided more voluntary disclosures, make earnings announcements more quickly, and provide higher quality public information about the contractor. Her results suggest that both having a government contract and a high dollar government contract are positively associated with

the quality of the contractor's external reporting. Moreover, she finds that the quality of external reporting improves once a firm is granted a government contract, as compared to firms that are not awarded government contracts. Huang, Lobo, Wang, and Xie (2017) also show that when firms have the federal government as a major customer, they are associated with lower levels of tax avoidance.

Cheng et al. (2019) find that government contractors issue more precise and accurate management earnings forecasts than non-government contractors. Their results suggest that government agencies have greater bargaining and enforcement power, which enables them to obtain more information about the supplier firm. This results in better public disclosure of management earnings and more accurate forecasts with regard to management earnings. These research findings suggest that the government might play a useful role in the contract process by monitoring its contractors.

Extant research also investigates firm and contract outcomes when the government accuses the contractor of fraudulent activities. Karpoff, Lee, and Vendrzyk (1999) investigate the capital market and legal consequences for defense contractors who have been accused or suspected of federal contracting procurement fraud. The researchers found that the announcement of these allegations is associated with significant negative average abnormal returns for the accused firms. Influential (top 100) contractors, however, are only penalized lightly, resulting in a small decline in market values and government contract revenues.

Similarly, a more recent study by Hesse and Perez-Cavazo (2018) examines whether there are negative consequences to the contracting relationship when the government contractor is accused of defrauding the federal government. Their results

indicate that the filing of a lawsuit does not affect the contractor's total contract dollar volume. However, the agency reduces the amount of cost-plus contracts granted to the accused contractor in order to minimize the risk of potential additional loss from fraud. The results suggest that when government contractors are accused of fraud against federal government, the agency does not terminate any existing contracts but to change the terms of the arrangements for these contractors.Their findings suggest that the government agency is either not effectively monitoring its contractors or has developed a significant dependency on its customers, in which case there is no product substitution for a government agency.

2.4 Summary of Prior Research

There is a large stream of literature that provides an extensive understanding of the impact that a close customer-supplier relationship has on the corporate outcomes of both parties, particularly if the supplier firm uses accounting method choice as a firm-level financial strategy to maintain healthy supply chain relationships (e.g., Bowen, DeCharme, and Shores 1995; Raman and Shahrur 2008). The corporate-government contracting relationship has a significant economic impact on firms, but this has been largely overlooked by prior literature. To date, there is only a limited number of empirical studies on corporate-government contracting and firm-level outcomes. These studies provide mixed findings as to whether government agencies are effectively monitoring their contractors.

To the best of my knowledge, only a limited number of study investigates whether the corporate-government contracting relationship affects the quality of the firm's external reporting. Further, no study examines whether government contractors manage

their accruals more effectively when they operate in environments where industry competition and government switching costs are high.

Chapter 3 Hypothesis Development

In this chapter, I develop my hypotheses, beginning with my first hypothesis regarding the association between the corporate-government contracting relationship and financial reporting quality. I then develop my prediction on whether government contractors manage their earnings more when they operate in environments where industry competition is low, and government switching costs are high.

3.1 Corporate-Government Contracting-related Determinants of Financial Reporting Quality

According to CFR 200.331, government contractors have to disclose their financial information in order to maintain their government contracts. Effective government monitoring deters earnings management because the government can terminate a contract at any given time if it identifies corporate wrongdoing (FAR 49.101). Moreover, government monitoring might be able to distort the incentive alignment, which could mitigate the agency problem inside the firm. Recent studies suggest that government agencies have a positive impact on the quality of contractor and firm external reporting in that management earnings forecasts are more precise and accurate (Cheng et al. 2019), information asymmetry is reduced, and the firm overall transparency is enhanced (Samuels 2018). Thus, government monitoring might help improve a contractor's financial reporting quality for the following reasons.

First, government procurement regulations and additional audit requirements ensure that contractors' financial reports are of high quality. Government contractors are required to submit annual audited financial statements and compliance reports, including a single audit report (CFR 200.331). Base on the CFR, the contractor's independent auditor has to identify whether there is a material weakness in internal control, any instance of material non-compliance with the federal code, any questionable costs related to the federal contract and/or, large and unusual amounts of federal contract-related expenses in comparison to total operating costs. As a result of the additional audit requirements stipulated by the regulations, the corporate-government contracting relationship is likely to be associated with higher financial reporting quality.

Second, government contractors benefit from the predictability of operating cash flows from government contract revenues as well as greater profitability. Dechow and Dichev (2002) show that a higher certainty of future cash flows is associated with a higher accrual quality. Accrual quality is also positively associated with earnings persistence. Therefore, government contractors are less likely to smooth earnings in order to signal private information about future performance to stakeholders (Watts and Zimmerman 1986, Sankar and Subramanyam 2001; Tucker and Zarowin 2006). Consistent with this argument, extant empirical evidence suggests that government contractors are associated with an environment that has better information about the contractors (Samuels 2018), a lower-level of tax avoidance (Hunag et al. 2017), and a lower cost of financing (Cohen and Li 2016; Dhaliwal et al. 2016).

Third, existing empirical research suggests that major customers have the ability and incentive to monitor their key suppliers in order to mitigate potential agency costs

(Itzkowitz 2015). Moreover, FAR regulations have extensively formalized government monitoring policies and procedures for government agencies. These policies and procedures enhance government agency's abilities to monitor contractors' internal control and information processing. Government agencies also constantly update their policies and procedures to ensure the monitoring is adequate. Further, according to the positive accounting theory, firms will choose accounting policies that minimize contract costs (Watts and Zimmerman's 1978). The political cost hypothesis predicts that firms subject to government scrutiny such as government contractors take actions to minimize the probability of negative government actions. Therefore, it is reasonable to believe that corporate-government contracting is associated with higher firm-level financial reporting quality.

Based on the above arguments, my first hypothesis predicts that the corporate-government contracting relationship enhances firm-level financial reporting quality. My first hypothesis is stated as follows:

H1: The corporate-government relationship is associated with higher firm-level financial reporting quality.

Despite this prediction, a negative association is possible given that firms dealing with government agencies are incentivized to disclose optimistic financial reports. Another reason for such an association is provided by existing earnings management literature suggesting that a firm's earnings management can also play an opportunistic role.

In the case of opportunistic financial reporting, agency theory suggests that self-interested contracting parties have the incentive to behave opportunistically in situations

of uncertainty and information asymmetry (e.g., Jensen 1976). Prior studies concur that earnings management can be driven by opportunism (e.g., Raman and Shahrur 2008; Healy and Wahlen 1999). This line of research generally finds that discretionary accruals are used to hide a firm's true underlying economic performance in order to meet certain goals, avoid debt covenant violations (e.g., DeFond and Jiambalvo 1994), and pursue of a higher valuation of seasoned equity offerings. (e.g., Teoh, Welch, and Wong 1998). In the case of government contracting, the contractor firm might use accruals to inflate reported earnings in order to signal to government agencies that it is able to continue to meet its contractual obligations.

In addition, government dependent firms incur additional costs that reduce their liquidity and profitability because the government retains several rights that are not typical of a commercial relationship. Contractors might result in lower profitability from government contracts because government agencies can adjust reimbursable cost rates (FAR 42.705); can unilaterally resolve contract disputes (FAR 33.210) and can terminate a contract at its convenience (FAR 49.101). Thus, government contractors are at increased risk that a government contract will be completed, revised, or terminated, resulting in declining revenue streams and declining liquidity. In this case, the corporate manager is incentivized to manage earnings in order to meet the company earnings' benchmarks for valuation purposes.

3.2 Corporate-Government Relationship and Financial Reporting Quality where Industry Competition and Government Switching Costs Are High

The above arguments imply that government contractors' financial reporting quality might be affected by the corporate-government contracting relationship

depending on the effectiveness of government monitoring. However, the influence and importance of government contracting relationships are not expected to be consistent across all government contractors. In the following paragraphs, I consider two situations in which inconsistencies may arise: industry competition and government switching costs.

Firms disclose superior financial positions to signal their future prospects (Spence 1973), commitment, and ability to compete, thereby deterring rivals (Bhattacharya and Ritter 1983; Baker and Mezzetti 2005; Anton and Yao 2004). The theory of competition (Nutter and Moore 1976) predicts that corporate managers take actions to ensure the completion of transactions in competitive markets when they expect that the outcome of the transaction will bring more benefits than costs. As a result, the use of signaling as a differentiation strategy is especially important for firms that operate in industries with larger number of competitors. In such industries, the need to differentiate (either through cost or quality) in order to remain competitive and ensure firm survival is higher (Nutter and Moore 1976).

Moreover, higher competition may trigger companies to engage in unethical or other forms of adverse behavior (e.g., Bennett, Pierce Snyder, and Toffel, 2013). Raman and Shahrur (2008) provide evidence that earnings management is used opportunistically to influence suppliers' and customers' perceptions of a firm's prospects. This is because industry leadership drives the market power of a firm (Nutter and Moore 1976). However, it is also possible that the firm produces a higher quality of financial reports to signal its quality in order to succeed in competing for a government contract in a high competition industry.

Opposite outcomes are expected for firms in industries with less competition for government contracts. For example, the weapon and ammunition industry typically ranks among the least competitive industries in the US (e.g., Mahajan 2006). As a result, contractors in the defense industry are less likely to differentiate themselves using opportunistic financial reporting, which results in higher financial reporting quality in comparison to firms in more competitive industries.

In addition, product-market power within an industry increases a firm's ability to get its customers to pay higher prices while having a negative impact on demand. Firms that are in lower competition industries and have unique products are often associated with greater flexibility in terms of their capacities to respond to unexpected changes, which in turn enhances the stability of cash flows and lowers stock volatility (Peress 2010).

Accordingly, I expect that contracting with the government will result in higher financial reporting quality for firms in less competitive industries. The above argument generates the following hypothesis:

H2a: The increased financial reporting quality associated with corporate-government contracting is less for government firms in industries with higher competition for government contracts.

I also consider the existence of high government switching costs. Coase's (1937) transaction-based theory suggests that trading transactions create an ex-post incentive problem for both supplier and customer. A firm that deals with both the input and output market make relationship-specific investments (Bowen, DuCharme, and Shores 1995). These investments aim to create high switching costs for the firm's customers and

suppliers, who will lose some or all of the expected value from their investments if they default on the associated contracts.

In a similar vein, Porter's (1980) competitive strategy theory suggests there is a bargaining power shift from the government to the contractor when contractor establishes a competitive advantage by differentiating relative to its rivals. One such case is that government contractors create higher switching costs for government agencies through relationship-specific investment that target the needs of government agencies. The higher switching cost argument is consistent with the empirical findings discussed in the previous chapter, which suggests that government agencies become more dependent on government contractors and that that the contracting relationship is not terminated even in extreme cases when contractors are accused of fraud against the government. (e.g., Karpoff, Lee, and Vendrzyk 1999; Hesse and Perez-Cavazo 2018).

This leads to my final hypothesis:

H2b: The increased financial reporting quality associated with corporate-government contracting is less for government contractors when the government has higher switching costs.

Chapter 4 Research Design

In this section, I present the research design used to test my hypotheses. I first discuss government contracting and financial reporting quality variables. Then, I define the models used to test my hypotheses concerning the association between corporate-government contracting and financial reporting quality.

4.1 Corporate-Government Contracting Variables

I examine the association between government contracts awards and the financial reporting quality of the contracting firms, controlling for the known determinants of these two constructs. First, I identify firms that have an existing corporate-government contracting relationship in a given year. Therein, I measure the GovContract as an indicator variable equal to one if the company is a government contractor in a given year, and zero otherwise.

I also use ContractSize, a continuous measure of contract award size relative to a firm's total sales (e.g., Mills, Nutter and Schwab 2013; Samuel 2018). The impact of the corporate government contracting relationship on the contractor's financial reporting quality might vary with the importance of the government contracts to the contractor. Because ContractSize is heavily right-skewed, I follow a prior study (e,g. Samuel 2018) by transforming the variable into decile ranks scaled from 0 to 1. This transformation has

the advantage of being robust to both outliers and nonlinearities and eases the interpretation of the results.[4]

4.2 Financial Reporting Quality Variables

I conduct tests of my hypotheses using multiple measures of financial reporting quality, including accruals management, internal control material weaknesses, and financial restatements.

The first construct for financial reporting quality is discretionary accruals, which I capture using the Kothari, Leone, and Wasley's (2005) performance-matched discretionary accruals measure. Prior studies argue that the modified Jones (1991) model does not capture a firms' earnings management when financial performance is extreme, resulting in potentially incorrect inferences and model misspecification. Building on the modified Jones model and Dechow et al. (1995), Kothari et al. (2005) use a control sample to create performance-matched discretionary accruals in order to identify abnormal earnings management. This performance-matched discretionary accrual model adjusts for industry and year performance. A greater value of discretionary accrual value indicates more earnings management.

I first construct a matched sample based on the firm's closest return on assets (ROA) in the same year. I then estimate the following model (Equation 1) annually in each three-digit SIC industry with more than 15 observations.

$$TA_{i,t}/A_{i,t-1} = \beta_1(1/A_{i,t-1}) + \beta_2(\Delta REV_{i,t}/A_{i,t-1} - \Delta REC_{i,t}/A_{i,t-1}) + \beta_3(PPE_{i,t}/At-1) + \beta_4(ROA_{i,t}) + \beta_5(MB_{i,t}) + \varepsilon_{it,} \quad (1)$$

[4] For example, the estimated regression coefficient measures the change in the respective measure of financial reporting quality when moving from the bottom decile to the top decile of contract size, ceteris paribus).

where TA is total accruals, A represents total assets, ΔREV is the change in revenues, ΔREC is the change in net receivables, and PPE represents the amount of property, plant, and equipment, ROA is defined as the net income before extraordinary items scaled by lagged total assets, and MB is the ratio of the book value of net assets scaled by the market capitalization. The residual from Equation (1) proxies for discretionary accruals. I then take the absolute value of the discretionary accruals (AbsAccruals) to capture a firm's financial reporting quality. Greater AbsAccruals indicate poorer financial reporting quality.

My next construct for financial reporting quality is the accruals quality measure developed by Dechow and Dichew (2002) and modified by McNichols (2002). Dechow and Dichev (2002) document that working capital accruals are affected by cash flows by mapping the working capital accruals into operating cashflows. McNochols (2002) modified the measure by including property, plant and equipment, and changes in sales. Following Ball and Shivakumar (2006) as well as Dou, Khan, and Zou (2016), I estimate the following model annually in each three-digit SIC industry with more than 15 observations:

$$\text{TotalAccruals}_{i,t} = \beta_0 + \beta_1 \text{CFO}_{i,t-1} + \beta_2 \text{CFO}_{i,t} + \beta_3 \text{CFO}_{i,t+1} + \beta_4 \Delta\text{SALES}_{i,t} + \beta_5 \text{PPE}_{it} + \varepsilon_{i,t} \quad (2)$$

where TotalAccruals, is computed as earnings before extraordinary items minus cash flow from operating activities from the statement of cash flows, CFO is cash flow from operating activities, ΔSALES is the year to year change in total sales, and PPE is gross property, plant, and equipment. All the variables are scaled by average total assets. The

residual from Equation (2) is the accrual quality measure (AccrualQuality). Greater values of AccrualQuality indicate poorer financial reporting quality.

A firm's financial reporting quality is a reflection of its willingness to put a strong internal control structure in place to ensure that financial reports are of adequate quality. Consequently, my third construct for financial reporting quality is the presence of an internal control material weakness. Internal control material weakness data is collected from the Audit Analytics database. I am interested in internal control material weaknesses reported since 2004 by either management or auditor and under the provisions of SOX 302 and SOX 404. I use two measures of internal control quality. First, I define IneffControls as an indicator variable equal to one if there is a general (systemic) material weakness in internal controls reported under either SOX 302 or SOX 404 in a given year, and zero otherwise. Second, I define NumWeaknesseses as the number of material weaknesses that are reported under either SOX 302 or SOX 404.

Restatements capture the failure of a firm's financial reporting process. Restatement data is obtained from the Audit Analytics database that tracks the restatements by publicly-traded firms since 2000. For each restatement event, Audit Analytics provides the nature of the restatement, the accounts involved, and the period of the restatement. For this study, I use two measures for restatements. I first identify which years of the government contractor's financial statements are subsequently restated. Restatement is an indicator variable equal to 1 if the government contractor's financial statement for that year is subsequently restated, and zero otherwise. My second measure of restatements captures intentional misstatements. Taking Hennes, Leone, and Miller (2008)'s suggestion that it is important to distinguish error and irregularities in

restatement research, my second restatement measure captures restatements that were followed by fraud-related class action lawsuits. Therefore, FRAUD is an indicator variable equal to 1 if the government contractor's financial statement for that year is subsequently restated due to fraud-related class action lawsuits, and zero otherwise.

4.2.1 Corporate-Government Relationship and Accounting Accruals

I test (H1) on the relationship between corporate-government contracting and discretionary accruals, and accruals quality, via Han, Lang, Seybert, and Wang (2017)'s empirical model in order to explain accruals management. This leads me to estimate the following:

$$\begin{aligned} AM_{it} = {} & \beta_0 + \beta_1\, CORP\_GOV_{i,t} + \beta_2\, lnAsset_{i,t} + \beta_3\, M/B_{i,t} + \beta_4\, FirmAge_{i,t} + \\ & \beta_5\, Leverage_{i,t} + \beta_6\, Loss_{i,t} + \beta_7\, CfoVolit_{i,t} + \beta_8\, SalesVol_{i,t} + \\ & \beta_9\, \%\Delta CashSales_{i,t} + \beta_{10}\, \Delta ROA_{i,t} + \beta_{11}\, NI/P_{i,t} + \beta_{12}\, CeoChair_{i,t} + \\ & \beta_{13}\, lnAnalyst_{i,t} + \beta_{14}\, ACSize_{i,t} + \beta_{15}\, Independence_{i,t} + \beta_{16}\, ACExperts_{i,t} + \\ & \beta_{16}\, Big4_{i,t} + \beta_{17}\, LnAudtenure_{i,t} + Fixed\ Effects + \varepsilon_{i,t} \end{aligned} \quad (3)$$

where variables are defined in Appendix A. I alsoinclude year and two-digit SIC industry fixed effect in my estimation to mitigate the impact of time-invariant year and industry characteristics. Standard errors are clustered by firm. In this and all subsequent equations, the suscripts i,t are associatied with firm i in year t.

I use two accruals management (AM) proxies in the hypothesis testings. The first EM proxy is discretionary accruals (AbsAccruals), and the second EM proxy is accruals quality (AccrualQuality). The key variable of interest is the presence of a corporate-government relationship (CORP_GOV). I use two measures of CORP_GOV. The first measure is GovContract, and it is defined as an binary variable equal to one if a firm has

a government agency as a customer in a given year. The second measure is ContractSize, and it is the decile ranks of contract award size relative to the firm's total sales. Consistent with H1, I expect a significant negative coefficient on CORP_GOV (both GovContract and ContractSize). A negative coefficient on CORP_GOV suggests that a government contractor is less likely to engage in accruals management and hence, have higher financial reporting quality.

I include several firm characteristics that might influence the level of discretionary accruals. Firm size (lnAsset) is a key determinant of accruals quality, and internal controls (e.g., Kinney and McDaniel 1989; Ge and McVay 2005). Larger firms have better financial reporting processes and procedures in place to ensure the quality of accruals. I expect the coefficients of lnAsset to be negative, indicating that larger firms are associated with higher accruals quality.

Firm age (FirmAage) is an indication of firm maturity. Younger firms are less likely to have established procedures. Thus, I expect the coefficient of FirmAage to be negative, indicating that younger firms have lower accruals quality. Market to book ratio (M/B) and leverage (Leverage) capture growth opportunities and default risk. High growth firms and firms with high default risk are more likely to choose accounting procedures that shift reported earnings from a future the period to the current period (e.g., Watts and Zimmerman 1986), resulting in higher discretionary accruals. I expect the coefficients on both M/B and Leverage to be positive.

Prior work suggests that firm financial performance influences the level of accruals management. I control for the change in return-on-asset (ΔROA), losses (Loss), and percentage change in sales (%ΔCashSales). I expect firms experiencing financial

difficulties may pay less attention to the financial reporting process. Thus, I expect the coefficients on ΔROA, Loss, and %ΔCashSales to be positive. Dechow and Dichev (2002) suggest that cash flows and sales volatility are significantly associated with accruals. As a result, I control for both. Higher cash flow sales volatility is associated with higher levels of earnings management (e.g., Garrett et al. 2014). I expect the coefficients of CfoVolit, and SalesVol to be positive, reflecting management's incentive to smooth earnings for compensation incentives (e.g., Jayaraman 2008). Lastly, I control for the earnings to price ratio (E/P) in order to reflect investors'anticipated demand for earnings growth in future periods. A higher earnings to price ratio might be associated with higher/lower earnings quality (Han, Lang, Seybert, and Wang 2017). Therefore, I do not predict the sign of the coefficient on E/P. Additionally, I control for the number of analysts following (LnAnalyst) in order to capture the amount of external monitoring. Higher external monitoring should restrict management's ability to manage earnings, resulting in a higher level of accruals quality. I expect the coefficient of LnAnalyst to be negative.

Firm governance characteristics are also a key determinant of a firm's financial reporting quality. I control for CEO duality (CeoChair), where the CEO is the chairman of the board. Agency theory argues that powerful CEOs have managerial discretion to manipulate earnings in order to meet personal goals. I expect the coefficient of CeoChair to be positive. I also control for audit committee size (ACSize). ACSize is the number of audit committee members on the board. Audit committee financial expertise (ACExpert) is the percentage of audit committee members with financial expertise, and board independence (Independence) is the proportion of independent board members to total

board members. Prior work suggests that audit committee financial expertise (ACExpert) and independent boards of directors (Independence) are better able to monitor earnings management in order to ensure the quality of financial reports (e.g., DeFond, Hann, and Hu 2005; Dhaliwal, Naiker, and Navissi 2010; Carcello, Hermanson, Neal, and Riley 2002). Thus, I expect the coefficients on ACExpert and Independence to be negative. While prior work shows that audit committee size may impact earnings management (Klein 2002), the empirical evidence is mixed (e.g., Larcker, Richardson, and Tuna 2007). As a result, I do not predict the coefficient of ACSize. Finally, I control for big 4 auditors (Big4), and auditor tenure (LnAudtenure) since prior studies find these variables have a significantly positive impact on financial reporting quality (e.g., Carcello et al. 2011). I expect the coefficients on both LnAudtenure and Big4 to be negative.

4.2.2 Corporate-Government Relationship and Internal Control Material Weakness

In addition, I test whether government contractors are associated with stronger internal control quality. To conduct this test, I again construct the internal control material weakness model based on Han, Lang, Seybert, and Wang (2017). Based on my first hypothesis, I expect that government contractors are more willing to put strong internal control structures in place in order to ensure the quality of financial reports. I test the relationship between the corporate-government relationship and internal control material weaknesses via the following model:

$$\begin{aligned} ICMW_{i,t} = {} & \delta_0 + \delta_1 CORP\_GOV_{i,t} + \delta_2 lnAsset_{i,t} + \delta_3 M/B_{i,t} + \delta_4 FirmAge_{i,t} + \\ & \delta_5 Leverage_{i,t} + \delta_6 \%Loss_{i,t} + \delta_7 SalesGrowth_{i,t} + \delta_8 Inventories_{i,t} + \\ & \delta_9 LnAuditFee_{i,t} + \delta_{10} CeoChair_{i,t} + \delta_{11} LnAnalyst_{i,t} + \delta_{12} ACSize_{i,t} + \\ & \delta_{13} Independence_{i,t} + \delta_{14} ACExperts_{i,t} + \delta_{15} Big4_{i,t} + \end{aligned}$$

$$\delta_{16} \text{ LnAudtenure}_{i,t} + \text{Fixed effects} + \varepsilon_{i,t} \quad (4)$$

where variables are defined in Appendix A. I again include year, and two-digit SIC industry fixed effect in my estimation to mitigate the impact of time-invariant year and industry characteristics. Standard errors are clustered by firm.

I use two internal control weakness (ICMW) proxies in the empirical test. The first ICMW proxy is IneffControls, defined as equal to one if the firm reports a material weakness in internal controls in a given year and zero otherwise in a logistic specification. The second ICMW proxy is NumWeaknesses, defined as the number of material weaknesses in an ordinal logistic specification. Consistent with H1, a negative coefficient on the CORP_GOV suggests that a firm with the government as a customer is less likely to receive an ICMW, corresponding to a higher level of financial reporting quality.

I follow prior studies (e.g., Han, Lang, Seybert, and Wang 2017; Krishnan 2005 and Ashbaugh-Skaife, Collins, and Kinney 2007) in first controlling the number of years that the firm reports negative earnings for in the prior four years (%Loss). I then control for inventory (Inventory), defined as inventories scaled by total assets. Sales growth (SalesGrowth) is the cumulative percentage change in sales over the prior three years. Inventory, % Loss, and SalesGrowth are measures of a firm's operating risk and business complexity. A risky firm with higher business complexity is associated with a higher probability of internal control weaknesses (ICMW). Thus, I expect %Loss, SalesGrowth, and Inventory to be positively associated with ICMW. The remaining control variables have been found by the prior study to have associations with an internal control (Han, Lang, Seybert, and Wang 2017; Krishnan 2005 and Ashbaugh Skaife, Collins, and

Kinney 2007) and were previously used in the discretionary accruals regressions to predict internal control material weaknesses. These variables are as previously defined.

4.2.3 Corporate Government Relationship and Restatements

The final test examines the consequence of the quality of financial statements. To the extent that firms with government contracts have a lower tendency to misreport, I expect to find a decreased likelihood that financial statements are misreported. Firms rarely restate their financial statements, and restatements do not capture all types of misreporting. However, the restatement tests represent a more objective and the outcome of misreporting. I test the relationship between the corporate-government contracting relationship and the probability of a financial restatement via the following model:

$$\begin{aligned}\text{Prob}(\text{Restate}_{i,t}=1) = F(\ & \delta_0 + \delta_1\ \text{CORP\_GOV}_{i,t} + \delta_2\ \text{lnAsset}_{i,t} + \delta_3\ \text{M/B}_{i,t} + \\ & \delta_4\ \text{FirmAge}_{i,t} + \delta_5\ \text{Leverage}_{i,t} + \delta_6\ \Delta\text{Inventories}_{i,t} + \\ & \delta_7\ \Delta\text{Receivables}_{i,t} + \delta_8\ \text{LnAuditFee}_{i,t} + \delta_9\ \%\Delta\text{CashSales}_{i,t} + \\ & \delta_{10}\ \text{E/P}_{i,t} + \delta_{11}\ \Delta\text{ROA}_{i,t} + \delta_{12}\ \text{CeoChair}_{i,t} + \delta_{13}\ \text{LnAnalyst}_{i,t} + \\ & \delta_{14}\ \text{ACSize}_{i,t} + \delta_{15}\ \text{Independence}_{i,t} + \delta_{16}\ \text{ACExperts}_{i,t} + \\ & \delta_{17}\ \text{Big4}_{i,t} + \delta_{18}\ \text{LnAudtenure}_{i,t} + \text{Fixed effects} + \varepsilon_{i,t}\ ) \end{aligned} \quad (5)$$

where variables are defined in Appendix A. I include year and two-digit SIC industry fixed effect in my Logit estimation to mitigate the impact of time-invariant year and industry characteristics Standard errors are clustered by firm.

I use two measures for restatements (Restate). Restatement (Restatement) is an indicator variable equal to 1 if the government contractor's financial statement for that year is subsequently restated, and zero otherwise. My second measure of restatement

(FRAUD) is an indicator variable equal to 1 if the government contractor's financial statement for that year is subsequently restated due to fraud-related class action lawsuits, and zero otherwise. Consistent with H1, a negative coefficient on the CORP_GOV suggests that a government contractor is less likely to restate the financial statements and hence, have higher financial reporting quality.

I also control for ΔInventories and ΔReceivables, which are the changes in inventory and accounts receivable scaled by average total assets in the past year, respectively. Prior work suggests that an increase in working capital and a decrease in cash sales is associated with earnings management and a higher probability of future restatements (e.g., Beneish 1999; Dechow et al. 2011). The remaining control variables have been found to predict misreporting (e.g., Dechow et al. 2011; Armstrong et al. 2013) and are those previously used in the discretionary accruals models. These variables are as previously defined.

4.2.4 Government Contracting Market Competition and Government Switching Costs

I modify Equations (3), (4) and (5) to test H2 regarding whether the effect of the corporate-government contracting relationship on financial reporting quality is stronger when contractor firms are in a lower competition industry, or the government has higher switching costs.

To test H2a, I first compute the government contracting market concentration. I use the Herfindahl-Hirschman index formula and the three-digit SIC industry classification as follows:

$$HH_{GOV_{i,j}} = \sum_{i=1}^{n_j} S_{i,j,t} \quad (6)$$

where $S_{i,j,t}$ is the market share of government sales in firm i and industry j in year t. The range of this measure lies between 0 and 1, with a high HH_Gov index suggesting less competition in the identified industry.

I modify Equations (3), (4), and (5) to include government contract market concentration (HHIGov) as the main effect and interact it with corporate-government contracting variables (GovContract and ContractSize). The HHIGov index measures competition in the government contracting market. The range of this measure lies between 0 and 1, with a high HHIGov index suggesting less competition in the identified industry. The interaction term captures whether government contractors with lower industry competition are associated with higher financial reporting quality. I predict a negative coefficient on the interaction term (Hypothesis 2a), suggesting that government contractors in lower competition industries exhibit a lower level of accruals management, lower probability of internal control material weakness, and fewer restatements. HH_Gov index is also included as a main effect for completeness, but I make no prediction.

For H2b, I modify Equations (3), (4), and (5) to include the proxy variable for government switching costs (GovSC) as the main effect and interact in with the corporate-government contracting variables (GovContract and ContractSize). I define GovSC based on the length of the corporate-government contracting relationship. I then estimate the modified Equations (3), (4), and (5) to include the GovSC and the interaction term with corporate-government contracting variables (GovContract and ContractSize). I expect a significant positive coefficient for the government contract relationship variables (Hypothesis 2b), and the interaction term captures whether government contractors with

high government switching costs are associated with lower financial reporting quality. GovSC is also included as a main effect for completeness; however, I make no prediction as to its sign.

Chapter 5 Sample Selection And Descriptive Statistics

5.1 Sample Selection

Data on government contractors come from the Federal Procurement Data System (FPDS). The FPDS contains information on all government contracts and contract modifications beginning in the fiscal year 2000. The U.S. government has disclosed detailed information on government contracts that are above $25,000, including the total contract value, information about the contractor, and the federal agency. I download the government contracts information from the USAspending.gov website to create variables to test my hypotheses.

I use CRSP and COMPUSTAT datasets to obtain my required financial and accounting data over the period from 2001 to 2017. Following prior studies, I delete firms in highly regulated industries (banking and utilities), which results in 115,572 firm-year observations. I then combine these observations with my contract data. As the contract data does not contain common identifiers such as GVKEY or PERMNO. I therefore use a fuzzy-match of the parent company names to the names of COMPUSTAT companies, and hand-check identified pairs to ensure proper matching. I aggregate all government contracts information by matched firm and year.

I first eliminate 41,392 and 8,712 firm-year observations with missing data to compute the discretionary accruals and control variables, respectively. Next, I eliminate additional 6,480 firm-year observations with missing audit information after merging the data with Audit Analytics. This gives me a sample size of 58,988 firm-year observations for the period 2001–2017 to estimate the discretionary accruals and restatement models. Since the internal control material weakness data is only available after 2004, I use the second sample of 48,208 firm-year observations for the period 2005-2017 to estimate the internal control material weaknesses models. Table 1 presents the sample construction.

<Insert Table 1>

Table 2, Panel A provides the sample distribution by year. The annual distribution is fairly constant across years both in the government contractor sample and the total sample. Sample distributions by the two-digit SIC industry classification are presented in panel B of Table 2. The sample covers a wide range of industries. Agriculture and forestry and construction firms represent the least at 0.29% and 0.58% of my sample, whereas manufacturing firms are the largest sector representing 55.77% of my sample.

<Insert Table 2>

Table 3, Panel A provides the distribution of government contracts amount by year. The total government contracts per year in my sample range from $75 billion in 2001 to $146 billion in 2017. Consistent with prior studies (e.g., Mills, Nutter, and Schwab 2013, and Samuels 2018), government contractors have an average annual contract value of about 2 to 4 percentage of total firm sales. Panel B of Table 3 provides the distribution of government contracts amount by industry. The manufacturing industry received $1 trillion from 2001 to 2017, which is the highest amount of government

contract awards among other industries. The energy industry receives the least at about $5 billion in government contracts.

<Insert Table 3>

5.2 Descriptive Statistics

Panel A Table 4 presents descriptive statistics for the Equation (3) – (5) variables. The mean value of CorpGov is 0.271, which indicates that, on average, about 27% of the sample firms are government contractors. The mean value of ContractSize indicates about 31% of the contracting firms in my sample report government agencies as a major customer. The descriptive statistics show that on average, the sample firms are characterized as larger, profitable, lower leverage, and a lower inherent risk, as indicated by mean total assets of approximately $249 million, mean change of 0.5% in return on assets, total debt representing about 23.8% of total assets, and inventory representing 11% of total assets. The average firm is ten years old. The descriptive statistics also show that, on average, the mean audit committee size and board independence for the sample firms are 2.62 directors and 44.9%, respectively. Furthermore, 29% of audit committee members have financial expertise, and 36.7% of my sample firms are audited by one of the Big four auditors and have several years of auditor tenure. Overall, our sample statistics are similar to those reported by prior research (e.g., Mills, Nutter, and Schwab 2013, and Samuels 2018).

In Panel B of Table 4, I compare sample firm-year observations with and without government contracts. The univariate tests show that firms with government contracts are characterized by significantly lower discretionary accruals and a lower probability of restatements than non-government suppliers. This significant difference in discretionary

accruals and restatement numbers provides initial support for H1. The statistics also show that government contractors are significantly larger, more profitable, more mature, better at corporate governance, and subject to more external monitoring.

<Insert Table 4>

The Pearson correlation coefficients of the model variables are presented in Table 5. The correlations between discretionary accruals and government contracting variables and the correlation between restatements and government contracting variables are negative and significant at a 1% level. This is consistent with the argument put forth by H1, which predicts that the government contractors produce better financial reports. All the significant pair-wise correlations are less than 0.50, with the exceptions of lnAsst and CeoChair, ACSize and ACExperts, lnAnalyst, and lnAuditfee, which were expected. I also conduct multicollinearity tests and find that VIFs for the independent variables are well below 5; Therefore, multicollinearity should not be a concern in my setting.

<Insert Table 5>

Chapter 6 Empirical Results

6.1 Corporate-Government Contracting and Financial Reporting Quality

6.1.1 Discretionary Accruals

Table 6 report the results of estimating Equation (3) using the ordinary least squares regression (OLS). The reported t-values are based on heteroscedasticity robust standard errors adjusting for clustering at the firm level, given the control of the overall industry and year effects. Panel A of Table 6 reports results with AbsAccurals as dependent variables. GovContract (Model 1) and ContractSize (Model 2) are the key variables of interest in each model. The adjusted R^2 for the estimation is 18.46% for Model 1. The estimated coefficient on the GovContract is negative and significant (-0.007, p-value < 0.01), which is consistent with my prediction that the government contractors are associated with a lower level of the absolute value of discretionary accruals. The adjusted R^2 for the estimation is 18.45% for Model 2. The estimated coefficient on the ContractSize is negative and significant (-0.008, p-value < 0.01), consistent with the argument that the government contract values are negatively associated with the absolute value of discretionary accruals.

I observe a negative and significant coefficient on lnAsset, FirmAge, lnAnalyst, ACExperts, Independence, Big4, and LnAudTenure. These results are in line with my prediction that larger, more mature, firms have a larger portion of audit committee members with the financial expertise, or that more independent board members are

associated with lower discretionary accruals. Moreover, Big4 auditors with longer auditor tenure help reduce the level of discretionary accruals. I also observe a positive and significant coefficient on Leverage, Loss, CfoVolit, and %ΔCashSales. These results are also in line with my prediction that firms with operational issues are associated with higher discretionary accruals. Significant estimated coefficients for the other control variables are consistent with my expectations except for the significant coefficient on SaleVol. However, SaleVol is only marginally significant. The results support H1.

Panel B of Table 6 reports results with AccrualQuality as dependent variables. GovContract (Model 1) and ContractSize (Model 2) are the key variables of interest in each model. The adjusted R^2 for the estimation is 3.24% for Model 1. The estimated coefficient on the GovContract is negative and significant (-0.002, p-value < 0.01), consistent with the argument that government contractors are associated with higher accruals quality. The adjusted R^2 for the estimation is 3.25% for Model 2. The estimated coefficient on the ContractSize is negative and significant (-0.003, p-value < 0.01), consistent with the argument that government contract value is associated with better accruals quality. The results of my control variables are similar to those reported in Panel A, which shows my finding that larger, more mature firms or firms that have greater external monitoring are associated with higher accruals quality. Firms that are experiencing operational difficulties or have powerful CEOs are associated with lower accrual quality. Significant estimated coefficients for the other control variables are consistent with my expectations except for the significant coefficient on Loss and %ΔCashSales. These results are consistent with those reported by Ham, Lan, Seybert, and Wang (2017). Again, the results support H1.

<Insert Table 6>

6.1.2 Internal Control Weaknesses

Table 7 present the results of estimating Equation (4) using Logit specifications.[5] The reported z-statistics are based on heteroscedasticity robust standard errors adjusting for clustering at the firm level and include industry and year fixed effects. The dependent variable in Panel A of Table 7 is IneffControls. Pseudo R^2 for the estimation is 10.29% for Model 1. The estimated coefficient on the GovContract is negative and significant (-0.202, p-value < 0.01), consistent with the argument that government contractors are associated with a lower probability of material internal control weaknesses. The Pseudo R^2 for the estimation is 10.28% for Model 2. The estimated coefficient on the ContractSize is negative and significant (-0.237, p-value < 0.01), consistent with the argument that the government contract value is negatively associated with a lower probability of internal control weaknesses. My results from using material internal control weaknesses as my construct for financial reporting quality support H1.

Panel B of Table 7, which uses a multinomial logit regression, reports results with NumWeaknesses as the dependent variable. The pseudo R^2 for the estimation is 7.75% for Model 1. The estimated coefficient on the GovContract is negative and significant (-0.202, p-value < 0.01), consistent with the argument that the government contractors are associated with a lower number of internal control weaknesses. The Pseudo R^2 for the estimation is 7.74% for Model 2. The estimated coefficient on the ContractSize is negative and significant (-0.237, p-value < 0.01), consistent with the argument that the

[5] N= 47,280 Internal control weakness data coverage start at 2004. Therefore, there are fewer observations for internal control weakness tests.

government contract value is associated with a lower number of internal control weaknesses. Again, the results support H1.

In both Panel A and Panel B of Table 7, I observe a negative and significant coefficient on lnAsset, FirmAge, and lnAnalyst, indicating that large firms, mature firms, or those with greater external monitoring are associated with better internal controls. Further, firms that have more AC members with financial expertise, a Big4 Auditor, or a longer auditor tenure are associated with a lower probability of having a material weakness in internal control. The significant estimated coefficients for the other control variables are consistent with my expectations and consistent with results reported in prior research (e.g., Ham, Lan, Seybert, and Wang 2017).

<Insert Table 7>

6.1.3 Restatements

Table 8 present the final tests for financial reporting quality using Restatements and FRAUD as dependent variables. Panel A and Panel B report the results of estimating Equation (5) using Logit specifications, including industry and year fixed effects. The reported z-statistics are based on heteroscedastic robust standard errors at the firm level. Restatement is the dependent variable in Panel A of Table 8. Pseudo R^2 for the estimation is 2.92% for Model 1 and is 2.91% for Model 2. The estimated coefficients on the GovContract and ContractSize are negative and significant (-0.095, -0.107, p-value < 0.05 p-value < 0.05, respectively). These results are consistent with the government contractors being associated with a lower probability of restatements. When reporting quality is defined as restatements, my results again support H1.

Panel B of Table 8 reports the results with FRAUD as dependent variables. The Pseudo R^2 for the estimation is 4.80% for Model 1 and 4.81% for Model 2. The estimated coefficients on the GovContract and ContractSize are negative and significant (-0.249, p-value < 0.01; and -0.312, p-value < 0.10), respectively. These results are consistent with the argument that the government contractors are associated with lower probabilities of financial statement fraud. Again, the results support H1.

In both Panel A and Panel B of Table 8, I observe a negative and significant coefficient on lnAsset, FirmAge, and lnAnalyst. results are similar to those reported in Table 6 and 7, and 8 indicate that firms which are larger, more mature, or have greater external monitoring are associated with a lower probability of restatements. Higher leverage firms, firms that require more audit efforts, or firms that with a greater percentage change in sales are associated with a higher probability of restatements. Significant estimated coefficients for the other control variables are consistent with my expectations.

<Insert Table 8>

6.2 Corporate-Government Contracting and Financial Reporting Quality in Industries with Higher Competition for Government Contracts

6.2.1

6.2.2 Discretionary Accruals

In Table 9, I present the results testing H2a, which involved adding HHIGov as the main effect and interaction with GovContract or ContractSize to Equation (3). HHIGov is a continuous variable that lies between 0 and 1, with a high HHIGov index suggesting a less competitive in the given industry. As a result, the larger HHIGov index

indicates a lower level of industry competition for government contracting. I predict that the interaction terms will be negative, indicating that government contractors operating in low competition industry are associated with higher financial reporting quality. I estimate the modified model using industry and year fixed effects. The explanatory power and significant control variables for both models are similar to those reported in Table 6.

Panel A of Table 9 presents the results using AbsAccruals as the dependent variable. The estimated coefficients of the interaction of and significant in both estimations (0.048, p-value < 0.01; and 0.056, p-value < 0.01), supporting H2a. When industry competitions for government contracts are lower, these government contractors appear to have a higher level of discretionary accruals than those who have government contractors in the higher competition industries. The main effects for GovContract and ContractSize are again negative and significant (-0.012, p-value < 0.01; and -0.014 p-value < 0.01), supporting H1 that government contractors only have a lower level of discretionary accruals when they are in higher competition industries.

Panel B Table 9 presents the results using AccrualQuality as the dependent variable. The estimated coefficients for the interaction term in both estimations are positive and significant (0.012, p-value < 0.01; and 0.015, p-value < 0.01), not supporting H2a. When the industry competition for government contracts is lower, these government contractors appear to have a lower level of accruals quality as compared to those who have government contractors in higher competition industries. The main effects for GovContract and ContractSize are again negative and significant (-0.004, p-value < 0.01; and -0.004 p-value < 0.01), supporting H1, consistent with government contractors in higher competition industries having higher accruals quality.

<Insert Table 9>

6.2.3 Internal Control Material Weakness

In Table 10, I present the results of testing H2a using internal control material weakness as my construct for financial reporting quality. HHIGov is included as the main effect and interaction with GovContract and ContractSize to Equation (4). I estimate the modified model using industry and year fixed effects. The explanatory power and significant control variables for both models are similar to those reported in Table 7.

Panel A of Table 10 presents the results of using IneffControls as the dependent variable. The estimated coefficient of the interaction are statistically significant in both estimations (-1.035, p-value < 0.05; and -1.198, p-value < 0.05), supporting with H2a. When industry competition for government contracts is lower, government contractors appear to have a lower probability of internal controls material weakness than government contractors in higher competition industries. The main effects of GovContract and ContractSize are negative but insignificant, indicating that government contracting competition has a dominating impact on government contractor's material weakness in internal controls.

Panel B of Table 10 presents the results of using NumWeaknesses as the dependent variable. The estimated coefficients of the interaction are again statistically significant in both estimations (-1.011, p-value < 0.05; and -1.156, p-value < 0.05), supporting H2b. However, the main effects of GovContract and ContractSize are again negative but insignificant, indicating that government contracting competition has a dominating impact on government contractor's material weakness in internal controls.

Overall, the internal control weakness analysis supports my prediction that government contractors have higher financial reporting quality when operating in a low competition industry where competition for government contracting is lower.

<Insert Table 10>

6.2.4 Restatements

In Table 11, I present the results of using restatements to test H2a. I add HHIGov as the main effect and interaction with GovContract and ContractSize to Equation (5). I estimate the modified model using industry and year fixed effects. The explanatory power and significant control variables for both models are similar to those reported in Table 8.

Table 11 Panel A presents results using restatements as the dependent variable. The estimated coefficient of the interaction is insignificant in both estimates. Table 10 Panel B presents the results of using FRAUD as the dependent variable. Again, the estimated coefficient of the interaction is insignificant in both estimates. Overall, the restatement analysis does not support my prediction that government contractors have higher financial reporting quality when operating in a lower competition industry.

<Insert Table 11>

6.3 Corporate-Government Contracting and Financial Reporting Quality when Government Switching Costs are high

I add the interaction terms of CovContract and GovSC and of ContractSize and GovSC in Equations (3) to (5) to capture the conditional effect of the government switching cost on government contractors' financial reporting quality. GovSC is a continuous variable that measures the length of the corporate-government contracting

relationship. Greater GovSC values indicate a higher government switching cost. I expect the interaction terms to be positive and significant across models. The positive coefficient suggests that government contractors are associated with a lower level of financial reporting quality when they have developed a high switching cost for government agencies.

6.3.1 Discretionary Accruals

Using OLS, I report the results of the estimating Equation (3) in Panel A and Panel B of Table 12, where the dependent variable is AbsAccruals and AccrualQuality, respectively. The adjusted R^2 for both estimations is 18.47% and 18.48% in Panel A, respectively. In panel B, the adjusted R^2 for both estimations is 3.24% and 3.25%, respectively. In Panel A, the estimated coefficients on both interaction terms are positive and significant (0.010, p-value < 0.01 and 0.012, p-value<0.01), supporting my H2a. However, the estimated coefficient on the main effect of GovContract is marginally significant at 10 percent level, but ContractSize is negative but is no longer significant, indicating that government contractors are associated with a higher level of financial reporting quality when they have not developed a high switching cost of government agencies. The estimated coefficients for the control variables are generally consistent with those reported in Table 6.

Combined, these results suggest that a higher level of accruals management occurs when government switching costs are high. The implication is that government contractor cares less about their quality of financial statements when they establish a competitive advantage over government agencies by creating a high switching cost. H2b is supported.

<Insert Table 12>

6.3.2 Internal Control Material Weakness

In Table 13, I present the results testing H2b using internal control material weaknesses, which involved adding GovSC as the main effect and interaction with GovContract and ContractSize to Equation (4). I estimate the modified model using industry and year fixed effects. The explanatory power and significant control variables for both models are similar to those reported in Table 7.

Both Panel A and Panel B of Table 13 present results using IneffControls and NumWeakness as the dependent variables, respectively. The estimated coefficient of the interaction in both estimations is statistically insignificant and does not support H2b. Overall, my internal control material weakness analysis does not support my prediction that government contractors have lower financial reporting quality when operating in a high government switching cost environment.

<Insert Table 13>

6.3.3 Restatements

In Table 14, I present the results used to test H2b on restatements, adding GovSC as the main effect and interaction with GovContract and ContractSize to Equation (5). I estimate the modified model using industry and year fixed effects.

Panel A of Table presents the result of using Restatements as the dependent variable. The pseudo R^2s for the estimations are 2.96% and 2.95%, respectively. The estimated coefficients for the control variables are generally consistent with those reported in Table 8. The estimated coefficients on both interaction terms are positive (0.134, p-value < 0.05 and 0.137, p-value<0.10), but the estimated coefficients on the

main effect for GovContract and ContractSize are negative as in Table 8, but no longer significant, indicating that government switching costs have the dominating impact on the contracting firm restatements rates. The results from panel A confirm that previously found results on discretionary accruals suggesting that government contractors pay less attention to their quality of financial statements when they establish a competitive advantage over government agencies by creating a high switching cost. This supports H2b.

Panel B of Table 14 presents the result that uses FRAUD as the dependent variable. The pseudo R^2s for both estimations are 4.93% and 4.92%, respectively. The estimated coefficients for the control variables are generally consistent with those reported in Table 8. The estimated coefficients on both interaction terms are negative (-0.401, p-value < 0.05 and -0.472, p-value<0.005); Therefore, these results do not support H2b. The results from panel B suggest that government contractors pay less attention to the quality of financial statements when they establish a competitive advantage resulting in a higher restatement rate. However, these restatements are significantly less likely to be related to subsequent SEC enforcement actions and fraud-related cases.

<Insert Table 14>

Chapter 7 Additional Analyses

In this section, I conduct additional analyses in order to demonstrate that the previously reported results are robust.

7.1 Propensity-Score Matching Model

In order to reduce concerns regarding the misspecification of functional form whereby the treatment of government contractors is dissimilar to the treatment of non-government contractors, I use a sample based on propensity-score matching (PSM) to provide stronger controls for the effects of various firm characteristics that are separate from my variables of interest Although Shipman et al. (2017) advise that this method does have weaknesses, I use PSM in combination with my main model to control for the effects of observable firm characteristics and increase the validity of my primary findings

I first use a logit model and the identified firm's characteristics to identify its probability of being a government contractor. Following the PSM model suggest by Shipman et al. (2017), I define the following model:

$$\begin{aligned} GovContract = {} & \beta_0 + \beta_1 lnAsset_{i,t} + \beta_2 M/B_{i,t} + \beta_3 FirmAge_{i,t} + \beta_4 Leverage_{i,t} + \beta_5 Loss_{i,t} + \\ & \beta_6 Loss_{i,t} + \beta_7 CfoVolit_{i,t} + \beta_8 SalesVol_{i,t} + Fixed\ Effects + \varepsilon_{i,t} \end{aligned} \quad (7)$$

where variables are defined in Appendix A. Using the caliper distance matching method within a maximum distance of one percent and without replacement, I match firms that

were government contractors in any given year with firms that never were government contractors. This procedure produces a sub-sample of firms which do not have different pre-existing firm characteristics but have different treatment effect (i.e., GovContract = 1 vs. GovContract = 0). Therefore, the differences in whether a firm is a government contractor between treatment and control groups, after controlling the firm-level characteristics, are adequate to test the impact of contracting with the government on firm-level financial reporting quality. In addition, I control for both industry and year fixed effects. All variables defined in Equation 6 also appear in Appendix A.

The matching procedures provide a sample that does not have significant differences in firm characteristics between firms with and without government contracts by comparing the mean and median values of two subsamples (untabulated). The results support my use of the PSM model. In table 15, I report the estimated coefficients for the test variables from the multivariate regressions for Equations (3) to (5) using the PSM sample. Results for the variables of interest (GovContract and ContractSize) are consistent with the results for the full sample across all six models, supporting H1. Overall, these results reduce the aforementioned concerns regarding the misspecification of functional form whereby treatment firms are dissimilar to control firms.

<Insert Table 15>

In table 16, I report the multivariate results of testing H2a using the PSM sample for the modified models of Equations (3) to (5). Consistent with previous findings, the interaction terms (GovContract*HHIGov and ContractSize*HHIGov) are positive and significant only in the discretionary accrual models. The coefficients of the interaction terms in the internal control weakness and restatement models are either negative or

insignificant. Overall, I find limited support for H2a, which asserts that government contractors only have higher financial reporting quality when they are in lower competition industries.

<Insert Table 16>

In Table 17, I report multivariate results for cases in which the PSM samples for the modified model of Equations (3) to (5) were used to test H2b. Consistent with previous findings, the interaction terms (GovContract*GovSC and ContractSize*GovSC) are positive and significant only in the discretionary accrual models. The coefficients on the interaction terms in the internal control weakness and restatement models are either negative or insignificant. Overall, I find limited support for H2b that government contractors have lower financial reporting quality when government switching costs are high.

<Insert Table 17>

7.2 Placebo Tests

I conduct placebo tests in a manner similar to those conducted by Bertrand and Schoar (2003) in order to address the endogeneity concern that my previous findings are not driven by an identified firm, which is a government contractor but instead is driven by a correlated omitted variable. I first exclude the observations in which the firm is a government contractor. I then randomly assign the non-government contractor as a placebo government contractor in the same percentage as identified government contractors in the original dataset. If my previous results are driven primarily by similarities between firms instead of the corporate-government contracting relationship, I should find that the coefficient on the placebo government contractor is also negative and

significant. If the association is due to the firm being a government contractor, the placebo government contractor coefficient should not be significant. Table 18 presents the placebo test results. None of the placebo government contractor coefficients are statistically significant, indicating that the government contractor's active influence on the financial statement drives my results, not the similarity of government contracting firms and non-government contracting firms.

To further ensure that the procedure is truly random, I repeat this placebo procedure 30 times. The coefficient of the placebo government contractor is not statistically significant(untabulated). Overall, my placebo tests provide further support for my conclusion that a government contractor plays a role in determining the quality of firms' financial statements.

<Insert Table 18>

7.3 Endogeneity Concerns

In preceding tests, I use PSM and placebo test methods to address endogeneity concerns of potential omitted variable bias. As an additional test to further confirm reliability of my results, I utilize the Arellano-Bond generalized method of moments (GMM) as my estimation method. I use GMM to address concerns over selection bias, reverse causality, and measurement error. Arellano and Bond (1991) suggest that GMM estimation is better specified to address concerns over endogeneity and omitted variable bias, in addition to unobserved panel heterogeneity. In this test, I apply the two-step GMM estimation to re-estimate my Equations (3) to (5) (untabulated). The two-step estimation expresses the first equation in levels, with the first differences of the control variables as my instrumental variables. The second equation is also expressed in first

differenced form with levels of my control variables as instruments . This approach transforms my control variables into instruments, which makes them uncorrelated (exogenous) in order to address the endogeneity concerns (Arellano and Bover 1995). After re-estimating Equations (3) to (5) using the GMM estimation method, all coefficient estimates of interest remain statistically significant and of similar magnitude and sign to the ones presented in Tables 6, 7, and 8.

7.4 Other Robustness Check

I combine the different control variables from Equations (3) to (5) into one model and re-estimate the regressions. This procedure addresses concerns that my previous findings may be driven by the selection of models and control variables. Using the same dependent variables on the combined set of control variables, I find that all coefficient estimates of interest (untabulated) are statistically significant and of similar magnitude to the ones presented in Tables 6, 7, and 8.

Chapter 8 Conclusion

Understanding the quality of government contractors' financial reporting is important for regulator, investors, and US citizens because of the massive amount of wealth that government agencies transfer to these contractors. I document those federal government contractors are associated with higher financial reporting quality. More specifically, firms with government contracts exhibit lower levels of discretionary accruals, a lower probability of material weaknesses in internal control, a lower probability of restatements. Collectively, my empirical results suggest that one benefit of contracting with the federal government that it reduces the contractor's incentive to manipulate earnings.

However, I also document that government contractors exhibit higher discretionary accruals in the industry when competition to compete for contracts are lower; and when government switching costs are high. These results suggest that government contractors are less concerned about the quality of financial statements when they have established a competitive advantage with government agencies.

The findings and results of my study have important implications for accounting and finance literature as they suggest that contracting with federal government agencies enhances a firm's financial reporting quality. Overall, my results are consistent and complement prior research that finds government contractors have higher profitability

(Cohen and Li 2019), associated with better information environments (Samuel 2018), and produce more precise and accurate earnings forecast (Cheng et al. 2019).

Appendix A

Panel A: Corporate-government contracting variables:

GovContract	An indicator variable equal to one if the company is a government contractor in a given year, and zero otherwise
ContractSize	A continuous measure of contract award size relative to the firm's total sales
GovSC	The natural logarithm transformation of the length of the corporate-government contracting relationship in years
HHIGov	The government contracting market concentration based on the Herfindahl-Hirschman index based on the three-digit SIC industry and year

Panel B: Financial reporting quality variables:

AccrualQuality	The standard deviation of residuals from t-4 to t from the Dechow and Dichev (2002) model, as modified by McNichols (2002): $CA_{i,t} = \alpha_1 + \alpha_2 CFO_{i,t-1} + \alpha_3 CFO_{i,t} + \alpha_4 CFO_{i,t+1} + \alpha_5 \Delta SALES_{i,t} + \alpha_6 PPE_{i,t} + \varepsilon_{i,t,}$ where CA is current accruals, CFO is cash flow from operations, ΔSALES is change in sales and PPE is plant, property and equipment

AbsAccruals	The absolute value of abnormal accruals using the modified Jones (1991) approach and including the firm performance adjustment suggested by Kothari et al. (2005)
IneffControls	An indicator variable equal to 1 if there is a general (systemic) material weakness in internal control reported under either SOX 302 and SOX 404 in a given year, and zero otherwise
NumWeaknesses	The number of material weaknesses reported under either SOX 302 and SOX 404.
Restatements	An indicator variable equal to 1 if the government contractor's financial statement for that year is subsequently restated and zero otherwise
FRAUD	An indicator variable equal to 1 if the government contractor's financial statement for that year is subsequently restated due to fraud-related class action lawsuits, and zero otherwise
Panel C: Firm-level control variables	
lnAuditFees	The natural logarithm transformation of audit fees
lnAsset	The natural logarithm transformation of total assets
CfoVolit	Standard deviation of cash flows scaled by total assets calculated over the prior five-year period

SalesVol	Standard deviation of sales scaled by total assets calculated over the prior five-year period
E/P	Current year earnings before extraordinary items scaled by the lagged market value of equity
M/B	The book value of assets scaled by the market capitalization
FirmAge	Number of years since the firm first appeared in the CRSP database
Leverage	The ratio of total debt to total assets
Loss	An indicator variable equal to one if the firm reports losses in a given year, and zero otherwise
%ΔCashSales	Percent change in sales minus change in accounts receivable in the past year
ΔROA	Change in net income scaled by average total assets in the past year.
CeoChair	An indicator variable equal to one if the CEO also serves as board chair, and zero otherwise
LnAnalyst	The natural logarithm transformation of the number of analysts followings
ACSize	Number of audit committee members

ACExperts	Proportion of financial experts on the audit committee, where financial expertise is defined as having one of the qualifications in the background of the member: certified public accountant, chief financial officer, chief accounting officer, controller, treasurer or vice-president for finance
Independence	Proportion of independent members on the board of directors
Big4	An indicator variable equal to one if a firm's auditor is a Big4 auditor, and zero otherwise
lnAudtenure	The natural logarithm transformation of auditor's tenure in years
%Loss	Percentage of loss years over the prior four years
SalesGrowth	Cumulative percentage change in sales over the prior three years
Inventory	Inventory scaled by total assets
ΔInventory	Change in inventory scaled by average total assets in the past year
ΔReceivables	Change in accounts receivable scaled by average total assets in the past year

Note: Continuous variables are winsorized at the1st and 99th percentile each year.

Table 1 Sample Selection

Total number of observations in CRSP-Compustat (2001-2017),	
Excluding banking and utilities industries	115,572
Less firm-year observations:	
Missing data to calculate accruals	41,392
Missing data for control variables	8,712
Audit Analytics data	6,480
Sample size for discretionary accruals and restatement tests	58,988
Less observations from 2001-2004	11,780
Sample size for internal control material weakness tests	48,208

Table 2 Sample Distribution

Panel A: Sample Distribution by Year

Year	Frequency of Gov't Contractor	%	Frequency of Total Sample	%
2001	752	4.71	3,706	6.28
2002	881	5.52	3,968	6.73
2003	959	6.01	4,025	6.82
2004	1,060	6.64	3,964	6.72
2005	1,126	7.06	3,864	6.55
2006	1,138	7.13	3,748	6.35
2007	1143	7.16	3,652	6.19
2008	1108	6.94	3,454	5.85
2009	1049	6.57	3,323	5.63
2010	1018	6.38	3,237	5.49
2011	967	6.06	3,135	5.31
2012	906	5.68	3,107	5.27
2013	847	5.31	3,147	5.33
2014	807	5.06	3,292	5.58
2015	774	4.85	3,220	5.46
2016	775	4.86	3,110	5.27
2017	679	4.25	3,046	5.16
Total	15,959	100.00	58,998	100.00

Table 2 (continued)

Panel B: Sample Distribution with/without Government Contracts by Industry (SIC 2)

Industry	w/ Gov't Contract (a)	w/o Gov't Contract (b)	Total	Gov't Contract % (a)/(b)	%
Agriculture and Forestry	21	149	170	14.09	0.29
Mining	252	4,288	4,540	5.88	7.70
Construction	145	195	340	74.36	0.58
Manufacturing	9,931	22,973	32,904	43.23	55.77
Utilities			Excluded		
Wholesale Trade	784	1,625	2,409	48.25	4.08
Retail Trade	629	3,620	4,249	17.38	7.02
Finance and Insurance			Excluded		
Services	4,097	9,571	13,668	42.81	23.17
Public Administration	100	618	718	16.18	1.22
Total	15,959	43,039	58,998	100.00	100.00

Table 3 Government Contract Awards

Panel A: Distribution of Government Contracts Amount by Year

Firm Fiscal Year	Gov't Contract Value ($ millions)	Gov't Contractor Total Sales ($ millions)	Percentage of Gov't Sales to Total Sales
2001	75,730	1,986,205	3.8%
2002	97,929	2,270,550	4.3%
2003	114,835	3,133,326	3.7%
2004	120,039	3,633,572	3.3%
2005	113,957	4,071,181	2.8%
2006	170,576	4,623,183	3.7%
2007	159,985	5,273,840	3.0%
2008	199,653	5,355,060	3.7%
2009	161,005	4,696,326	3.4%
2010	148,280	5,070,994	2.9%
2011	143,837	5,624,189	2.6%
2012	159,579	5,101,447	3.1%
2013	109,682	4,922,144	2.2%
2014	116,697	4,851,576	2.4%
2015	111,875	4,865,324	2.3%
2016	129,098	4,571,868	2.8%
2017	146,906	4,733,035	3.1%
Total	2,279,663	47,783,820	3.0%

Table 3 (continued)

Panel B: Distribution Government Contracts Amount by Industry (Fama-French 12)

Industry	Gov't Contract Value ($ millions)	Gov't Contractor Total Sales ($ millions)	Percentage of Gov't Sales to Total Sales
Consumer Non-Durables	16,609	5,123,382	0.3%
Consumer Durables	52,211	4,886,591	1.1%
Manufacturing	1,068,203	11,900,000	9.0%
Energy Oil, Gas, and Coal Products	5,315	3,178,877	0.2%
Chemicals and Allied Products	8,050	2,901,472	0.3%
Computers, Software, and Electronic	712,129	15,500,000	4.6%
Telephone and Television Transmission	16,609	5,123,382	0.3%
Utilities		Excluded	
Wholesale, Retail, and Some Services	140,743	17,900,000	0.8%
Healthcare, Medical Equipment	59,778	8,689,075	0.7%
Finance		Excluded	
Other	216,623	4,791,957	4.5%
Total	2,279,662	74,871,354	3.0%

Table 4 Summary Statistics

Panel A: Summary Statistics for Full Sample

Variable (N=58,998)	Mean	Standard Deviation	25th Percentile	Median	75th Percentile
AbsAccruals	0.140	0.248	0.031	0.071	0.151
AccrualQuality	0.003	0.093	-0.027	0.000	0.034
IneffControls[a]	0.046	0.209	0.000	0.000	0.000
NumWeaknesses[a]	0.110	0.717	0.000	0.000	0.000
Restatement	0.080	0.271	0.000	0.000	0.000
FRAUD	0.014	0.117	0.000	0.000	0.000
CorpGov	0.271	0.444	0.000	0.000	1.000
ContractSize	0.316	0.360	0.100	0.100	0.700
lnAsset	5.519	2.321	3.857	5.521	7.174
M/B	2.514	5.225	1.158	1.632	2.600
FirmAge	10.772	8.723	5.000	9.000	14.000
Leverage	0.238	0.471	0.003	0.147	0.327
Loss	0.426	0.494	0.000	0.000	1.000
CfoVolit	0.084	0.237	0.015	0.035	0.073
SalesVol	0.208	0.479	0.042	0.109	0.219
%ΔCashSales	0.183	1.028	-0.063	0.058	0.217
ΔROA	0.005	0.228	-0.027	0.000	0.023
E/P	-0.253	1.563	-0.117	0.019	0.056
CeoChair	0.308	0.462	0.000	0.000	1.000
LnAnalyst	1.116	1.070	0.000	1.022	2.004
ACSize	2.622	2.019	0.000	3.000	4.000
ACExperts	0.294	0.304	0.000	0.250	0.400
Independence	0.449	0.339	0.000	0.571	0.750
Big4	0.367	0.482	0.000	0.000	1.000
LnAudtenure	2.051	0.686	1.946	1.986	2.197
%Loss	0.399	0.384	0.000	0.250	0.750
SalesGrowth	1.988	14.332	-0.061	0.171	0.636
Inventory	0.111	0.131	0.001	0.069	0.170
lnAuditFees	13.220	1.472	12.122	13.251	14.251
ΔInventory	0.002	0.022	-0.001	0.000	0.007
ΔReceivables	0.004	0.033	-0.005	0.002	0.013

All variables are defined in Appendix A. Continuous variables are winsorized at the1st and 99th percentile each year.

[a] N= 47,280 Internal control weakness data coverage start in 2004. Therefore, there are fewer observations for internal control weakness tests.

Table 4 (continued)

Panel B: Comparison of the Mean Value of Variables of Firms with and without Government Contracts

Variable	Gov't Contractors (N=15,959) Mean	Std. Dev	Median	Non-Gov'tContractors (N=43,039) Mean	Std. Dev	Median	Mean Diff	p-value for t-test of means
AbsAccruals	0.099	0.154	0.058	0.155	0.273	0.078	-0.056	<0.001
AccrualQuality	0.000	0.072	0.000	0.004	0.100	0.000	-0.004	<0.001
IneffControls[b]	0.046	0.209	0.000	0.046	0.209	0.000	0.000	0.963
NumWeaknesses[b]	0.114	0.751	0.000	0.109	0.703	0.000	0.006	0.452
Restatement	0.075	0.263	0.000	0.082	0.274	0.000	-0.007	-0.005
FRAUD	0.013	0.112	0.000	0.014	0.118	0.000	-0.001	-0.184
lnAsset	6.293	2.265	6.358	5.233	2.275	5.204	1.061	<0.001
M/B	2.149	1.834	1.630	2.649	6.009	1.632	-0.500	<0.001
FirmAge	12.721	9.764	11.000	10.050	8.186	8.000	2.672	<0.001
Leverage	0.211	0.366	0.160	0.248	0.504	0.141	-0.037	-0.052
Loss	0.314	0.464	0.000	0.467	0.499	0.000	-0.153	<0.001
CfoVolit	0.059	0.154	0.031	0.094	0.260	0.037	-0.034	<0.001
SalesVol	0.187	0.343	0.115	0.216	0.521	0.105	-0.029	<0.001
%ΔCashSales	0.123	0.551	0.065	0.205	1.155	0.054	-0.082	<0.001
ΔROA	0.002	0.131	0.000	0.006	0.255	-0.001	-0.004	0.065
E/P	-0.128	1.244	0.033	-0.300	1.664	0.009	0.171	<0.001
CeoChair	0.400	0.490	0.000	0.273	0.446	0.000	0.127	<0.001
LnAnalyst	1.455	1.071	1.593	0.991	1.042	0.693	0.464	<0.001
ACSize	3.289	1.869	3.000	2.374	2.016	3.000	0.914	<0.001
ACExperts	0.370	0.314	0.333	0.265	0.296	0.250	0.105	<0.001

Independence	0.541	0.293	0.615	0.414	0.348	0.533	0.126	<0.001
Big4	0.408	0.491	0.000	0.352	0.478	0.000	0.056	<0.001
LnAudtenure	2.203	0.769	1.986	1.994	0.644	1.986	0.209	<0.001
%Loss	0.303	0.358	0.250	0.434	0.387	0.500	-0.131	<0.001
SalesGrowth	0.925	7.913	0.204	2.383	16.056	0.153	-1.458	<0.001
Inventory	0.125	0.124	0.097	0.106	0.133	0.055	0.019	<0.001
lnAuditFees	13.791	1.466	13.875	13.009	1.417	13.015	0.782	<0.001
ΔInventory	0.003	0.021	0.000	0.002	0.023	0.000	0.001	<0.001
ΔReceivables	0.004	0.028	0.003	0.004	0.034	0.002	0.001	0.015

[b] Government contractor N=13,337 and non-Government contractor N=33,871.

Table 5 Pairwise Correlations

Panel A: Variables 1 to 9

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
(1)	1.00								
(2)	0.03*	1.00							
(3)	-0.01*	-0.02*	1.00						
(4)	-0.01	-0.02*	0.70*	1.00					
(5)	0.05*	-0.02*	0.21*	0.15*	1.00				
(6)	0.00	-0.01*	0.09*	0.10*	0.17*	1.00			
(7)	-0.10*	-0.02*	0.00	0.00	-0.01*	-0.01	1.00		
(8)	-0.10*	-0.02*	0.00	0.00	-0.01*	-0.01	0.99*	1.00	
(9)	-0.32*	-0.05*	0.04*	0.03*	-0.01	0.02*	0.20*	0.20*	1.00
(10)	0.23*	0.02*	-0.01*	0.00	0.00	0.00	-0.04*	-0.04*	-0.18*
(11)	-0.06*	-0.01	-0.03*	-0.02*	-0.01	-0.01*	0.14*	0.14*	0.15*
(12)	0.16*	0.00	0.00	0.00	0.02*	0.01*	-0.04*	-0.03*	-0.05*
(13)	0.24*	0.00	0.02*	0.02*	0.02*	0.00	-0.14*	-0.13*	-0.42*
(14)	0.17*	0.04*	-0.02*	-0.01*	0.00	-0.01	-0.06*	-0.06*	-0.31*
(15)	0.05*	0.01	-0.01	0.00	0.00	0.00	-0.03*	-0.03*	-0.20*
(16)	0.10*	0.00	0.00	0.00	0.01*	0.00	-0.04*	-0.03*	-0.04*
(17)	0.03*	0.15*	-0.01*	-0.01	-0.01	0.00	-0.01	-0.01	-0.03*
(18)	-0.10*	0.06*	-0.01	-0.01	-0.01*	0.00	0.05*	0.05*	0.11*
(19)	-0.10*	0.00	0.01	0.00	0.01	0.01*	0.12*	0.12*	0.22*
(20)	-0.21*	-0.04*	0.00	-0.01	-0.03*	0.00	0.19*	0.19*	0.64*
(21)	-0.17*	-0.02*	0.03*	0.00	0.01	0.00	0.20*	0.20*	0.41*
(22)	-0.14*	-0.01*	0.00	-0.02*	0.00	-0.01*	0.15*	0.14*	0.33*
(23)	-0.15*	-0.01*	0.02*	-0.01	0.00	-0.01*	0.17*	0.16*	0.28*
(24)	-0.11*	-0.01*	0.00	-0.01	-0.03*	-0.01	0.05*	0.05*	0.26*
(25)	-0.14*	-0.02*	0.00	-0.01	0.00	0.00	0.14*	0.13*	0.32*
(26)	0.26*	0.02*	0.01*	0.02*	0.02*	0.00	-0.15*	-0.15*	-0.50*
(27)	0.06*	0.01	0.00	0.00	0.02*	0.00	-0.05*	-0.04*	-0.04*
(28)	-0.07*	0.02*	0.00	0.00	0.00	0.00	0.07*	0.06*	-0.04*
(29)	-0.24*	-0.05*	0.10*	0.09*	0.02*	0.01*	0.24*	0.23*	0.86*
(30)	0.03*	0.24*	-0.01	-0.01	0.01	0.00	0.02*	0.01*	0.06*
(31)	0.06*	0.26*	0.00	-0.01	0.00	0.00	0.01	0.01	0.05*

Table 5 (continued)

Panel B: Variables 9 to 18

	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)
(10)	1.00								
(11)	-0.05*	1.00							
(12)	0.22*	0.02*	1.00						
(13)	0.11*	-0.15*	0.10*	1.00					
(14)	0.16*	-0.01	0.20*	0.20*	1.00				
(15)	0.01*	0.02*	0.06*	0.09*	0.46*	1.00			
(16)	0.03*	-0.06*	-0.01	0.08*	-0.03*	-0.07*	1.00		
(17)	-0.02*	-0.02*	-0.04*	0.13*	-0.04*	-0.03*	0.08*	1.00	
(18)	0.01	0.03*	-0.17*	-0.17*	-0.11*	-0.10*	0.03*	0.11*	1.00
(19)	-0.03*	0.08*	-0.04*	-0.16*	-0.08*	-0.05*	-0.01	-0.01*	0.07*
(20)	-0.04*	0.05*	-0.06*	-0.30*	-0.18*	-0.15*	-0.01*	-0.02*	0.13*
(21)	-0.07*	0.16*	-0.09*	-0.19*	-0.14*	-0.10*	-0.02*	-0.02*	0.12*
(22)	-0.05*	0.10*	-0.06*	-0.15*	-0.11*	-0.09*	-0.02*	-0.01*	0.10*
(23)	-0.05*	0.09*	-0.11*	-0.11*	-0.12*	-0.11*	-0.01	-0.01*	0.12*
(24)	-0.05*	-0.03*	-0.04*	-0.09*	-0.08*	-0.05*	-0.01	-0.01*	0.02*
(25)	-0.06*	0.21*	-0.03*	-0.17*	-0.07*	-0.04*	-0.05*	-0.02*	0.06*
(26)	0.13*	-0.15*	0.11*	0.77*	0.27*	0.13*	0.08*	0.08*	-0.16*
(27)	0.02*	-0.06*	0.01	0.06*	-0.02*	-0.04*	0.15*	0.03*	-0.02*
(28)	-0.07*	0.12*	0.01*	-0.13*	-0.03*	0.06*	-0.05*	-0.02*	0.00
(29)	-0.12*	0.15*	-0.02*	-0.30*	-0.20*	-0.14*	-0.04*	-0.03*	0.08*
(30)	0.02*	-0.01*	-0.03*	-0.12*	-0.09*	-0.11*	0.13*	0.04*	0.11*
(31)	0.03*	-0.03*	-0.04*	-0.06*	-0.11*	-0.13*	0.15*	0.09*	0.13*

Table 5 (continued)

Panel C: Variables 18 to 27

	(19)	(20)	(21)	(22)	(23)	(24)	(25)	(26)	(27)
(19)	1.00								
(20)	0.22*	1.00							
(21)	0.43*	0.41*	1.00						
(22)	0.28*	0.35*	0.60*	1.00					
(23)	0.40*	0.33*	0.85*	0.66*	1.00				
(24)	0.06*	0.21*	0.10*	0.09*	0.08*	1.00			
(25)	0.11*	0.25*	0.24*	0.17*	0.17*	0.09*	1.00		
(26)	-0.17*	-0.35*	-0.21*	-0.16*	-0.11*	-0.10*	-0.20*	1.00	
(27)	-0.02*	-0.03*	-0.04*	-0.04*	-0.03*	0.00	-0.06*	0.08*	1.00
(28)	0.01*	-0.08*	0.01*	0.01	-0.01*	-0.03*	0.04*	-0.15*	-0.04*
(29)	0.21*	0.59*	0.45*	0.39*	0.36*	0.25*	0.30*	-0.36*	-0.04*
(30)	0.04*	0.05*	0.04*	0.04*	0.05*	0.01	-0.01*	-0.08*	0.04*
(31)	0.04*	0.05*	0.03*	0.03*	0.04*	0.00	-0.02*	-0.04*	0.05*

Panel D: Varialbe 28 to 31

	(28)	(29)	(30)	(31)
(28)	1.00			
(29)	-0.05*	1.00		
(30)	0.16*	0.03*	1.00	
(31)	-0.03*	0.02*	0.27*	1.00

Table 5 shows Pearson correlation coefficients for variables included in Equations: (1) AbsAccruals (2) AccrualQuality (3) IneffControls (4) NumWeaknesses (5) Restatement (6) FRAUD (7) CorpGov (8) ContractSize (9) lnAsset (10) M/B (11) FirmAge (12) Leverage (13) Loss (14) CfoVolit (15) SalesVol (16) %ΔCashSales (17) ΔROA (18) E/P (19) CeoChair (20) LnAnalyst (21) ACSize (22) ACExperts (23) Independence (24) Big4 (25) LnAudtenure (26) %Loss (27)SalesGrowth (28)Inventory (29) lnAuditFees (30) ΔInventory (31) ΔReceivables.

All variables are defined in the Appendix. * represent significance at the 0.01 level.

Table 6 Regression of Accruals Management on Government Contracting

Panel A: Regression of Discretionary Accruals on Government Contracting

$$AM_{it} = \beta_0 + \beta_1\ CORP\_GOV_{i,t} + \beta_2\ lnAsset_{i,t} + \beta_3\ M/B_{i,t} + \beta_4\ FirmAge_{i,t} + \beta_5\ Leverage_{i,t} + \beta_6\ Loss_{i,t} + \beta_7\ CfoVolit_{i,t} + \beta_8\ SalesVol_{i,t} + \beta_9\ \%\Delta CashSales_{i,t} + \beta_{10}\ \Delta ROA_{i,t} + \beta_{11}\ NI/P_{i,t} + \beta_{12}\ CeoChair_{i,t} + \beta_{13}\ LnAnalyst_{i,t} + \beta_{14}\ ACSize_{i,t} + \beta_{15}\ Independence_{i,t} + \beta_{16}\ ACExperts_{i,t} + \beta_{16}\ Big4_{i,t} + \beta_{17}\ LnAudtenure_{i,t} + Fixed\ Effects + \varepsilon_{i,t}$$

		Dependent Variable = AbsAccruals			
		Model (1)		**Model (2)**	
Variables	**Pred.**	**Coefficients**	**t-stat.**	**Coefficients**	**t-stat.**
Constant		0.210***	13.16	0.211***	13.22
GovContract	**H1: -**	-0.007***	2.95		
ContractSize	**H1: -**			-0.008***	2.87
lnAsset	-	-0.023***	22.80	-0.023***	22.81
M/B	+	0.006***	4.92	0.006***	4.92
FirmAge	-	-0.000	1.31	-0.000	1.31
Leverage	+	0.044***	4.99	0.044***	4.99
Loss	+	0.039***	14.06	0.039***	14.07
CfoVolit	+	0.043***	2.96	0.043***	2.96
SalesVol	+	-0.008*	1.89	-0.008*	1.89
%ΔCashSales	+	0.017***	8.37	0.017***	8.37
ΔROA	+	0.020	0.90	0.020	0.90
E/P	?	-0.007***	6.36	-0.007***	6.35
CeoChair	+	0.003	1.60	0.003	1.60
LnAnalyst	-	-0.002	1.17	-0.002	1.18
ACSize	?	0.007***	7.54	0.007***	7.55
ACExperts	-	-0.009***	2.62	-0.009***	2.63
Independence	-	-0.090***	12.67	-0.090***	12.68
Big4	-	-0.010***	5.45	-0.010***	5.46
LnAudTenure	-	-0.007***	4.38	-0.007***	4.39
Year Fixed Effect		Yes		Yes	
Industry Fixed Effect		Yes		Yes	
Adjusted R^2		18.46%		18.45%	
Observations		58,988		58,988	

Table 6 Panel A report results from estimating Equation (3). All variables are defined in Appendix A. Industry fixed effects are based on SIC 2-digit codes, and reported significance is based on robust standard errors and two-tailed tests, adjusted for heteroscedasticity and clustered by firm. ***, ** and * represent significance at 1%, 5% and 10% levels, respectively.

Table 6 (continued)

Panel B: Regression of Accruals Quality on Government Contracting

		Dependent Variable = AccrualQuality			
		Model (1)		Model (2)	
Variables	**Pred.**	**Coefficients**	**t-stat.**	**Coefficients**	**t-stat.**
Constant		0.018***	3.86	0.018***	3.94
GovContract	**H1: -**	-0.002***	2.98		
ContractSize	**H1: -**			-0.003***	2.83
lnAsset	-	-0.002***	5.65	-0.002***	5.67
M/B	+	0.000	0.58	0.000	0.58
FirmAge	-	-0.000*	1.79	-0.000*	1.79
Leverage	+	0.002	0.66	0.002	0.66
Loss	+	-0.009***	9.78	-0.009***	9.78
CfoVolit	+	0.019***	3.42	0.019***	3.42
SalesVol	+	-0.002	1.19	-0.002	1.19
%ΔCashSales	+	-0.001**	2.09	-0.001**	2.09
ΔROA	+	0.065***	12.02	0.065***	12.02
E/P	?	0.003***	6.19	0.003***	6.19
CeoChair	+	0.001*	1.95	0.001*	1.95
LnAnalyst	-	-0.002***	3.87	-0.002***	3.88
ACSize	?	0.000	0.77	0.000	0.78
ACExperts	-	0.000	0.31	0.000	0.30
Independence	-	-0.001	0.36	-0.001	0.36
Big4	-	0.001	1.11	0.001	1.10
LnAudTenure	-	-0.001	1.36	-0.001	1.36
Year Fixed Effect		Yes		Yes	
Industry Fixed Effect		Yes		Yes	
Adjusted R^2		3.24%		3.25%	
Observations		58,988		58,988	

Table 6 Panel B reports results from estimating Equation (3). All variables are defined in Appendix A. Industry fixed effects are based on SIC 2-digit codes, and reported significance is based on robust standard errors and two-tailed tests, adjusted for heteroscedasticity and clustered by firm. ***, ** and * represent significance at 1%, 5% and 10% levels, respectively.

Table 7 Regression of Internal Control Quality on Government Contracting

Panel A: Regression of Internal Control Weakness on Government Contracting

$$ICMW_{i,t} = \delta_0 + \delta_1 CORP\_GOV_{i,t} + \delta_2 lnAsset_{i,t} + \delta_3 M/B_{i,t} + \delta_4 FirmAge_{i,t} + \delta_5 Leverage_{i,t} + \delta_6 \%Loss_{i,t} + \delta_7 SalesGrowth_{i,t} + \delta_8 Inventories_{i,t} + \delta_9 LnAuditFee_{i,t} + \delta_{10} CeoChair_{i,t} + \delta_{11} LnAnalyst_{i,t} + \delta_{12} ACSize_{i,t} + \delta_{13} Independence_{i,t} + \delta_{14} ACExperts_{i,t} + \delta_{15} Big4_{i,t} + \delta_{16} LnAudtenure_{i,t} + \text{Fixed effects} + e_{i,t}$$

		Dependent Variable = IneffControls			
		Model (1)		**Model (2)**	
Variables	**Pred.**	**Coefficients**	**z-stat.**	**Coefficients**	**z-stat.**
Constant		-16.353***	16.79	-16.327***	16.76
GovContract	**H1: -**	-0.202***	2.89		
ContractSize	**H1: -**			-0.237***	2.73
lnAsset	-	-0.504***	12.00	-0.505***	12.02
M/B	+	-0.026	1.15	-0.026	1.15
FirmAge	-	-0.017***	4.62	-0.017***	4.62
Leverage	+	-0.092	1.09	-0.092	1.09
%Loss	+	0.197**	2.10	0.197**	2.11
SalesGrowth	+	0.001	0.94	0.001	0.96
Inventory	+	0.218	0.68	0.218	0.68
lnAuditFees	+	1.243***	19.56	1.243***	19.56
CeoChair	+	0.020	0.33	0.020	0.33
LnAnalyst	-	-0.086**	2.39	-0.087**	2.41
ACSize	?	0.017	0.67	0.017	0.68
ACExperts	-	-0.483***	4.07	-0.484***	4.08
Independence	-	0.322**	2.00	0.320**	1.99
Big4	-	-0.253***	4.15	-0.254***	4.16
LnAudtenure	-	-0.108**	2.31	-0.108**	2.31
Year Fixed Effect		Yes		Yes	
Industry Fixed Effect		Yes		Yes	
Pseudo R^2		10.29%		10.28%	
Observations		47,208		47,208	

Table 7 Panel A reports results from estimating Equation (4). All variables are defined in Appendix A. Industry fixed effects are based on SIC 2-digit codes, and reported significance is based on robust standard errors and two-tailed tests, adjusted for heteroscedasticity and clustered by firm. ***, ** and * represent significance at 1%, 5% and 10% levels, respectively.

Table 7 (continued)

Panel B: Regression of Number of Internal Control Weakness on Government Contracting

		Dependent Variable = NumWeaknesses			
		Model (1)		Model (2)	
Variables	**Pred.**	**Coefficients**	**z-stat.**	**Coefficients**	**z-stat.**
GovContract	**H1: -**	-0.202***	2.89		
ContractSize	**H1: -**			-0.237***	2.66
lnAsset	-	-0.545***	11.93	-0.546***	11.94
M/B	+	-0.029	1.20	-0.029	1.21
FirmAge	-	-0.017***	4.54	-0.017***	4.55
Leverage	+	-0.086	1.02	-0.086	1.02
%Loss	+	0.187*	1.96	0.188**	1.96
SalesGrowth	+	0.001	0.97	0.001	0.98
Inventory	+	0.251	0.76	0.252	0.76
lnAuditFees	+	1.324***	18.42	1.324***	18.41
CeoChair	+	0.016	0.27	0.017	0.27
LnAnalyst	-	-0.091**	2.48	-0.091**	2.49
ACSize	?	0.015	0.57	0.015	0.58
ACExperts	-	-0.504***	4.21	-0.505***	4.22
Independence	-	0.317*	1.92	0.316*	1.91
Big4	-	-0.266***	4.29	-0.266***	4.30
LnAudtenure	-	-0.109**	2.27	-0.109**	2.28
Year Fixed Effect		Yes		Yes	
Industry Fixed Effect		Yes		Yes	
Pseudo R^2		7.75%		7.74%	
Observations		47,208		47,208	

Table 7 Panel B reports results from estimating Equation (4). All variables are defined in Appendix A. Industry fixed effects are based on SIC 2-digit codes, and reported significance is based on robust standard errors and two-tailed tests, adjusted for heteroscedasticity and clustered by firm. ***, ** and * represent significance at 1%, 5% and 10% levels, respectively.

Table 8 Regression of Accounting Restatements on Government Contracting

Panel A: Regression of Restatements on Government Contracting

$$\text{Logit}(\text{Restate}_{i,t}=1) = F(\delta_0 + \delta_1 \text{CORP\_GOV}_{i,t} + \delta_2 \text{lnAsset}_{i,t} + \delta_3 \text{M/B}_{i,t} + \delta_4 \text{FirmAge}_{i,t} + \delta_5 \text{Leverage}_{i,t} + \delta_6 \Delta\text{Inventories}_{i,t} + \delta_7 \Delta\text{Receivables}_{i,t} + \delta_8 \text{LnAuditFee}_{i,t} + \delta_9 \%\Delta\text{CashSales}_{i,t} + \delta_{10} \text{E/P}_{i,t} + \delta_{11} \Delta\text{ROA}_{i,t} + \delta_{12} \text{CeoChair}_{i,t} + \delta_{13} \text{LnAnalyst}_{i,t} + \delta_{14} \text{ACSize}_{i,t} + \delta_{15} \text{Independence}_{i,t} + \delta_{16} \text{ACExperts}_{i,t} + \delta_{17} \text{Big4}_{i,t} + \delta_{18} \text{LnAudtenure}_{i,t} + \text{Fixed effects} + e_{i,t})$$

		Dependent Variable = Restatement			
		Model (1)		**Model (2)**	
Variables	**Pred.**	**Coefficients**	**z-stat.**	**Coefficients**	**z-stat.**
Constant		-5.738***	12.85	-5.723***	12.83
GovContract	**H1: -**	-0.095**	2.20		
ContractSize	**H1: -**			-0.107**	2.01
lnAsset	-	-0.143***	7.51	-0.144***	7.53
M/B	+	-0.001	0.15	-0.001	0.16
FirmAge	-	-0.004**	1.98	-0.004**	1.99
Leverage	+	0.081***	3.15	0.081***	3.15
ΔInventory	+	0.775	1.02	0.776	1.02
ΔReceivables	+	0.187	0.36	0.188	0.36
lnAuditFees	+	0.304***	10.16	0.304***	10.16
%ΔCashSales	+	0.040***	2.88	0.040***	2.88
E/P	+	-0.018**	2.36	-0.018**	2.36
ΔROA	-	-0.130	1.59	-0.130	1.60
CeoChair	?	0.041	1.02	0.041	1.02
LnAnalyst	-	-0.115***	5.35	-0.116***	5.37
ACSize	?	0.035*	1.94	0.035*	1.94
ACExperts	-	0.002	0.03	0.002	0.02
Independence	-	-0.167	1.44	-0.168	1.45
Year Fixed Effect		Yes		Yes	
Industry Fixed Effect		Yes		Yes	
Pseudo R^2		2.92%		2.91%	
Observations		58,988		58,988	

Table 8 Panel A reports results from estimating Equation (4). All variables are defined in Appendix A. Industry fixed effects are based on SIC 2-digit codes, and reported significance is based on robust standard errors and two-tailed tests, adjusted for heteroscedasticity and clustered by firm. ***, ** and * represent significance at 1%, 5% and 10% levels, respectively.

Table 8 (continued)

Panel B: Regression of SEC Enforcement and Fraud on Government Contracting

		Dependent Variable = FRAUD			
		Model (1)		Model (2)	
Variables	**Pred.**	**Coefficients**	**z-stat.**	**Coefficients**	**z-stat.**
Constant		-6.309***	4.98	-6.281***	4.97
GovContract	**H1: -**	-0.249*	1.69		
ContractSize	**H1: -**			-0.312*	1.73
lnAsset	-	0.051	0.87	0.050	0.87
M/B	+	0.005	0.88	0.005	0.88
FirmAge	-	-0.012*	1.73	-0.012*	1.72
Leverage	+	0.164***	3.27	0.165***	3.27
ΔInventory	+	-1.203	0.70	-1.203	0.70
ΔReceivables	+	0.262	0.21	0.263	0.21
lnAuditFees	+	0.196**	2.18	0.197**	2.18
%ΔCashSales	+	0.042	1.42	0.042	1.42
E/P	+	0.019	0.92	0.019	0.92
ΔROA	-	-0.127	0.81	-0.128	0.82
CeoChair	?	0.210	1.57	0.211	1.57
LnAnalyst	-	-0.127	1.59	-0.127	1.59
ACSize	?	0.094**	2.01	0.094**	2.02
ACExperts	-	-0.163	0.61	-0.163	0.61
Independence	-	-0.500	1.52	-0.502	1.52
Year Fixed Effect		Yes		Yes	
Industry Fixed Effect		Yes		Yes	
Pseudo R^2		4.80%		4.81%	
Observations		58,988		58,988	

Table 8 Panel B reports results from estimating Equation (4). All variables are defined in Appendix A. Industry fixed effects are based on SIC 2-digit codes, and reported significance is based on robust standard errors and two-tailed tests, adjusted for heteroscedasticity and clustered by firm. ***, ** and * represent significance at 1%, 5% and 10% levels, respectively.

Table 9 Regression of Accruals Management on Government Contracting in Low Competition Industry

Panel A: Regression of Discretionary Accruals on Government Contracting in Low Competition Industry

		Dependent Variable = AbsAccruals			
		Model (1)		**Model (2)**	
Variables	**Pred.**	**Coefficients**	**t-stat.**	**Coefficients**	**t-stat.**
Constant		0.216***	13.65	0.218***	13.72
GovContract*HHIGov	**H2a: -**	0.048***	4.98		
ContractSize*HHIGov	**H2a: -**			0.056***	4.92
GovContract	-	-0.012***	4.20		
ContractSize	-			-0.014***	4.13
HHIGov	?	-0.016**	2.42	-0.022***	3.18
lnAsset	-	-0.023***	22.81	-0.023***	22.83
M/B	+	0.006***	4.91	0.006***	4.91
FirmAge	-	-0.000	1.23	-0.000	1.21
Leverage	+	0.044***	4.99	0.044***	4.99
Loss	+	0.038***	13.99	0.038***	14.00
CfoVolit	+	0.043***	2.95	0.043***	2.95
SalesVol	+	-0.008*	1.90	-0.008*	1.90
%ΔCashSales	+	0.017***	8.36	0.017***	8.36
ΔROA	+	0.020	0.90	0.020	0.90
E/P	?	-0.007***	6.37	-0.007***	6.37
CeoChair	+	0.003	1.52	0.003	1.52
LnAnalyst	-	-0.002	1.22	-0.002	1.22
ACSize	?	0.007***	7.48	0.007***	7.50
ACExperts	-	-0.009**	2.57	-0.009**	2.58
Independence	-	-0.089***	12.64	-0.089***	12.65
Big4	-	-0.010***	5.47	-0.010***	5.48
LnAudTenure	-	-0.007***	4.43	-0.007***	4.43
Year Fixed Effect		Yes		Yes	
Industry Fixed Effect		Yes		Yes	
Adjusted R^2		18.48%		18.47%	
Observations		58,988		58,988	

Table 9 Panel A reports results from estimating Equation (3) modified to include HHIGov and its interaction with GovContract and GovContract to test Hypothesis 2a. The dependent variable is AbsAccruals. All variables are defined in Appendix A. Industry fixed effects are based on SIC 2-digit codes, and reported significance is based on robust standard errors and two-tailed tests, adjusted for heteroscedasticity and clustered by firm. ***, ** and * represent significance at 1%, 5% and 10% levels, respectively.

Table 9 (continued)

Panel B: Regression of Accruals Quality on Government Contracting in Low Competition Industry

		Dependent Variable = AccrualQuality			
		Model (1)		Model (2)	
Variables	**Pred.**	**Coefficients**	**t-stat.**	**Coefficients**	**t-stat.**
Constant		0.017***	3.20	0.017***	3.30
GovContract*HHIGov	**H2a: -**	0.012***	2.94		
ContractSize*HHIGov	**H2a: -**			0.015***	3.03
GovContract	-	-0.004***	3.85		
ContractSize	-			-0.004***	3.76
HHIGov	?	-0.000	0.07	-0.002	0.51
lnAsset	-	-0.002***	5.66	-0.002***	5.68
M/B	+	0.000	0.57	0.000	0.57
FirmAge	-	-0.000*	1.73	-0.000*	1.72
Leverage	+	0.002	0.67	0.002	0.67
Loss	+	-0.009***	9.83	-0.009***	9.82
CfoVolit	+	0.019***	3.41	0.019***	3.41
SalesVol	+	-0.002	1.20	-0.002	1.20
%ΔCashSales	+	-0.001**	2.09	-0.001**	2.09
ΔROA	+	0.065***	12.01	0.065***	12.01
E/P	?	0.003***	6.18	0.003***	6.19
CeoChair	+	0.001*	1.90	0.001*	1.90
LnAnalyst	-	-0.002***	3.90	-0.002***	3.91
ACSize	?	0.000	0.72	0.000	0.73
ACExperts	-	0.000	0.34	0.000	0.34
Independence	-	-0.001	0.32	-0.001	0.33
Big4	-	0.001	1.09	0.001	1.08
LnAudTenure	-	-0.001	1.40	-0.001	1.41
Year Fixed Effect		Yes		Yes	
Industry Fixed Effect		Yes		Yes	
Adjusted R^2		3.24%		3.24%	
Observations		58,988		58,988	

Table 9 Panel B reports results from estimating Equation (3) modified to include HHIGov and its interaction with GovContract and GovContract to test Hypothesis 2a. The dependent variable is AccrualQuality. All variables are defined in Appendix A. Industry fixed effects are based on SIC 2-digit codes, and reported significance is based on robust standard errors and two-tailed tests, adjusted for heteroscedasticity and clustered by firm. ***, ** and * represent significance at 1%, 5% and 10% levels, respectively.

Table 10 Regression of Internal Control Quality on Government Contracting in Low Competition Industry

Panel A: Regression of Internal Control Weakness on Government Contracting in Low Competition Industry

		Dependent Variable = IneffControls			
		Model (1)		**Model (2)**	
Variables	**Pred.**	**Coefficients**	**z-stat.**	**Coefficients**	**z-stat.**
Constant		-16.151***	16.58	-16.138***	16.56
GovContract*HHIGov	**H2a: -**	-1.035**	2.21		
ContractSize*HHIGov	**H2a: -**			-1.198**	2.15
GovContract	-	-0.105	1.27		
ContractSize	-			-0.117	1.13
HHIGov	?	-0.310	1.17	-0.189	0.69
lnAsset	-	-0.504***	12.03	-0.505***	12.04
M/B	+	-0.026	1.13	-0.026	1.13
FirmAge	-	-0.017***	4.66	-0.017***	4.67
Leverage	+	-0.095	1.12	-0.095	1.12
%Loss	+	0.206**	2.20	0.206**	2.21
SalesGrowth	+	0.001	1.03	0.001	1.04
Inventory	+	0.232	0.72	0.231	0.72
lnAuditFees	+	1.244***	19.61	1.244***	19.60
CeoChair	+	0.023	0.38	0.023	0.38
LnAnalyst	-	-0.085**	2.36	-0.085**	2.38
ACSize	?	0.019	0.73	0.019	0.74
ACExperts	-	-0.489***	4.12	-0.490***	4.13
Independence	-	0.318**	1.98	0.317**	1.97
Big4	-	-0.253***	4.16	-0.254***	4.16
LnAudtenure	-	-0.105**	2.24	-0.105**	2.25
Year Fixed Effect		Yes		Yes	
Industry Fixed Effect		Yes		Yes	
Pseudo R^2		10.34%		10.33%	
Observations		47,208		47,208	

Table 10 Panel A reports results from estimating Equation (4) modified to include HHIGov and its interaction with GovContract and GovContract to test Hypothesis 2a. The dependent variable is IneffControls. All variables are defined in Appendix A. Industry fixed effects are based on SIC 2-digit codes, and reported significance is based on robust standard errors and two-tailed tests, adjusted for heteroscedasticity and clustered by firm. ***, ** and * represent significance at 1%, 5% and 10% levels, respectively.

Table 10 (continued)

Panel B: Regression of Number of Internal Control Weakness on Government Contracting in Low Competition Industry

		Dependent Variable = NumWeaknesses			
		Model (1)		Model (2)	
Variables	**Pred.**	**Coefficients**	**z-stat.**	**Coefficients**	**z-stat.**
GovContract*HHIGov	**H2a: -**	-1.011**	2.09		
ContractSize*HHIGov	**H2a: -**			-1.156**	2.02
GovContract	-	-0.108	1.27		
ContractSize	-			-0.122	1.16
HHIGov	?	-0.341	1.28	-0.225	0.81
lnAsset	-	-0.545***	11.95	-0.545***	11.96
M/B	+	-0.028	1.19	-0.028	1.19
FirmAge	-	-0.017***	4.58	-0.017***	4.59
Leverage	+	-0.088	1.04	-0.088	1.04
%Loss	+	0.197**	2.06	0.197**	2.06
SalesGrowth	+	0.001	1.05	0.001	1.07
Inventory	+	0.265	0.81	0.265	0.80
lnAuditFees	+	1.325***	18.46	1.324***	18.44
CeoChair	+	0.019	0.32	0.020	0.32
LnAnalyst	-	-0.090**	2.45	-0.091**	2.47
ACSize	?	0.017	0.63	0.017	0.63
ACExperts	-	-0.510***	4.26	-0.511***	4.27
Independence	-	0.312*	1.89	0.312*	1.89
Big4	-	-0.266***	4.30	-0.267***	4.30
LnAudtenure	-	-0.106**	2.22	-0.106**	2.23
Year Fixed Effect		Yes		Yes	
Industry Fixed Effect		Yes		Yes	
Pseudo R^2		7.79%		7.78%	
Observations		47,208		47,208	

Table 10 Panel B reports results from estimating Equation (4) modified to include HHIGov and its interaction with GovContract and GovContract to test Hypothesis 2a. The dependent variable is NumWeaknesses. All variables are defined in Appendix A. Industry fixed effects are based on SIC 2-digit codes, and reported significance is based on robust standard errors and two-tailed tests, adjusted for heteroscedasticity and clustered by firm. ***, ** and * represent significance at 1%, 5% and 10% levels, respectively.

Table 11 Regression of Accounting Restatements on Government Contracting in Low Competition Industry

Panel A: Regression of Restatements on Government Contracting in Low Competition Industry

		Dependent Variable = Restatement			
		Model (1)		**Model (2)**	
Variables	**Pred.**	**Coefficients**	**z-stat.**	**Coefficients**	**z-stat.**
Constant		-6.000***	13.03	-5.981***	13.01
GovContract*HHIGov	**H2a: -**	0.183	0.80		
ContractSize*HHIGov	**H2a: -**			0.190	0.71
GovContract	-	-0.114**	2.24		
ContractSize	-			-0.128**	2.03
HHIGov	?	0.384**	2.50	0.366**	2.31
lnAsset	-	-0.143***	7.49	-0.143***	7.51
M/B	+	-0.001	0.15	-0.001	0.15
FirmAge	-	-0.004**	1.96	-0.004**	1.97
Leverage	+	0.081***	3.14	0.081***	3.14
ΔInventory	+	0.766	1.00	0.767	1.00
ΔReceivables	+	0.185	0.35	0.186	0.35
lnAuditFees	+	0.304***	10.14	0.304***	10.14
%ΔCashSales	+	0.040***	2.89	0.040***	2.89
E/P	?	-0.018**	2.34	-0.018**	2.34
ΔROA	-	-0.129	1.60	-0.130	1.60
CeoChair	?	0.041	1.02	0.041	1.02
LnAnalyst	-	-0.115***	5.33	-0.115***	5.35
ACSize	-	0.035*	1.93	0.035*	1.93
ACExperts	-	0.002	0.03	0.002	0.03
Independence	-	-0.167	1.44	-0.167	1.44
Big4	-	-0.246***	6.59	-0.246***	6.59
LnAudtenure	-	0.035	1.24	0.035	1.23
Year Fixed Effect		Yes		Yes	
Industry Fixed Effect		Yes		Yes	
Pseudo R^2		2.94%		2.93%	
Observations		58,988		58,988	

Table 11 Panel A reports results from estimating Equation (5) modified to include HHIGov and its interaction with GovContract and GovContract to test Hypothesis 2a. The dependent variable is Restatement. All variables are defined in Appendix A. Industry fixed effects are based on SIC 2-digit codes, and reported significance is based on robust standard errors and two-tailed tests, adjusted for heteroscedasticity and clustered by firm. ***, ** and * represent significance at 1%, 5% and 10% levels, respectively.

Table 11 (continued)

Panel B: Regression of SEC Enforcement and Fraud on Government Contracting in Low Competition Industry

		Dependent Variable = FRAUD			
		Model (1)		Model (2)	
Variables	**Pred.**	**Coefficients**	**z-stat.**	**Coefficients**	**z-stat.**
Constant		-6.276***	4.89	-6.245***	4.87
GovContract*HHIGov	**H2a: -**	0.456	0.59		
ContractSize*HHIGov	**H2a: -**			0.622	0.69
GovContract	-	-0.296*	1.68		
ContractSize	-			-0.381*	1.76
HHIGov	?	-0.118	0.29	-0.187	0.44
lnAsset	-	0.051	0.87	0.050	0.86
M/B	+	0.005	0.87	0.005	0.86
FirmAge	-	-0.012*	1.71	-0.012*	1.70
Leverage	+	0.164***	3.27	0.164***	3.27
ΔInventory	+	-1.194	0.70	-1.193	0.70
ΔReceivables	+	0.260	0.21	0.260	0.21
lnAuditFees	+	0.196**	2.18	0.197**	2.19
%ΔCashSales	+	0.042	1.42	0.042	1.42
E/P	?	0.019	0.91	0.019	0.92
ΔROA	-	-0.128	0.82	-0.128	0.82
CeoChair	?	0.209	1.56	0.210	1.57
LnAnalyst	-	-0.127	1.60	-0.128	1.60
ACSize	-	0.093**	2.01	0.094**	2.02
ACExperts	-	-0.160	0.60	-0.160	0.60
Independence	-	-0.500	1.52	-0.501	1.52
Big4	-	-0.320**	2.38	-0.321**	2.39
LnAudtenure	-	-0.102	1.10	-0.102	1.10
Year Fixed Effect		Yes		Yes	
Industry Fixed Effect		Yes		Yes	
Pseudo R^2		4.81%		4.82%	
Observations		58,988		58,988	

Table 11 Panel B reports results from estimating Equation (5) modified to include HHIGov and its interaction with GovContract and GovContract to test Hypothesis 2a. The dependent variable is FRAUD. The dependent variable is Restatement. All variables are defined in Appendix A. Industry fixed effects are based on SIC 2-digit codes, and reported significance is based on robust standard errors and two-tailed tests, adjusted for heteroscedasticity and clustered by firm. ***, ** and * represent significance at 1%, 5% and 10% levels, respectively.

Table 12 Regression of Accruals Management on Government Contracting in High Government Switching Cost Firms

Panel A: Regression of Discretionary Accruals on Government Contracting in High Government Switching Cost Firms

		Dependent Variable = AbsAccruals			
		Model (1)		**Model (2)**	
Variables	**Pred.**	**Coefficients**	**t-stat.**	**Coefficients**	**t-stat.**
Constant		0.212***	12.79	0.214***	12.83
GovContract*GovSC	**H2b: +**	0.010***	2.64		
ContractSize*GovSC	**H2b: +**			0.012**	2.46
GovContract	-	-0.014*	1.72		
ContractSize	-			-0.017	1.55
GovSC	?	-0.008***	4.62	-0.009***	4.55
lnAsset	-	-0.023***	22.74	-0.023***	22.73
M/B	+	0.006***	4.91	0.006***	4.91
FirmAge	-	-0.000	1.09	-0.000	1.10
Leverage	+	0.044***	4.99	0.044***	4.99
Loss	+	0.039***	14.02	0.039***	14.01
CfoVolit	+	0.043***	2.97	0.043***	2.97
SalesVol	+	-0.008*	1.89	-0.008*	1.89
%ΔCashSales	+	0.017***	8.37	0.017***	8.37
ΔROA	+	0.020	0.90	0.020	0.90
E/P	?	-0.007***	6.35	-0.007***	6.35
CeoChair	+	0.003	1.56	0.003	1.56
LnAnalyst	-	-0.001	0.96	-0.001	0.96
ACSize	?	0.007***	7.65	0.007***	7.64
ACExperts	-	-0.009***	2.64	-0.009***	2.61
Independence	-	-0.089***	12.60	-0.089***	12.60
Big4	-	-0.010***	5.38	-0.010***	5.37
LnAudTenure	-	-0.007***	4.20	-0.007***	4.20
Year Fixed Effect		Yes		Yes	
Industry Fixed Effect		Yes		Yes	
Adjusted R^2		18.47%		18.48%	
Observations		58,988		58,988	

Table 12 Panel A reports results from estimating Equation (3) modified to include GovSC and its interaction with GovContract and GovContract to test Hypothesis 2b. The dependent variable is AbsAccruals. All variables are defined in Appendix A. Industry fixed effects are based on SIC 2-digit codes, and reported significance is based on robust standard errors and two-tailed tests, adjusted for heteroscedasticity and clustered by firm. ***, ** and * represent significance at 1%, 5% and 10% levels, respectively.

Table 12 (continued)

Panel B: Regression of Accruals Quality on Government Contracting in High Government Switching Cost Firms

		Dependent Variable = AccrualQuality			
		Model (1)		**Model (2)**	
Variables	**Pred.**	**Coefficients**	**t-stat.**	**Coefficients**	**t-stat.**
Constant		0.018***	4.00	0.020***	4.25
GovContract*GovSC	**H2b: +**	0.003**	2.48		
GovContract*GovSC	**H2b: +**			0.005**	2.57
GovContract	-	-0.010***	3.05		
ContractSize	-			-0.012***	2.97
GovSC	?	-0.000	0.63	-0.001	1.25
lnAsset	-	-0.002***	5.76	-0.002***	5.77
M/B	+	0.000	0.57	0.000	0.57
FirmAge	-	-0.000*	1.94	-0.000*	1.94
Leverage	+	0.002	0.68	0.002	0.68
Loss	+	-0.009***	9.66	-0.009***	9.65
CfoVolit	+	0.019***	3.42	0.019***	3.42
SalesVol	+	-0.002	1.20	-0.002	1.20
%ΔCashSales	+	-0.001**	2.08	-0.001**	2.08
ΔROA	+	0.065***	12.03	0.065***	12.03
E/P	?	0.003***	6.17	0.003***	6.17
CeoChair	+	0.001*	1.91	0.001*	1.90
LnAnalyst	-	-0.002***	3.80	-0.002***	3.80
ACSize	?	0.000	0.65	0.000	0.65
ACExperts	-	0.000	0.21	0.000	0.21
Independence	-	-0.001	0.26	-0.001	0.26
Big4	-	0.001	1.12	0.001	1.12
LnAudTenure	-	-0.001	1.43	-0.001	1.42
Year Fixed Effect		Yes		Yes	
Industry Fixed Effect		Yes		Yes	
Adjusted R^2		3.24%		3.25%	
Observations		58,988		58,988	

Table 12 Panel B reports results from estimating Equation (3) modified to include GovSC and its interaction with GovContract and GovContract to test Hypothesis 2b. The dependent variable is AccrualQuality. All variables are defined in Appendix A. Industry fixed effects are based on SIC 2-digit codes, and reported significance is based on robust standard errors and two-tailed tests, adjusted for heteroscedasticity and clustered by firm. ***, ** and * represent significance at 1%, 5% and 10% levels, respectively.

Table 13 Regression of Internal Control Quality on Government Contracting in High Government Switching Cost Firms

Panel A: Regression of Internal Control Weakness on Government Contracting in High Government Switching Cost Firms

		Dependent Variable = IneffControls			
		Model (1)		**Model (2)**	
Variables	**Pred.**	**Coefficients**	**z-stat.**	**Coefficients**	**z-stat.**
Constant		-16.361***	16.78	-16.363***	16.76
GovContract* GovSC	**H2b: +**	0.047	0.41		
ContractSize* GovSC	**H2b: +**			0.027	0.20
GovContract	-	-0.064	0.30		
ContractSize	-			0.014	0.05
GovSC	?	-0.123**	2.10	-0.130**	1.97
lnAsset	-	-0.503***	11.98	-0.503***	11.97
M/B	+	-0.026	1.14	-0.026	1.14
FirmAge	-	-0.017***	4.42	-0.017***	4.41
Leverage	+	-0.095	1.12	-0.096	1.13
%Loss	+	0.195**	2.09	0.194**	2.07
SalesGrowth	+	0.001	0.89	0.001	0.89
Inventory	+	0.247	0.77	0.247	0.77
lnAuditFees	+	1.243***	19.58	1.243***	19.57
CeoChair	+	0.020	0.33	0.020	0.33
LnAnalyst	-	-0.083**	2.31	-0.083**	2.31
ACSize	?	0.020	0.77	0.020	0.78
ACExperts	-	-0.482***	4.06	-0.481***	4.05
Independence	-	0.326**	2.03	0.325**	2.02
Big4	-	-0.252***	4.13	-0.252***	4.14
LnAudtenure	-	-0.102**	2.17	-0.101**	2.16
Year Fixed Effect		Yes		Yes	
Industry Fixed Effect		Yes		Yes	
Pseudo R^2		10.33%		10.34%	
Observations		47,208		47,208	

Table 13 Panel A reports results from estimating Equation (4) modified to include GovSC and its interaction with GovContract and GovContract to test Hypothesis 2b. The dependent variable is IneffControls. All variables are defined in Appendix A. Industry fixed effects are based on SIC 2-digit codes, and reported significance is based on robust standard errors and two-tailed tests, adjusted for heteroscedasticity and clustered by firm. ***, ** and * represent significance at 1%, 5% and 10% levels, respectively.

Table 13 (continue)

Panel B: Regression of Number of Internal Control Weakness on Government Contracting in High Government Switching Cost Firms

		Dependent Variable = NumWeaknesses			
		Model (1)		**Model (2)**	
Variables	**Pred.**	**Coefficients**	**z-stat.**	**Coefficients**	**z-stat.**
GovContract* GovSC	**H2b: +**	0.045	0.39		
ContractSize* GovSC	**H2b: +**			0.021	0.15
GovContract	-	-0.060	0.27		
ContractSize	-			0.028	0.10
GovSC	?	-0.123**	2.09	-0.129*	1.93
lnAsset	-	-0.544***	11.90	-0.544***	11.89
M/B	+	-0.028	1.20	-0.028	1.19
FirmAge	-	-0.017***	4.35	-0.016***	4.34
Leverage	+	-0.089	1.04	-0.089	1.05
%Loss	+	0.185*	1.94	0.184*	1.92
SalesGrowth	+	0.001	0.91	0.001	0.91
Inventory	+	0.281	0.85	0.281	0.85
lnAuditFees	+	1.324***	18.44	1.324***	18.43
CeoChair	+	0.016	0.26	0.016	0.26
LnAnalyst	-	-0.088**	2.40	-0.088**	2.40
ACSize	?	0.018	0.67	0.018	0.68
ACExperts	-	-0.503***	4.19	-0.501***	4.19
Independence	-	0.320*	1.94	0.319*	1.93
Big4	-	-0.264***	4.27	-0.265***	4.28
LnAudtenure	-	-0.102**	2.13	-0.102**	2.12
Year Fixed Effect		Yes		Yes	
Industry Fixed Effect		Yes		Yes	
Pseudo R^2		7.78%		7.79%	
Observations		47,208		47,208	

Table 13 panel B reports results from estimating Equation (4) modified to include GovSC and its interaction with GovContract and GovContract to test Hypothesis 2b. The dependent variable is NumWeaknesses. All variables are defined in Appendix A. Industry fixed effects are based on SIC 2-digit codes, and reported significance is based on robust standard errors and two-tailed tests, adjusted for heteroscedasticity and clustered by firm. ***, ** and * represent significance at 1%, 5% and 10% levels, respectively.

Table 14 Regression of Accounting Restatements on Government Contracting in High Government Switching Cost Firms

Panel A: Regression of Restatements on Government Contracting in High Government Switching Cost Firms

		Dependent Variable = Restatement			
		Model (1)		**Model (2)**	
Variables	**Pred.**	**Coefficients**	**z-stat.**	**Coefficients**	**z-stat.**
Constant		-5.718***	12.87	-5.704***	12.82
GovContract* GovSC	**H2b: +**	0.134**	1.99		
ContractSize* GovSC	**H2b: +**			0.137*	1.69
GovContract	-	-0.178	1.28		
ContractSize	-			-0.150	0.87
GovSC	?	-0.115***	3.31	-0.129***	3.34
lnAsset	-	-0.144***	7.53	-0.143***	7.50
M/B	+	-0.001	0.17	-0.001	0.16
FirmAge	-	-0.004*	1.81	-0.004*	1.80
Leverage	+	0.081***	3.15	0.081***	3.14
ΔInventory	+	0.799	1.05	0.802	1.05
ΔReceivables	+	0.194	0.37	0.194	0.37
lnAuditFees	+	0.305***	10.17	0.304***	10.16
%ΔCashSales	+	0.040***	2.86	0.040***	2.86
E/P	?	-0.018**	2.35	-0.018**	2.35
ΔROA	-	-0.130	1.60	-0.130	1.60
CeoChair	?	0.040	1.00	0.040	1.00
LnAnalyst	-	-0.112***	5.15	-0.112***	5.16
ACSize	-	0.037**	2.02	0.037**	2.02
ACExperts	-	0.002	0.02	0.004	0.05
Independence	-	-0.159	1.37	-0.160	1.38
Big4	-	-0.243***	6.52	-0.243***	6.51
LnAudtenure	-	0.040	1.40	0.041	1.42
Year Fixed Effect		Yes		Yes	
Industry Fixed Effect		Yes		Yes	
Pseudo R^2		2.96%		2.95%	
Observations		58,988		58,988	

Table 14 Panel A reports results from estimating Equation (5) modified to include GovSC and its interaction with GovContract and GovContract to test Hypothesis 2b. The dependent variable is Restatement. All variables are defined in Appendix A. Industry fixed effects are based on SIC 2-digit codes, and reported significance is based on robust standard errors and two-tailed tests, adjusted for heteroscedasticity and clustered by firm. ***, ** and * represent significance at 1%, 5% and 10% levels, respectively.

Table 14 (continued)

Panel B: Regression of SEC Enforcement and Fraud on Government Contracting in High Government Switching Cost Firms

		Dependent Variable = FRAUD			
		Model (1)		Model (2)	
Variables	**Pred.**	**Coefficients**	**z-stat.**	**Coefficients**	**z-stat.**
Constant		-6.394***	5.07	-6.471***	5.13
GovContract* GovSC	**H2b: +**	-0.401**	2.09		
ContractSize* GovSC	**H2b: +**			-0.472**	1.99
GovContract	-	0.658*	1.84		
ContractSize	-			0.780*	1.75
GovSC	?	0.007	0.07	0.049	0.41
lnAsset	-	0.056	0.96	0.056	0.95
M/B	+	0.005	0.94	0.005	0.94
FirmAge	-	-0.011	1.61	-0.011	1.61
Leverage	+	0.164***	3.23	0.164***	3.23
ΔInventory	+	-1.145	0.67	-1.150	0.67
ΔReceivables	+	0.267	0.21	0.264	0.21
lnAuditFees	+	0.196**	2.18	0.196**	2.19
%ΔCashSales	+	0.041	1.39	0.041	1.39
E/P	?	0.020	0.94	0.020	0.95
ΔROA	-	-0.128	0.81	-0.128	0.81
CeoChair	?	0.214	1.60	0.215	1.60
LnAnalyst	-	-0.127	1.61	-0.127	1.61
ACSize	-	0.099**	2.15	0.100**	2.16
ACExperts	-	-0.146	0.55	-0.148	0.56
Independence	-	-0.523	1.59	-0.522	1.59
Big4	-	-0.320**	2.39	-0.320**	2.39
LnAudtenure	-	-0.098	1.04	-0.098	1.04
Year Fixed Effect		Yes		Yes	
Industry Fixed Effect		Yes		Yes	
Pseudo R^2		4.93%		4.92%	
Observations		58,988		58,988	

Table 14 Panel B reports results from estimating Equation (5) modified to include GovSC and its interaction with GovContract and GovContract to test Hypothesis 2b. The dependent variable is FRAUD. All variables are defined in Appendix A. Industry fixed effects are based on SIC 2-digit codes, and reported significance is based on robust standard errors and two-tailed tests, adjusted for heteroscedasticity and clustered by firm. ***, ** and * represent significance at 1%, 5% and 10% levels, respectively.

Table 15 Estimations H1 using PSM sample

Panel A: Re-estimating AbsAccruals as the dependent variable using PSM sample

		Model (1)		Model (2)	
Variables	**Pred.**	**Coefficients**	**t-stat.**	**Coefficients**	**t-stat.**
GovContract	**H1: -**	-0.006***	2.73		
ContractSize	**H1: -**			-0.018***	15.74
Controls		Yes		Yes	
Year Fixed Effect		Yes		Yes	
Industry Fixed Effect		Yes		Yes	
Adjusted R^2		16.11%		16.10%	
Observations		38,462		38,462	

Panel B: Re-estimating AccrualQuality as the dependent variable using PSM sample

		Model (1)		Model (2)	
Variables	**Pred.**	**Coefficients**	**t-stat.**	**Coefficients**	**t-stat.**
GovContract	**H1: -**	-0.003***	3.17		
ContractSize	**H1: -**			-0.001***	4.09
Controls		Yes		Yes	
Year Fixed Effect		Yes		Yes	
Industry Fixed Effect		Yes		Yes	
Adjusted R^2		3.01%		3.00%	
Observations		38,462		38,462	

Panel C: Re-estimating IneffControl as the dependent variable using PSM sample

		Model (1)		Model (2)	
Variables	**Pred.**	**Coefficients**	**t-stat.**	**Coefficients**	**t-stat.**
GovContract	**H1: -**	-0.149***	2.08		
ContractSize	**H1: -**			-0.559***	11.51
Controls		Yes		Yes	
Year Fixed Effect		Yes		Yes	
Industry Fixed Effect		Yes		Yes	
Adjusted R^2		9.21%		9.20%	
Observations		30,578		30,578	

Table 15 (continued)

Panel D: Re-estimating NumWeaknesses as the dependent variable using PSM sample

		Model (1)		Model (2)	
Variables	**Pred.**	**Coefficients**	**t-stat.**	**Coefficients**	**t-stat.**
GovContract	**H1: -**	-0.161***	2.18		
ContractSize	**H1: -**			-0.592***	11.27
Controls		Yes		Yes	
Year Fixed Effect		Yes		Yes	
Industry Fixed Effect		Yes		Yes	
Adjusted R^2		8.12%		8.11%	
Observations		30,578		30,578	

Panel E: Re-estimating Restatement as the dependent variable using PSM sample

		Model (1)		Model (2)	
Variables	**Pred.**	**Coefficients**	**t-stat.**	**Coefficients**	**t-stat.**
GovContract	**H1: -**	-0.098**	2.11		
ContractSize	**H1: -**			-0.166***	6.81
Controls		Yes		Yes	
Year Fixed Effect		Yes		Yes	
Industry Fixed Effect		Yes		Yes	
Adjusted R^2		3.16%		3.17%	
Observations		38,462		38,462	

Panel F: Re-estimating FRAUD as the dependent variable using PSM sample

		Model (1)		Model (2)	
Variables	**Pred.**	**Coefficients**	**t-stat.**	**Coefficients**	**t-stat.**
GovContract	**H1: -**	-0.25*	1.67		
ContractSize	**H1: -**			-0.027	0.39
Controls		Yes		Yes	
Year Fixed Effect		Yes		Yes	
Industry Fixed Effect		Yes		Yes	
Adjusted R^2		5.45%		5.43%	
Observations		38,462		38,462	

Table 16 Estimations H2a using PSM sample

Panel A: Re-estimating AbsAccruals as the dependent variable using PSM sample

		Model (1)		Model (2)	
Variables	**Pred.**	**Coefficients**	**t-stat.**	**Coefficients**	**t-stat.**
GovContract*HHIGov	**H2a: -**	0.029***	3.35		
ContractSize*HHIGov	**H2a: -**			0.033***	3.16
Controls		Yes		Yes	
Year Fixed Effect		Yes		Yes	
Industry Fixed Effect		Yes		Yes	
Adjusted R^2		16.11%		16.10%	
Observations		38,462		38,462	

Panel B: Re-estimating AccrualQuality as the dependent variable using PSM sample

		Model (1)		Model (2)	
Variables	**Pred.**	**Coefficients**	**t-stat.**	**Coefficients**	**t-stat.**
GovContract*HHIGov	**H2a: -**	0.014***	3.06		
ContractSize*HHIGov	**H2a: -**			0.016***	3.04
Controls		Yes		Yes	
Year Fixed Effect		Yes		Yes	
Industry Fixed Effect		Yes		Yes	
Adjusted R^2		3.01%		3.00%	
Observations		38,462		38,462	

Panel C: Re-estimating IneffControls as the dependent variable using PSM sample

		Model (1)		Model (2)	
Variables	**Pred.**	**Coefficients**	**t-stat.**	**Coefficients**	**t-stat.**
GovContract*HHIGov	**H2a: -**	-0.981**	2.15		
ContractSize*HHIGov	**H2a: -**			-1.171**	2.17
Controls		Yes		Yes	
Year Fixed Effect		Yes		Yes	
Industry Fixed Effect		Yes		Yes	
Adjusted R^2		9.27%		9.26%	
Observations		30,578		30,578	

Table 16 (continued)

Panel D: Re-estimating NumWeaknesses as the dependent variable using PSM sample

		Model (1)		Model (2)	
Variables	**Pred.**	**Coefficients**	**t-stat.**	**Coefficients**	**t-stat.**
GovContract*HHIGov	**H2a: -**	-0.892*	1.93		
ContractSize*HHIGov	**H2a: -**			-1.050*	1.92
Controls		Yes		Yes	
Year Fixed Effect		Yes		Yes	
Industry Fixed Effect		Yes		Yes	
Adjusted R^2		8.16%		8.15%	
Observations		30,578		30,578	

Panel E: Re-estimating Restatement as the dependent variable using PSM sample

		Model (1)		Model (2)	
Variables	**Pred.**	**Coefficients**	**t-stat.**	**Coefficients**	**t-stat.**
GovContract*HHIGov	**H2a: -**	0.091	0.39		
ContractSize*HHIGov	**H2a: -**			0.047	0.17
Controls		Yes		Yes	
Year Fixed Effect		Yes		Yes	
Industry Fixed Effect		Yes		Yes	
Adjusted R^2		3.19%		3.18%	
Observations		38,462		38,462	

Panel F: Re-estimating FRAUD as the dependent variable using PSM sample

		Model (1)		Model (2)	
Variables	**Pred.**	**Coefficients**	**t-stat.**	**Coefficients**	**t-stat.**
GovContract*HHIGov	**H2a: -**	0.559	0.69		
ContractSize*HHIGov	**H2a: -**			0.708	0.76
Controls		Yes		Yes	
Year Fixed Effect		Yes		Yes	
Industry Fixed Effect		Yes		Yes	
Adjusted R^2		5.46%		5.45%	
Observations		38,462		38,462	

Table 17 Estimations H2b using PSM sample

Panel A: Re-estimating AbsAccruals as the dependent variable using PSM sample

		Model (1)		Model (2)	
Variables	**Pred.**	**Coefficients**	**t-stat.**	**Coefficients**	**t-stat.**
GovContract* GovSC	**H2b: +**	-0.002	0.47		
ContractSize* GovSC	**H2b: +**			-0.003	0.467
Controls		Yes		Yes	
Year Fixed Effect		Yes		Yes	
Industry Fixed Effect		Yes		Yes	
Adjusted R^2		16.21%		16.20%	
Observations		38,462		38,462	

Panel B: Re-estimating AccrualQuality as the dependent variable using PSM sample

		Model (1)		Model (2)	
Variables	**Pred.**	**Coefficients**	**t-stat.**	**Coefficients**	**t-stat.**
GovContract* GovSC	**H2b: +**	-0.003*	1.92		
ContractSize* GovSC	**H2b: +**			-0.004**	2.01
Controls		Yes		Yes	
Year Fixed Effect		Yes		Yes	
Industry Fixed Effect		Yes		Yes	
Adjusted R^2		3.01%		3.00%	
Observations		38,462		38,462	

Panel C: Re-estimating IneffControls as the dependent variable using PSM sample

		Model (1)		Model (2)	
Variables	**Pred.**	**Coefficients**	**t-stat.**	**Coefficients**	**t-stat.**
GovContract* GovSC	**H2b: +**	-0.001	0.002		
ContractSize* GovSC	**H2b: +**			0.016	0.109
Controls		Yes		Yes	
Year Fixed Effect		Yes		Yes	
Industry Fixed Effect		Yes		Yes	
Adjusted R^2		9.25%		9.26%	
Observations		30,578		30,578	

Table 17 (continued)

Panel D: Re-estimating NumWeaknesses as the dependent variable using PSM sample

		Model (1)		Model (2)	
Variables	**Pred.**	**Coefficients**	**t-stat.**	**Coefficients**	**t-stat.**
GovContract* GovSC	**H2b: +**	0.029	0.232		
ContractSize* GovSC	**H2b: +**			0.043	0.285
Controls		Yes		Yes	
Year Fixed Effect		Yes		Yes	
Industry Fixed Effect		Yes		Yes	
Adjusted R^2		8.14%		8.14%	
Observations		30,578		30,578	

Panel E: Re-estimating Restatement as the dependent variable using PSM sample

		Model (1)		Model (2)	
Variables	**Pred.**	**Coefficients**	**t-stat.**	**Coefficients**	**t-stat.**
GovContract* GovSC	**H2b: +**	0.158**	2.13		
ContractSize* GovSC	**H2b: +**			0.174**	1.97
Controls		Yes		Yes	
Year Fixed Effect		Yes		Yes	
Industry Fixed Effect		Yes		Yes	
Adjusted R^2		3.23%		3.23%	
Observations		38,462		38,462	

Panel F: Re-estimating FRAUD as the dependent variable using PSM sample

		Model (1)		Model (2)	
Variables	**Pred.**	**Coefficients**	**t-stat.**	**Coefficients**	**t-stat.**
GovContract* GovSC	**H2b: +**	-0.311	1.46		
ContractSize* GovSC	**H2b: +**			-0.342	1.32
Controls		Yes		Yes	
Year Fixed Effect		Yes		Yes	
Industry Fixed Effect		Yes		Yes	
Adjusted R^2		5.52%		5.55%	
Observations		38,462		38,462	

Table 18 Placebo Tests

Panel A: Discretionary Accruals

	AbsAccruals		AccrualQuality	
Variables	**Coefficients**	**t-stat.**	**Coefficients**	**t-stat.**
Placebo_GovContract	0.004	1.59	0.001	0.78
Controls	Yes		Yes	
Year Fixed Effect	Yes		Yes	
Industry Fixed Effect	Yes		Yes	
Adjusted R^2	18.40%		3.20%	
Observations	58,988		58,988	

Panel B: Internal Control Weakness

	IneffControls		NumWeaknesses	
Variables	**Coefficients**	**t-stat.**	**Coefficients**	**t-stat.**
Placebo_GovContract	0.079	1.52	0.084	1.59
Controls	Yes		Yes	
Year Fixed Effect	Yes		Yes	
Industry Fixed Effect	Yes		Yes	
Adjusted R^2	3.01%		3.00%	
Observations	38,462		38,462	

Panel C: Restatements

	Restatement		FRAUD	
Variables	**Coefficients**	**t-stat.**	**Coefficients**	**t-stat.**
Placebo_GovContract	0.062	1.57	0.072	0.843
Controls	Yes		Yes	
Year Fixed Effect	Yes		Yes	
Industry Fixed Effect	Yes		Yes	
Adjusted R^2	2.90%		4.70%	
Observations	58,988		58,988	

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