

## **Audit Engagement Partner Ideology, Ideological Homophily, and Audit Quality**

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## **Abstract**

Previous studies have shown that audit quality is influenced by the audit engagement partner's characteristics. Extending this literature, we examine the association between audit engagement partner ideology (i.e., conservatism) and audit quality. We find that clients whose audit engagement partners are ideologically more conservative receive higher quality audits, as indicated by lower discretionary accruals, than clients with less conservative auditors. Additionally, we find evidence that the relation between the auditor's ideology and that of the client's executives influences audit quality, as does the ideological homophily between the auditor and client's audit committee. Homophilous pairings between the audit engagement partner and the client's executives, where the two parties share a similar ideology, are associated with both higher discretionary accruals, and higher probabilities of restatement. Discretionary accruals are also shown to be higher when engagement partners share an ideology with their client's audit committee. We interpret these results as evidence of less effective monitoring by the engagement partner when they share political views with their clients.

**KEYWORDS:** audit quality, engagement partner characteristics, ideology, ideology homophily, discretionary accruals, restatement.

**JEL:** M42

## **1 INTRODUCTION**

The quality of a firm's financial reporting depends a great deal on the management's judgement on the application of accounting principles. An independent audit thus serves as a check on management's discretion by attesting to the quality of a firm's financial statements. Recent studies, though, have demonstrated that an audit engagement partner's characteristics can influence their decision making, and thus the quality of their audits. Gul, Wu, and Yang (2013) find that controlling for the variation in engagement partner style increases the explanatory power of their model specifications of audit quality by up to 34%. Differences in an audit engagement partner's past audit quality (Li, Qi, Tian, and Zhang, 2017), disciplinary sanctions (Chang, Chen, Chou, and Ko, 2016), experience (Chi, Myers, Omer, and Xie, 2017; Gul et al.,

2013), and education (Gul et al., 2013; Chu, Florou, and Pope, 2022) have each been shown to impact the quality of their work.

In this study we examine the effect that audit engagement partner ideology has on audit quality. An individual's ideology is associated with several key personality traits (Mondak and Halperin, 2008; Verhulst, Eaves, and Hatemi, 2012), which influence their decision making (Carney, Jost, Gosling, and Potter, 2008). Prior research finds differences in business decisions made by ideologically conservative versus ideologically liberal decision makers (Christensen, Dhaliwal, Boivie, and Graffin, 2015; Hutton, Jiang, and Kumar, 2014, 2015; Notbohm, Campbell, Smedema, and Zhang, 2019). We posit this difference in personality traits between conservative and liberal audit engagement partners influences their perspective and audit judgements, which ultimately impacts the quality of the audit.

To test this prediction, we empirically examine the relation between proxies for audit quality and a proxy for an audit engagement partner's ideology. The measure of the auditor's ideology is based on the pattern of the engagement partner's partisan political contributions. We find that discretionary accruals are 24% lower with an engagement partner who contributes exclusively to the Republican Party, relative to an engagement partner who contributes exclusively to the Democratic Party. Our main results hold in different samples of firms constructed using both entropy balancing and propensity score matching and under an alternative assumption regarding the effects of non-donors. The results of our robustness tests are consistent with the conclusion that audit quality is impacted by the audit engagement partner's ideology.

Although our model controls separately for the ideologies of the client's top executive team and audit committee, it is also important to consider the effects of the degree of ideological alignment (i.e., homophily of thoughts) between the audit engagement partner and the client's

executives and audit committee. Lee, Lee, and Nagaragin (2014, p. 233) hypothesize that monitoring becomes less effective in corporate governance when the monitor shares the same ideology with those monitored, as there is “increased empathy and acceptance” between the two parties. They observe empirical evidence of this behavior as a firm’s performance is decreasing in the ideological alignment between a firm’s executives and its board of directors.

Applying this theory of homophily to an audit engagement, we predict that an engagement partner’s empathy and acceptance of the judgement of their client’s executives will increase with the degree of ideological alignment between the parties, such that monitoring will worsen along with audit quality. Similarly, we expect that the audit committee’s monitoring of the audit will also decrease in the ideological alignment between the audit engagement partner and audit committee members. We compute separate measures of homophily between the audit engagement partner and each of the top executive team and the audit committee, based on the measure of homophily developed in Lee et al. (2014). We find that discretionary accruals are 16% higher for our firm-engagement partner pairings when executives and engagement partners share the same ideology relative to when they are dissimilar; and 21% higher for our engagement partner and audit committee pairings when they share the same ideology. In addition, the probability that a firm files a restatement increases by 4.3 percentage points when the firm’s executives and engagement partner share the same ideology. Our results also suggest that the effect of ideological alignment does not depend on the political party of the alignment.

Our findings contribute to the accounting literature in several important ways. Our study responds to the call from DeFond and Francis (2005) for additional research into identifying individual auditor characteristics that influence audit quality. This study investigates the effects of the audit engagement partner’s ideology, which has not yet been examined by researchers.

Our findings support the notion that the audit engagement partner's ideology influences audit quality. Second, we add to the growing literature on the effects a decision maker's ideology has on firm decisions (e.g., Christensen et al., 2015; Hutton et al., 2014; Notbohm et al., 2019). Although prior research finds that decision maker ideology influences decisions in other contexts, this study is the first to examine the impacts of ideology on auditing decisions. Third, our results with respect to the effects of shared ideology provide further evidence of the importance of partner-client relationships in determining audit quality. Together these findings suggest both individual traits and the diversity of traits between partners and client executives as well as client audit committees influence audit quality. Finally, our homophily results may also suggest that diversity along other dimensions between auditors and executives may be informative to the auditor selection and monitoring process, which contributes to the growing literature that examines how relationships between auditors and their client's executives influence audit outcomes (e.g., Lennox, 2005; Menon and Williams, 2004; Guan, Su, Wu, and Yang, 2016).

The remainder of our study is organized as follows: in section 2 we discuss the literature with respect to audit quality and political ideology, and then we motivate our hypotheses. Then, in section 3 we explain our empirical models, our data, and our sample. Section 4 presents our findings, and in section 5 we explain the results of our supplemental analyses. We conclude in the final section.

## **2 LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT**

### **2.1 Auditor Characteristics and Audit Quality**

The very public accounting scandals that preceded passage of the Sarbanes-Oxley Act brought to the forefront both the importance of high-quality auditing and questions about the

independence of audit engagement partners from their clients. DeFond and Francis (2005) note a number of changes imposed by the law, including restrictions on the audit partner's tenure, were intended to improve auditor independence and audit quality. While the empirical evidence suggests partner tenure influences audit quality, the direction of the effect varies by study. For example, Fitzgerald, Thompson, and Omer (2018) find partner tenure reduces internal control audit quality, whereas Chi et al. (2017) find partner experience with a specific audit client improves both audit quality and creditor perceptions of audit quality. Partner rotations also increase the probability of restatement discoveries and deferred tax valuation allowances (Laurion, Lawrence, and Ryans, 2017), suggesting that audit partner rotation may improve audit quality.

Audit quality is also influenced by other auditor characteristics. Auditors who perform poorly in one audit are shown to be more likely to perform poorly on other audits during the same time period and in subsequent years (Li et al., 2017). In addition, auditors majoring in quantitative areas and those more closely related to accounting also perform higher quality audits (Chu et al., 2022). Using Chinese data, Gul et al. (2013) similarly find strong relations between audit quality and several engagement partner characteristics, including exposure to "Western" accounting systems during their education, experience working at a Big N accounting firm, having earned a master's degree, and membership in the Chinese Communist Party.

Audit partners who are members of the Chinese Communist Party (CCP) exhibit lower audit quality (Gul et al., 2013). This finding, they note, is potentially due to Party members' ties to government elites, which weakens these auditors' incentives for oversight. Their finding, however, suggests little with respect to our interest in the effect an auditor's ideology has on their decision making. China is governed exclusively by a one-party system, thus political

affiliation in China differs fundamentally from the United States and its largely two-party system. Membership in the CCP is highly selective, as only 3.16 million applicants were admitted out of pool of 21.6 million in 2011 (Dickson, 2014). Dickson (2014, p. 43) notes the “conventional wisdom is that people join the Party, especially in recent years, primarily to enhance their career prospects rather than for political or ideological reasons.” Party affiliation with the CCP therefore reflects more about an auditors’ credentials rather than their personal ideology, in relation to non-members.

A growing literature, though, focuses on the relation between a decision maker’s ideology and the judgement they apply to business decisions. An individual’s ideology, i.e., whether they identify as conservative (Republican) or liberal (Democrat), tends to be related to differences in an individual’s core personality traits. Personality traits are important for explaining variation in decision making, as they reflect “differences in people’s motivational reactions to ... stimuli” (Dennison and Penke, 2008, p. 1298). Research has shown that individuals tend to behave similarly across different situations (Epstein, 1979; Sherman, Nave, and Funder, 2010), which is consistent with personality traits impacting decisions at home and in the office.

Personality traits are generally categorized (Dennison and Penke, 2008) as the “Big Five” and include the traits of openness to experience, conscientiousness, extraversion, agreeableness, and emotional stability. Studies find that individuals who identify as conservatives or Republicans have more conscientious personalities (Carney et al., 2008; Gerber, Huber, Doherty, Dowling, and Ha, 2010) than their counterparts who are liberals or Democrats.<sup>1</sup> Individuals with high levels of conscientiousness tend to have higher needs to achieve (Buss, 1991), are more deliberate (Kowert and Hermann, 1997), have greater self-control (Carney et al., 2008; Nettle,

2006), and more strictly adhere to rules (Atieh, Brief, and Vollrath, 1987; Carney et al., 2008 and Feather, 1979). The result is that conservatives are more risk averse in their judgement (Atieh et al., 1987; Kam and Simas, 2010).

Differences in risk aversion may explain why business decisions vary between firms managed by conservatives and those managed by liberals. For example, companies managed by Republicans tend to invest less in R&D, have less risky assets, and borrow less (Hutton et al., 2014). Similarly, companies managed by Republicans are less likely to avoid corporate taxes (Christensen et al. 2015), make more conservative accounting judgements (Dong, Li, Xie, and Zhang, 2018; Notbohm et al., 2019), and invest in larger and less risky companies (DeVault and Sias, 2017), relative to their counterparts managed by Democrats.

Determining whether psychological differences between conservative and liberal audit engagement partners influence their auditing decisions and audit quality is one purpose of our study. Auditing involves several important decisions, many of which require significant professional judgment by the audit engagement partner. These include decisions about the effects of risk factors on audit risk assessments, the audit strategy, the dollar value of materiality, the approach to negotiating with management about necessary adjustments, and the audit opinion ultimately given. Audit engagement partners are human, and thus their decisions are likely influenced by the way the engagement partner views the world, which is a function of the auditor's personal ideology. A heightened risk aversion among ideologically conservative audit engagement partners likely influences the auditor's judgements, causing conservative audit partners to place greater weights on indicators of risk of material misstatement during risk assessment activities, set lower materiality levels, and more quickly qualify the audit opinion when management refuses to record an audit difference.



Other research finds that conservatives (Republicans) place greater value on strict adherence to rules (Atieh et al., 1987; Carney et al., 2008; Feather, 1979). Conservatives' greater concerns about rule adherence likely stem from higher levels of conscientiousness (Carney et al., 2008). We expect that ideologically conservative audit engagement partners, who likely place higher value on strict rule adherence, will respond to indicators of risk of material misstatement with more extensive audit testing and respond to identified misstatements by more quickly modifying the audit opinion than liberal audit engagement partners do.

For these reasons we expect that ideologically conservative audit engagement partners, who are likely more risk averse and rule adhering, will produce audits of higher quality than their less ideologically conservative counterparts. We formalize this prediction as our first hypothesis, provided below in the alternative form.

***H<sub>1</sub>: Audits conducted by ideologically conservative audit engagement partners are of higher quality than those conducted by less conservative audit engagement partners.***

## **2.2 Engagement Partner-Client Characteristics and Audit Quality**

Audit quality is not only a function of the audit engagement partner's judgement, but it is also influenced by the judgement of the client's management and audit committee. Senior managers' personal philosophies and personality characteristics impact how aggressively management reports (Notbohm et al., 2019). Additionally, much of the auditor's investigation involves inquiry of senior managers and assessment of evidence provided by those managers. Senior management's personality characteristics may impact both how transparently they respond to auditor inquiries and their willingness to provide audit evidence. Further, at the end of

the audit, management may need to negotiate with the audit engagement partner about recognition of identified audit differences. Management's negotiation approach and willingness to journalize these differences impacts the auditor's opinion.

In the post-Sarbanes Oxley era, the audit committee's role in the audit has grown. The audit committee hires, compensates, and fires the financial statement auditor (Sarbanes Oxley Act, 2002, Section 301). The audit committee is also responsible for overseeing the audit process, "including resolution of disagreements between management and the auditor regarding financial reporting" (Sarbanes Oxley Act, 2002, Section 301). Additionally, the auditor is required to communicate to the audit committee about all significant and unusual transactions, difficult or contentious auditing matters that necessitated the auditor consult outside the engagement team, and both corrected and uncorrected audit differences (PCAOB, AS1301). Thus, the audit committee potentially plays an important monitoring role over both the auditor and management.

We theorize that shared ties between the engagement partner and their client's senior executives and audit committee may reduce their effectiveness as an independent monitor. Previous research finds that strong executive-board member network ties weaken the board's ability to exercise their governance role over management (Fich and White, 2005; Fracassi and Tate, 2012). Others (Lennox, 2005; Menon and Williams, 2004) find that executives and directors with previous affiliations with their employer's auditing firm can impair the auditor's ability to objectively assess audit evidence. Guan et al. (2016) finds that when school ties exist between auditors and executives, the probability of a clean audit opinion or a less severe audit opinion is higher. These studies suggest a monitoring party's (board member's or auditor's)

connections with the monitored party (executive) results in a bias in favor of, or trust in, the monitored party (executive).

Psychologists and sociologists have long studied the effects of homophily, a type of interconnectedness between individuals, on decision making. Homophily is defined by McPherson, Smith-Lovin, and Cook (2001, p. 416) as “the principle that a contact between similar people occurs at a higher rate than among dissimilar people.” The idea behind the homophily principle is that similarity between individuals breeds connection (McPherson et al., 2001) and builds trust (Ruef, Aldrich, and Carter, 2003), which is valued by individuals, such that individuals prefer interactions with others who are similar to them. Currarini and Mengel (2016) finds experimental evidence in support of the homophily principle-that individuals self-select into groups of other similar individuals (homophily) and individuals tend to give disproportionate economic benefits to individuals who are similar (in-group bias) relative to those who are dissimilar.

Knoke (1990) finds that the homophily principle extends to individuals’ personal political beliefs. Lee et al. (2014) theorize that this similarity in personal, political values between executives and board members breeds personal connections between the two groups, resulting in shared “empathy and acceptance” of each other. They find, consistent with their predictions and the findings in other connectedness studies, that greater board-executive homophily is associated with weaker governance. Similarly, Alnahedh and Alhashel (2021) find higher probability of merger when acquirer and target companies share common executive ideologies, and these homophilous mergers have lower announcement period returns, lower post-merger performance, and higher proportions of retained target managers. If ideological homophily between executives and board members can induce shared “empathy and acceptance” of each other (Lee et al. 2014), then it’s likely that ideological homophily between the audit engagement partner and either the

firm's executives or the audit committee members will result in a similar effect. Stated succinctly, we expect auditor independence, and thus audit quality, is decreasing with the magnitude of ideological homophily between the audit engagement partner and both the client's audit committee and the client's executives. These two predictions are stated formally as our second and third hypotheses, given below in the alternative form.

***H<sub>2</sub>: Audit quality decreases with the degree of ideological alignment between the audit engagement partner and members of the client's senior executives.***

***H<sub>3</sub>: Audit quality decreases with the degree of ideological alignment between the audit engagement partner and members of the client's audit committee.***

However, there are also reasons why the audit engagement partner's ideology and their ideological homophily with the client's audit committee and management may be unrelated to audit quality. One, auditors are required to maintain strong independence from client representatives. The auditor's independence from the client is both a formal requirement and a professional ideal.<sup>2</sup> Independence requirements likely reduce the influences of the auditor's ideology and ideological alignment with management and/or the audit committee on audit quality. Two, PCAOB Auditing Standard 7 requires all risk assessments, responses to significant risks, significant judgements made, conclusions decided, and documentation created for audits of issuer financial statements be reviewed by a second independent audit partner or equivalent individual (PCAOB, AS7). This type of second partner review likely reduces variation in audit quality, potentially decoupling audit quality from the engagement partner's ideology. Ultimately,

each of the hypothesized relations are empirical issues. In the next section we discuss how we empirically test them.

### **3 MODEL SPECIFICATIONS, DATA AND SAMPLE**

#### **3.1 Sample of Engagement Partners and Client Firms**

To test our hypotheses, we use data from Form AP filings with the PCAOB, which requires disclosure of the engagement partner's name for issuer audit reports issued on or after January 31, 2017.<sup>3</sup> In the dataset, there are 12,584 firm-year observations of U.S. issuer audit clients for which the ticker or CIK is found in Compustat. This restriction is required for us to construct a number of financial statement-based control variables. To test our second and third hypotheses we must identify the clients' key executives and audit committee members. We rely on data from two additional databases to identify those individuals. ExecuComp is used to identify the senior executives (i.e., five highest paid employees) and their characteristics, while ISS is used to identify members of the audit committee and their characteristics. Both databases, though, lack information for a number of firms in the PCAOB dataset. So, we eliminate 7,376 observations where we lack Execucomp data and another 1,387 observations where we lack ISS director data. Finally, we remove another 1,561 observations due to missing values for other controls used in our analyses. Our sample thus consists of 2,260 observations, which cover fiscal years 2016-2019.<sup>4</sup> Table 1 summarizes the construction of our sample.

[Insert Table 1 about here]

#### **3.2 Measures of Audit Quality**

Archival auditing researchers have employed many different measures of audit quality (see DeFond and Zhang, 2014 for more discussion on these). Since our research question is focused on the audit quality differences that result from the audit engagement partner's ideology,

we selected measures of audit output quality, rather than input quality, and of actual quality, rather than perceived quality. Among those, three measures of audit quality have been used extensively throughout the audit quality literature and include discretionary accruals (Becker, DeFond, Jiambalvo, and Subramanyam, 1998; Bryan and Mason, 2020; Francis and Yu, 2009), probability of restatement (Kinney, Palmrose, and Scholz 2004), and probability of a going-concern audit opinion (Blay, Moon, and Paterson, 2016). In our analyses we use two of these measures of audit quality: the absolute value of discretionary accruals and the probability of restatement.<sup>5</sup>

We estimate discretionary accruals (*DISCRETIONARY ACCRUALS*) using a cross-sectional performance-adjusted discretionary accrual model, as described in Kothari, Leone, and Wasley (2005) and below in equation (1). We estimate equation (1) by year and industry, where we identify the industry using the first two-digits of the client's SIC code.

$$TA_{i,t}/ASSETS_{i,t-1} = \alpha_1 * 1/ASSETS_{i,t-1} + \alpha_2 * (\Delta SALES_{i,t} - \Delta AR_{i,t})/ASSETS_{i,t-1} + \alpha_3 * PPE_{i,t}/ASSETS_{i,t-1} + \alpha_4 * ROA_{i,t} + \varepsilon_{i,t} \quad (1)$$

Total accruals,  $TA_{it}$ , is calculated as the change in non-cash current assets minus the change in current liabilities, excluding the current portion of long-term debt, depreciation, and amortization. The modified change in sales variable is calculated as  $\Delta SALES_{it} - \Delta AR_{it}$ , where  $\Delta SALES_{it}$  is the change in sales and  $\Delta AR_{it}$  is the change in net accounts receivable.  $PPE_{it}$  is the level of gross property, plant, and equipment. All the variables are scaled by lagged total assets  $ASSETS_{it-1}$ . We also include  $ROA_{it}$ , which equals net income scaled by lagged total assets, as the measure of firm performance. The model's residuals are the estimated signed discretionary accruals, and we use the absolute value of the signed discretionary accruals as our first measure of audit quality.<sup>6</sup>

The probability of restatement has also been used extensively in the literature as an indicator of poor audit quality because of its unambiguous association with poor financial reporting and audit quality (Francis and Yu, 2009; Kinney et al., 2004; Paterson and Valencia, 2011). For this reason, we also use the probability of a financial statement restatement (*RESTATEMENT*) as an alternative measure of audit quality. We define *RESTATEMENT* as an indicator variable that is equal to one if the client company restated their financial statements for a given fiscal year, and zero otherwise.

Each of our models controls for several factors identified in the literature as influencing audit quality. A number of client firm-level measures based on the firm's financial statement data are included in the specification. Firm size (*SIZE*) and cash flow from operations (*CFO*) are included because prior literature finds that they are negatively associated with the absolute value of discretionary accruals (Becker et al., 1998; Dechow, Sloan, and Sweeney 1995; Francis and Yu, 2009; Hribar and Nichols, 2007). We include sales growth (*SALES GROWTH*), leverage (*LEVERAGE*), bankruptcy risk (*Z-SCORE*), and reported losses (*LAGLOSS*) as controls because they are positively associated with earnings management (DeFond and Jiambalvo, 1994; Menon and Williams, 2004; Francis and Yu, 2009). We also include the market-to-book ratio (*MARKET TO BOOK*), following Francis and Yu (2009). Operating volatility is positively related to the absolute value of discretionary accruals (Hribar and Nichols, 2007), so we control for volatility of sales (*SALES VOLATILITY*) and volatility of cash flow from operations (*CF VOLATILITY*). We control for internal control weakness (*MATERIAL WEAKNESS*) because internal control strength is correlated with financial reporting quality (Doyle, Ge, and McVay, 2007).

The specification also includes several controls for management and audit committee characteristics that may affect financial reporting decisions. We include the age of the CEO

(*CEO AGE*) and the CEO's gender (*CEO GENDER*) (Krishnan and Parsons, 2008; Lee et al., 2014; Pham, Pham and Truong, 2022). We control for the percentage of financial experts on the audit committee (*AUDIT COM. FINEXP*) because prior research (Abbott, Parker, and Peters, 2004; Dhaliwal, Naiker, and Navissi, 2010) finds that audit committee financial expertise improves oversight of the financial reporting process and is negatively associated with indicators of poor financial reporting. We include the percentage of total audit committee compensation represented by stock option awards (*AUDIT COM. OPTIONS*) to control for the audit committee's incentives to monitor management (Lee et al., 2014). The average age of audit committee members (*AUDIT COM. AGE*) and size of the committee (*AUDIT COM. SIZE*) are also included, as they have been shown to affect accounting quality (Dao, Huang, and Zhu, 2013; Ghosh, Marra, and Moon, 2010).

Auditor characteristics, beyond their political ideology, may also influence audit quality. We control for the size of the audit firm (*AUDITOR BIG 4*) because prior research finds that larger firms provide better quality audits (e.g., Teoh and Wong, 1993 and Becker et al., 1998). We also control for audit firm tenure (*AUDITOR TENURE*) because longer auditor tenure is associated with higher audit quality (Ghosh and Moon, 2005; Myers, Myers, and Omer, 2003). Since tax-related non-audit service fees are positively associated with financial reporting quality (e.g., Kinney et al., 2004), we include the natural log of tax nonaudit service fees (*LNTAXFEE*) in each of our models. There is also evidence that auditors from larger offices (Choi, Kim, Kim, and Zang, 2010; Francis and Yu, 2009) and office-level industry expert auditors perform higher quality audits (Reichelt and Wang, 2010 and Whitworth and Lambert, 2014). Thus, we follow prior research by including auditor national-level industry expertise (*AUDITOR NAT. LEAD*), office-level industry expertise (*AUDITOR OFF. LEAD*), and auditor office size (*AUDITOR*



*OFF. SIZE*) to control for the positive effects of auditor expertise and auditor office size on audit quality. We also include other audit engagement partner characteristics that may influence audit quality, including the audit partner's gender (*PARTNER GENDER*) and its overlap with top management's average gender (*GENDER DIVERSITY*).<sup>7</sup>

Another measure that may be related to our decision makers' (audit partners, executives, and audit committee) political ideologies is their degree of religiosity. We do not directly observe any of our decision makers' religiosity or religious affiliations, but data on the percentage of religious adherents in the county of the company's corporate headquarters is available.<sup>8</sup> Prior research (McGuire, Omer, and Sharp, 2012) finds a positive relation between financial reporting quality and the religiosity of the county of the company's headquarters. For this reason, we include this percentage (*RELIGIOSITY*) in our models. Finally, we include industry-level fixed effects, based on the client company's two-digit SIC code, and year fixed effects in each model specification. As a robustness check we also include state fixed effects in the specification to control for differences in geographic factors (tabulated in appendix).<sup>9</sup>

### **3.3 Measures of Political Ideology and Homophily**

The key independent variables in our models are based on our decision makers' political ideologies. A decision maker's political ideology is not directly observed and thus a proxy is constructed. Similar to others (Christensen et al., 2015; Di Giuli and Kostovetsky, 2014; Hong and Kostovetsky, 2012; Hutton et al., 2014, 2015; Lee et al., 2014; Notbohm et al., 2019), we base our proxy on the decision maker's pattern of individual political contributions in local, state, and federal elections during their lifetime. Construction of the empirical measure of political ideology is based solely on contributions to political candidates, candidate committees, and political parties that are affiliated with either the Democratic or Republican parties.<sup>10</sup> Individual

contributions made to nonpartisan political action committees (PACs), such as the Deloitte political action committee or KPMG partners/principals and employees PAC are not included in the determination of an individual's ideology. The lifetime contributions included in our measure's construction cover election cycles between 1979-2018. We draw on two data sources for identifying individuals' contributions. For the period 1979-2014 we use political contributions data from Bonica (2016), which includes 140 million itemized political contributions made by individuals that are drawn from disclosures made to the Federal Election Commission (FEC) and state elections offices. We supplement this data with individual contributions data drawn directly from the FEC for federal election contributions made during the 2016 and 2018 election cycles (2015-2018).

Our sample includes 961 unique audit engagement partners, of which 246 (26%) are identified as having made partisan contributions. Summary data on these audit partners' individual contributions appear in Panel A of Table 2. The majority of engagement partners (77%) who make political contributions give exclusively to one party, as 46% give only to the Republican Party and 31% give only to the Democratic Party. The mean (median) amount of contributions by partners who give only to Republicans equals \$2,129 (\$788), and the contributions made by partners who give solely to Democrats equals \$1,319 (\$500). The remaining partners contribute to both parties during their lifetime. Partners who give to both parties, but give more money to Republicans than Democrats, on average, contribute \$2,649 to Republicans and \$551 to Democrats. Similarly, the partners who give more to Democrats, on average, give \$3,421 to Democrats and \$1,454 to Republicans. Overall, 61% of engagement partners who made contributions give more to Republicans than Democrats, and 38% give more to Democrats. Three of our partners (1%) gave equally to both parties.

[Insert Table 2 about here]

We also use data on political contributions of client company executives and audit committee members. The individual contributions of the firms' executives and audit committee members are summarized in Panels B and C, respectively, of Table 2. Our sample of firms includes 5,721 executives and 3,861 audit committee members, of which, 1531 (27%) executives and 1219 (32%) audit committee members are observed to make partisan contributions. Executives and audit committee members, on average, make substantially more and larger contributions than audit engagement partners do. For example, executives and audit committee members who contribute exclusively to Republicans, on average, give \$9,850 and \$10,435, relative to \$2,129 by engagement partners. Similarly, executives and audit committee members who contribute exclusively to Democrats, on average, give \$7,120 and \$6,153, relative to \$1,319 by audit partners. Executives and audit committee members were also more likely to be net contributors to the Republican Party, as 61% of executives and 59% of directors give more to Republicans than Democrats.

We use the pattern of our decision makers' contributions to construct measures of ideological conservatism, following Lee et al. (2014). An engagement partner's conservatism, *PARTNER REP*, equals the sum of the dollar amount of contributions made to Republican candidates and the Republican Party net of their contributions to Democratic candidates and the Democratic Party, divided by their total partisan contributions made over the partner's lifetime. This index of contributions ranges between 1 for contributions made exclusively to Republicans and -1 for contributions made exclusively to Democrats. We assume individuals who do not contribute at all are nonpartisan and are assigned an index value of 0, which is observationally equivalent to those who contribute equally to each party. While this assumption is common in

the literature (Hong and Kostovesky, 2012; Hutton et al., 2014; Lee et al., 2014), we later test the robustness of our results to this assumption.

Individual indices of each executive's and audit committee member's political ideology are constructed similarly to the index for engagement partners, where each index ranges between 1 if the individual's contributions were made exclusively to Republicans and -1 if the individual's contributions were made exclusively to Democrats. The firm-level measures of political ideology for the firm's executives (*EXECUTIVE REP*) and audit committee members (*AUDIT COM. REP*) used in our analyses are weighted averages of each group's individual ideology indices. The weights used for executives are determined by each executive's compensation rank within the group (e.g., Hutton et al., 2014; Notbohm et al., 2019).<sup>11</sup> For the audit committee, weights are based on whether the audit committee members serve as the committee chair and/or have financial expertise.<sup>12</sup> Our model specifications include the ideologies of our engagement partners, executives, and the audit committee. The baseline models for our two measures of audit quality are given by equation (2).

$$\begin{aligned}
 \text{Audit Quality}_{it} = & \beta_0 + \beta_1 * \text{PARTNER REP}_{it} + \beta_2 * \text{EXECUTIVE REP}_{it} \\
 & + \beta_3 * \text{AUDIT COM. REP}_{it} + \Phi * \text{Controls}_{it} + \text{INDUSTRY FE} + \text{YEAR FE} + \varepsilon_{it}
 \end{aligned} \tag{2}$$

Our first prediction is that more conservative audit engagement partners perform higher quality audits. Since each of our measures of audit quality is inversely related to audit quality, we expect a negative relation between our measures of audit quality and *PARTNER REP*, i.e., we expect  $\beta_1 < 0$  in equation (2).

In addition, we also test the effects ideological alignment (i.e., homophily) between the engagement partner and the client's leadership (executives and audit committee directors) has on audit quality. To measure the engagement partner's alignment with client executives, we use a

measure of their similarity, *PARTNER & EXEC ALIGN*, which is an ideological homophily index between the audit engagement partner and the client's top five executive team (Lee et al., 2014). It equals one minus the absolute value of the difference in the groups' ideology indices divided by two.<sup>13</sup> This measure (*PARTNER & EXEC ALIGN*) ranges between one (when *PARTNER REP* is the same as *EXECUTIVE REP*) and zero (when *PARTNER REP* is the opposite of *EXECUTIVE REP* and both are at the extremes). To measure the engagement partner's ideological alignment with the client's audit committee members, we use *PARTNER & AC ALIGN*, which is an ideological homophily index between the audit engagement partner and the client's audit committee. *PARTNER & AC ALIGN* is measured as one minus the absolute value of the difference between *PARTNER REP* and *AUDIT COM. REP* divided by two. This measure (*PARTNER & AC ALIGN*) ranges between one (when *PARTNER REP* is the same as *AUDIT COM. REP*) and zero (when *PARTNER REP* is the opposite of *AUDIT COM. REP* and both are at the extremes).

To test our second hypothesis, we add *PARTNER & EXEC ALIGN* to our baseline model specification from equation (2). This specification is provided as equation (3) below.

$$\begin{aligned}
 \text{Audit Quality}_{it} = & \gamma_0 + \gamma_1 * \text{PARTNER REP}_{it} + \gamma_2 * \text{EXCECUTIVE REP}_{it} \\
 & + \gamma_3 * \text{AUDIT COM. REP}_{it} + \gamma_4 * \text{PARTNER \& EXEC ALIGN}_{it} + \Phi * \text{Controls}_{it} + \\
 & \text{INDUSTRY FE} + \text{YEAR FE} + \varepsilon_{it}
 \end{aligned}
 \tag{3}$$

Our prediction is that  $\gamma_4 > 0$  in equation (3).

Finally, to test our third hypothesis we add to the baseline model specification in equation (2) our measure (*PARTNER & AC ALIGN*) of the alignment of ideology between the engagement partner and our firm's directors on the audit committee, where our prediction in equation (4) is  $\delta_4 > 0$ .

$$\begin{aligned}
\text{Audit Quality}_{it} = & \delta_0 + \delta_1 * \text{PARTNER REP}_{it} + \delta_2 * \text{EXCECUTIVE REP}_{it} \\
& + \delta_3 * \text{AUDIT COM. REP}_{it} + \delta_4 * \text{PARTNER \& AC ALIGN}_{it} + \Phi * \text{Controls}_{it} + \\
& \text{INDUSTRY FE} + \text{YEAR FE} + \varepsilon_{it}
\end{aligned}
\tag{4}$$

## 4 EMPIRICAL RESULTS

### 4.1 Summary Statistics

Descriptive statistics for our sample appear in Table 3. In Panel A we present the descriptive statistics for our sample as a whole. Audit engagement partners, on average, are slightly conservative, based on their political contributions. Directors on the audit committee, on average, are quite similar to partners in terms of their ideology, whereas executives tend towards being slightly more conservative. We also observe strong alignment between the engagement partner's ideology and the ideologies of their client's executives and audit committee. The mean values for *PARTNER & EXEC ALIGN* and *PARTNER & AC ALIGN* are both greater than 0.8. This suggests that the ideologies of audit engagement partners are highly similar to the ideologies of the audit committees and management teams of companies hiring them. The firms in our sample tend, on average, to be larger, less levered, and have higher market to book values than the firms found in other studies. Firms in our sample, for example, have log assets (in millions of dollars) of 8.2, as compared to 6.2 in Whitworth and Lambert's (2014) sample.<sup>14</sup>

[Insert Table 3 about here]

In Panel B of Table 3 we present means and standard deviations of our variables, but we partition the descriptive statistics by the audit engagement partner's ideology, i.e., whether they are conservative (column (1)), non-partisan (column (2)), or liberal (column (3)). The univariate test of the difference in means indicates that the absolute value of discretionary accruals is lower

for firms with engagement partners who are conservative, relative to firms with partners without an ideology (non-partisan) – a difference that is statistically significant at the 1% level. We also observe that firms with partners who are conservative have lower discretionary accruals than those with liberal partners, which is statistically significant at the 5% level. The data also reveal differences in the degree of engagement partner-executive homophily between the groups. Conservative engagement partners have more homophilous relations with both their clients' executives and audit committee members than their liberal counterparts.

## 4.2 Main Results

We test each of our hypotheses using the multivariate regression models described in equations (2), (3), and (4). Each of our hypothesis tests were calculated using heteroscedasticity robust standard errors. Consistent with our hypotheses, we predict coefficient  $\beta_1 < 0$ ,  $\gamma_4 > 0$  and  $\delta_4 > 0$ . We interpret our results using one-tailed tests wherever a coefficient sign was predicted and two-tailed tests elsewhere.

Table 4 presents our estimates of the effects of audit engagement partner political ideology on discretionary accruals. Column (1) is a regression using our baseline model specification (equation 2), which is a regression of *DISCRETIONARY ACCRUALS* on *PARTNER REP* and our set of control variables. Column (2) adds to the baseline model specification our measure of engagement partner-executive homophily (*PARTNER & EXEC ALIGN*), enabling us to test hypothesis 2. Column (3) adds the measure of homophily between the engagement partner and the client's audit committee (*PARTNER & AC ALIGN*), enabling us to test hypothesis 3.

Consistent with our first hypothesis, in each of the first three columns we find the coefficients on *PARTNER REP* are negative and statistically significant at the 1% level. The coefficients on *PARTNER REP* and mean value of accruals (0.076) implies that discretionary

accruals are 12% lower with an engagement partner who is conservative, relative to a partner who is non-partisan.<sup>15</sup> Similarly, discretionary accruals are 12% higher among liberal engagement partners, relative to a partner who is non-partisan. The results indicate that conservative engagement partners more effectively constrain their clients' propensities to aggressively manage earnings, resulting in lower absolute discretionary accruals. The statistically insignificant coefficient estimates on *EXECUTIVE REP* and *AUDIT COM. REP* indicate that the ideologies of the client's leaders (executives and audit committee directors) are not associated with the firm's discretionary accruals when considering the effects of the audit engagement partner's ideology.<sup>16</sup> The statistically significant coefficients for our control variables are largely consistent with our predictions.<sup>17</sup>

We next turn our attention to the effect that ideological similarities have on audit quality. In Table 4 column (2), we estimate a positive and statistically significant coefficient on *PARTNER & EXEC ALIGN*, which provides evidence in support of our second hypothesis. Discretionary accruals are 16% higher for pairings where executives and engagement partners share the same ideology as to when they are dissimilar.<sup>18</sup> This result supports our prediction that when audit engagement partners and their clients' executives share similar ideologies their clients tend to receive lower audit quality. Diversity of ideological thought between auditors and the client's executives improves audit quality. The coefficients for our primary control variables are similar to those in column (1).

Table 4 column (3) presents the results of our tests of the audit quality effects of homophily between the engagement partner and the client's audit committee. The coefficient on *PARTNER & AC ALIGN* is also positive and statistically significant, which supports our third hypothesis. Discretionary accruals are 21% higher for pairings where the audit committee and



the engagement partner share the same ideology as to when they are dissimilar. Similar to the results in column (2), the results support our prediction that ideological alignment between the engagement partner and the audit committee tends to result in less monitoring. Diversity of ideological thought between auditors and the client's audit committee improves audit quality. Again, the coefficients for the main controls are similar to before.

A possible concern with our regression model estimates is the potential for bias due to sample selection. If the pairings of auditors with firms that we observe are non-random, for example due to conservatively managed firms pairing with more conservative auditors, this would result in endogeneity that would bias our estimates. Techniques using propensity score matching (PSM) and entropy balancing are popular methods in the social sciences to reduce the possible effects of selection bias and test the robustness of one's results. We use entropy balancing in our main analyses to preserve the number of observations. Entropy balancing involves a reweighting scheme that directly incorporates covariate balance into the weight function that is applied to the sample units. In other words, it rebalances the sample moments without losing any observations, which is important in our relatively small sample. Following Hainmueller (2012) and Hainmueller and Xu (2013), we balance the first two moments (mean and variance) between the group of firms with a conservative executive team and a group of firms without a conservative executive team. After balancing the main characteristics of the two groups, they are quite similar.<sup>19</sup> As an additional robustness check we also conduct the analyses using a sample constructed with PSM and report these results in Online Appendix B.<sup>20</sup>

[Insert Table 4 about here]

Columns (4), (5), and (6) of Table 4 use the same specifications as in columns (1-3) but applied to the entropy balanced sample. The results in columns (4-6) are consistent with the

results estimated on the original sample. In particular, the coefficient estimates for *PARTNER REP* are all negative and statistically significant at the 5% level or stronger. These results provide further evidence for our first hypothesis that firms with more conservative engagement partners receive higher quality audits. We also continue to find the coefficient for *PARTNER & EXEC ALIGN*, in column (5), is positive and significant. In our entropy balanced sample, discretionary accruals are 36% higher for pairings where executives and engagement partners share the same ideology as to when they are dissimilar. This result adds support for our second hypothesis. Similarly, the discretionary accruals are 30% higher for pairings where the audit committee and engagement partners share the same ideology as to when they are dissimilar.

Our estimation of the discretionary accruals model reported in Table 4 above uses a standard two-stage procedure, where we use residuals from the first-stage as our dependent variable in the second-stage. Chen, Hribar, and Melessa (2018) demonstrate that use of this type of two-stage method may result in biased coefficients and standard errors. Their solution to eliminate this potential bias is to regress the first-stage residuals on all of the regressors used in the first-stage and second-stage regressions. For robustness we re-estimate the model using this approach and report the results in Table B6 of online Appendix B. We find that the coefficients and the standard errors for all our variables of interest (*PARTNER REP*, *PARTNER & EXEC ALIGN*, *PARTNER & AC ALIGN*) are nearly identical to the results reported in Table 4. Thus, our inferences regarding the effects of ideology on discretionary accruals remain robust.

Table 5 presents the coefficient estimates and standard errors from a logit model estimating the probability of restatement. In these analyses we re-estimate the models from Table 4 after replacing our dependent variable, *DISCRETIONARY ACCRUALS*, with the probability the client restated their financial statements (*RESTATEMENT*). Similar to Table 4, in Table 5

columns (1-3) we estimate our models using our original sample, and in columns (4-6) we estimate the same specification applied to an entropy balanced sample. Each specification includes year and industry fixed effects. The insignificant coefficients on *PARTNER REP*, in all columns, indicate the engagement partner's ideology does not influence the auditor's investigation of and willingness to report on more serious, material misstatements. This finding may stem from either liberal engagement partners more thoroughly testing for material misstatements than for immaterial misstatements or from conservative engagement partners excessively testing for immaterial misstatements. On the other hand, our estimates of the coefficients on *PARTNER & EXEC ALIGN* in Table 5 columns (2) and (5) are positive and significant at the 10% level. The probability that a client files a restatement increases by 4.3 percentage points when the firm's executives and engagement partner share the same ideology in our full sample, and by 4.5 percentage points in our entropy balanced sample. This finding provides evidence that ideological homophily between the audit engagement partner and the firm's executives harms an auditor's ability to detect material misstatements. These results provide further evidence in support of hypothesis 2, that ideological homophily between the audit engagement partner and the client's executives harms audit quality. Additionally, the estimates of the coefficients on *PARTNER & AC ALIGN* are insignificant in columns (3) and (6) which does not support our third prediction with respect to restatements.<sup>21</sup> We believe that one of the reasons the results with respect to restatements and our second and third hypotheses are weaker is due to the lag of 2-3 years before most restatements are filed. When we drop fiscal year 2019 observations from our analysis, the results using our entropy balanced sample indicate that homophily between the engagement partner and executives is statistically significant at 1% level, while the homophily between the engagement partner and audit committee is statistically

significant at the 5% level. These results appear in columns 5 and 6 in Panel B of Online Appendix Table B2.

[Insert Table 5 about here]

## **5 Supplemental Analyses**

In our dataset, we identify individuals with an ideology score of zero as non-partisan if they either give equally to both parties or are not observed in the FEC database having made a partisan contribution to any candidate or party. Most of our sample (75%) consists of engagement partners who are non-partisan and nearly all (99.6%) of these non-partisan partners do not make political contributions. Non-partisan ideologies are also observed among our sample of client firms' top-5 executives (74%) and directors on the audit committee (69%). A potential question is whether the observed effects of ideological homophily were driven by non-partisan pairings of partners-executives and partners-audit committee members with unobserved contributions. Our previous model specification did not allow us to differentiate between homophilous pairings among those with conservative, liberal, or non-partisan ideologies.

Additionally, Hudson and Morgan (2021) document differential preferences for ideological similarity between liberal board members and conservative board members. Specifically, these authors find that boards dominated by liberals (conservatives) tend to be more (less) ideologically homophilous, and this effect is increasing over time. If liberal board members place greater value on homophily than conservative board members do, then this asymmetric board member preference may carry over to an auditing setting. Thus, another important question is whether the audit quality effects of liberal partners-executives (partners-audit committee members) homophily differs from the audit quality effects of conservative partners-executives (partners-audit committee members) homophily.

To investigate these questions, we add to our previous model specification (equation (3)) two variables that interact the degree of alignment between engagement partners and executives (*PARTNER & EXEC ALIGN*) with each parties' ideology. The variable *REPUBLICAN\_EXEC\_ALIGN* represents the ideological similarity amongst conservatives, and it is equal to the alignment of the audit engagement partner and executives (top 5 managers), if both are net contributors to Republicans. A statistically significant coefficient for *REPUBLICAN\_EXEC\_ALIGN* would indicate that the alignment of conservative pairs of executives and engagement partners affects audit quality differently than pairs with non-partisan ideologies. *DEMOCRAT\_EXEC\_ALIGN* represents the ideological similarity amongst liberals and is equal to the alignment of the engagement partner and the executives (top 5 managers), if both are net contributors to Democrats. Similar to our other indicator, *DEMOCRAT\_EXEC\_ALIGN* indicates whether the effect of homophily between a pairing of liberals is different than for pairs with non-partisan ideologies. To test whether the homophily effect between partners and executives differs between Republicans and Democrats, we use an F-test to determine whether the interaction terms are jointly equal to each other and zero. All other control variables are the same as those in previous specifications. We omit reporting the coefficients on control variables from this table for brevity.

Columns (1) and (2) in Panel A of Table 6 indicate the results of estimating the discretionary accruals model for the full and entropy balanced samples, where we add to equation (3) the indicator variables *REPUBLICAN\_EXEC\_ALIGN* and *DEMOCRAT\_EXEC\_ALIGN*. The estimates from this specification offer insight into whether the effects of ideological homophily on discretionary accruals differs by party. The coefficients on *PARTNER REP* are again negative and statistically significant at the 5% level, for our full

sample (column (1)), and entropy balanced sample (column (2)). We find the coefficients on *PARTNER & EXEC ALIGN* continue to be positive and statistically significant, offering further evidence that audit partner-executive ideological similarity harms audit quality. However, the t-tests for the coefficients on the two ideological similarity variables (*REPUBLICAN\_EXEC\_ALIGN* and *DEMOCRAT\_EXEC\_ALIGN*) are insignificant, which implies the effects of shared ideology is similar between non-partisan pairs and Republican pairs, along with non-partisan pairs and Democratic pairs. We then confirm with an F-test that homophilous pairings of Republican audit partners and executives affect discretionary accruals similarly to homophilous pairings between Democrats.<sup>22</sup> We find that ideological homophily influences audit quality, as measured by discretionary accruals, but the effect does not differ across ideologies.

We draw a similar conclusion from our analysis of the probability of restatement. Table 6, Panel A, columns (3) and (4), include the results of estimating the augmented version of equation (3) with *RESTATEMENT* as the dependent variable. The coefficient estimates for *PARTNER & EXEC ALIGN* indicate that homophily increases the probability of restatement in both samples. Individual tests (t-tests) on the statistical significance of the coefficients for *REPUBLICAN\_EXEC\_ALIGN* and *DEMOCRAT\_EXEC\_ALIGN* indicate that neither is statistically significant at the 10% level, and both coefficients are not jointly different from zero based on an F-test.<sup>23</sup> This, again, suggests homophilous pairings reduce audit quality, yet this effect does not vary by ideology.

We also performed a similar analysis to examine the homophily between audit engagement partners and directors on the audit committee, where we add to equation (4) the two variables *REPUBLICAN\_AC\_ALIGN* and *DEMOCRAT\_AC\_ALIGN*. These two variables are

constructed similarly to the counterparts we created for the above engagement partner-executive homophily analyses. The results from this model specification appear in Table 6, Panel B. The effects are quite similar to what we observed between audit partners and executives. Ideological alignment between audit partners and audit committee members results in higher discretionary accruals (Table 6, Panel B, columns (1) and (2) and increases the probability of restatement (columns (3) and (4)). Similar to the homophily between partners and executives, we find no evidence to suggest the effect of homophily on audit quality differs across pairs who are conservative, liberal, or non-partisan.

[Insert Table 6 about here]

We interpret our results as evidence that (1) ideological homophily between the audit engagement partner and client leadership (executives and audit committee members) harms audit quality, (2) neither party's alignment causes more audit quality harm than the other, and (3) the effect of homophily is not driven by the alignment of non-partisans who do not contribute.

In our previous results we assume individuals who do not make political contributions are ideologically similar to those who contribute equally to each party (i.e., non-partisan). Some may question the reasonableness of this assumption and whether biased coefficient estimates may result if non-contributors differ from contributors in meaningful ways that also affect audit quality. Given most engagement partners, executives, and audit committee members in our sample do not make contributions, the findings might be sensitive to our assumption. To test this assumption, we compare the individual characteristics of executives and audit committee members who donate similarly to each party to those who do not donate at all.<sup>24</sup> Unfortunately, a similar comparison is not possible between engagement partners due to only observing a small handful of partners with equal contributions. The comparisons indicate our executives and

directors' demographic, and firm characteristics, are quite similar (normalized difference less than 0.25) between individuals who donate similarly to both parties and those who do not make contributions. These results appear in Online Appendix Table B7. The only differences we find are that executives who contribute equally tend to be slightly older and work at larger firms than those who do not contribute.

Similarities between executives and audit committee members based on their observables, however, do not necessarily imply similarity on unobservable characteristics. Therefore, we further test the robustness of our findings by omitting observations where we lack contribution data for engagement partners, executive teams, and audit committees. Our sample is reduced to 332 observations. The results in Table 7 Panel A using our reduced sample (column (1)) and the entropy balanced version (column (4)) indicate that an engagement partner's conservatism has a negative and statistically significant effect at the 5% level on a firm's discretionary accruals. The coefficients for *PARTNER\_REP* (-0.010 and -0.013) when omitting observations lacking contribution data are similar in magnitude to our previous estimates (-0.009 and -0.008) for the two samples. Adding the homophily between our partners and executives' ideologies to the model, we find (Table 7 Panel A, columns (2) and (5)) that homophily has a stronger effect than our previous results (Table 4, columns (2) and (5)). While the coefficient of *PARTNER & EXEC ALIGN* increases in size, the statistical significance is reduced to the 10% level for the un-balanced sample and is statistically significant at the 1% level for the entropy balanced sample. When we add to the specification the homophily between the engagement partner and the client's audit committee, *PARTNER & AC ALIGN*, the coefficients are similar to our previous results. However, the coefficient is no longer statistically significant in the unbalanced sample, yet it remains statistically significant at the 10% level in the entropy



balanced sample. Overall, the results of analyses using the sample that eliminates observations without contributions support our main findings based on the full sample.

Turning our attention to restatements, we find that the results (Table 7 Panel B) are similar to our earlier results. An audit partner's conservatism (*PARTNER\_REP*) does not have an effect on the probability of restatement in either the unbalanced or entropy-balanced samples after omitting observations lacking contributions data. We also continue to find that increasing the degree of ideological alignment between the partner and the client firm's executive team increases the probability of restatement. The coefficient for *PARTNER & EXEC ALIGN* is statistically significant at the 1% level for both the unbalanced and entropy-balanced samples. This effect is stronger in both magnitude and statistical significance than in our previous analyses. Using the smaller sample of observations with contributions, we now find evidence that the homophily between a partner and client firm's audit committee also increases the probability of restatement, with the coefficient for *PARTNER & AC ALIGN* statistically significant at the 10% level for both the balanced and unbalanced samples. Similar to the model of discretionary accruals, our main results with respect to the probability of restatements are supported using the subset of observations where we observe political contributions.<sup>25</sup>

[Insert Table 7 about here]

In our main analyses, we control for several measures believed to influence an audit committee's role in the corporate governance of accounting decisions. These measures include the audit committee's size, average age, whether they have financial expertise, and their option-based compensation. Our main results show that homophily has an influence on reducing audit quality independent of these measures related to a firm's governance of audit quality. As a robustness check, we also consider whether the observed homophily effects are moderated by

more general governance measures of the firm and its board of directors. To test this we add to our baseline specification several governance measures, which include an indicator for whether the number of the independent directors is smaller than the median in our sample (*SMALL BOARD*), an indicator of whether the CEO is chair of the board (*CEO\_CHAIR*), the proportion of independent directors (*ID\_PORTION*), the average tenure of independent directors (*ID\_TENURE*), and an indicator for whether the percentage of independent directors' shares is greater than the median (*ID\_HOLD*).

The results of estimating our discretionary accruals models with these added governance variables appear in Appendix Table B9 and estimates for our restatements models appear in Appendix Table B10. The coefficients of the homophily measures in our discretionary accruals models, in terms of their magnitude and statistical significance, are unaffected by the inclusion of the added controls from our baseline accruals model. Our results examining restatements were also quite similar to the baseline model. However, we did find a stronger impact of homophily between partners and audit committee members (*PARTNER & AC ALIGN*) on restatements using our entropy balanced sample. Further, in most cases, we find that the added governance measures were statistically insignificant.

Previous research (Lee et al., 2014), though, also suggests ideological homophily between a firm's decision makers may have an indirect effect on firm behavior, based on the size of the board of directors. The presence of a small board is said (Jensen, 1993) to reduce agency issues in corporate governance as they are less susceptible of managerial (CEO) control. We therefore theorize that the audit quality effects of homophily between decisionmakers (audit partners – executives and audit partners – audit committee) may be mitigated by a smaller and more cohesive board, which is less easy to control.

To test this indirect effect, we measure the closeness of these interactions, similar to Lee et al. (2014), using an indicator of whether the board is governed by a number of independent directors smaller than our sample median, which is interacted with our measure of homophily. We add the interaction term to the discretionary accruals model that includes our extended list of governance measures. Coefficient estimates using our original sample appear in Appendix Table B11, where Panel A column (2) includes homophily between partners and executives (*PARTNER & EXEC ALIGN*) and its interaction with *SMALL BOARD*, and Panel B column (2) includes homophily between partners and the audit committee (*PARTNER & AC ALIGN*) along with its interaction. These results indicate that the coefficients of the homophily measures are slightly larger with the addition of the interaction term, where each is statistically significant at the 5% level. However, the interaction between homophily and a small board is not statistically significant at the 10% level for either measure of homophily. Using the entropy balanced sample, we find (column (4)) largely similar results.

The results of estimating the impact of small board size on the relation between ideological homophily and the probability of restatement are in Appendix Table B12. We find, using our original sample, that the coefficients for each of our homophily measures (*PARTNER & EXEC ALIGN* and *PARTNER & AC ALIGN*) are larger in magnitude than our baseline results. The coefficient on the interaction between *PARTNER & EXEC ALIGN* and *SMALL BOARD* (Appendix Table B12, column (2)) is statistically significant at the 10% level when using our original sample, but it is statistically insignificant for our entropy balanced sample (column (4)). These results indicate some evidence that the impact of homophily between audit partner-executives is partially mitigated by having a small board. However, we do not find a similar

relation in the partner-audit committee homophily model, as the interaction term is not statistically significant at the 10% level for either sample used.

Lastly, as an additional robustness check, we also consider whether the impact of homophily on audit quality is stronger when our set of three decisionmakers (engagement partners, executives, and audit committee) share a similar ideology than if only two parties share the same ideology. The theory is that monitoring may be even less effective when the three groups share a similar ideology. To test this theory, we construct a measure of similarity of the three based on the Euclidean distance between each group's ideology indices (*PARTNER REP*, *EXECUTIVE REP*, *AUDIT COM. REP*). The homophily measure of this triad (*PARTNER & EXEC & AC ALIGN*) is normalized to range between 0 and 1 and is equal to 1 minus 1/8 multiplied by the sum of the difference in each separate pairs' ideology scores squared. An index value of 1 implies the three groups each share the same ideology, whereas a value of 0 implies two groups share the same partisan ideology and the other has the opposite. We then estimate our baseline model specification of discretionary accruals, where we replace our homophily measure based on pairings with our triad-based measure. The estimates, which are in Appendix Table B13, indicate that the homophily of the three decisionmakers has a positive and statistically significant effect on discretionary accruals in both our original sample and entropy balanced samples (Panel A). The magnitude of the *PARTNER & EXEC & AC ALIGN* coefficients for both samples (0.030; 0.039) are larger than the effects that we observe in the baseline model for both the homophily between audit partner-executives (0.012; 0.027) and homophily between partner-audit committee (0.016; 0.023). We find a similar result in the model for restatements (Panel B), where a similar ideology among the three groups of decision makers also has a stronger effect on the likelihood of filing a restatement. We interpret these results as

evidence of an incremental reduction of audit quality when all three monitoring parties share the same ideology relative to when only two are ideologically aligned.

## **6 CONCLUSIONS**

We identify the political ideology of audit engagement partners using the pattern of their partisan contributions in political elections and theorize that their ideology influences the quality of their audit services. We find strong evidence that ideologically conservative audit engagement partners constrain their client firms' propensity towards accruals-based earnings management. Discretionary accruals are shown to be 24% lower with an engagement partner who contributes exclusively to Republicans, relative to an engagement partner who contributes exclusively to the Democrats. This finding is robust to different samples of firms constructed using both entropy balancing and propensity score matching. These results are consistent with our hypothesis that conservative audit engagement partners are more likely to be risk averse and rule adhering and therefore provide higher quality audits. Our study is the first to our knowledge to demonstrate the importance an auditor's ideology has on audit quality and contributes to a growing literature that examines the effects of other individual characteristics of auditors.

This study also finds that the similarity between the audit engagement partner's ideology and that of their client's executives harms audit quality. Discretionary accruals are shown to be 16% higher when audit engagement partners and client executives share the same ideology relative to when they are dissimilar. We find further evidence of this relationship with respect to the probability of financial restatement, which we show increases when the firm's executives and engagement partner share the same ideology. These results are consistent with our hypothesis that monitoring and audit quality decrease with the ideological alignment between the audit engagement partner and the client's executives. Our results extend and support those of other

studies that find firm performance in non-audit contexts decreases when monitors share the same political ideology with those they monitor. These results also contribute to the growing literature that examines the effects that relationships between auditors and their client executives have on audit outcomes, based on past employment (Lennox, 2005; Menon and Williams, 2004) and school ties (Guan et al., 2016).

Our results also show that discretionary accruals are 21% higher when engagement partners and audit committee members share the same ideology relative to when they are dissimilar. This result provides some support for our prediction that when audit engagement partners and their clients' audit committee share similar ideologies their clients receive lower audit quality.

Our findings may have implications for future studies. Given that the cultural heritage of CEOs has been shown (Pham et al., 2022) to influence corporate risk culture and audit fees, it is likely that the ideological conservatism of executives and audit committees has an effect on audit fees. Additionally, our findings that ideological homophily between client leadership and the audit engagement partner harms audit quality may suggest that diversity along other dimensions between auditors and client leadership may be informative to the auditor selection and monitoring process. Lastly, our analysis was limited to a sample of large firms, and therefore future studies may wish to consider whether the relations we observe hold for smaller firms. Smaller firms tend to have a more cohesive culture, more reflecting that of their executives. Thus, we would expect the relations we find to either continue to hold or to strengthen.

## **Endnotes**

<sup>1</sup> Individuals who self-identify as being liberal and Democrats tend to be more open to experience and are more likely to be imaginative and creative and apply unconventional ways of thinking. Liberals and conservatives tend to be similar across traits of extraversion, agreeableness, and emotional stability.

<sup>2</sup> See PCAOB auditor independence rules at <https://pcaobus.org/Standards/EI/Pages/default.aspx>.

<sup>3</sup> Prior to this date the audit firm could provide this information voluntarily. For further details see Auditor Reporting of Certain Audit Participants and Related Voluntary Audit Report Disclosure Under AS 3101.

<sup>4</sup> The sample used in our analysis did not include any early adopters, i.e., firms that voluntarily reported the engagement partner's identity prior to the required date.

<sup>5</sup> We do not examine the probability of a going-concern as it is an extremely rare event in our dataset. The final sample size with available going concern opinion data is 2,194, which includes only 3 instances of going concern audit opinions. We do not use this smaller sample in any of our analyses.

<sup>6</sup> We also estimated our primary regression models with the absolute value of cross sectional (estimated by year and 2-digit SIC) modified Jones model discretionary accruals. Our results were not qualitatively impacted.

<sup>7</sup> Auditing firm and auditing office variables are computed from data available in Audit Analytics. We hand collected partner genders from engagement partner LinkedIn profiles. We also attempted to collect data on partner age, based on bachelor's degree graduation year. However, the data was too sparsely available to use. We acknowledge the inability to control for audit engagement partner age is a potential limitation.

<sup>8</sup> The data is available from the Association of Religion Data Archives website [www.theARDA.com](http://www.theARDA.com). We use the Churches and Church Membership in the United States, 1990, Churches and Church Membership in the United States, 2000, and the U.S. Religion Census: Religious Congregations and Membership Study, 2010 (County file).

<sup>9</sup> These results appear in Tables B1-B2 in our Online Appendix B. Our main findings are consistent to the inclusion of state fixed effects.

<sup>10</sup> Research (Gerber et al., 2012; Mondak & Halperin, 2008; Verhulst et al., 2012) has shown that affiliation with the Democratic or Republican parties is associated with differences in political ideology and personality traits. A measure based on lifetime contributions is used because an individual's ideology is generally viewed as being stable over time.

<sup>11</sup> We followed Hutton et al. (2015) when computing weights for each executive's ideology as: the weight assigned to the  $i^{th}$  highest paid manager (of the five available in ExecuComp) is  $\omega_i$ , computed as  $\frac{i^{-1}}{\sum_{i=1}^5 i^{-1}}$ .

<sup>12</sup> Audit committee member rank equals 4 if the member is an audit committee financial expert and the audit committee chair, or the rank equals 3 if the committee member is the committee chair only, or the member's rank is equal to 2 if they are a financial expert only, or otherwise the member's rank is equal to 1. Weights applied to each member's ideology index are the member's rank divided by the sum of all committee member ranks. It is bounded by 0 and 1. Using an equally weighted measure does not meaningfully change our results.

<sup>13</sup> We followed the Lee et al. (2014) approach to computing a continuous measure of homophily because it (a) captures homophily between moderates while also capturing homophily between extreme ideologues, (b) avoids the use of a subjectively determined cutoff value for homophily to be scored, and (c) differentiates between mild homophily and extreme homophily levels.

<sup>14</sup> The mean leverage and market to book ratio of firms in our sample equal 0.24 and 4.0, respectively. For comparison, the values in Whitworth and Lambert (2014) are 0.52 and 2.1, respectively.

<sup>15</sup> An engagement partner who only gives to the Republican party has a value of *PARTNER REP* equal to one, whereas a non-partisan partner has a value equal to zero. A partner who only gives to the Democratic party has a value equal to negative one.

<sup>16</sup> The difference between our results and those in Notbohm et al (2019) is likely caused by a number of differences in our studies. First, we have a much smaller sample size due to the partner data and sample period used in this study (2,260 observations), relative to Notbohm et al. (19,211). Second, our study's sample period is during the post-Sarbanes Oxley (SOX) period. Notbohm et al. (2019) find the effects they observe are stronger during the pre-SOX versus post-SOX period. Third, the measures of ideology differ in our two studies. Our measure of the audit engagement partner's ideology is the ratio of lifetime net Republican contributions to total lifetime contributions whereas Notbohm et al. use the percent of years when the manager gives 100% of contributions to Republicans.

<sup>17</sup> The only exception is the coefficient for *AUDITOR BIG4*, which is positive in each specification. This finding might be caused, in part, by our sample as nearly all of our firms (91%) have an engagement partner from the Big 4.

<sup>18</sup> The range of *PARTNER & EXEC ALIGN* is between one (ideology similar) and zero (dissimilar). The percentage change is then  $0.012 / 0.076 = 0.158$

<sup>19</sup> The results comparing the mean and variance of variables between conservative and non-conservative groups before and after the entropy balancing appear in Table B3 of Online Appendix B.

<sup>20</sup> We create a sample of firms with conservative executive teams matched with firms led by non-conservatives based on propensity scores and nearest neighbor matching (Guo and Fraser, 2010). The sample on the common support consists of 923 firm-years with management identified as conservative and 923 non-conservative firm-years, which results in a PSM sample of 1,846 observations. The test results based on the PSM sample are consistent with our main results. A detailed explanation of the matching process and tables of estimates (Tables B4 and B5) are included in Online Appendix B.

<sup>21</sup> In the sample using PSM we find (Online Appendix Table B4) some evidence that homophily between the auditor and the audit committee influences the probability of restatement, as the coefficient for *PARTNER & AC ALIGN* is statistically significant at the 10% level.

<sup>22</sup> The F-test statistics for the full sample, entropy balanced sample and PSM matched sample (un-tabulated) are 1.00, 0.95 and 0.21, and the corresponding p-values are 0.37, 0.39 and 0.81 respectively.

<sup>23</sup> The F-statistics are 1.13, 1.07 and 0.93 for the full sample, entropy balanced sample and PSM matched sample (un-tabulated), with the p-values of 0.57, 0.59 and 0.63 respectively.

<sup>24</sup> Very few individuals contribute the same amount to each party, therefore we use in our comparison those who contribute nearly similarly, which we define as making less than 15% of ones' net political contributions to a particular party.

<sup>25</sup> The complete version of Table 7 appear in Appendix Table B8 Panel A and Panel B. Table B8 Panel A and Panel B represent coefficients (standard errors) for all the control variables.

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## APPENDIX

Appendix should be inserted here. Please find it in a separate file.

### TABLES

Table 1 Sample Composition

	N
PCAOB form AP filing of US firms in Compustat (2016-2019)	12,584
Lack necessary executive data in ExecuComp	(7,376)
Lack necessary director data in ISS Director Data	(1,387)
Lack other controls and demographic data used for controls	(1,561)
Final sample of firm-engagement partner-years:	2,260

*Table 1 describes our data screens and sample reconciliation process, which includes 2,260 firm years for fiscal years 2016 - 2019.*

Table 2 The political contributions of engagement partners, firm executives, and audit committee members

Panel A. Engagement Partner Contributions								
Unique engagement partners: 961	Exclusively Republican	Favor Republican		Equal		Favor Democrat		Exclusively Democrat
	REP	REP	DEM	REP	DEM	REP	DEM	DEM
Number of contributions	3.59 (2)	4.42 (3)	1.64 (1)	1.33 (1.5)	1 (1)	2.82 (1)	3.35 (2)	2.03 (1)
Amount of contributions	\$2,129 (\$788)	\$2,649 (\$2,000)	\$551 (\$500)	\$333 (\$250)	\$333 (\$250)	\$1,454 (\$500)	\$3,421 (\$1,500)	\$1,319 (\$500)
Number of engagement partners	114	36		3		17		76
Panel B. Executives' Contributions								
Unique executives: 5721	Exclusively Republican	Favor Republican		Equal		Favor Democrat		Exclusively Democrat
	REP	REP	DEM	REP	DEM	REP	DEM	DEM
Number of contributions	5.70 (2)	33.28 (12)	10.03 (3)	1.4 (1)	1.13 (1)	9.25 (3)	31.53 (9)	5.40 (2)
Amount of contributions	\$9,850 (\$2,000)	\$101,390 (\$15,400)	\$17,317 (\$2,700)	\$1,050 (\$1,000)	\$1,050 (\$1,000)	\$16,432 (\$2,700)	\$68,383 (\$10,254)	\$7,120 (\$1,933)
Number of executives	548	387		15		210		371
Panel C. Audit Committee Directors' Contributions								
Unique audit com. Directors: 3861	Exclusively Republican	Favor Republican		Equal		Favor Democrat		Exclusively Democrat
	REP	REP	DEM	REP	DEM	REP	DEM	DEM
Number of contributions	6.05 (2)	36.00 (14.5)	9.13 (3)	1.83 (1)	1.67 (1)	7.82 (3)	26.10 (11)	5.37 (2)
Amount of contributions	\$10,435 (\$2,550)	\$82,234 (\$16,000)	\$9,975 (\$2,700)	\$2,054 (\$1,000)	\$2,054 (\$1,000)	\$11,171 (\$2,800)	\$51,964 (\$10,525)	\$6,153 (\$2,500)
Number of audit com. directors	368	354		12		227		258

Table 2 reports the mean (median) of the number and amount of political contributions made to Republicans (REP) and Democrats (DEM) by engagement partners (Panel A), executives (Panel B), and audit committee members (Panel C).



Table 3 Descriptive Statistics

## Panel A. Descriptive Statistics for the Full Sample

Variable	N	MEAN	STD	Q1	MEDIAN	Q3
DISCRETIONARY ACCRUALS	2260	0.076	0.073	0.025	0.056	0.102
RESTATEMENT	2260	0.099	0.298	0.000	0.000	0.000
PARTNER REP	2260	0.058	0.474	0.000	0.000	0.000
EXECUTIVE REP	2260	0.092	0.334	0.000	0.000	0.307
AUDIT COM. REP	2260	0.057	0.300	-0.041	0.000	0.162
PARTNER & EXEC ALIGN	2260	0.809	0.195	0.704	0.867	1.000
PARTNER & AC ALIGN	2260	0.820	0.194	0.667	0.913	0.985
SIZE	2260	8.189	1.528	7.081	8.024	9.180
MARKET TO BOOK	2260	3.988	9.768	1.637	2.782	4.745
LEVERAGE	2260	0.239	0.144	0.134	0.203	0.305
LAGLOSS	2260	0.150	0.357	0.000	0.000	0.000
Z-SCORE	2260	1.851	0.982	1.177	1.772	2.390
CFO	2260	0.110	0.069	0.068	0.101	0.143
SALES GROWTH	2260	0.076	0.168	0.001	0.060	0.130
SALES VOLATILITY	2260	0.090	0.097	0.032	0.060	0.110
CF VOLATILITY	2260	0.029	0.025	0.012	0.022	0.036
AUDIT COM. SIZE	2260	3.968	0.962	3.000	4.000	4.000
AUDIT COM. FINEXP	2260	0.611	0.488	0.000	1.000	1.000
AUDIT COM. OPTIONS	2260	0.052	0.153	0.000	0.000	0.000
AUDIT COM. AGE	2260	62.603	5.692	60.000	63.000	65.667
AUDITOR BIG 4	2260	0.914	0.280	1.000	1.000	1.000
AUDITOR NAT. LEAD	2260	0.300	0.458	0.000	0.000	1.000

AUDITOR OFF. LEAD	2260	0.671	0.470	0.000	1.000	1.000
AUDITOR OFF. SIZE	2260	17.817	1.334	17.023	18.042	18.873
CEO AGE	2260	55.357	13.944	53.000	58.000	62.000
PARTNER GENDER	2260	0.172	0.377	0.000	0.000	0.000
CEO GENDER	2260	0.053	0.224	0.000	0.000	0.000
GENDER DIVERSITY	2260	0.208	0.406	0.000	0.000	0.000
MATERIAL WEAKNESS	2260	0.042	0.202	0.000	0.000	0.000
AUDITOR TENURE	2260	17.481	7.905	12.000	18.000	26.000
RELIGIOSITY	2260	0.475	0.112	0.393	0.476	0.575
LNTAXFEE	2260	7.465	9.347	9.085	12.011	13.424

Panel B. Differences in means between conservative, non-partisan, & liberal engagement partners

Variable	(1)		(2)		(3)		(4)		
	Conservative		Non-partisan		Liberal		Difference		
	Mean	STD	Mean	STD	Mean	STD	(1)-(2)	(2)-(3)	(1)-(3)
DISCRETIONARY ACCRUALS	0.065	0.065	0.080	0.076	0.069	0.059	-0.014***	0.010**	-0.004**
PARTNER REP	0.917	0.196	0.000	0.000	-0.910	0.218	0.917***	0.910***	1.827***
EXECUTIVE REP	0.165	0.346	0.088	0.325	-0.003	0.349	0.077***	0.091***	0.169***
AUDIT COM. REP	0.106	0.294	0.057	0.294	-0.028	0.330	0.049***	0.085***	0.134***
PARTNER & EXEC ALIGN	0.620	0.188	0.885	0.125	0.548	0.198	-0.265***	0.337***	0.072***
PARTNER & AC ALIGN	0.593	0.160	0.904	0.118	0.561	0.174	-0.312***	0.343***	0.031***
SIZE	8.708	1.554	7.994	1.447	8.774	1.721	0.714***	-0.781	-0.066***
MARKET TO BOOK	4.505	11.823	3.851	8.828	4.162	12.360	0.654	-0.312*	0.343
LEVERAGE	0.249	0.148	0.235	0.143	0.254	0.140	0.014	-0.019***	-0.005*
LAGLOSS	0.118	0.323	0.164	0.370	0.094	0.293	-0.046**	0.070	0.024***
Z-SCORE	1.933	0.921	1.851	0.999	1.740	0.943	0.082	0.111*	0.193
CFO	0.106	0.064	0.110	0.070	0.119	0.068	-0.004	-0.009	-0.013*
SALES GROWTH	0.064	0.140	0.079	0.176	0.079	0.142	-0.015*	-0.001*	-0.015
SALES VOLATILITY	0.096	0.118	0.090	0.094	0.077	0.078	0.005	0.014***	0.019**

CF VOLATILITY	0.027	0.026	0.030	0.025	0.026	0.022	-0.003**	0.004	0.001***
AUDIT COM. SIZE	4.159	1.024	3.926	0.942	3.973	0.958	0.234***	-0.048	0.186
AUDIT COM. FINEXP	0.646	0.479	0.604	0.489	0.605	0.490	0.042	-0.001	0.040
AUDIT COM. OPTIONS	0.040	0.144	0.054	0.157	0.052	0.138	-0.014*	0.002	-0.012
AUDIT COM. AGE	63.031	5.679	62.543	5.773	62.325	5.061	0.489	0.218	0.706
AUDITOR BIG 4	0.975	0.156	0.890	0.312	0.973	0.162	0.085***	-0.083***	0.002***
AUDITOR NAT. LEAD	0.299	0.459	0.297	0.457	0.318	0.467	0.003	-0.022	-0.019
AUDITOR OFF. LEAD	0.742	0.438	0.653	0.476	0.695	0.461	0.088***	-0.042	0.047
AUDITOR OFF. SIZE	17.879	1.173	17.719	1.369	18.391	1.199	0.159**	-0.672***	-0.512***
CEO AGE	54.181	15.094	55.594	13.561	55.404	14.619	-1.412	0.190	-1.222
PARTNER GENDER	0.115	0.320	0.183	0.387	0.175	0.381	-0.067***	0.008	-0.060
CEO GENDER	0.044	0.205	0.053	0.224	0.067	0.251	-0.009	-0.014	-0.023
GENDER DIVERSITY	0.154	0.361	0.216	0.411	0.233	0.424	-0.062***	-0.018	-0.079
MATERIAL WEAKNESS	0.027	0.164	0.048	0.214	0.022	0.148	-0.021**	0.026**	0.005**
AUDITOR TENURE	18.599	7.874	16.859	7.933	19.942	7.331	1.740***	-3.083***	-1.343***
RELIGIOSITY	0.480	0.101	0.474	0.113	0.473	0.124	0.006	0.001	0.007
LNTAXFEE	9.338	8.315	6.653	9.660	10.239	7.558	2.685***	-3.586***	-0.902***
N of observations	364		1,673		223				

Table 3 presents descriptive statistics of the variables used in our analyses. Panel A provides the mean, standard deviation (SD), 25th percentile (Q1), median, and 75th percentile (Q3) of the entire sample. Panel B, columns (1-3), report the statistics for subsamples of observations where engagement partners are either Conservative (1), Non-partisan (2), or Liberal (3). Panel B columns (4-6) reports the difference in variable means for the two types indicated, where \*, \*\*, and \*\*\* denote the statistical significance at the 10%, 5%, and 1% level, respectively, of a t-test of equal means under the assumption of unequal variances. Variable definitions are in Appendix A.

Table 4 The effects of political ideology on discretionary accruals

	Predicted sign	Original Sample			Entropy Balanced		
		(1)	(2)	(3)	(4)	(5)	(6)
PARTNER REP	—	-0.009*** (0.003)	-0.009*** (0.003)	-0.008*** (0.003)	-0.008** (0.003)	-0.007** (0.003)	-0.008*** (0.003)
EXECUTIVE REP	—	-0.004 (0.005)	-0.003 (0.005)	-0.004 (0.005)	-0.002 (0.005)	-0.004 (0.005)	-0.002 (0.005)
AUDIT COM. REP	?	-0.001 (0.005)	-0.000 (0.005)	0.000 (0.005)	-0.001 (0.005)	-0.001 (0.005)	-0.000 (0.005)
PARTNER & EXEC ALIGN	+		0.012** (0.007)			0.027*** (0.009)	
PARTNER & AC ALIGN	+			0.016** (0.007)			0.023*** (0.008)
SIZE	—	-0.006*** (0.001)	-0.006*** (0.001)	-0.006*** (0.001)	-0.008*** (0.001)	-0.007*** (0.001)	-0.008*** (0.001)
MARKET TO BOOK	+	-0.000 (0.000)	-0.000 (0.000)	-0.000 (0.000)	-0.000 (0.000)	-0.000 (0.000)	-0.000 (0.000)
LEVERAGE	+	0.043*** (0.014)	0.045*** (0.014)	0.046*** (0.014)	0.097*** (0.013)	0.097*** (0.013)	0.098*** (0.013)
LAGLOSS	+	0.019*** (0.005)	0.011** (0.005)	0.010** (0.005)	0.007* (0.005)	0.006 (0.005)	0.005 (0.005)
Z-SCORE	+	0.008*** (0.003)	0.007*** (0.003)	0.007*** (0.003)	0.011*** (0.003)	0.012*** (0.003)	0.011*** (0.003)
CFO	—	0.005 (0.031)	-0.006 (0.031)	-0.007 (0.031)	0.017 (0.029)	0.017 (0.029)	0.017 (0.029)
SALES GROWTH	+	0.007 (0.011)	0.002 (0.011)	0.002 (0.011)	0.007 (0.010)	0.007 (0.010)	0.007 (0.010)
SALES VOLATILITY	+	-0.001 (0.019)	0.004 (0.018)	0.003 (0.018)	-0.037** (0.018)	-0.036** (0.018)	-0.039** (0.018)

CF VOLATILITY	+	0.236*** (0.082)	0.249*** (0.082)	0.249*** (0.082)	0.350*** (0.073)	0.350*** (0.072)	0.350*** (0.073)
AUDIT COM. SIZE	?	0.004** (0.002)	0.004** (0.002)	0.004** (0.002)	0.005*** (0.002)	0.005*** (0.002)	0.005*** (0.002)
AUDIT COM. FINEXP	-	-0.001 (0.003)	-0.000 (0.003)	-0.000 (0.003)	-0.002 (0.003)	-0.002 (0.003)	-0.002 (0.003)
AUDIT COM. OPTIONS	?	-0.021** (0.010)	-0.020** (0.010)	-0.020** (0.010)	-0.017* (0.010)	-0.018* (0.010)	-0.018* (0.010)
AUDIT COM. AGE	?	0.001*** (0.000)	0.001*** (0.000)	0.001*** (0.000)	0.001*** (0.000)	0.001*** (0.000)	0.001*** (0.000)
AUDITOR BIG 4	-	0.020*** (0.007)	0.020*** (0.008)	0.020*** (0.008)	0.028*** (0.007)	0.028*** (0.007)	0.029*** (0.007)
AUDITOR NAT. LEAD	-	0.006** (0.003)	0.006** (0.003)	0.006** (0.003)	-0.001 (0.004)	-0.001 (0.004)	-0.001 (0.004)
AUDITOR OFF. LEAD	-	-0.006* (0.004)	-0.006* (0.004)	-0.006 (0.004)	-0.010*** (0.004)	-0.010*** (0.004)	-0.010*** (0.004)
AUDITOR OFF. SIZE	-	-0.001 (0.002)	-0.001 (0.002)	-0.001 (0.002)	-0.001 (0.002)	-0.002 (0.002)	-0.001 (0.002)
CEO AGE	?	-0.000 (0.000)	-0.000 (0.000)	-0.000 (0.000)	-0.000 (0.000)	-0.000 (0.000)	-0.000 (0.000)
PARTNER GENDER	?	-0.008 (0.007)	-0.008 (0.007)	-0.009 (0.007)	-0.018** (0.009)	-0.020** (0.009)	-0.019** (0.009)
CEO GENDER	-	-0.012* (0.007)	-0.011* (0.007)	-0.011* (0.007)	-0.025*** (0.009)	-0.025*** (0.009)	-0.027*** (0.009)
GENDER DIVERSITY	?	0.006 (0.007)	0.006 (0.007)	0.006 (0.007)	0.014* (0.009)	0.014* (0.009)	0.014* (0.009)
MATERIAL WEAKNESS	+	0.010 (0.009)	0.011 (0.009)	0.011 (0.009)	0.007 (0.007)	0.007 (0.007)	0.007 (0.007)
AUDITOR TENURE	-	-0.002*** (0.000)	-0.002*** (0.000)	-0.002*** (0.000)	-0.002*** (0.000)	-0.001*** (0.000)	-0.001*** (0.000)
RELIGIOSITY	-	0.013	0.014	0.014	0.017	0.015	0.015

LNTAXFEE	—	(0.013) 0.016 (0.000)	(0.013) 0.017 (0.000)	(0.013) 0.016 (0.000)	(0.015) 0.013*** (0.000)	(0.015) 0.014*** (0.000)	(0.015) 0.013*** (0.000)
Industry Fixed Effects		Yes	Yes	Yes	Yes	Yes	Yes
Year Fixed Effects		Yes	Yes	Yes	Yes	Yes	Yes
N of observations		2260	2260	2260	2260	2260	2260
Adjusted R-square		0.159	0.156	0.157	0.165	0.169	0.168

*Table 4 presents the effects of political ideology and ideological alignment on firms' discretionary accruals. Column (1) reports our baseline results using equation (2). Column (2) adds to the baseline model in column (1) the ideological alignment between the engagement partner and the firm's executive team using equation (3), while column (3) adds to the model the ideological alignment between the engagement partner and the firm's directors on the audit committee using equation (4). Columns (4-6) use the same specifications in columns (1-3) but applied to firms after entropy balancing. Each specification (columns (1-6)) includes year and industry fixed effects (not reported). Heteroskedasticity robust standard errors are reported in parentheses. \*, \*\*, and \*\*\* denote the statistical significance at the 10%, 5%, and 1% level for one-tailed tests, wherever a coefficient sign was predicted, or a two-tailed test elsewhere, respectively. Variable definitions are in Appendix A.*

Table 5 The effects of political ideology on probability of restatement

	Predicted sign	Original Sample			Entropy Balanced		
		(1)	(2)	(3)	(4)	(5)	(6)
PARTNER REP	–	-0.245 (0.203)	-0.278 (0.241)	-0.286 (0.275)	-0.146 (0.184)	-0.184 (0.204)	-0.168 (0.206)
EXECUTIVE REP	–	-0.246 (0.256)	-0.262 (0.266)	-0.254 (0.258)	-0.557 (0.451)	-0.540 (0.403)	-0.566 (0.390)
AUDIT COM. REP	?	0.115 (0.279)	0.125 (0.282)	0.134 (0.291)	0.304 (0.317)	0.316 (0.322)	0.328 (0.333)
PARTNER & EXEC ALIGN	+		0.482* (0.327)			0.506* (0.379)	
PARTNER & AC ALIGN	+			0.364 (0.450)			0.358 (0.534)
SIZE	–	-0.024 (0.071)	-0.017 (0.072)	-0.021 (0.071)	-0.126* (0.086)	-0.121* (0.087)	-0.125* (0.087)
MARKET TO BOOK	+	-0.002 (0.005)	-0.003 (0.005)	-0.003 (0.005)	-0.001 (0.005)	-0.001 (0.005)	-0.001 (0.005)
LEVERAGE	+	-0.621 (0.700)	-0.599 (0.699)	-0.588 (0.700)	-0.470 (0.769)	-0.451 (0.768)	-0.436 (0.765)
LAGLOSS	+	-0.002 (0.268)	-0.009 (0.269)	-0.013 (0.270)	-0.234 (0.294)	-0.247 (0.298)	-0.248 (0.302)
Z-SCORE	+	0.108 (0.121)	0.106 (0.121)	0.104 (0.120)	0.039 (0.144)	0.037 (0.145)	0.033 (0.143)
CFO	–	-1.447 (1.420)	-1.384 (1.426)	-1.401 (1.417)	-4.453*** (1.639)	-4.395*** (1.645)	-4.442*** (1.639)
SALES GROWTH	+	-0.284 (0.504)	-0.292 (0.502)	-0.277 (0.503)	0.381 (0.618)	0.354 (0.616)	0.371 (0.616)
SALES VOLATILITY	+	-1.484* (1.092)	-1.498* (1.093)	-1.505* (1.090)	-1.894* (1.324)	-1.870* (1.328)	-1.910* (1.325)

CF VOLATILITY	+	5.741*	5.908**	5.848**	5.099	5.143	5.134
		(3.284)	(3.308)	(3.279)	(3.909)	(3.921)	(3.920)
AUDIT COM. SIZE	?	0.057	0.060	0.059	0.073	0.076	0.074
		(0.094)	(0.095)	(0.095)	(0.100)	(0.101)	(0.101)
AUDIT COM. FINEXP	-	0.163	0.168	0.168	0.171	0.178	0.180
		(0.164)	(0.164)	(0.164)	(0.203)	(0.202)	(0.202)
AUDIT COM. OPTIONS	?	0.416	0.434	0.429	0.962	0.972	0.960
		(0.524)	(0.526)	(0.521)	(0.618)	(0.621)	(0.614)
AUDIT COM. AGE	?	0.024	0.025	0.025	0.033*	0.034*	0.033*
		(0.015)	(0.016)	(0.016)	(0.019)	(0.019)	(0.019)
AUDITOR BIG 4	-	-0.075	-0.051	-0.072	-0.654*	-0.626	-0.645
		(0.338)	(0.336)	(0.338)	(0.419)	(0.418)	(0.420)
AUDITOR NAT. LEAD	-	-0.266*	-0.272*	-0.267*	-0.215	-0.220	-0.220
		(0.193)	(0.193)	(0.192)	(0.236)	(0.237)	(0.235)
AUDITOR OFF. LEAD	-	0.283*	0.279*	0.284*	0.572***	0.576***	0.579***
		(0.194)	(0.195)	(0.194)	(0.226)	(0.228)	(0.227)
AUDITOR OFF. SIZE	-	-0.064	-0.067	-0.062	0.072	0.067	0.073
		(0.078)	(0.078)	(0.078)	(0.088)	(0.089)	(0.089)
CEO AGE	?	0.003	0.004	0.003	0.009	0.009	0.008
		(0.006)	(0.006)	(0.006)	(0.007)	(0.007)	(0.007)
PARTNER GENDER	?	-0.507	-0.514	-0.512	-0.754	-0.774	-0.762
		(0.551)	(0.548)	(0.554)	(0.595)	(0.595)	(0.600)
CEO GENDER	-	-0.151	-0.150	-0.152	-0.409	-0.421	-0.430
		(0.551)	(0.548)	(0.553)	(0.613)	(0.613)	(0.620)
GENDER DIVERSITY	?	0.193	0.197	0.189	0.545	0.564	0.550
		(0.553)	(0.550)	(0.555)	(0.608)	(0.609)	(0.612)
MATERIAL WEAKNESS	+	-0.118	-0.123	-0.127	-0.543	-0.538	-0.544
		(0.411)	(0.410)	(0.413)	(0.431)	(0.430)	(0.431)
AUDITOR TENURE	-	-0.018*	-0.017	-0.017	-0.011	-0.010	-0.010
		(0.011)	(0.011)	(0.011)	(0.014)	(0.014)	(0.014)
RELIGIOSITY	-	-1.149*	-1.171*	-1.160*	-1.050	-1.053	-1.056



LNTAXFEE	—	(0.764) 0.009 (0.009)	(0.765) 0.009 (0.009)	(0.765) 0.009 (0.009)	(0.850) 0.006 (0.011)	(0.851) 0.007 (0.011)	(0.847) 0.006 (0.011)
Industry Fixed Effects		Yes	Yes	Yes	Yes	Yes	Yes
Year Fixed Effects		Yes	Yes	Yes	Yes	Yes	Yes
N of observations		2242	2242	2242	2242	2242	2242
Pseudo R-square		0.044	0.045	0.045	0.067	0.068	0.067

*Table 5 presents the effects of political ideology and ideological alignment variables on the probability of financial statement restatement, where the coefficients and standard errors reported are from a logit model. Column (1) reports our baseline results using equation (2). Column (2) adds to the baseline model in column (1) the ideological alignment between the engagement partner and the firm's executive team using equation (3), while column (3) adds to the model the ideological alignment between the engagement partner and the firm's directors on the audit committee using equation (4). Columns (4-6) use the same specifications in columns (1-3) but applied to the sample after entropy balancing. Each specification (columns (1-6)) includes year and industry fixed effects (not reported). Heteroscedasticity robust standard errors are reported in parentheses. \*, \*\*, and \*\*\* denote the statistical significance at the 10%, 5%, and 1% level for one-tailed tests, wherever a coefficient sign was predicted, or a two-tailed test elsewhere, respectively. Variable definitions are in Appendix A.*

Table 6 The effects of party alignment on audit quality

Panel A. The effects of party alignment between engagement partners and executives

	Predicted sign	Discretionary Accruals		Restatement	
		Original Sample	Entropy Balanced	Original Sample	Entropy Balanced
		(1)	(2)	(3)	(4)
PARTNER REP	–	-0.006** (0.003)	-0.005** (0.002)	-0.291 (0.254)	-0.068 (0.270)
EXECUTIVE REP	–	-0.001 (0.005)	-0.002 (0.007)	-0.283 (0.294)	-0.573 (0.427)
AUDIT COM. REP	?	-0.001 (0.005)	-0.002 (0.005)	0.147 (0.286)	0.182 (0.319)
PARTNER & EXEC ALIGN	+	0.013** (0.007)	0.022*** (0.004)	0.523* (0.404)	0.898** (0.449)
REPUBLICAN_ EXEC_ALIGN	?	-0.007 (0.007)	-0.009 (0.008)	0.088 (0.384)	0.397 (0.410)
DEMOCRAT_ EXEC_ALIGN	?	0.008 (0.009)	0.001 (0.010)	0.443 (0.546)	0.105 (0.587)
Control variables		Yes	Yes	Yes	Yes
Industry Fixed Effects		Yes	Yes	Yes	Yes
Year Fixed Effects		Yes	Yes	Yes	Yes
N of observations		2260	2260	2242	2242
Adjusted and Pseudo R-square		0.160	0.167	0.046	0.069

Panel B. The effects of party alignment between engagement partners and audit committee

	Predicted sign	Discretionary Accruals		Restatement	
		Original Sample	Entropy Balanced	Original Sample	Entropy Balanced
		(1)	(2)	(3)	(4)
PARTNER REP	–	-0.011*** (0.004)	-0.009** (0.004)	-0.267 (0.248)	-0.160 (0.241)
EXECUTIVE REP	–	-0.003 (0.005)	-0.002 (0.004)	-0.263 (0.255)	-0.916 (0.643)
AUDIT COM. REP	?	-0.002 (0.005)	-0.002 (0.005)	0.156 (0.328)	0.149 (0.328)
PARTNER & AC ALIGN	+	0.016** (0.007)	0.018** (0.008)	0.637* (0.471)	0.971** (0.489)
REPUBLICAN_AC_ALIGN	?	0.007 (0.006)	0.000 (0.007)	0.398 (0.340)	0.224 (0.343)
DEMOCRAT_AC_ALIGN	?	-0.005 (0.008)	-0.004 (0.010)	0.679 (0.506)	0.364 (0.551)
Control variables		Yes	Yes	Yes	Yes
Industry Fixed Effects		Yes	Yes	Yes	Yes
Year Fixed Effects		Yes	Yes	Yes	Yes
N of observations		2260	2260	2242	2242
Adjusted and Pseudo R-square		0.161	0.167	0.048	0.081

*Table 6 presents the effects of party alignment on measures of audit quality. Panel A reports results based on the political alignment between engagement partners and executives. The first two columns present regression estimates of discretionary accruals and the last two columns present logistic regression estimates of the probability of restatement. Columns (1, 3) use our original sample, whereas columns (2, 4) use the entropy balanced sample. Inclusion of the interaction terms allow us to test whether there is a difference between homophilous pairings of partners-executives who are both Republicans, Democrats, or Non-Partisan. Panel B reports results based on the political alignment between engagement partners and members of the audit*

*committee. Each specification includes the same additional controls used in Tables 4 and 5 (not reported). Heteroscedasticity robust standard errors are reported in parentheses. \*, \*\*, and \*\*\* denote the statistical significance at the 10%, 5%, and 1% level for one-tailed tests, wherever a coefficient sign was predicted, or a two-tailed test elsewhere, respectively. Variable definitions are in Appendix A.*

Table 7 The effects of political ideology on audit quality excluding zero contributors

Panel A. The effects of political ideology on discretionary accruals excluding zero contributors

	Predicted sign	Original Sample			Entropy balanced		
		(1)	(2)	(3)	(4)	(5)	(6)
PARTNER REP	–	-0.010** (0.005)	-0.010** (0.005)	-0.010** (0.005)	-0.013*** (0.005)	-0.012*** (0.004)	-0.013*** (0.005)
EXECUTIVE REP	–	-0.013* (0.009)	-0.015* (0.009)	-0.013* (0.009)	-0.007 (0.008)	-0.014* (0.009)	-0.007 (0.008)
AUDIT COM. REP	?	0.014 (0.010)	0.014 (0.010)	0.012 (0.010)	0.009 (0.012)	0.009 (0.012)	0.004 (0.013)
PARTNER & EXEC ALIGN	+		0.021* (0.016)			0.043*** (0.016)	
PARTNER & AC ALIGN	+			0.018 (0.020)			0.031* (0.022)
Industry Fixed Effects		Yes	Yes	Yes	Yes	Yes	Yes
Year Fixed Effects		Yes	Yes	Yes	Yes	Yes	Yes
N of observations		332	332	332	328	328	328
Adjusted R-square		0.525	0.528	0.526	0.374	0.388	0.376

Panel B. The effects of political ideology on probability of restatement excluding zero contributors

	Predicted sign	Original Sample			Entropy Balanced		
		(1)	(2)	(3)	(4)	(5)	(6)
PARTNER REP	–	0.118 (0.322)	-0.018 (0.355)	0.156 (0.350)	0.306 (0.397)	-0.252 (0.427)	0.537 (0.402)
EXECUTIVE REP	–	-0.241 (0.492)	-0.337 (0.530)	-0.127 (0.534)	0.530 (0.553)	-0.072 (0.652)	-0.498 (0.463)
AUDIT COM. REP	?	-0.273 (0.642)	0.040 (0.684)	-0.489 (0.673)	-0.279 (0.772)	-0.076 (0.804)	-1.002 (0.831)
PARTNER & EXEC ALIGN	+		3.051*** (1.264)			3.739*** (1.552)	
PARTNER & AC ALIGN	+			2.163* (1.548)			2.697* (1.667)
Industry Fixed Effects		Yes	Yes	Yes	Yes	Yes	Yes
Year Fixed Effects		Yes	Yes	Yes	Yes	Yes	Yes
N of observations		312	312	312	312	312	312
Pseudo R-square		0.251	0.277	0.261	0.305	0.337	0.267

Table 7 presents the effects of political ideology on firms' audit quality after excluding observations where either partners, executives, or audit committee members do not make contributions. Panel A reports results when audit quality is proxied by discretionary accruals. Column (1) reports our baseline results using equation (2). Column (2) adds to the baseline model in column (1) the ideological alignment between the engagement partner and the firm's executive team using equation (3), while column (3) adds to the model the ideological alignment between the engagement partner and the firm's directors on the audit committee using equation (4). Columns (4-6) use the same specifications in columns (1-3) but applied to firms after entropy balancing. Panel B reports results when audit quality is proxied by probability of restatement. The model specifications in Panel B are the same as those in Panel A. Each specification includes the same additional controls used in Table 4 (not reported). Heteroskedasticity robust standard errors are reported in parentheses. \*, \*\*, and \*\*\* denote the statistical significance at the 10%, 5%, and 1% level for one-tailed tests, wherever a coefficient sign was predicted, or a two-tailed test elsewhere, respectively. Variable definitions are in Appendix A.