Political connection and the quality of profit information for publicly traded Brazilian companies

Conexão Política e a Qualidade da Informação do Lucro das Empresas Brasileiras de Capital Aberto

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ABSTRACT

Research conducted with the aim of investigating the influence of political connection on the profit quality of Brazilian companies. The study proxy was electoral donations from 2002 to 2014, extracted from the Superior Electoral Court website, the economic-financial ones, from Economática. It used Stata 15, panel data, estimated by Generalized Least Squares, Modified Jones and Persistence by Fran- cis, Lafond and Olsson (2005). It concluded that political connection influences the quality of earnings, the greater the donation, the greater the influence, only from the perspective of earnings management based on accruals, as for persistence, it was not possible to infer that a politically connected company presents more persistent earnings.

Keywords: Political connection; Profit Quality; Persistence; Results Management; Performance.

RESUMO

Pesquisa realizada objetivo de investigar a influência da conexão política na qualidade do lucro de empresas brasileiras. A proxy de estudo foram as doações eleitorais de 2002 a 2014, extraídas do website Tribunal Superior Eleitoral, os econômico-financeiros, do Economática. Utilizou Stata 15, dados em painel, estimados por Mínimos Quadrados Generalizados, Jones Modificado e Persistência de Francis, Lafond e Olsson (2005). Concluiu que, conexão política influencia a qualidade do lucro, quanto maior doação maior influência, somente sob a ótica do gerenciamento de resultados baseado em accruals, quanto à persistência não foi possível inferir que empresa conectada politicamente apresente lucros mais persistentes.

Palavras-chave: Conexão Política; Qualidade do Lucro; Persistência; Gerenciamento de Resultados; Desempenho.

1 INTRODUCTION

With the aim of improving the quality of accounting information, Brazil began to adopt new accounting practices based on International Financial Reporting Standards (IFRS) with the enactment of Federal Law No. 11.638/2007 (ANTUNES et al., 2012). This law amended and revoked provisions of Law No. 6.404/1976 and Law No. 6.385/1976, extending provisions on the preparation and disclosure of financial statements to large companies, as well as the creation of the Accounting Pronouncements Committee (CPC), by Resolution of the Federal Accounting Council (CFC) No. 1. 055/2005 with the composition of representatives from entities that regulate accounting standards in Brazil, whose objective is to issue technical documents on accounting procedures and issue standards, with a view to centralizing and standardizing accounting information, in view of the convergence of Brazilian accounting to international standards (Accounting Pronouncements Committee [CFC], 2005).

Studies on the impact of the International Financial Reporting Standards (IFRS) have shown a positive effect and an increase in the quality of accounting information in Brazil (COELHO; NIYAMA; RODRIGUES, 2011; SILVA, 2013). However, adopting accounting standards alone does not guarantee the best quality of financial reporting, given the complexity of the reality of the institutional issues, as well as aspects inherent in the political and legal systems of the countries and other incentives that influence the quality of accounting information and which must be taken into account (DUARTE; AMARAL; AZEVEDO, 2014).

Soderstrom and Sun (2007) document that after the adoption of IFRS, the quality of accounting information depends on three factors: (1) the quality of accounting standards; (2) a country's legal and political system; (3) economic incentives granted to managers to improve the quality of financial reports. The authors note that these incentives are a primary mechanism for pointing out information to the market and its participants in order to meet

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the demands of related parties, but that this mechanism can affect the quality of the information reported.

In an attempt to maximize their interests, managers may engage in opportunistic behavior and support accounting practices that guarantee an increase in reported profits (COELHO; LOPES, 2007). However, this practice may result in a reduction in the quality of accounting information (CLAESSENS; FEIJEN; LAEVEN, 2008). One of the most analyzed variables to assess the quality of accounting information is the analysis of accounting profit, which can be broken down into cash-based transactions and accruals, the latter coming from the accrual basis (ALMEIDA, 2010).

Chaney, Faccio and Parsley (2011) document that the political connection is associated with a lower quality of disclosed earnings information, since there is always the possibility of creditors of connected companies providing capital at a low cost. In addition, managers could omit or delay information, so as not to face negative consequences for their disclosures or lack of them. In view of the amount of donations made in the 2002, 2006 and 2010 elections in Brazil, it is important to study this issue in Brazil, as the amounts involved in financing electoral campaigns can have an impact on the economic and financial performance shown by donor companies (ASTORINO, 2015).

In light of the above, this research seeks to answer the following research question: do political connections influence the quality of earnings reported by publicly traded companies in Brazil? It also aims to identify whether political connections through donations influence the quality of earnings reported by Brazilian listed companies traded on B3.

One of the distinguishing features of this study is that it analyzes the influence of the political connection on the earnings quality of the companies studied, specifically the quality of the information reported, using two earnings quality metrics: the manipulation of the discretionary accrual, using the Modified Jones model and the evaluation of the persistence of earnings; and it also differs in the way the political connection proxy was measured. A control was performed on the donations made in the presidential elections in the period under study by sector, measuring the donation made by the company in relation to the total donations made in the period, divided into quartiles. In previous work, the political connection measured by the donation is considered in its entirety, without considering the intensity or importance of each sector's donation in relation to the total donated. We hope to contribute to the theory on the impact of political connections on aspects of the quality of accounting information.

This is a relevant issue in the economic and political context that the country has been through and has shown, through the results of the Operation Car Wash investigation team at the Federal Public Prosecutor's Office, relationships of agreements and benefits arising from affinity between companies and the government, such as advantages, return of favors, provision of non-existent services, overvalued and flexible contracts, payments actually made in an improper manner, privileged information among other irregularities (CLAESSENS; FEIJEN; LAEVEN, 2008).

2 THEORETICAL FRAMEWORK

2.1 POLITICAL CONNECTIONS

The company can connect politically with the external environment in various ways, including through donations to election campaigns (CAMILO; MARCON, 2011; CAMILO; MARCON; BANDEIRA-DE-MELO, 2012).

Claessens, Feijen and Laeven (2008) and Lazzarini (2011) see that the political connection can be analyzed considering the contributions made by companies to electoral campaigns and the result of this would be the strengthening of political ties that could minimize future risks of operations.

The donation of financial resources to candidates for elective office in electoral campaigns was legally instituted in Brazil under Article 35 of Federal Law No. 8,713, 1993. Subsequently, other rules were established limiting donations to 2% of the company's gross turnover in the year prior to the election, by means of Ordinary Law No. 9.504, due to the prohibition on donating financial resources by Electoral Law No. 9.504, 1997, Art. 24. Currently, Federal Law No. 13.165, 2015 prohibits legal entities from donating to electoral campaigns and determines that only natural persons may make donations and contributions in cash, limited to 10% of the gross income earned by the donor in the year prior to the election.

According to Fonseca (2017), companies that donated to members of the coalition base received more financial resources from the government through public contracts than donors to members of the opposition, and the difference between the values of these public contracts before the elections is significant in relation to the values of public contracts after the elections. In addition, companies that donate to both groups, the ruling coalition and the opposition, benefit more and receive more funds through public contracts.

2.2 QUALITY OF PROFIT INFORMATION

One of the variables used in the literature as a proxy for measuring the quality of accounting information is accounting profit. Profit is made up of transactions that have a direct impact on the company's cash and transactions conducted by competence criteria (with no direct impact on the company's cash), the latter being referred to here as accruals (ALMEIDA, 2010).

The result (profit/loss) of a company is the result of discretionary decisions in the treatment and disclosure of accruals, due to a margin of interpretation of the accounting standard. The problem can occur if this interpretation is aimed at private motivations and, in these cases, the manager can act within the legal limits prescribed by the accounting standard; however, where the standard allows for a certain amount of discretion, choices based on other incentives can lead the company to report a different result from the one that would be the most reliable (MARTINEZ, 2001).

Dechow and Schrand (2004) document that high quality profits accurately express the company's current operating performance, represent a good indicator for future operating performance and also represent a relevant intrinsic measure of the company's value. In addition, they concluded that the quality of profits depends on their composition, the time and sector in which the company operates, as well as the moment in its life cycle, and that profits are of high quality when the return on equity is a good measure of the internal rate of return of the company's current portfolio of projects.

Dechow, Ge and Schrand (2010) document three categories of proxies or indicators of earnings quality, which the authors call earnings properties, investor responsiveness to earnings and external indicators of earnings distortions. In this study, specifically, two proxies will be used as indicators of earnings quality: earnings management measured by accruals and earnings persistence.

2.2.1 Results Management

Earnings management occurs when managers make accounting choices in order to adjust financial reports to manipulate how they are viewed by some parties interested in the underlying economic performance of the company or to influence contractual outcomes that depend on the reported accounting figures (HEALY; WAHLEN, 1999).

Martinez and Cardoso (2009) understand results management as the management of accounting information based on choices of accounting practices or operating decisions with the aim of preparing reports and disclosing accounting figures that differ from those that would have been prepared and disclosed without the adoption of such practices and/or decisions. The authors document that most of the evidence of the manipulation of accounting information through accounting choices considers the accumulation of discretionary accruals, that the standard allows the manager some autonomy to define the form that best fits what happens in the company, such as estimating the expected useful life of an asset, defining the residual value of a long-term asset and probable bad debts, by making these estimates managers manage the final product of accounting information, especially profit information.

The determination of profits requires estimates and judgments; therefore, a large volume of accruals may indicate great underlying volatility in the company's operations and low-quality profit information, even when these operations are in accordance with generally accepted accounting principles (GAAP), (DECHOW; SCHRAND, 2004).

Dechow, Ge and Schrand (2010) present a summary of models for assessing earnings management based on accruals, which are widely used to estimate normal levels of accruals, while their residuals are considered a measure of “abnormal” accruals.

- Jones model (1991): accruals are in function of revenue growth and depreciation of fixed assets and the variables are scaled by total assets.

$$Acc_t = \propto + \beta_1 \Delta Rev_t + \beta_2 PPE_t + \varepsilon_t$$

Where:

Acct – total accruals of firm i in the year t; Δ*REVit* – variation in gross revenue of firm i in year t; *PPEit* – fixed assets of company i in the year t; and *εit* – regression residual for firm i in the year t.

- Modified Jones Model Dechow, Sloan and Sweeney (1995): adjusts the Jones model to exclude the growth of credit sales in the period, identifying it as manipulation.

$$Acc_t = \propto + \beta_1 [\Delta REV_{it} - \Delta REC_{it}] + \beta_2 PPE_t + \varepsilon_t$$

Where:

Acct - total accruals of firm i in the year t; Δ*REVit* – variation in gross revenue of firm i between years t and t-1, weighted by total assets at the end of the period t-1; Δ*RECit* – variation in firm i's accounts receivable between years t and t-1, weighted by total assets at the end of period t-1; *PPEit* – fixed assets of firm i in year t, and εit - regression residual for firm i in year t.

- Model for estimating accruals Dechow and Dichev (2002): accruals are modeled in terms of past, present and future cash flows (t-1, t and t+1), with the aim of altering the timing of the recognition of cash flows in earnings.

Where:

WCAt **-** total accruals of firm i in year t; *CFOt-1* – cash flow of the firm in the year t-1; *CFOt* – cash flow of the firm in the year t; *CFOt+1* – cash flow of the firm in the year t+1, and *εit* – regression residual for firm i in the year t.

2.2.2 Management of Results and Political Connection

Roychowdhury (2006) defines that results management can be through real activities, carried out in two ways: through the manipulation of accruals, i.e. the manipulation of data on accrual records, and management actions carried out through the execution of operational practices considered abnormal, out of the ordinary, carried out with the aim of manipulating profits (for example, the purchase of a large volume of stock to reduce the average cost of the product and generate higher profit information).

Chaney, Faccio and Parsley (2011) concluded that the presence of political connections is associated with a lower quality of reported earnings, and that companies with this connectivity do not seem to worry about the consequences, as political relations can make it possible to eliminate these effects.

The company can use the political connection and its potential benefits, given the government intervenes in the country's economic policy. As a result, accounting information can be disclosed in an attempt to hide and/or delay the disclosure of information, through accounting choices influenced by political pressures, reducing the quality of profit information and creating a possible decision bias for investors, and managers can opportunistically take actions that maximize and protect their interests, actions to reduce uncertainties and external dependencies, as well as increase the resources they need (PARENTE; MOTA; LEITE FILHO, 2017).

Political connections represent a new magnitude to the process that generates profits for the company and can also increase errors in estimating accruals, which can consequently result in lower accrual quality (CHEN; DING; KIM, 2007).

Given these perspectives, this research proposes that the existence of a political connection, through donations, influences the incentives of preparation and generation of accounting reports, which, consequently, can cause systematic differences in the quality of reported earnings information between companies that maintain and those that do not maintain a political connection, and proposes as a hypothesis:

Hypothesis 1: Political connection is a factor that influences the level of earnings management in publicly traded companies in Brazil.

2.2.3 Profit Persistence and Political Connection

Dechow and Schrand (2004) define quality profits as persistent and permanent profits and, furthermore, point out that the profits that best represent future cash flows are persistent profits and predictable. The authors argue that managers usually want highly persistent and predictable earnings, since these characteristics can improve their reputation with analysts and investors. However, if earnings do not represent the intrinsic value of the company, they can be considered to be of low quality. This level of quality would be the result of the discretionary use of estimates and judgments by managers in relation to the company's assets, from depreciation methods to the creation of provisions related to the expectation of receiving a duplicate.

Sloan (1996) demonstrates that the cash flow component is more persistent in predicting future profits when compared to the previous year's profit component, since the latter is the result of transactions defined by the accrual basis (which allows for interference generated by the estimates defined by managers), thus inferring that companies with a high degree of accrual (accumulations generated by the accrual basis in Accounting) have lower quality profits, which can result in an incorrect value of the shares.

Frankel and Litov (2009) highlight the importance of predicting profits for the analysis of financial statements and point out that if it were not for the economic impacts and aspects of calculating accounting profit, profits would be persistent and, in view of this, they are in favor of identifying factors that predict the persistence of profits. Agreements arising from political connection fall into political favoritism among other relationships, and are usually not fully disclosed, which can cause different transactions than usual and lead to the interruption of permanent profit patterns, thus decreasing the persistence of the company's profits (CHEN; DING; KIM, 2007).

Companies in Malaysia that maintain a political connection are associated with lower earnings persistence, indicating a lower quality of earnings (TEE; RASIAH, 2019). These findings corroborate the work of Sejati (2009), who showed that political connection is directly associated with lower earnings persistence for companies that maintain political connection during the financial crisis period. The author points out that this may be caused by operational inefficiencies (as a result of favoritism) and the government's inability to provide valuable subsidies to companies that maintain political connection during the crisis period.

These studies corroborate evidence documented by Chaney, Faccio and Parsley (2011) who, when examining the association between political connections and accrual quality, found that the earnings quality of companies that maintain a political connection is lower than that of companies that do not maintain this connectivity.

This research therefore proposes the following hypothesis:

Hypothesis 2: political connection is a factor that influences the level of profit persistence in publicly traded companies in Brazil.

2.2.4 Control variables

Some company characteristics can affect the quality of earnings and influence the effect of results management, such as company size, return on equity and level of internal controls (DECHOW; RICHARDSON; SLOAN 2008). In view of this, we included in the econometric model of this study control variables considered important in the literature on the subject: Corporate Governance (GOV); Size (TAM); Return on Assets (ROA); Degree of Leverage (GAT); Indebtedness (ENDIV) and Audit performed by one of the four auditing firms (BigFour).

Dechow and Skinner (2000) show that companies with weak and precarious governance structures have a greater tendency to practice earnings management. For Martinez (2001), corporate governance levels are alternative means that can minimize the practice of earnings management.

Xie, Davidson III and DaDalt (2003), supporting a SEC report, showed that board and audit committee members with corporate or financial experience are associated with companies that have lower discretionary accruals, since their activities can be important factors in restricting managers from practicing earnings management.

Company size interferes with the quality of accruals, as larger firms have more stable and predictable operations, as well as lower error estimates. To measure firm size, they used the logarithm of total assets (DECHOW; DICHEV, 2002). For Watts and Zimmerman (1990), large companies have a greater tendency to use accounting choices that reduce reported profits.

Gu, Lee and Rosett (2005) document that size is one of the most important characteristics of a company, with large companies enjoying more of the benefits of economies of scale and economies of scope. These companies tend to be modified, because they undergo constant changes in different business sectors, given that they are more politically sensitive and bear higher political costs, with fewer incentives to manage results.

The purpose of ROA is to control the bias that may exist between accruals and company performance (DECHOW; SLOAN; SWEENEY, 1995). For Kothari, Leone and Wasley (2005), the tests that use models to analyze earnings management by accruals are better specified and capable of drawing more reliable inferences, since they can control the decisions that interfere in calculating the return on assets, an important source of discretionary accruals.

According to Morsfield and Tan (2006), financial leverage must be controlled, as a highly leveraged company faces a high financial risk or bankruptcy which could jeopardize the success of a public offering of shares, and therefore has reason to practice results management, i.e. the manipulation of accruals to avoid a reduction in sources of finance. Gu, Lee and Rosett (2005) show in their studies that financial leverage is directly related to earnings management through accruals.

Watts and Zimmerman (1990) exemplify the relationship between the company's debt and equity as a procedure for managing profits and that the higher the company's debt, the more managers use accounting procedures to increase earnings.

Gu, Lee and Rosett (2005) indicate a similar result to that of Francis, Lafond and Olsson (2005), in relation to companies audited by BigFour having a lower level of results management, since contracting BigFour audits favors a reduction in the practice of manipulating earnings, mitigating the occurrence of results management.

Dechow, Ge and Schrand (2010) document various operational characteristics of the company related to proxies of earnings quality, and with regard to earnings persistence, they highlight performance, leverage, indebtedness, size and governance. They show that poor performance provides incentives to manage profits. With regard to leverage, they point out that managers of highly leveraged companies tend to manipulate financial statements, and they also argue that highly indebted companies are associated with various quality-of-place biases, as they opt for accounting choices and methods that tend to increase their profits.

In relation to size, the authors also suggest that larger companies can choose accounting methods with the intent of decreasing their profits in response to regulation, as well as that the size of the company and its market share can lead to accounting practices to obtain consistent profits. As for the persistence of earnings by Big Four audited companies, Tee and Rasiah (2019) document greater earnings persistence for firms that maintain a political connection and are audited by the largest audit firms, i.e. for companies audited by the Big Four.

3 METHODOLOGY

3.1 SAMPLE AND DATA COLLECTION

This research used a quantitative, descriptive, longitudinal approach with secondary data. Initially, the population was made up of publicly traded companies listed on B3, excluding regulated companies (public service concessionaires), as well as those with blank data, as can be seen in Table 1, which shows all the publicly traded companies listed on B3 that made donations to election campaigns between 2002 and 2014, which make up the final sample.

The quality of the profits of companies that made donations was evaluated in relation to companies that did not make donations in the 2002, 2006, 2010 and 2014 presidential elections, with donations being considered as the study's proxy for measuring political connection.

TABLE 1 - Distribution of the final sample by donation volume

ECONOMÁTICA SECTOR	DONATED VALUE	% DONATED VALUE	% CUMULATIVE
Food and drink	353.227.066	69,75%	69,75%
Others	39.703.550	7,84%	77,59%
Chemistry	36.040.000	7,12%	84,71%
Steel & Metallurgy	22.517.544	4,45%	89,15%
Vehicles and parts	12.866.000	2,54%	91,69%
Construction	12.659.716	2,50%	94,19%
Textile	7.903.492	1,56%	95,75%
Paper and Pulp	5.880.000	1,16%	96,91%
Electronics	4.727.566	0,93%	97,85%
Trade	4.581.365	0,90%	98,75%
Oil and Gas	3.200.000	0,63%	99,38%
Agriculture and Fishing	1.340.000	0,26%	99,65%
Electricity	900.000	0,18%	99,83%
Non-metal minerals	860.000	0,17%	100,00%
Transportation Services	20.000	0,00%	100,00%
Software and Data	-	0,00%	100,00%
Telecommunications	-	0,00%	100,00%
Industrial machinery	-	0,00%	100,00%
Mining	-	0,00%	100,00%

Source: Research data

Among the 465 companies listed on B3 during the period studied, 8 companies belonging to the financial sector and concessionaires and permissionaires were excluded. Observations with missing values were also excluded, leaving a final sample of 411 companies, which generated a total of 3,892 observations. It is important to note the excessive number of observations excluded due to missing values. Therefore, the donations used to identify the existence of a political connection were those made to candidates and committees from 2002 to 2014, extracted from the website of the Superior Electoral Court (TSE), through the National Register of Legal Entities (CNPJ) of the company listed on B3.

It should be noted that the political connection was measured considering the proportion of the donation made by the company in relation to the total donation for the period.

The companies' financial data was taken from the Economática database. The analysis of earnings quality was conducted using results management based on discretionary accruals, using the Modified Jones model (DECHOW; SLOAN; SWEENEY, 1995), and from the calculation of earnings persistence (FRANCIS; LAFOND; OLSSON, 2005).

Stata 15 software was used to analyze the data, with panel data, and all the econometric models were estimated by Generalized Least Squares (MQG).

Table 1 shows the amount donated by economic sector during the period analyzed in this study.

The sample will be further divided into quartiles in order to assess whether the intensity of donations or political connection influences the quality of profit in these groups.

The Dechow, Sloan and Sweeney Modified Jones Model (1995) was used to measure the quality of companies' earnings, together with the deterministic and response variables, to check whether the study's variable, political connection, influences the dependent variable, designated by the discretionary accrual. To this end, discretionary accruals are estimated using the following steps:

Total Accruals (TA) are calculated, based on the economic and financial data contained in the financial statements, using the following equation. Equation (1).

$$TAit = [(\Delta ACit - \Delta Dispit) - (\Delta PCit - \Delta Divit) - Deprit]/Ait{-}1$$

Where: $\Delta ACit$ - variation in current assets of company i at the end of period t-1 to the end of period t; $\Delta Dispit$ - variation in available funds of company i at the end of period t-1 to the end of period t; $\Delta PCit$ - variation in current liabilities of company i at the end of period t-1 to the end of period t; $\Delta Divit$ - variation in company i's short-term financing and loans at the end of period t-1 to the end of period t; *Deprit* - amount of company i's depreciation and amortization expenses during period t; and *Ait-1* - total assets of company i in year t-1.

To estimate non-discretionary accruals, we obtain the coefficients to be estimated using the regression model in the following equation, whose dependent variable was defined by the total accruals. Equation (2).

$$TAit = \alpha i[1/Ait{-}1] + \beta 1i[(\Delta REVit - \Delta RECit)/Ait{-}1] + \beta 2i[PPEit/Ait{-}1] + \varepsilon it$$

Where:

TAit - total accruals of firm i in year t; $\Delta REVit$ - variation in gross revenue of firm i between years t and t-1, weighted by total assets at the end of period t-1; $\Delta RECit$ - variation in accounts receivable of firm i between years t and t-1, weighted by total assets at the end of period t-1; *PPEit* - fixed assets of firm i in year t, weighted by total assets at the end of period t-1; *Ait-1* - total assets of firm i in year t-1; and εit-*1* - regression residual for firm

i in year t. Once the parameters of Equation 2 have been estimated, these estimates are used to calculate the Non-Discretionary Accruals (NDA), as shown in Equation 3.

$$NDA_{it} = \hat{\alpha}_i[1/A_{it-1}] + \widehat{\beta_{1i}}[\Delta REV_{it} - \Delta REC_{it}] + \widehat{\beta_{2i}}[PPE_{it}]$$

Finally, through the difference between total accruals and non-discretionary accruals, discretionary accruals are obtained. Discretionary accruals (DA) are measured by subtracting non-discretionary accruals (NDA) from total accruals (TA) (Dechow, Sloan, & Sweeney, 1995), as described below. Equation (4).

DA = TA – NDA

The following subsection presents the first econometric model of this study. The discretionary accruals estimated from equations 1, 2 and 3 were used as the dependent variable in order to assess the link between the quality of earnings and the political connection of companies listed on B3. The proposed econometric model made it possible to correlate earnings quality and corporate reputation with their appropriate proxies.

3.2 Theoretical Model - Discretionary Accrual

According to the literature, companies that maintain political connections receive incentives and this relationship can interfere with their performance and affect reported profits. From the point of view of looking for statistical evidence, we outlined the coefficient in which it is expected that this coefficient, after estimation, will prove to be significant and positive (), which would allow us to statistically conclude whether political connection influences the quality of discretionary accruals. To this end, the econometric model represented by Equation 5 was proposed.

$$DA_{it} = \alpha + \beta_1 CONPOL_{it} + \beta_2 GOV_{it} + \beta_3 TAM_{it} + \beta_4 ENDIV_{it} + \beta_5 ROA_{it} + \beta_6 BigFour_{it} + \varepsilon_i$$

Where:

DAit - accruals or discretionary accruals of firm i in year t. Dependent variable that was estimated to identify discretionary accruals (DA) for the study period (2002 to 2014), using the Modified Jones model of Dechow, Sloan and Sweeney (1995), where the variable representing DA is obtained from the difference between total accruals and non-discretionary accruals;

COMPOLit - the study's main variable, the proportion of donations made by the company that represents the political connection made to the electoral campaign, assigning a value between zero (0) and one (1) to the company that has made a donation, indicating that it has a political connection, and, if not, a value of zero (0) for a company that has not made a donation, indicating that firm i does not have a political connection. This is the study's main proxy, as it will be considered in the effect of discretionary accruals and will be decisive in explaining whether companies that maintain this connection manage their results more or not.

GOVit - governance level dummy, which assumes values “1” for companies with new market governance and level 2, and “0” otherwise;

TAMit - control variable representing the natural logarithm of firm i's total assets in year t;

ENDIVit - control variable representing the level of indebtedness of firm i in year t;

ROAit - control variable representing the return on assets of firm i in year t;

GATit - control variable representing the degree of total leverage of firm i in year t;

BigFour - represents the variable dummy and indicates the companies listed on B3 that have been audited by a BigFour audit firm (*Deloitte; PricewaterhouseCoopers; Ernst & Young;* KPMG), with a value of “1” for a company audited by BigFour and “0” for a company not audited by BigFour or by any other company;

εit - Residual of the regression for firm i in year t.

3.2.2 Theoretical model - Profit Persistence

In this study, we also used the earnings persistence model (FRANCIS; LAFOND; OLSSON, 2005). In order to analyze and evaluate the quality of earnings, a self-regressive model was adapted to investigate the persistence of earnings based on the earnings per share variable - Equation 6, adding another interaction variable that relates political connection to earnings per share, the coefficient. It is therefore expected that this coefficient will show, after estimation, significant and positive (), statistically indicating that the political connection influences the persistence of companies' profits.

$$LPA_{it} = \alpha + \beta_1(CONPOL_{it} * LPA_{it-1}) + \beta_2(GOV_{it} * LPA_{it-1}) + \beta_3(TAM_{it} * LPA_{it-1}) + \beta_4(GAT_{it} * LPA_{it-1}) + \beta_5(ENDIV_{it} * LPA_{it-1}) + \beta_6(ROA_{it} * LPA_{it-1}) + \varepsilon_i$$

Where:

LPA - dependent variable, which represents the adjusted earnings per share of company i in period t;

LPAt-1 - independent variable, which represents the earnings per share of company i in period t-1;

COMPOLit - the study's main variable, the proportion of donations made by the company that represents the political connection made to the electoral campaign, assigning a value between zero (0) and one (1) to the company that made a donation, indicating that it maintains a political connection, and otherwise assigning a value of zero (0) to the company that did not make a donation, indicating that firm i does not maintain a political connection. This is the main proxy in the study, as it will be considered in the effect of the discretionary accrual and will be decisive in explaining whether companies that maintain this connection manage their results more or not.

GOVit - governance level dummy, which assumes values “1” for companies with new market governance and level 2, and “0” otherwise;

TAMit - control variable representing the natural logarithm of firm i's total assets in year t;

ENDIVit - control variable representing the level of indebtedness of firm i in year t;

ROAit - control variable representing the return on assets of firm i in year t;

GATit - control variable representing the degree of total leverage of firm i in year t.

4 ANALYSIS OF RESULTS

4.1 ECONOMETRIC MODEL – ACCRUAL DISCRITIONAL

Table 2 shows the descriptive statistics of the variables in the Modified Jones model used to capture the effect of results management, through the manipulation of accruals, on the information of the companies observed. The results obtained with these variables show the estimates of the previously explained

TABLE 2 - Descriptive statistics modified Jones model

VARIABLES	AVERAGE	STANDARD DEVIATION	MINIMUM	PERCENTAGE 25	MEDIAN	PERCENTAGE 75	MAXIMUM	N
TAit	-0,0201	0,1118	-0,6043	-0,0681	-0,0273	0,0179	0,7336	3892
1/Ait-1	0,0000	0,0000	0,0000	0,0000	0,0000	0,0000	0,0001	3892
ΔREVit	0,0572	0,1830	-0,9947	-0,0058	0,0355	0,1057	2,8399	3892
ΔRECit	0,0310	0,1212	-0,5249	-0,0081	0,0101	0,0506	1,1203	3892
PPEit	0,3068	0,2749	0,0000	0,0414	0,2751	0,4783	2,0844	3892

Note: TA - Total Accruals; 1/A - The inverse of Total Assets; REV - Variation in Gross Revenue; REC - Variation in Accounts Receivable and PPE - Fixed Assets. | **Source**: Research data.

coefficients applied to estimate the discretionary accrual (DA) of the research sample.

The independent variables in the Modified Jones model showed statistical significance, as did the regression which showed a significant Wald-Chi2 statistic at the 1% significance level. In this case, the inverse value of Total Assets showed a negative relationship with Total Accrual, as did the difference between the variation in net revenue and accounts receivable and fixed assets, both scaled by Total Assets.

The estimated error in this model is the proxy used to describe discretionary accruals (DA). The descriptive statistics for NDA and DA are shown. The average value of non-discretionary accruals is negative 0.0212 and the standard deviation is 0.0276. Compared to discretionary accruals (whose mean value is different from zero), the latter shows less variability. This result is consistent with Dechow, Sloan and Sweeney (1995), who described earnings management in the sample through non-provisioned accruals as a successful estimate when it is not biased towards zero.

The statistics of the Dechow, Sloan and Sweeney (1995) model adopted in this research proved to be well adjusted, which made it possible to estimate the DA used as the dependent variable in the proposed model and associated with hypothesis H1, the variation of which will be determined with the inclusion of the variable ConPol.

Table 3 presents the results of the descriptive statistics of the variables in the regression model proposed in Equation 5, showing the distribution of the dependent variable discretionary accrual (DA) estimated by the Modified Jones model including the measures for political connection and the other control variables.

With regard to discretionary accruals (DA), it can be seen that this variable presented, on average, values different from zero, according to the Dechow, Sloan and Sweeney (1995) model. The median of negative DA seems to indicate that, regardless of the magnitude, more than 50% of the sample would be managing to reduce their results.

As for the correlation between the variables, the quality of earnings, represented by the calculated levels of discretionary accruals (DA) and the study proxy, political connection (CONPOL), the correlation coefficient was significant at 5% and had a positive sign, i.e. an increase in donations by companies increases the possibility of earnings management through discretionary accruals (CHANEY; FACCIO; PARSLEY, 2011; SEJATI, 2009). As for the correlation coefficient between discretionary accruals (DA) and the control variables, at a significance level of 1%, a positive correlation was observed with the level of governance (GOV), size (TAM) and return on assets (ROA). At the 5% significance level, the BigFour variable indicated a significant coefficient, and the level of indebtedness (ENDIV) showed a negative correlation with discretionary accrual at the 1% level.

Table 4 shows the results of the regression model (Eq.5). Initially, when the entire sample is considered, it can be seen that

TABLE 3 - Descriptive statistics of the variables in the theoretical model - Discretionary Accruals

VARIABLES	AVERAGE	STANDARD DEVIATION	MINIMUM	PERCENTAGE 25	MEDIAN	PERCENTAGE 75	MAXIMUM	N
DAit	0,0011	0,1070	-0,5772	-0,0429	-0,0017	0,0382	0,7801	3892
CONPOLit	0,0033	0,0332	0,0000	0,0000	0,0000	0,0000	0,7247	3892
GOVit	0,3728	0,4836	0,0000	0,0000	0,0000	1,0000	1,0000	3892
TAMit	14,7218	1,8419	9,5208	13,4341	14,8990	15,9699	19,7127	3892
GATit	-0,7753	65,5686	-1236,7870	-0,1994	0,0936	0,5360	946,2143	3892
ENDIVit	67,6032	65,4694	1,6811	45,4355	58,7623	72,2195	1103,8230	3892
ROAit	0,0165	0,1436	-1,6020	-0,0014	0,0316	0,0739	0,5168	3892
BigFourit	0,7012	0,4578	0,0000	0,0000	1,0000	1,0000	1,0000	3892

Note: DA - Discretionary Accruals; CONPOL - main variable of the study, the proportion donated by the company that represents political connection through donations made to electoral campaigns, assigning a value between zero (0) and one (1) for the company that donated - proportion, indicating that it maintains a political connection and, otherwise, a value of zero (0) for the company that did not donate, indicating that firm i does not maintain a political connection; GOV - Governance level dummy, which assumes a value of "1" for companies with new market governance and level 2 and a value of "0" otherwise; TAM - Natural logarithm of total assets; GAT - Total Leverage Level; ENDIV - Indebtedness; ROA - Return on Assets; BigFour - BigFour dummy, which assumes a value of "1" for companies audited by BigFour and a value of "0" otherwise. | **Source:** Research data.

TABLE 4 - Estimates of the theoretical model discretionary accruals - MQG

INDEPENDENT VARIABLE	DEPENDENT VARIABLE: AD							
	ACCRUALS QUALITY MODEL - CUMULATIVE QUARTILE BY SECTOR							
	ALL		Q3		Q2		Q1	
	BETA	P-VALUE	BETA	P-VALUE	BETA	P-VALUE	BETA	P-VALUE
Constant	-0,020*	0,0710	0,050***	0,0010	0,032**	0,0220	-0,0130	0,2650
CONPOLit	0,0560	0,1540	0,089**	0,0260	0,091**	0,0170	0,0630	0,1010
GOVit	0,0020	0,4720	0,0000	0,8930	-0,0010	0,6740	0,0000	0,9870
TAMit	0,001**	0,0360	-0,0010	0,2560	-0,002*	0,0540	0,0010	0,1730
GATit	0,0000	0,8430	0,0000	0,3370	0,0000	0,8620	0,0000	0,7350
ENDIVit	0,0000	0,1230	-0,000*	0,0880	0,000*	0,0790	-0,000*	0,0770
ROAit	0,121***	0,0000	0,164***	0,0000	0,186***	0,0000	0,123***	0,0000
BigFourit	-0,008***	0,0030	-0,014***	0,0010	-0,008**	0,0120	-0,007**	0,0120
Year	Yes		Yes		Yes		Yes	
Sector	Yes		Yes		Yes		Yes	
Observations	3892,00		1746,00		2579,00		3505,00	
Wald-Chi2	172,9220***		198,0690***		230,9820***		167,2960***	

Note: (i) Estimation Method: MQO - Ordinary Least Squares and MQG - Generalized Least Squares; (ii) Description of Variables: DA - Accruals Discretionary; CONPOL - main variable of the study, the proportion donated by the company that represents political connection through a donation made to an electoral campaign, assigning a value between zero (0) and one (1) for the company that made a donation - proportion, indicating that it maintains a political connection and, otherwise, a value of zero (0) for the company that did not make a donation, indicating that firm i does not maintain a political connection; GOV - Governance level dummy, which assumes a value of "1" for a company with new market governance and level 2 and a value of "0" otherwise; TAM - Natural logarithm of total assets; GAT - Total Leverage Level; ENDIV - Indebtedness; ROA - Return on Assets; BigFour - BigFour dummy, which assumes a value of "1" for a company audited by BigFour and a value of "0" otherwise; (iii) Statistical Significance: ***, **, * significant at the 1%, 5% and 10% level, respectively. | **Source**: Research data.

political connection does not influence the quality of profit in a statistically significant way.

However, when analyzing the sample based on the concentration of amounts donated by sector according to the quartiles, Q3 and Q2, it became clear at the 95% confidence level that the political connection influences the quality of the earnings of the companies studied, from the perspective of discretionary accruals (CHANEY; FACCIO; PARSLEY, 2011; SEJATI, 2009).

The results found in this research, represented by the importance of the concentration of the volume of donations, showed that political connection influences the quality of accounting information, specifically the quality of earnings of companies that maintain political connection, from the perspective of discretionary accruals, corroborating Chaney, Faccio and Parsley (2011) and Sejati (2009), who document that the quality of earnings of politically connected companies is significantly lower compared to similar companies that do not maintain connection. In other words, there seems to be a relationship between the quantity of donations, or the intensity of the political connection, and the quality of the profit information produced by the companies.

These results contrast statistically with those of Parente, Mota and Leite Filho (2017), who, in an analysis of Brazilian publicly traded companies that maintained a political connection through donations, found no effect of the political connection on result management, analyzing the discretionary accrual of these companies. However, Parente et al. (2017) did not consider the intensity of the donation made by the companies.

As for the control variables, the results obtained showed statistically that only the variables ENDIV, ROA and BigFour obtained significant coefficients for the total sample and by quartile, with the exception of ENDIV in the total sample. It can therefore be concluded that these variables can influence the management of discretionary accruals. Based on these results, it can be inferred that the higher the company's indebtedness, the less likely it is to manipulate discretionary accruals, corresponding to the study by Boubakri, Cosset and Saffar (2012).

As for ROA, the higher the companies' return on assets, the greater their propensity to use discretionary accruals is observed. According to Dechow, Sloan and Sweeney (1995), ROA has the purpose of controlling the bias that may exist between accruals and company performance.

Finally, with regard to the control variables with significant coefficients, the results allow us to state that companies audited by large auditing firms (BigFour), on average, have a lower propensity to manage discretionary accruals, findings in line with Gu, Lee and Rosett (2005), who document that companies audited by BigFour have a lower degree of discretionary accruals, since hiring them favors a reduction in the practice of manipulating accruals, mitigating earnings management.

With regard to the GOV and GAT variables, no significant coefficients were obtained for the total sample, so statistically it cannot be inferred that these variables influence the management of discretionary accruals of the companies under study.

Regarding the control variable Size (TAM), considering the sample as a whole, the coefficient was significant (at the 5% level) and had a positive sign, indicating that the larger the size of the company, the greater its earnings management (Watts and Zimmerman, 1990). This relationship is confirmed by Camilo, Marcon and Bandeira-de-Melo (2012), who document that there is a positive association, that these companies have easier access to politicians and are therefore favored by political connections.

However, when evaluating the sample restricted to quartile 2, the coefficient associated with this TAM variable was significant (at the 10% level) and had a negative sign, indicating that the larger the size of the company, the lower its earnings management (DECHOW; DICHEV, 2002). Parente et al. (2017) found in Brazil that the larger the average company size, the lower the levels of earnings management in 2015.

4.2 ECONOMETRIC MODEL - PERSISTENCE OF PROFITS

Initially, estimates were made using the MQO method (Appendix B), which indicated an explanatory power (R2 adjusted) close to 60% in all the estimated models, i.e. the proposed independent variables explain 60% of the variability in Earnings per Share. However, as the assumptions of the MQO were not respected, the MQG estimation method was considered, where the presence of non-constant variance and independence of errors were admitted.

Table 5 presents the results of the descriptive statistics for the variable earnings per share (LPA) in period t and t-1, and again shows the distribution of the political connection proxy. Evaluating the measures of central tendency (average and median), dispersion (standard deviation) and position it can be seen that there is a high degree of variability in the distribution of the variable earnings per share (LPA) for the sample outlined.

Table 6 shows the coefficients of the model for the persistence of company profits for the whole sample and by quartile groups of the value donated controlled by year and by sector. According to Sejati (2009), the closer the coefficient is to 1, the higher the persistence. In the adjusted persistence model (Eq. 6), the coefficient allows us to assess whether the persistence of profits of companies that maintain a political connection is influenced by this connectivity.

With regard to the results of the model proposed for the persistence of profits, the estimated coefficient was not significant. As a result, there was no statistical evidence that political connection influences the persistence of companies' profits.

Based on this result, using the same sample control, represented by the concentration of donations by sector, the estimated coefficient showed statistically that the aspects resulting from the connectivity of these companies, through donations, may not interfere with the volatility of their profits. As for the control variables included in the persistence model, the results showed that only the TAM variable did not have a significant coefficient for the total sample. Based on these results, it can be inferred that the higher the company's level of governance, the lower its earnings persistence, contrary to Dechow, Ge and Schrand (2010).

As for Leverage (GAT), considering the sample as a whole, as well as quartile 1 and quartile 2, the coefficients were significant (1% level) and had a positive sign, indicating that the higher the degree of leverage, the greater the persistence of profits, contrary to Dechow, Ge and Schrand (2010); Morsfield and Tan (2006) and Gu, Lee and Rosett (2005), which show that highly leveraged companies tend to manage earnings through accruals, which can reduce the quality of reported earnings. These results may occur in view of the findings of Kuronuma et al. (2018), which showed that in Brazil, politically connected companies through donations to electoral campaigns tend to have preferential access to BNDES credit, corroborating the findings of Bandeira-de-Mello and Marcon (2011) and Lopes (2016).

As for indebtedness, the results statistically showed that the higher the company's level of indebtedness, the lower the persistence of profits. According to Dechow, Ge and Schrand (2010), highly indebted companies are associated with various earnings quality biases, as they opt for accounting choices and methods that tend to increase their profits.

Martins et al. (2013) show that in Brazil companies that maintain some kind of political connection increase their debt as well as changes in leverage, given the ease of obtaining financing.

Finally, the higher the return on assets, the lower the persistence of profits. These results contradict the findings of Dechow, Ge and Schrand (2010). Pinheiro et al. (2016) document that in Brazil companies with political connections have higher ROA than companies without political connections.

TABLE 5 - Descriptive statistics of the variables in the earnings persistence model

VARIABLES	AVERAGE	STANDARD DEVIATION	MINIMUM	PERCENTAGE 25	MEDIAN	PERCENTAGE 75	MAXIMUM	N
LPAit	-4,2065	81,3986	-810,4749	-0,0248	0,6071	1,7816	559,5147	3891
LPAit-1	-2,9485	78,4273	-810,4749	0,0097	0,6188	1,7888	559,5147	3452
CONPOLit	0,0033	0,0332	0,0000	0,0000	0,0000	0,0000	0,7247	3892

Note: LPA - Earnings per Share; and CONPOL - the study's main variable, the proportion donated by the company that represents a political connection through a donation made to an election campaign, assigning a value between zero (0) and one (1) to the company that donated the proportion, indicating that it maintains a political connection and, otherwise, a value of zero (0) for the company that did not donate, indicating that firm i does not maintain a political connection. |

Source: Research data.

5 FINAL CONSIDERATIONS

The results show that the political connection influences the quality of the discretionary accruals of the companies studied, specifically the quality of the information reported.

According to the results obtained, it is statistically evident that the political connection influences the quality of earnings from the perspective of discretionary accruals.

However, it was not possible to confirm, in terms of the persistence of profits, that the intensity of the political connection influences the persistence of the profits of the companies analyzed.

Among the limitations of the research, we can consider the size of the sample, which due to the legal prohibition by Federal Law No. 13.165 (BRAZIL, 2015) of donations by legal persons to electoral campaigns, the 2018 presidential campaign was not

TABLE 6 - Estimates of the earnings persistence model – MQG

INDEPENDENT VARIABLE	DEPENDENT VARIABLE: LPA							
	QUALITY MODEL - CUMULATIVE QUARTILE BY SECTOR							
	ALL		Q1		Q2		Q3	
	BETA	VALOR-P	BETA	P-VALUE	BETA	P-VALUE	BETA	P-VALUE
Constante	0,4650	0,5350	0,4700	0,5370	-0,0200	0,9860	-0,0810	0,9410
LPAit-1	0,662***	0,0010	0,488**	0,0290	0,0570	0,8430	-1,518***	0,0000
CONPOLit*LPAit-1	1,3950	0,8390	2,1190	0,7520	0,2920	0,9730	-1,5560	0,7320
GOVit*LPAit-1	-0,436***	0,0000	-0,379***	0,0000	-0,570***	0,0000	-0,763***	0,0000
TAMit*LPAit-1	0,0130	0,3440	0,0190	0,2560	0,060***	0,0080	0,167***	0,0000
GATit*LPAit-1	0,001***	0,0000	0,001***	0,0060	0,001***	0,0000	0,0000	0,7000
ENDIVit*LPAit-1	-0,001***	0,0010	-0,001***	0,0010	-0,001***	0,0000	0,0000	0,9700
ROAit*LPAit-1	-1,152***	0,0000	-1,435***	0,0000	-1,650***	0,0000	-1,416***	0,0000
Dummies Year	Yes		Yes		Yes		Sim	
Dummies Sector	Yes		Yes		Yes		Sim	
Obervations	3451		3110		2295		1555	
Wald-Chi2	1595,253***		1137,282***		1083,112***		1119,151***	

Explanatory Note: (i) Estimation Method: MQG - Generalized Least Squares; (ii) Description of Variables: LPA - Earnings per Share; CONPOL - main variable of the study, the proportion donated by the company that represents a political connection by means of a donation made to an electoral campaign, assigning a value between zero (0) and one (1) for the company that made a donation - proportion, indicating that it maintains a political connection and, otherwise, a value of zero (0) for the company that did not make a donation, indicating that firm i does not maintain a political connection; GOV - Governance level dummy, which assumes a value of "1" for companies with new market governance and level 2 and a value of "0" otherwise; TAM - Natural logarithm of total assets; GAT - Degree of Total Leverage; ENDIV - Indebtedness; ROA - Return on Assets; (iii) Statistical Significance: ***, **, * significant at the 1%, 5% and 10% level, respectively. | **Source:** Research data

included, although four presidential elections were analyzed. There was also a reduction in the sample due to missing values for economic and financial data in some periods.

Future studies on the subject in Brazilian companies could use new models using other proxies to measure the political connection, such as the participation of political members on the board and management, considering different ways of measuring the connection from the existing ones, as well as other metrics and models of earnings management, the results of which should be compared, and it is also important to verify Governance Contracts and evaluate share prices for connected companies.

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