ABSTRACT

Title of Document: AN INTEGRATED ANALYSIS OF THE CORPORATE GENERAL COUNSEL'S IMPACT ON ACCOUNTING CHOICES AND LEGAL RISK

Charles G. Ham, Doctor of Philosophy, 2015

Directed by: Professor Michael Kimbrough
Department of Accounting and Information Assurance
Robert H. Smith School of Business

Companies are increasingly relying on highly paid corporate general counsels (GCs) to help manage the risks of costly regulatory sanctions and shareholder lawsuits associated with their firms' accounting and overall business practices. While recent research documents the role of the GC on specific decisions in isolation, whether and how GCs fulfill their intended role of managing their firms' expected legal costs remains an open question. I document several ways in which GCs affect the expected legal costs associated with their firms' accounting choices.

The analysis is based on the insight that the expected legal costs associated with the firm's accounting choices depend on three factors: (1) the extent to which the firm undertakes legally risky accounting practices, (2) the likelihood that such practices are detected by outsiders, and (3) the severity of penalties outsiders impose on the firm upon detection. Managers can affect the first factor by taking the external legal environment as given and altering their internal decisions accordingly, whereas managers can affect the latter two factors by altering the firm's external legal environment through their influence on the intensity of outside monitoring and enforcement. I provide evidence that the GC decreases the firm's expected legal costs via all three factors.

First, firms with an influential GC (GC firms) display a preference for real earnings management relative to accrual earnings management and GC firms accelerate the recognition of losses in earnings, both of which entail less legal risk. Second, firms that make aggressive accounting choices are less likely to be targeted by SEC enforcement actions in the presence of an influential GC. This finding indicates that GCs are able to advise their firms about how to use accounting discretion in a way that avoids unwanted regulatory scrutiny. Third, GC firms are less likely to be sued following a restatement announcement. When their firms are sued, the lawsuits are more likely to be dismissed and the settlement amounts are lower. These findings indicate that the GC's advocacy is associated with a reduction in the severity of penalties outsiders impose on the firm when improper accounting choices are discovered.

The analyses culminate with an examination of the GC's effect on the firm's overall corporate risk and the market's assessment of the GC's contribution to the firm. I find that GC firms are associated with lower corporate risk as measured by the volatility of future stock returns and lower levels of future risky investments in the form of capital expenditures and research and development expenditures. Finally, the market responds favorably in years that firms appoint a GC to the top management team, consistent with the market perceiving the net impact of GCs' activities to be value enhancing.

AN INTEGRATED ANALYSIS OF THE CORPORATE GENERAL COUNSEL'S IMPACT ON ACCOUNTING CHOICES AND LEGAL RISK

By

Charles G. Ham

Dissertation submitted to the Faculty of the Graduate School of the
University of Maryland, College Park, in partial fulfillment
of the requirements for the degree of
Doctor of Philosophy
2015

Advisory Committee:
Professor Michael Kimbrough, Chair
Professor Lawrence Gordon
Professor Rebecca Hann
Professor Nicholas Seybert
Professor Sally Simpson

Acknowledgements

I am extremely grateful to have had the opportunity to study at the University of Maryland's Robert H. Smith School of Business. There are many individuals who have supported me throughout my Ph.D. studies. First and foremost, I am particularly indebted to my dissertation advisor, Michael Kimbrough. Michael has supported me through thick and thin and has pushed me to become the researcher that I am, for which I am especially grateful.

I would like to thank Larry Gordon for his constant support throughout my studies, and for innumerable coffees in Columbia. I thank my dissertation committee members, Rebecca Hann, Nick Seybert, and Sally Simpson for their time, suggestions, effort, and encouragement, as well as the faculty members Stephen Brown, Shijun Cheng, Oliver Kim, Hanna Lee, Marty Loeb, Stephen Loeb, Jim Staihar, Lei Zhou, and Emanuel Zur.

I would like to thank Justina Blanco for keeping our Ph.D. program so organized and constantly stocked with candy. I am especially grateful to my fellow Ph.D. students Lindsey Gallo, MaryJane Rabier, Congcong Li, and Wenfeng Wang for their close friendship, as well as Amanda Wilford, Robert Felix, Kyungran Lee, Sijing Wei, Yue Zheng, Yi Cao, and Heedong Kim.

I am thankful to my family and friends for always being by my side. Particularly, my amazing parents, sisters Becky and Julia, brothers-in-law Ben and Mike, and the rug rats Hunter, Lawson, Hadley, and Cooper.

Last, but certainly not least, I would like to thank my wife, Sarah. Thank you for your unwavering love and support. Without you, I would not be the person I am today.

Table of Contents

List of Appendices

List of Figures

List of Tables

Chapter 1: Introduction

Firms face the risk of costly regulatory sanctions or shareholder lawsuits as a result of their accounting and overall business practices (Dechow et al., 1995; Beneish, 1999; DuCharme et al., 2004; Jones et al., 2008; Kim and Skinner, 2012). In an effort to manage this risk, companies are increasingly including corporate general counsels as members of the top management team and paying them substantial compensation (Duggin, 2006). Recent research examines the general counsel's influence on individual firm decisions, but the manner and extent to which corporate general counsels fulfill their intended role of lowering their firms' legal risk remains unclear. Insight into this issue is necessary to evaluate whether firms' increasing reliance on and investment in the general counsel is justified. Accordingly, this study examines the general counsel's effect on the various channels that collectively contribute to the legal risk associated with the firm's accounting choices.

The analysis is based on the insight that the firm's expected legal costs depend on the following three factors: (1) the extent to which the firm undertakes legally risky activities, (2) the likelihood that such activities are detected by outsiders, and (3) the severity of penalties outsiders impose on the firm upon detection. Managers can affect the expected legal costs from the first factor by taking the external legal environment as given and altering their internal decisions accordingly. Managers can also affect the expected legal costs from the latter two factors by altering the firm's external legal environment through their influence on the intensity of outside monitoring and enforcement. Whereas prior literature solely focuses on the first channel, I study the general counsel's (GC) effect on all three channels.

The potential for GCs to affect each of these factors arises from the various roles they play in an organization. Specifically, GCs can serve as business advisors, legal advisors, and as agents in the firm's dealings with outside parties (Nelson and Nielson, 2000; DeMott, 2005). In their role as business advisors, GCs may influence the extent to which firms undertake legally risky activities, consistent with the argument that GCs contribute to strategic and operational decisions in a similar manner to other members of the executive team (Nelson and Nielson, 2000; DeMott, 2005). For example, Heineman (2010) argues that as a business advisor "The General Counsel should be at the table with the CEO on the broad array of performance issues: key operational initiatives, economic risk assessment and mitigation, major transactions, new strategic directions…***and major accounting decisions***" (Heineman, 2010, pg. 8) (emphasis added). In their role as legal advisors, GCs may influence the likelihood that legally risky activities are detected by using their legal and business expertise to structure transactions in a way that passes legal muster. Finally, as an agent in the firm's dealings with third parties, the GC may affect the severity of legal penalties the firm faces through the effectiveness of her advocacy.

I study each of these possibilities using a sample that consists of 36,220 firm-year observations and 3,395 unique firms over the period 1992-2013, obtained from Compustat's Execucomp database. Similar to other studies (Kwak et al., 2012; Goh et al., 2014; Hopkins et al., 2015), I identify firms with an influential GC (GC firms) as those in which the GC is among the top five highest paid executives in the respective firm-year.

I begin with an examination of the GC's impact on the riskiness of the firm's accounting practices. I first test the association between the presence of a GC on the top management team and the firm's earnings management practices. While Hopkins et al.

(2015) find that GC firms use greater accruals management, firms can also reach financial reporting goals by altering operational activities to influence reported earnings. Because GCs' judgments may extend to operational decisions in their role as business advisors (Heineman, 2010), I expand upon Hopkins et al.'s (2015) finding by considering whether GC firms also differ in the extent to which they rely on real earnings management.

I then examine whether GC firms are associated with the documented tradeoff between real and accrual-based earnings management (Cohen et al., 2008; Badertscher, 2011; Zang, 2012) based on the different legal risks associated with the two forms of earnings management. Specifically, accrual-based earnings management is subject to greater legal scrutiny because accounting choices can be evaluated against U.S. GAAP (Graham et al., 2005; Cohen et al., 2008; Zang, 2012). By contrast, there is a more tenuous basis for regulators to evaluate the propriety of operating decisions that result in real earnings management. Given these differences, GCs may prefer real relative to accrual earnings management tactics. I find that GC firms are associated with higher levels of real earnings management and that GC firms display a relative preference for real relative to accrual earnings management. This finding is consistent with GCs encouraging firms to use a less legally risky form of earnings management to reach their financial reporting goals.

Given that litigation risk is a key source of demand for accounting conservatism (Watts, 2003), I also examine the GC's effect on legal risk via the asymmetric timeliness of earnings. I find that GC firms accelerate the recognition of bad news, suggesting that GCs reduce the firm's legal risk by promoting the timely recognition of losses. These

findings suggest that GCs encourage less legally risky accounting practices and provide an interesting perspective on Hopkins et al.'s (2015) finding of greater discretionary accruals for GC firms. While GC firms are associated with a greater use of discretion, my results suggest that GCs encourage their firms to be prudent in their use of this discretion.

To examine the GC's impact on the likelihood that regulators detect the firm's risky accounting activities, I test whether GCs affect the extent to which earnings management results in SEC enforcement actions. I find that firms that make aggressive earnings management choices are less likely to be targeted by SEC enforcement actions in the presence of an influential GC. This finding indicates that GCs are able to advise firms about how to use discretion in a way that avoids unwanted regulatory scrutiny and supports the notion that the GC reduces the firm's detection risk.

I study the GC's effect on the severity of penalties from detection by examining whether the firm is targeted by a class action lawsuit following a financial restatement. I find that GC firms are less likely to be sued following a restatement announcement. Further, when the firm is sued following a restatement announcement, the lawsuits are more likely to be dismissed and the settlement amounts are lower in the presence of an influential GC. This evidence suggests that the GC is able to effectively advocate on behalf of the firm when aggressive accounting choices are detected.

Having established the GC's effect on the firm's legal risk with respect to its accounting practices, my analyses culminate with an examination of the GC's effect on the firm's overall corporate risk and the market's assessment of the GC's contribution to the firm. I first examine the GC's association with overall corporate risk, as reflected in

the volatility of firm performance. Because sharp stock price declines are often precursors to litigation, volatile firms are more susceptible to litigation (Kim and Skinner, 2012). I find that GC firms are associated with lower corporate risk as measured by the volatility of stock returns. I also find that GC firms are associated with lower future risky investments in the form of capital expenditures and research and development expenditures. Finally, I test the market's assessment of the GC's contribution to the firm and find that the market responds favorably in years where the firm appoints a GC to the top management team. This finding is consistent with the market perceiving the GC's activities to enhance firm value by lowering the expected costs associated with regulatory scrutiny or shareholder litigation.

This study contributes to the literature in several ways. First, I demonstrate that GCs have a positive net effect on firm value, an insight that cannot be obtained from prior studies that examine the GC's effect on individual firm policies in isolation. Second, I provide evidence on the three channels by which GCs enhance firm value. Specifically, I demonstrate that GCs reduce the firm's expected legal costs through their influence on: (1) the firm's tendency to undertake legally risky accounting practices, (2) the likelihood that legally risky accounting practices are detected by outsiders, and (3) the severity of penalties outsiders impose on the firm upon detection. Prior studies have primarily studied the GC's effect on internal firm policies, while taking the external legal environment as given (Kwak et al., 2012; Goh et al., 2014; Hopkins et al., 2015). I expand upon this analysis and provide new evidence that an influential GC can impact the firm's external legal environment through her influence on the intensity of outside monitoring and enforcement. Thus, this study contributes to more complete insight on

whether GCs are successful in lowering the legal risk associated with their firms' accounting practices.

Third, the evidence I provide extends prior insights on the GC's role with respect to earnings management. Specifically, my finding that GC firms display a preference for real earnings management indicates that GCs encourage a less legally risky form of earnings management. Moreover, the fact that GC firms are associated with greater conservatism despite their greater use of discretion in accruals suggests that GCs encourage the prudent use of accounting discretion.

Finally, the findings that GCs are associated with the extent of real earnings management and overall corporate risk extend our understanding of the GC's role by showing that their influence extends to operational decisions. This confirms that the contemporary GC's role extends beyond that of a narrowly defined legal compliance officer.

The remainder of the paper is organized as follows. Chapter 2 reviews the prior literature and develops the hypotheses. Chapter 3 describes the research design. Chapter 4 reports the empirical findings and Chapter 5 concludes.

Chapter 2: Literature Review and Hypothesis Development

2.1 Legal Risk in Accounting Practices

Lawmakers and policymakers devote substantial resources to investor protection. Because investors rely heavily on published financial statements, ensuring that publicly traded companies comply with generally accepted accounting principles (GAAP) is a top priority. Companies that utilize overly aggressive accounting choices or are found not to comply with U.S. GAAP are subject to a range of potentially negative legal consequences.[1] For instance, firms with aggressive accruals are more frequently subject to SEC enforcement actions and are more likely to be sued (Dechow et al., 1995; Dechow et al., 1996).[2] Similarly, higher levels of discretionary accruals around seasoned equity offerings are associated with a greater likelihood of a subsequent lawsuit and higher corresponding settlement amounts (DuCharme et al., 2004). In response to several accounting-related scandals in the early 2000s, the Sarbanes-Oxley Act (SOX) sharpened the legal penalties for fraudulent financial reporting and other forms of corporate misconduct by allowing greater avenues for criminal prosecution.[3] Meanwhile, lawyers

[1] A considerable body of research has also linked managers' disclosure decisions to the firm's legal risk (Francis et al., 1994; Skinner, 1994, 1997; Johnson et al., 2001; Baginski et al., 2002; Rogers and Stocken, 2005; Rogers and Van Buskirk, 2009; Rogers et al., 2011). Given this work, Kwak et al. (2012) study the relation between the presence of a GC and managerial forecasts. In the current study I focus on the firm's accounting choices rather than the firm's disclosure choices.

[2] SEC enforcement actions relate to investigations into alleged accounting or auditing misconduct. Upon conclusion of the investigation the SEC releases an Accounting and Auditing Enforcement Release (AAER) summarizing the investigation.

[3] The SEC has charged numerous executives in the post-SOX era. For example, former Riteaid CEO Martin Grass was sentenced to eight years in prison and fined $500,000 in 2004, former Qwest CEO Joseph Nacchio was sentenced to six years in prison and fined $19 million in 2007, and former Cendant CEO Walter Forbes was sentenced to 12 years in prison and fined over $3 million in 2007 (Sauter et al., 2012).

have become more involved in, and responsible for, financial decisions as the boundary between accounting and legal duties has increasingly blurred (Schwarcz, 2006).

The expected legal costs associated with improper accounting practices can be economically significant, as reflected in how others price this risk. For instance, several studies document that auditors' litigation risk from accounting improprieties are associated with higher audit fees (Beatty, 1993; Taylor and Simon, 1999; Venkataraman et al., 2008). Further, firms with high litigation risk are more likely to carry directors' and officers' insurance and to purchase greater coverage (Core, 1997, 2000).

Given the importance of the legal costs associated with accounting choices, firms have significant incentives to reduce or avoid them. The expected legal costs associated with the firm's accounting choices depend on three channels: (1) the riskiness of the firm's accounting practices, (2) the likelihood that aggressive accounting practices are discovered, and (3) the sanctions imposed if these practices are detected. Thus, firms can lower the expected legal costs through any of these channels in isolation or jointly. Practically speaking, however, this can be difficult given the complex legal environment U.S. firms face. Therefore, there is a prominent role for legal expertise among the executives responsible for the firm's financial reporting strategy.[4]

2.2 The Distinct Roles of the General Counsel

Demand for corporate general counsels has increased substantially since the 1970s due to the increasingly complex legal environment faced by U.S. firms, as evidenced by the growth in both litigation and the cost of external counsel (Duggin,

[4] This is consistent with Bagley's (2008) argument that "legal astuteness" is a valuable capability among the top management team that can create competitive advantages for the firm.

2006). As the demand for internal counsel has increased, so too has the supply. Internal counsel positions have become an increasingly attractive career option due to the growth in power, prestige, compensation, and career opportunities associated with these positions (Duggin, 2006; Heineman, 2012).[5] The legal literature documents three primary roles that fall within the purview of the contemporary GC: (1) business advisor or entrepreneur, (2) legal advisor, and (3) advocate or agent. I discuss each role in turn.

Contemporary GCs frequently act as business advisors – a role that has been rarely recognized outside of the legal literature. This literature indicates that the GC often plays an entrepreneurial role as a senior executive of the firm while leveraging a unique set of skills (Nelson and Nielson, 2000; DeMott, 2005; Heineman, 2010).[6] Thus, similar to other executives, the GC provides input into strategic and operational decisions. This role also involves keeping managers up to date on the relevant laws and anticipating how the legal environment will unfold in the future. For instance, Liggio (1997) argues: "Counsel must use his legal foresight to discern trends in the law and to predict how those trends will impact the company's business over time." (Liggio, 1997, pg. 1208).

The GC is most frequently recognized as the firm's resident legal advisor. The accompanying responsibilities include advising executives and the board of directors on the firm's legal compliance and litigation risk. While the GC often reports to the CEO in

[5] The role of internal counsel has varied significantly over time. In the early 1900s GCs played a prominent role in the firm, were highly respected, and were highly compensated (Liggio, 2002). The GC's prestige began to subside in the 1940s as companies favored marketing and finance backgrounds for internal positions and the use of large external law firms to fulfill the firm's legal expertise (Liggio, 2002). However, the pendulum began to swing back in favor of internal counsel as early as the 1970s (DeMott, 2005; Duggin, 2006).

[6] As one GC describes his role, "I always feel I have one hat, and this is: I am a corporate officer who is a lawyer" (Spangler, 1986; DeMott, 2005).

this regard, she also serves as the legal advisor to the board of directors (Duggin, 2006).[7] This function may include acting as an internal corporate governance mechanism or "gatekeeper" to monitor managers' unusual or fraudulent behavior (Kwak et al., 2012) and has been widely recognized (Coffee, 2003; Hamdani, 2003; Choudhary et al., 2013a, 2013b). However, the legal advisory role may also include a "facilitating" function wherein GCs use their legal expertise to allow their firms to engage in risky behavior on the fringes of legality. Parker et al. (2009) illustrate this notion: "[L]awyers may play games with the law, using their considerable expertise in interpreting and manipulating the law to help their clients avoid or evade the effects of the law. Much of the 'genius' of corporate lawyering is to contrive ways in which business conduct that defeats the purpose of the law can be performed 'legally', or at least to create enough 'wobble' room to make the application of law to corporate activities uncertain." (Parker et al., 2009, pgs. 210-211).

The GC acts as an advocate or agent in dealings with third parties such as regulators, governmental bodies, and outside counsel (Chayes and Chayes, 1985; DeMott, 2005; Duggin, 2006). This reflects another familiar "lawyering" role in which the GC represents the firm in situations such as litigation and the acquisition of governmental approvals. As depicted by Duggin (2006, pg. 1007): "A general counsel's advocacy function also includes the role of liaison with governmental authorities…Participation of counsel is critical in those situations in which government actions may result in significant sanctions, especially when criminal proceedings are a risk." Therefore, the "zealous advocate" role involves casting the firm in the best possible light to outsiders

[7] Duggin (2006, pg. 1004) states: "The general counsel's ultimate responsibility, however, is always to the client, and the highest authority capable of speaking on behalf of a corporate client is ordinarily its board of directors."

without violating laws or compromising ethical standards (Fischel, 1998; Nelson and Nielson, 2000; Kim, 2010).[8]

It is important to note that the GC's roles are not mutually exclusive. A GC may assume the different roles at various times depending on the circumstances. Recent research provides mixed evidence on the GC's role in either promoting or discouraging risky financial reporting practices. Specifically, GC firms are more likely to issue management earnings forecasts, and particularly bad news forecasts (Kwak et al., 2012). Because increased disclosure (especially with respect to negative news) is commonly expected to reduce litigation risk (Skinner, 1994, 1997; Healy and Palepu, 2001; Baginski et al., 2002), these results are consistent with the GC encouraging less risky behavior.[9] By contrast, GC firms use discretionary accruals to a greater extent and are more aggressive in their tax planning (Goh et al., 2014; Hopkins et al., 2015).[10] Because aggressive accounting choices are subject to regulatory scrutiny, these latter results suggest that GCs encourage or enable riskier activities. The contrasting evidence suggests the need for more evidence on the role GCs play in their firms' tendency to undertake risky financial reporting activities.

Moreover, as previously discussed, overall legal risk does not only depend on the riskiness of the underlying activities. It also depends on the likelihood that risky

[8] Law firm Sullivan and Cromwell states: "An attorney's principal obligation, both to the client and to the public interest, is to be a zealous advocate for his or her client within the bounds of the law." (Sullivan & Cromwell LLP, 2002; Kim, 2010).

[9] Also consistent with GCs reducing firm risk, though not exclusively with respect to financial reporting, insiders' trading profits are restricted when GC approval is required to execute a trade (Jagolinzer et al., 2011). Additionally, Armstrong et al. (2010) find that internal monitors' (i.e. general counsel and internal auditors) performance-based incentives are associated with fewer adverse firm outcomes.

[10] However, Krishnan et al. (2011) find that legal expertise on the audit committee is associated with higher financial reporting quality.

activities are detected and the severity of sanctions upon detection. Thus, more complete insight regarding whether GCs fulfill their intended role of lowering their firms' legal exposure requires an analysis of the GC's impact on all three channels. I undertake this analysis in the current study, focusing on the legal risk associated with firms' accounting practices.

2.3 Hypothesis Development

As discussed in Section 2.1, there are significant legal implications associated with the firm's accounting choices. And, as outlined in Section 2.2, the GC's role in the firm has grown substantially due to the increasingly complex legal environment that firms now face. Though studies have begun to examine the GC's role on the firm's tendency to undertake specific risky activities, it is unclear what their overall impact is on the legal risk associated with the firm's accounting choices. I argue that the firm's expected legal costs depend on three channels: (1) the riskiness of the firm's activities, (2) the likelihood that these activities are discovered, and (3) the sanctions imposed if these activities are detected. Therefore, the GC can affect the firm's overall legal exposure via their impact on each of these channels.

As a business advisor whose influence extends to operational decisions and as a legal advisor who can either serve as a gatekeeper or facilitator, the GC can affect the extent to which firms undertake legally risky accounting practices. Therefore, I propose the first hypothesis (in the alternative form):

> **H1:** The general counsel affects the firm's legal risk via the riskiness of the firm's accounting practices.

In their role as legal advisors, GCs may influence the likelihood that legally risky activities are detected by using their legal and business expertise to structure transactions in a way that passes legal muster. Therefore, I propose the second hypothesis (in the alternative form):

> **H2:** The general counsel affects the firm's legal risk via the likelihood that aggressive accounting practices are detected by outsiders.

The GC's role as a zealous advocate suggests she will impact the third channel, the severity of sanctions. Once a risky behavior is revealed, the GC will attempt to protect the firm from the associated penalties. Therefore, I propose the third hypothesis (in the alternative form):

> **H3:** The general counsel affects the firm's legal risk via the severity of sanctions imposed upon detection.

Chapter 3: Research Design

3.1 Measuring Legal Risk in Accounting Practices

3.1.1 Accrual and Real Earnings Management

A key financial reporting choice that managers make and that GCs may influence is how to use the discretion permitted under U.S. GAAP (Schipper, 1989; Healy and Wahlen, 1999). Accounting standards permit managerial discretion so that managers can reveal their private information through their accounting choices, thereby increasing the usefulness of the financial reports to stakeholders (Healy and Wahlen, 1999). However, the risk of permitting managerial discretion is that managers may abuse the discretion by engaging in accruals management, thereby undermining the usefulness of financial reports. Managers engage in accruals management because of the significant capital market incentives to meet earnings expectations. Specifically, the stock market rewards firms that meet performance expectations and penalizes firms that miss expectations (Kasznik and McNichols, 2002; Bartov et al., 2002; Lopez and Rees, 2002; Skinner and Sloan, 2002; Brown and Caylor, 2005). In addition, managers' compensation is frequently tied to the firm's earnings and stock market performance.

Managers can also reach financial reporting and performance goals by manipulating the firm's operations. Roychowdhury (2006) outlines several ways in which managers can alter the firm's operations to meet these goals – namely, sales manipulation, the overproduction of inventory, and the reduction of discretionary expenses. Unlike accounting decisions that are subject to auditor and SEC scrutiny (Gunny, 2010), the firm's operating decisions are generally outside the purview of these

oversight roles.[11] Therefore, real earnings management tactics are less likely to be detected and are more difficult to prove in the case of litigation. Given the weaker legal implications associated with real earnings management activities, the GC may have a limited role towards affecting these decisions. However, the GC's role as a business advisor suggests that the scope of the GC's duties may extend to the firm's real earnings management activities.

Though real and accrual earnings management are employed to achieve similar outcomes, the enforceability of laws against the abuse of these practices varies considerably. Regarding accruals management, firms must comply with U.S. GAAP and the SEC has a clear mandate to monitor firms' accounting choices for such compliance.[12] With regards to real earnings management, managers owe a fiduciary duty to the firm's shareholders. The abuse of discretion in how to run the firm's operations is illegal to the extent that it violates the manager's fiduciary obligations. However, breaches of fiduciary duty are notoriously difficult to prove: "Claims for breach of the duty of care generally are subject to the business judgment rule…Simply put, courts will not hear complaints challenging management's business decisions provided that the decisions are based on ***any*** rational business purpose." (Casey, 2010, pgs. 20-21) (emphasis added).

[11] This excludes extreme cases of fraudulent behavior such as channel stuffing.

[12] Former SEC Chairman Arthur Levitt illustrated the SEC's concern over firms' earnings management activities in a speech given on this topic – "I fear that we are witnessing an erosion in the quality of earnings, and therefore, the quality of financial reporting. Managing may be giving way to manipulation; Integrity may be losing out to illusion… I am calling for immediate and coordinated action: technical rule changes by the regulators and standard setters to improve the transparency of financial statements; enhanced oversight of the financial reporting process by those entrusted as the shareholders' guardians; and nothing less than a fundamental cultural change on the part of corporate management as well as the whole financial community." (Levitt, 1998). The SEC's efforts to mitigate earnings management continue to more recent years as depicted by the development of an "Accounting Quality Model" designed to identify firms that are managing earnings aggressively or fraudulently (Lewis, 2012).

Therefore, whereas operating decisions can only be evaluated against the broad principle of managers' fiduciary responsibility, inappropriate accruals choices can be evaluated against U.S. GAAP. Moreover, auditors and regulators scrutinize firms' adherence to accounting rules, but these parties do not provide a similar oversight role with regards to the firms' business decisions. Therefore, the expected legal sanctions associated with real and accruals management differs based on the differences in their enforceability.[13] Consistent with managers structuring earnings management tactics in response to legal concerns, firms increased (decreased) their use of real (accrual) earnings management tactics after the enactment of SOX (Cohen et al., 2008). This suggests that firms responded to the increased scrutiny placed on the manipulation of accounting numbers in the post-SOX period. Further, managers have indicated they are more likely to alter firm operations, with negative long-term consequences, rather than make within GAAP accounting choices to manage earnings after SOX (Graham et al., 2005). Given these varying degrees of enforceability, I examine whether the GC affects the firm's preferred earnings management tactic.

3.1.2 Asymmetric Timeliness of Earnings

Accounting conservatism results from a higher degree of verifiability required to recognize gains than losses (Basu, 1997), and is rooted in the notion that managers should "anticipate no profits, but anticipate all losses" (Bliss, 1924). The greater verifiability for gains than losses leads to losses being recognized in earnings more quickly than gains.

[13] Beneish et al. (2012) argue that the threat of litigation affects managers' earnings management choices. However, Laux and Stocken (2012) theoretically illustrate that the threat of litigation can increase *or* decrease managers' incentives to misreport performance.

Watts (2003) argues that the threat of shareholder litigation is a primary determinant of conservatism because litigation is more likely to result from overstating rather than understating the firm's net assets. Accelerating (delaying) the recognition of bad (good) news reduces the likelihood that investors can claim damages were incurred, and decreases the length of the class period in the event that damages have occurred (Qiang, 2007). Therefore, managers can reduce the firm's expected legal costs by adopting conservative accounting practices. Consistent with this notion, considerable evidence suggests that managers respond to litigation concerns with a greater use of accounting conservatism (Basu, 1997; Ball et al., 2000; Huijgen and Lubberink, 2005; Qiang, 2007).

Specifically, Basu (1997) illustrates that firms reported more conservatively during periods marked by greater legal liability. Studying international differences in accounting conservatism, Ball et al. (2000) find that, among the common law countries analyzed, the U.K. has the lowest expected litigation costs and the U.K. firms report less conservatively than the firms in the remaining common law countries. Expanding upon this study, Huijgen and Lubberink (2005) find that U.K. firms that are cross-listed in the U.S. report more conservatively than U.K. firms that are not cross-listed in the U.S. Collectively, these results support the notion that litigation concerns are a determinant of accounting conservatism and that managers respond to legal concerns by adopting more conservative accounting practices.[14] Therefore, given the role of accounting conservatism in mitigating litigation, I also examine the GC's influence on the firm's degree of accounting conservatism.

[14] Donelson et al. (2012b) also document that the timely recognition of bad earnings news reduces the likelihood of litigation.

3.2 Empirical Specifications for Hypothesis Tests

3.2.1 GCs and the Firm's Accounting Practices (H1)

Hypothesis 1 argues that the GC influences the legal risk associated with the firm's accounting practices. Based on the discussion in sections 3.1.1 and 3.1.2, I examine the riskiness of the firm's accounting practices in three ways. First, I examine the levels of real and accrual earnings management. Second, due to the varying degree of legal risk associated with real and accrual earnings management, I examine GC firms' relative preference between the two forms of earnings management activities. Third, I examine the degree of accounting conservatism exhibited by GC firms. The following model tests the levels of earnings management activities.

$$EM_{i,t} = \beta_0 + \beta_1(GC_{i,t}) + \Sigma\beta_i(\text{Controls}) + \varepsilon_{i,t} \quad (1)$$

EM represents the earnings management variable of interest in the respective firm-year. *DACC* is discretionary accruals, estimated via the cross-sectional modified Jones model (Jones, 1991; Dechow et al., 1995). *REM1* and *REM2* are aggregate measures of real earnings management, estimated as in Roychowdhury (2006). *REM1* is the sum of abnormal cash flows and abnormal discretionary expenses. *REM2* is the sum of abnormal production costs and abnormal discretionary expenses.[15][16] All three earnings management proxies are increasing in the level of earnings management. The primary

[15] I do not form a measure of real earnings management that includes both abnormal cash flows and abnormal production costs because activities that lead to abnormally high production costs can also lead to abnormally low cash flows, thus confounding the measure (Roychowdhury, 2006; Cohen and Zarowin, 2010).

[16] The three earnings management proxies are set to missing for firms in financial or regulated industries (SIC 6000-6999 and 4900-4999, respectively).

variable of interest, *GC*, is an indicator variable equal to one if the general counsel is among the top five paid executives in the respective firm-year, zero otherwise.

I test the relative preference between the two forms of earnings management by restricting the sample to "suspect" firm-years that narrowly meet or beat one of three documented earnings targets: (1) zero earnings, (2) zero earnings growth, and (3) the consensus analyst forecast (Burgstahler and Dichev, 1997; Degeorge et al., 1999).[17] This provides two key advantages. First, the expected level of earnings management is high, thereby increasing the power of the tests. Second, the earnings management tactics of suspect firm-years are more likely to be scrutinized, thus increasing the expected legal consequences associated with the firms' accounting choices in this setting.

I then conduct three analyses to test GC firms' preference for real or accrual earnings management. First, I partition the GC and non-GC firm-years into groups of positive and negative values of the earnings management proxies and compare the frequencies of positive earnings management across the GC and non-GC firms. This analysis highlights the form of earnings management that firms likely used to reach the earnings target. Because the legal risks associated with real earnings management are lower than those associated with accruals management, a relative preference for real earnings management tactics suggests the firm prefers a less legally risky form of earnings management. Second, I estimate modified versions of equation (1) via binary logit specifications. The dependent variables are indicator variables equal to one if the respective earnings management proxy is positive. Third, I estimate modified versions of equation (1) via ordered logit specifications. I group the firm-years into four buckets

[17] Narrowly meeting or beating is defined as in DeGeorge et al. (1999): $2*IQR*N^{-1/3}$ where IQR is the interquartile range and N is the number of observations.

based on their propensity to use real or accrual earnings management to reach the earnings target, as follows.

	$REM_{i,t} > 0$	$REM_{i,t} < 0$
$DACC_{i,t} > 0$	Bucket 3	Bucket 1
$DACC_{i,t} < 0$	Bucket 4	Bucket 2

Consistent with the above matrix, *REM1_DACC* equals one if *REM1* is negative and *DACC* is positive, two if *REM1* is negative and *DACC* is negative, three if *REM1* is positive and *DACC* is positive, and four if *REM1* is positive and *DACC* is negative.[18] Therefore, higher values of *REM1_DACC* indicate a relative preference for real earnings management relative to accrual earnings management. *REM2_DACC* is analogous to *REM1_DACC* using *REM2* and *DACC*.

I test the degree of accounting conservatism via the asymmetric timeliness of earnings. This modified version of the Basu (1997) conservatism model is as follows.

$$ROE_{i,t} = \beta_0 + \beta_1(D_{i,t}) + \beta_2(RET_{i,t}) + \beta_3(D_{i,t}*RET_{i,t}) + \beta_4(GC_{i,t}) + \beta_5(D_{i,t}*GC_{i,t}) + \beta_6(RET_{i,t}*GC_{i,t}) + \beta_7(D_{i,t}*RET_{i,t}*GC_{i,t}) + \varepsilon_{i,t} \quad (2)$$

ROE is income before extraordinary items scaled by lagged market value of equity. *RET* is the market-adjusted cumulative monthly return. *D* is an indicator variable that equals one if *RET* is negative, zero otherwise. All other variables were previously defined. A positive coefficient on the *D*RET* interaction indicates conservative accounting because it suggests negative news is recognized in earnings more quickly than

[18] Results are similar if the firm-years are grouped into three buckets whereby buckets two and three are combined into one bucket or if bucket two is dropped from the analysis.

positive news. A positive coefficient on the *D*RET*GC* interaction suggests that the GC firms report more conservatively than non-GC firms.

3.2.2 GCs and the Firm's Detection Risk (H2)

Hypothesis 2 argues that the GC affects legal risk via the likelihood that the firm's aggressive accounting practices are detected by outsiders. I use AAER enforcement actions to capture the detection of the firm's earnings management practices. The model is as follows.

$$AAER_{i,t} = \beta_0 + \beta_1(GC_{i,t}) + \beta_2(EM_{i,t}) + \beta_3(GC_{i,t}*EM_{i,t}) + \Sigma\beta_i(Controls) + \varepsilon_{i,t} \quad (3)$$

AAER is an indicator variable equal to one if the firm-year is subject to an *AAER* enforcement action, zero otherwise. All other variables were previously defined. Because *EM* is expected to be positively associated with *AAER* (for both the real and accrual earnings management) a negative coefficient on the *GC*EM* interaction suggests that the GC is able to effectively reduce the detection risk associated with the firm's earnings management activities.

3.2.3 GCs and the Severity of Penalties (H3)

Hypothesis 3 argues that the GC influences legal risk by reducing the severity of penalties that are imposed if the firm's aggressive accounting practices are discovered. Both SEC enforcement actions and restatements are associated with negative consequences (Dechow et al., 2010). For example, managers and directors experience higher turnover following a restatement and are less likely to find a position at another

firm (Srinivasan, 2005; Desai et al., 2006; Hennes et al., 2008). The announcements impose significant negative capital market effects (Palmrose et al., 2004; Lev et al., 2008) and often result in litigation against the company, the officers, the board of directors, and/or the firm's auditors (Palmrose and Scholz, 2004; Lev et al., 2008). Given the significant costs following a restatement, I study whether firms with an influential GC are associated with lower subsequent costs. The model is as follows.

$$SUED_{i,t} = \beta_0 + \beta_1(GCANN_{i,t}) + \Sigma\beta_i(Controls) + \varepsilon_{i,t} \quad (4)$$

The sample is restricted to restatement announcements from the Audit Analytics database. I exclude immaterial restatements such as those due to clerical mistakes or changes in accounting rules. I also exclude restatement announcements made in 2012 and beyond to allow for an appropriate window for penalties to be imposed.

I hand collect data on class action lawsuit filings and outcomes from Stanford Law School's Securities Class Action Clearinghouse. *SUED* is an indicator variable equal to one if a class action lawsuit is filed against the company within two years of the restatement announcement. If the firm is sued following a restatement announcement, I also examine the corresponding lawsuit outcomes. Specifically, *DISMISS* is an indicator variable equal to one if the lawsuit is dismissed, zero otherwise. *SETTLEMENT* is the dollar value of the lawsuit settlement amount in millions.

GCANN is an indicator variable equal to one if the GC is a member of the top management team at the time of the restatement announcement, zero otherwise. A negative coefficient on the *GCANN* indicator variable suggests that the GC is able to

effectively reduce the sanctions resulting from restatement announcements through her advocacy, consistent with hypothesis 3.

Chapter 4: Empirical Findings

4.1 Data and Sample Selection

The sample is comprised of all firm-years covered by Compustat's Execucomp database over the period 1992-2013. After dropping firm-years for which the GC is not identifiable, the sample includes 36,220 firm-year observations corresponding to 3,395 unique firms. Similar to prior studies (Kwak et al., 2012; Hopkins et al., 2015) I search the annual titles of the available executive-firm-years for the words "counsel", "law", "legal", and similar variants to identify executives who are general counsel.[19] The GC is considered highly paid if she is among the five highest paid executives in terms of total compensation in the corresponding firm-year.[20] Table 1 Panel A reports the number and percentage of firms with a highly paid GC (GC firms) by fiscal year. The percentage of GC firms increases nearly monotonically over the sample period from 18% in 1993 to 43% in 2013.[21] The mean of 29% for the full sample period is comparable to other studies (Kwak et al., 2012; Goh et al., 2014; Hopkins et al., 2015). Table 1 Panel B reports the percentage of GC firms by industry, using the Fama-French 48 industry classifications (Fama and French, 1997). The five industries with the lowest percentage of GC firms include electronic equipment, retail, banking, fabricated products, and candy and soda. The five industries with the highest percentage of GC firms include utilities,

[19] I manually review the executives' titles that are captured by this search and exclude the titles that do not refer to legal experts such as tax counsel, investment counsel, etc. I also manually review the job titles that are not captured via the search and code these titles accordingly.
[20] Total compensation is the variable *tdc1* from Execucomp.
[21] Although Table 1 Panel A reports on 2% of firms with an influential GC in 1992. The inferences remain unchanged if all observations from 1992 are excluded from the sample.

entertainment, communication, chemicals, and tobacco products, which is the highest by a large margin.[22]

Figures 1-3 provide more detailed descriptive analyses of the increasing prevalence of influential GCs through the sample period. Figure 1 is simply a visual depiction of the data in Table 1 Panel A. The increasing prevalence of GCs is nearly monotonic, although there appears to be slight jumps over the periods 1999-2001 and 2008-2010, which would be expected following the dot-com bubble crash and the financial crisis. Figure 2 reports a similar graph by firm size quintile. Specifically, each year firms are sorted into quintiles based on the market value of equity. The increasing trend is comparable across the five size groups, though the jumps over the periods 1999-2001 and 2008-2010 are more pronounced for the smaller firms. Figure 3 reports a similar graph by industry, using the Fama-French 10 industry classifications.[23] There are substantial increases in GC prevalence within the utilities, telecommunications, and energy industries, whereas the increases are present, but more muted, in industries such as consumer products (durables and nondurables) as well as retail.

The baseline sample of GC firm-years from Execucomp is merged with various data sources based on the corresponding test. The resulting number of firm-years varies due to data availability from the respective sources. Accounting data are from Compustat. Stock return data are from CRSP. AAER data are from the Center for Financial Reporting and Management at the University of California, Berkeley (Dechow et al., 2011). Restatement data are from Audit Analytics. Governance data are from Risk

[22] The inferences remain unchanged if all observations from the tobacco products industry are excluded from the sample.
[23] I use the Fama-French 10, rather than 48, industry classifications in Figure 3 for visual ease.

Metrics. Institutional ownership data are from Thomson Reuters. Litigation data are hand-collected from Stanford Law School's Securities Class Action Clearinghouse.[24]

4.2 Descriptive Statistics

Table 2 Panel A (B) reports the descriptive statistics for the full sample (restatement sample). The final three columns report the variable means for GC firms and non-GC firms separately, as well as the p-value testing the equality of means across the two groups. Panel A indicates that GC firms utilize more real and accrual earnings management as evidenced by higher values of *DACC*, *REM1*, and *REM2*. GC firms are less likely to experience an AAER enforcement action, but the test of hypothesis 2 examines whether the relation between earnings management activities and AAER outcomes varies between the GC and non-GC firms. Panel B indicates that GC firms are less likely to be targeted by a class action lawsuit following a restatement announcement. Further, the class action lawsuits are more likely to be dismissed for GC firms, and the settlement amounts are (insignificantly) lower. Table 3 reports the correlation matrices for the full sample (Panel A) and the restatement sample (Panel B). The inferences are largely consistent with those obtained from Table 2.

4.3 GCs and the Firm's Accounting Practices (H1)

Hypothesis 1 argues that the GC affects the firm's legal risk via the riskiness of the firm's accounting practices. Table 4 reports the results from estimating equation (1), which tests the levels of real and accrual earnings management. Consistent with Hopkins

[24] http://securities.stanford.edu.

et al. (2015), GC firms are associated with greater discretionary accruals, as evidenced by the positive and significant coefficient on the GC indicator variable (β=0.008, $p<0.01$) in column 1. Columns 2 and 3 indicate that the GC's role extends to the firm's real earnings management practices as evidenced by the positive and significant coefficient on the GC indicator variable in both specifications (β=0.017, $p<0.01$; β=0.025, $p<0.05$). Interestingly, the coefficients on GC are substantially larger in the real earnings management specifications as compared to the accruals management specifications. This provides preliminary evidence of a preference for real earnings management, though I test this directly in Table 5.

Table 5 reports the results on the GC's relative preference for real or accrual earnings management. The sample is limited to firm-years that narrowly meet or beat one of three earnings thresholds: (1) positive earnings, (2) positive earnings growth, and (3) the consensus analyst forecast. Table 5 Panel A reports the percentage of firm-years with positive values for each of the three earnings management proxies separately for the GC and non-GC firm-years. Although the results indicate that GC firms use more accrual and real earnings management practices, the relative difference is much larger for the real earnings management proxies. Specifically, 71% of the GC firm-years have a positive *DACC* value and 68% of the non-GC firm-years have a positive *DACC* value. The 3% difference is significant at the 10% level. The corresponding figures for *REM1* are 61% for the GC firm-years and 51% for non-GC firm-years (the 10% difference is significant at the 1% level); the corresponding figures for *REM2* are 64% for the GC firm-years and 56% for non-GC firm-years (the 7% difference is significant at the 1%

level).[25] Further, the 7% difference-in-difference between *REM1* and *DACC* (10%-3%) is significant at the 1% level and the 4% difference-in-difference between *REM2* and *DACC* (7%-3%) is significant at the 10% level.

Table 5 Panel B reports the results from estimating modified versions of equation (1). Columns 1-3 (4-5) report the binary logit (ordered logit) regression results. The insignificant coefficient on the GC indicator variable in column 1 (β=0.068, $p>0.10$) suggests that the GC firms do not use greater accruals management in this setting of heightened legal risk. However, the positive coefficient on the GC indicator variable in column 2 (β=0.263, $p<0.05$) suggests that the GC firms do use greater real earnings management in this setting. Further, the positive coefficient on the GC indicator variable in column 4 (β=0.183, $p<0.05$) suggests a relative preference for real earnings management tactics. The coefficients on GC are also insignificant in columns 3 and 5 (β=0.167, $p>0.10$; β=0.085, $p>0.10$). Collectively, these results are consistent with GCs encouraging the use of real earnings management tactics in favor of accrual earnings management tactics to reach earnings targets and thus promoting the use of a less legally risky form of earnings management.

Table 6 reports the results of the GC's effect on the asymmetric timeliness of earnings (accounting conservatism). Column 1 reports the baseline Basu (1997) model. The significantly positive coefficient on the *D*RET* interaction (β=0.332, $p<0.01$) confirms that the sample firms report conservatively on average, meaning that losses are recognized in earnings more quickly than gains. Column 2 incorporates the GC indicator variable and the corresponding interactions. The significantly positive coefficient on the

[25] Though a greater proportion of the total firms appear to use accruals management to reach the earnings thresholds, my analysis is concerned with the *relative* difference between the GC and non-GC firms.

*D*RET*GC* interaction (β=0.071, p<0.01) suggests that the GC firms report more conservatively than the non-GC firms. The results are similar in column 3 in which the control variables *MVE*, *MTB*, *LEV*, and *LITRISK* are included along with the corresponding interactions. Specifically, the coefficient on the *D*RET*GC* interaction is positive and significant (β=0.047, p<0.01). Collectively, the results indicate that the GC firms utilize more conservative accounting practices, thereby reducing the legal risk associated with the firm's accounting practices.

4.4 GCs and the Firm's Detection Risk (H2)

Hypothesis 2 argues that the GC affects the firm's legal risk via the likelihood that aggressive accounting practices are detected by outsiders. Table 7 tests this hypothesis by estimating equation (3). Column 1 reports the main effect of the GC indicator variable on AAER outcomes. The coefficient on the GC indicator variable insignificant (β=-0.195, p>0.10). Columns 2-4 test whether the likelihood that the firm's earnings management activities are detected varies between the GC and non-GC firms. As expected, the coefficient on each of the three earnings management proxies is positive and significant: *DACC* (β=2.866, p<0.01), *REM1* (β=1.960, p<0.01), and *REM2* (β=1.331, p<0.01). Further, the coefficient on each of the three interactions between the respective earnings management proxy and the GC indicator variable is negative and significant: *DACC*GC* (β=-5.626, p<0.01), *REM1*GC* (β=-1.822, p<0.05), and *REM2*GC* (β=-1.163, p<0.10). These results indicate that the earnings management tactics of the GC firms are less likely to be scrutinized by the SEC and thus targeted by an AAER

investigation. Collectively, these results suggest that the GC reduces the likelihood that risky accounting practices are detected by outsiders.

4.5 GCs and the Severity of Penalties (H3)

Hypothesis 3 argues that the GC decreases the firm's legal risk by reducing the severity of penalties imposed when aggressive accounting practices are detected. I test this hypothesis by examining whether the severity of penalties imposed on firms following financial restatement announcements varies between the GC and non-GC firms. I first examine the announcement period stock returns to confirm that the restatements are of similar magnitude across the GC and non-GC firms. I calculate raw returns, market-adjusted returns, and abnormal returns over days (-1,+1) surrounding the restatement announcement as well as over days (-2,+2) surrounding the restatement announcement. *RET(-1,+1)* and *RET(-2,+2)* are the firm's daily compounded returns. *MARET(-1,+1)* and *MARET(-2,+2)* are the firm's daily compounded returns less the market's daily compounded returns over the corresponding time period. The market return is the CRSP value-weighted index. *ABRET(-1,+1)* and *ABRET(-2,+2)* are the firm's daily abnormal compounded returns. Abnormal returns are calculated as the residual from the market model where the firm's daily returns are regressed on the market's daily returns over the 100 days ending 30 days before the restatement announcement. The market return is again the CRSP value-weighted index.

Table 8 Panel A reports the announcement periods returns separately for the GC and non-GC firms. As expected, the mean returns are negative for both the GC and non-GC firms. Although the GC firms' announcement period returns are slightly more

negative, they are not statistically different in any of the specifications. This should help allay concerns that the restatements are different in terms of magnitude across the GC and non-GC firms.

Table 8 Panel B tests hypothesis 3 by estimating equation (4). In columns 1-2 the dependent variable is *SUED*, which identifies whether the firm was sued within two years of the restatement announcement. To capture the GC's effect on the restatement outcomes I include *GCANN*, an indicator variable equal to one if the GC is among the top five paid executives at the time of the restatement announcement. The coefficient on *GCANN* is negative and significant in both specifications (β=-0.619, $p<0.01$; β=-0.617, $p<0.01$). This indicates that GC firms are less likely to be sued following a restatement announcement. Column 3 excludes restatements with subsequent lawsuits that are pending and the coefficient on *GCANN* remains negative and significant (β=-0.602, $p<0.05$). Similar to Donelson et al. (2012a), column 4 (5) includes only restatements without a subsequent lawsuit and restatements with a subsequent lawsuit that was dismissed (settled). Interestingly, the coefficient on *GCANN* is insignificant in column 4 (β=-0.286, $p>0.10$), but negative and significant in column 5 (β=-0.884, $p<0.01$). This result suggests that the GC is able to effectively deter lawsuits following restatement announcements, except in the case of frivolous lawsuits.

Table 8 Panel C examines the outcomes of the lawsuits filed subsequent to the restatement announcements in the analyses thus far. The results indicate that these lawsuits are more likely to be dismissed if the GC is a member of top management at the time of the restatement announcement. Specifically, whereas approximately 38% of the lawsuits are dismissed for the non-GC firms, over 57% of lawsuits are dismissed for the

GC firms. The nearly 20% difference is significant at the 10% level. Further, the average settlement for the non-GC firms is approximately $119 million, compared to approximately $34 million for the GC firms. Although the $84 million difference is not statistically significant, it does appear to be a very economically significant figure. Collectively, the results in Table 8 suggest that the GC is able to effectively reduce the severity of penalties imposed on the firm following restatement announcements, which confirms hypothesis 3.

4.6 Robustness Tests

4.6.1 Industry Effects

A possible concern with the results thus far is that I may be capturing industry effects rather than firm effects because there is substantial industry variation in the *GC* measure as reflected in Table 1 Panel B and Figure 3. Therefore, I first re-estimate each of the models after also incorporating industry fixed effects using the Fama-French 48 industry classifications. The results are reported in Table 9 and the inferences remain unchanged in each of these robustness tests. Further, the results are frequently stronger after controlling for industry effects.

Table 9 Panel A reports the firm's earnings management activities. The coefficient on the GC indicator variable is insignificant in the discretionary accrual specification (β=0.002, $p>0.10$), though it remains positive and significant in both of the real earnings management specifications (β=0.017, $p<0.01$; β=0.025, $p<0.01$). Table 9 Panel B reports the firm's preference for real or accrual earnings management activities. The GC firms are not more likely to use accrual earnings management tactics to reach the

earnings targets as evidenced by the insignificant coefficient on the GC indicator variable in the *DACC* specification (β=-0.020, p>0.10), though the GC firms are more likely to use real earnings management tactics as evidenced by the positive and significant coefficient on the GC indicator variable in both the *REM1* specification (β=0.312, p<0.01) and the *REM2* specification (β=0.218, p<0.05). Further, the coefficient on *GC* is positive and significant in both of the ordered logit specifications (β=0.241, p<0.01; β=0.143, p<0.10).

Table 9 Panel C reports the asymmetric timeliness of earnings results. The coefficient on the *D*MARET*GC* interaction is positive and significant when the control variables are excluded (β=0.071, p<0.01) and when the control variables are included (β=0.051, p<0.01). Table 9 Panel D reports the detection risk results. The coefficient on the interaction between the earnings management proxy and the GC indicator variable is negative and significant in all three specifications: *DACC*GC* (β=-5.575, p<0.01), *REM1*GC* (β=-1.809, p<0.05), *REM2*GC* (β=-1.132, p<0.05). Finally, Table 9 Panel E reports the severity of penalties results. The GC firms are less likely to be sued following restatement announcements as evidenced by the negative and significant coefficient on the GC indicator when all lawsuits are included (β=-0.602, p<0.05), when pending lawsuits are excluded (β=-0.579, p<0.05), and when only settled lawsuits are included (β=-0.921, p<0.01). Similar to the earlier results, the coefficient on the GC indicator variable is insignificant when only dismissed lawsuits are included (β=-0.178, p>0.10).

Including industry fixed effects in the model captures time invariant variation in the dependent variable. To address variation in the experimental variable, *GC*, I construct a modified version of the variable. Specifically, I first calculate the industry

average of *GC* by fiscal year. I then calculate the modified variable, *GCINDADJ*, as the indicator variable *GC* less the corresponding industry-year average of *GC*. I then re-estimate the primary model specifications after replacing GC with GCINDADJ.[26] The results are reported in Table 9 and the inferences remain unchanged in each of these robustness tests. Again, the results are frequently stronger after controlling for industry effects.

Table 9 Panel A reports the firm's earnings management activities. The coefficient on *GCINDADJ* is insignificant in the discretionary accrual specification (β=0.001, p>0.10), though it is positive and significant in both of the real earnings management specifications (β=0.018, p<0.01; β=0.027, p<0.01). Table 9 Panel B reports the firm's preference for real or accrual earnings management activities. The GC firms are not more likely to use accrual earnings management tactics to reach the earnings targets as evidenced by the insignificant coefficient on *GCINDADJ* in the *DACC* specification (β=-0.004, p>0.10), though the GC firms are more likely to use real earnings management tactics as evidenced by the positive and significant coefficient on the GC indicator variable in both the *REM1* specification (β=0.322, p<0.01) and the *REM2* specification (β=0.238, p<0.05). Further, the coefficient on *GCINDADJ* is positive and significant in both of the ordered logit specifications (β=0.241, p<0.01; β=0.149, p<0.10).

Table 9 Panel C reports the asymmetric timeliness of earnings results. The coefficient on the *D*MARET*GCINDADJ* interaction is positive and significant when the

[26] I calculate the industry average of *GC* by year because Figure 3 displays time-series variation in *GC* within industries over the sample period. Therefore, *GCINDADJ* captures both the variation in *GC* **across** industries in each year as well as the variation in *GC* **within** the firm's industry over the sample period. However, the inferences remain unchanged if I use one industry average of *GC* for the full sample period.

control variables are excluded (β=0.051, p<0.05) and when the control variables are included (β=0.038, p<0.01). Table 9 Panel D reports the detection risk results. The coefficient on the interaction between the earnings management proxy and *GCINDADJ* is negative and significant in all three specifications: *DACC*GCINDADJ* (β=-5.716, p<0.01), *REM1*GCINDADJ* (β=-2.056, p<0.01), *REM2*GCINDADJ* (β=-1.332, p<0.05). Finally, Table 9 Panel E reports the severity of penalties results. The GC firms are less likely to be sued following restatement announcements as evidenced by the negative and significant coefficient on *GCINDADJ* when all lawsuits are included (β=-0.594, p<0.05), when pending lawsuits are excluded (β=-0.548, p<0.05), and when only settled lawsuits are included (β=-0.860, p<0.05). Similar to the earlier results, the coefficient on *GCINDADJ* is insignificant when only dismissed lawsuits are included (β=-0.175, p>0.10).

4.6.2 Self-Selection

Another possible concern is that having a GC on the top management team is a choice the firm makes. Therefore, this self-selection problem may lead to biased results. To address this concern, I employ a propensity matching procedure that addresses the selection bias due to observable firm characteristics (Tucker, 2010). Specifically, I estimate a binary logit specification to model the firm's decision to have a GC on the top management team. I then use this model to create a propensity score that captures the likelihood of having a GC on the top management team. Finally, within each test, I match each GC firm observation to a non-GC firm observation in the same year with the closest propensity score. The resulting sample includes firms with similar propensities to

have a GC on the top management team, except for the feature that the treatment firms (i.e. GC firms) did have a GC on the top management team whereas the control firms (i.e. non-GC firms) did not have a GC on the top management team.

The dependent variable in the first stage model is the GC indicator variable. The determinants begin with a series of variables to capture the firm's litigation risk from Kim and Skinner (2012). These include firm size (*AT*), sales growth (*ΔREV*), stock returns (*MARET*), stock return skewness (*SKEWRET*), stock return volatility (*SDRET*), and share volume (*TURN*).[27] I then include a series of corporate governance characteristics including the G-Index (*GINDEX*) (Gompers et al., 2003),[28] the percentage of shares owned by insiders (*INSIDEOWN*), and the percentage of shares owned by institutional investors (*INSTOWN*). I also include firm age (*FIRMAGE*), an indicator variable that captures CEO turnover (*CEOTURN*), an indicator variable that captures whether the Chief Risk Officer is a member of the top management team (*CRO*), and an indicator variable that captures whether the firm was previously sued during the sample period (*HISTSUIT*). Finally, I include industry fixed effects using the Fama-French 48 industry classifications. All variables are lagged one year to precede the decision to include the GC on the top management team (except *FIRMAGE*, *CRO*, and the industry fixed effects).

The first stage results are reported in Table 10 Panel A. Stock volatility, firm age, and institutional ownership are positively associated with having a GC on top

[27] I exclude the indicator variable *FPS* for litigious industries because I include industry fixed effects in the model.

[28] Because *GINDEX* is missing for many observations I utilize zero-order regression to avoid sample attrition. Specifically, missing *GINDEX* observations are set to zero and I include an indicator variable (*GDUM*) equal to one if *GINDEX* is missing, zero otherwise (Greene, 1993; Hopkins et al., 2015).

management. The indicator variables for CEO turnover, a historical lawsuit, and for firms with a Chief Risk Officer on top management are also positively associated with having a GC on top management. Sales growth, stock return skewness, the G-Index, and inside share ownership are all negatively associated with having a GC on top management.

The second stage results are reported in Table 10 Panels B-F. Table 10 Panel B reports the firm's earnings management activities. The coefficient on the GC indicator variable is insignificant in the discretionary accrual specification (β=-0.001, $p>0.10$), though it remains positive and significant in both of the real earnings management specifications (β=0.020, $p<0.01$; β=0.033, $p<0.01$). Table 10 Panel C reports the firm's preference for real or accrual earnings management activities. The GC firms are not more likely to use accrual earnings management tactics to reach the earnings targets as evidenced by the insignificant coefficient on the GC indicator variable in the *DACC* specification (β=-0.048, $p>0.10$), though the GC firms are more likely to use real earnings management tactics as evidenced by the positive coefficient on the GC indicator variable in both of the *REM1* specifications (β=0.324, $p<0.05$; β=0.267, $p<0.10$). However, the coefficient on *GC* is insignificant in both of the *REM2* specifications (β=0.173, $p>0.10$; β=0.214, $p>0.10$).

Table 10 Panel D reports the asymmetric timeliness of earnings results. The coefficient on the *D*MARET*GC* interaction is insignificant when the control variables are excluded (β=0.047, $p>0.10$) and when the control variables are included (β=0.038, $p>0.10$). Table 10 Panel E reports the detection risk results. The coefficient on the interaction between the earnings management proxy and the GC indicator variable is

negative and significant in all three specifications: *DACC*GC* (β=-5.522, p<0.05), *REM1*GC* (β=-2.491, p<0.05), *REM2*GC* (β=-1.405, p<0.10). Finally, Table 10 Panel F reports the severity of penalties results. The GC firms are less likely to be sued following restatement announcements as evidenced by the negative and significant coefficient on the GC indicator when all lawsuits are included (β=-0.595, p<0.05) and when only settled lawsuits are included (β=-0.707, p<0.10). Similar to the earlier results, the coefficient on the GC indicator variable is insignificant when only dismissed lawsuits are included (β=-0.460, p>0.10).[29]

4.7 Additional Analyses

4.7.1 GCs and Corporate Risk

Having established the GC's effect on the firm's accounting practices, I now turn to the GC's effect on the firm's overall corporate risk and the market's assessment of the GC's contribution to the firm. Corporate risk, as reflected in performance volatility, increases the likelihood of a large stock price decline and a subsequent lawsuit (Kim and Skinner, 2012). Further, managers owe a fiduciary duty to shareholders to act in their interests. The fiduciary duty has become especially relevant to GCs in recent years due to Section 307 of SOX. Section 307 requires the firm's attorneys to report securities law violations or breaches of fiduciary duty "up-the-ladder" to the chief legal officer, CEO, audit committee, and/or board of directors (U.S. Congress, 2002). Risky corporate activities can raise questions about how well managers' have fulfilled their fiduciary

[29] I exclude the specification without pending lawsuits because the propensity-matched sample does not include any observations with a subsequent pending lawsuit. Therefore, the results are identical to those in column 1.

duties. In fact, by March 2005 the SEC had already filed enforcement actions against 76 attorneys under SOX Section 307 (Hogan and Hartson LLP, 2005; Lowenfels et al., 2006; Choudhary et al., 2013a).

In their role as business advisors, GCs can affect their firms' corporate risk by influencing managers' choice of projects to invest in as well as financial decisions such as the degree of leverage the firm carries. Following Bova et al. (2015), I focus on aggregate measures of corporate risk to capture the GC's net effect on corporate risk.[30] The model is as follows.

$$CORPRISK_{i,t+1} = \beta_0 + \beta_1(GC_{i,t}) + \Sigma\beta_i(Controls) + \varepsilon_{i,t} \quad (5)$$

CORPRISK represents the corporate risk variable of interest in the respective firm-year. *SDRETD* is the standard deviation of daily returns over the fiscal year. *SDRETD_ID* is the idiosyncratic component of the standard deviation of daily returns. *SDROA* is the standard deviation of seasonally adjusted quarterly return on assets over the years t+1 to t+4. *CAPEX* is capital expenditures scaled by lagged net property, plant, and equipment. *RD* is research and development expenditures scaled by lagged sales. All other variables were previously defined. A negative (positive) coefficient on the GC indicator variable suggests the GC is associated with lower (higher) corporate risk.

Table 11 reports the results of the GC's effect on the firm's corporate risk. The coefficient on the GC indicator variable is negative and significant in columns 1 and 2, where the dependent variable is daily stock return volatility and the idiosyncratic component of daily stock return volatility, respectively (β=-0.124, $p<0.01$; β=-0.109,

[30] Though understanding the exact channel by which the GC affects corporate risk is interesting in its own right, this is beyond the scope of the current study and thus left for future research.

p<0.01). The coefficient on GC is insignificant in column 3, where the dependent variable is ROA volatility (β=0.013, p>0.10). The coefficient on the GC indicator variable is negative and significant in columns 4 and 5, where the dependent variable is *CAPEX* and *RD*, respectively (β=-0.029, p<0.01; β=-0.009, p<0.01). Collectively, these results suggest that GC firms are associated with lower overall corporate risk.

4.7.2 GCs and Firm Value

To assess the GC's value to the firm, I examine the firm's stock market performance during years in which the GC is appointed to a top management position. Each firm-year in which the GC indicator variable equals 0 in year *t-1* and equals 1 in year *t* is matched to a firm-year in which the GC indicator variable equals 0 in year *t-1* and year *t*. The firm-years are also matched using lagged firm size (*MVE*) and litigation risk (*LITRISK*) to control for the likelihood that the GC is appointed to top management. I then compare the cumulative market-adjusted returns across the two groups via the following model.

$$MARET_t = \beta_0 + \beta_1(GCAPPT_t) + \Sigma\beta_i(Controls) + \varepsilon_t \quad (6)$$

GCAPPT is an indicator variable equal to one if the GC was promoted to the top five highest paid executives in the current fiscal year, zero otherwise. The returns are cumulated from the fourth month of the appointment fiscal year to the third month of the following fiscal year, inclusive. A positive coefficient on *GCAPPT* suggests that the market values the GC's contribution to the firm.

Table 12 reports the results. *GCAPPT* captures the differential stock market performance between the two groups after controlling for several determinants of stock market performance. The coefficient on *GCAPPT* is positive and significant in column 1 (β=0.031, $p<0.01$), indicating that the GC appointment years outperform non-appointment years with similar characteristics. In column 2 the sample is restricted to the first GC appointment year for each firm over the sample period. This helps to alleviate concerns that the results are capturing GCs who fluctuate between being in and out of the top five highest paid executives from year to year (i.e. 6th in 2005, 5th in 2006, 6th in 2007, and so on). The coefficient on *GCAPPT* remains positive and significant (β=0.052, $p<0.05$), and the magnitude of the coefficient increases by nearly 70%. Overall, these results suggest that the market places considerable value on the GC's role in the firm.

Chapter 5: Conclusion

This study examines the impact of corporate general counsels on the legal risk associated with the firm's accounting practices. I argue that the GC can affect the firm's legal risk via three channels: (1) the riskiness of the firm's accounting practices, (2) the likelihood that these activities are detected by outsiders, and (3) the sanctions imposed if these activities are detected.

I test the riskiness of the firm's activities via the firm's earnings management activities and the degree of accounting conservatism exhibited by the firm. I find that GCs reduce legal risk by encouraging the use of a less risky form of earnings management, real earnings management, relative to accruals management. I also find that GC firms accelerate the recognition of losses (i.e. report more conservatively), which is also associated with reduced legal risk. I examine the GC's effect on detection risk by testing whether the firm's aggressive accounting practices are detected by external parties. I find that, in the presence of a GC, the firm's earnings management activities are less likely to be targeted by the SEC via an AAER enforcement action. I examine the GC's effect on the sanctions imposed upon detection by testing the litigation outcomes resulting from financial restatements. I find that GC firms are less likely to be sued following a restatement announcement. Further, when sued, the GC firms' lawsuits are more likely to be dismissed and the settlement amounts are lower. In aggregate, these results suggest that the GC reduces the firm's legal risk via all three channels analyzed – the firm's risky activities, its detection risk, and the sanctions imposed upon detection.

The analyses culminate with an examination of the GC's impact on overall corporate risk and the market's assessment of the GC's contribution to the firm. I find

that GC firms are associated with lower corporate risk as reflected in the volatility of the firm's stock returns and the firm's investing behavior. I also find that the market responds favorably to GC appointments to top management, suggesting that the market sees value in the GC position.

By contributing to a greater understanding of the GC's role in financial reporting, this study adds to the burgeoning literature on the role of managers in financial reporting. While prior studies have traditionally focused on CEOs and CFOs (Cheng and Warfield, 2005; Bergstresser and Philippon, 2006; Jiang et al., 2010), GCs have only recently been acknowledged as a key contributor (Kwak et al., 2012; Choudhary et al., 2013a, 2013b; Goh et al., 2014; Hopkins et al., 2015). I provide evidence that GCs play a more expansive role in the firm's accounting choices than previously acknowledged. More importantly, I contribute to this literature by documenting and providing evidence on the three channels by which GCs can affect the legal risks associated with the firm's accounting choices.

Appendix A
Variable Definitions

Experimental Variables	
GC	Indicator variable equal to one if the general counsel is among the top five paid executives in the respective firm-year, zero otherwise. I identify whether the GC is on the top management team via the annual job titles reported by Execucomp. I search the annual titles of all available executive-firm-years for the words "counsel", "law", "legal", and similar variants to identify executives who are general counsel. I manually review the executives' titles that are captured by this search and exclude the titles that do not refer to legal experts such as tax counsel, investment counsel, etc. I also manually review the job titles that are not captured via the search and code these titles accordingly.
GCANN	Indicator variable equal to one if the general counsel is among the top five paid executives at the time of the restatement announcement, zero otherwise.
GCAPPT	Indicator variable equal to one if the general counsel is appointed to the top five paid executives in the current fiscal year, zero otherwise.
GCINDADJ	*GC* less the industry average of *GC* for the corresponding industry-year. Industry is defined by the Fama-French 48 industry classifications.
Outcome Variables	
AAER	Indicator variable equal to one if the fiscal year is associated with an AAER investigation, zero otherwise. AAER data are obtained from the Center for Financial Reporting and Management at the University of California, Berkeley (Dechow et al., 2011).
CAPEX	Capital expenditures scaled by lagged net PP&E.
DACC	Discretionary accruals measured as the residual from the following modified Jones (1991) model (Dechow et al., 1995). $TA_{i,t} = \beta_0 + \beta_1 1/AT_{i,t-1} + \beta_2 \Delta REV_{i,t} + \beta_3 PPE_{i,t} + \varepsilon_{i,t}$ where TA is total accruals for firm *i* in year *t*. Total accruals are calculated as the difference between income before extraordinary items and operating cash flows. AT is total assets, ΔREV is the change in total revenue, PPE is gross property, plant, and equipment. ΔREV and PPE are scaled by beginning assets. The model is estimated for each industry-year with at least 10 observations. Industry is defined by 2-digit SIC code. The variable is set to missing for financial firms (SIC 6000-6999) and utility firms (SIC 4900-4999).
DISMISS	Indicator variable equal to one if the class action lawsuit is dismissed, zero otherwise.
MARET	Market-adjusted cumulative monthly returns over the year. Market return is the value-weighted CRSP index. Returns are cumulated from the fourth month of the fiscal year to the third month of the following fiscal year, inclusive.
RD	Research and development expenditures scaled by lagged sales.

REM1	Real earnings management proxy 1, which equals the sum of abnormal discretionary expenses multiplied by negative one and abnormal production costs, calculated as in Roychowdhury (2006). Abnormal discretionary expenses are calculated as the residual from the following model. $DISEXP_{i,t} = \beta_0 + \beta_1 1/AT_{i,t-1} + \beta_2 REV_{i,t-1} + \varepsilon_{i,t}$ where DISEXP is discretionary expenses for firm *i* in year *t*. Discretionary expenses are calculated as the sum of R&D expenses, advertising expenses, and SG&A expenses. AT is total assets and REV is total revenue. DISEXP and REV are scaled by beginning assets. The model is estimated for each industry-year with at least 10 observations. Industry is defined by 2-digit SIC code. The variable is set to missing for financial firms (SIC 6000-6999) and utility firms (SIC 4900-4999). Abnormal production costs are calculated as the residual from the following model. $PROD_{i,t} = \beta_0 + \beta_1 1/AT_{i,t-1} + \beta_2 REV_{i,t} + \beta_3 \Delta REV_{i,t} + \beta_4 \Delta REV_{i,t-1} + \varepsilon_{i,t}$ where $PROD_{i,t}$ is production costs for firm *i* in year *t*. Production costs are the sum of COGS and the change in inventory. PROD is scaled by lagged assets. The model is estimated for each industry-year with at least 10 observations. Industry is defined by 2-digit SIC code. The variable is set to missing for financial firms (SIC 6000-6999) and utility firms (SIC 4900-4999).
REM2	Real earnings management proxy 2, which equals the sum of abnormal discretionary expenses and abnormal cash flows, both multiplied by negative one, calculated as in Roychowdhury (2006). Abnormal cash flows are calculated as the residual from the following model. $CFO_{i,t} = \beta_0 + \beta_1 1/AT_{i,t-1} + \beta_2 REV_{i,t} + \beta_3 \Delta REV_{i,t} + \varepsilon_{i,t}$ where $CFO_{i,t}$ is cash flows from operations for firm *i* in year *t*. CFO is scaled by lagged assets. All other variables are defined in REM1. The model is estimated for each industry-year with at least 10 observations. Industry is defined by 2-digit SIC code. The variable is set to missing for financial firms (SIC 6000-6999) and utility firms (SIC 4900-4999).
SDRETD	Standard deviation of daily returns over the fiscal year.
SDRETD_ID	Idiosyncratic volatility calculated as the standard deviation of the residuals from the market model wherein the firm's daily returns are regressed on the value-weighted CRSP index daily returns over the fiscal year.
SDROA	Standard deviation of seasonally-adjusted quarterly ROA over years t+1 to t+4. Quarterly ROA is income before extraordinary items scaled by average assets. Quarterly ROA is seasonally-adjusted as the difference between current quarter ROA and ROA in the same quarter of the previous fiscal year.
SETTLEMENT	Dollar value of the class action lawsuit settlement amount in millions.
SUED	Indicator variable equal to one if a class action lawsuit was filed against the firm within two years of the restatement announcement, zero otherwise. I exclude lawsuits filed within 30 days of the restatement announcement because these are likely due to events that occurred prior to the restatement announcement.

Control Variables	
ACIND	Indicator variable equal to one if the firm's audit committee is comprised of all independent directors, zero otherwise.
AUDTEN	Natural log of auditor tenure in years.
BIG4	Indicator variable equal to one if the firm's auditor is a big four accounting firm (big 5/6 for earlier years), zero otherwise.
BOARDIND	Percentage of board members that are independent.
BOARDSIZE	Natural log of the number of directors on the board.
CEODUAL	Indicator variable equal to one if the CEO is also chairman of the board, zero otherwise.
CFO	Cash flows from operations scaled by lagged assets.
CYCLE	Natural log of the firm's operating cycle defined as the sum of days' accounts receivable and days' inventory. Days' AR is calculated as average AR scaled by sales and divided by 360. Days' inventory is calculated as average inventory scaled by COGS and divided by 360.
D	Indicator variable equal to one if MARET is negative, zero otherwise.
FPS	Indicator variable equal to one for high litigation risk industries, zero otherwise (SIC 2833-2836, 3570-3577, 3600-3674, 5200-5961, 7370-7374, 8731-8734).
INSTOWN	Percentage of institutional ownership.
ISSUE	Indicator variable equal to one if the sum of issued securities (*sstk* or *dltis*) during the fiscal year is greater than ten percent of total assets, zero otherwise (Badolato et al., 2015).
LEV	Current debt plus long-term debt scaled by the market value of equity.
LITRISK	Litigation risk measured as the predicted value from the following model (Kim and Skinner, 2012). $SUIT_{i,t} = \beta_0 + \beta_1 FPS_{i,t} + \beta_2 LOGAT_{i,t-1} + \beta_3 \Delta REV_{i,t-1} + \beta_4 RET_{i,t-1} + \beta_5 SKEWRET_{i,t-1} + \beta_6 SDRET_{i,t-1} + \beta_7 TURN_{i,t-1} + \varepsilon_{i,t}$ where SUIT is an indicator variable equal to one if a class action lawsuit is filed against firm *i* in year *t*, zero otherwise. FPS is an indicator variable equal to one for high litigation risk industries, zero otherwise (SIC 2833-2836, 3570-3577, 3600-3674, 5200-5961, 7370-7374, 8731-8734), LOGAT is the natural log of total assets, ΔREV is the change in revenue scaled by lagged assets, MARET is the market-adjusted cumulative monthly return over the fiscal year, SKEWRET is the skewness in monthly returns over the fiscal year, SDRET is the standard deviation in monthly returns over the fiscal year, and TURN is trading volume over the fiscal year scaled by beginning shares outstanding. The model is estimated once for the full sample with available data.
LOSS	Indicator variable equal to one if net income is negative, zero otherwise.
MKTSH	Firm revenue scaled by industry revenue. Industry is defined by the Fama-French 48 industry classifications.
MTB	Market value of equity scaled by the book value of equity.
MTR	Marginal tax rates provided by Professor John Graham at the link below. Missing values are calculated as in Graham and Mills (2008). https://faculty.fuqua.duke.edu/~jgraham/taxform.html
MVE	Natural log of the market value of equity.
NOA	Net operating assets calculated as shareholders' equity less cash and marketable securities plus current and long-term debt scaled by lagged sales.

NOL	Net operating loss indicator variable equal to one if the firm has a positive net operating loss carry-forward, zero otherwise.
REVENUE	Indicator variable equal to one if revenue was restated, zero otherwise.
ROE	Income before extraordinary items scaled by lagged market value of equity.
SDRET	Standard deviation of monthly stock returns over the fiscal year.
TURN	Trading volume over the fiscal year scaled by beginning shares outstanding.
ZSCORE	Indicator variable equal to one if the Z-Score is above the sample median, zero otherwise. Z-score is calculated as follows (Altman 1968, 2000). 3.3*(earnings before interest and taxes / total assets) + 1.0*(total revenue / total assets) + 1.4*(retained earnings / total assets) + 1.2*(current assets - current liabilities / total assets) + 0.6*(market value of equity / total liabilities)

Figure 1
The Prevalence of Highly Paid General Counsel

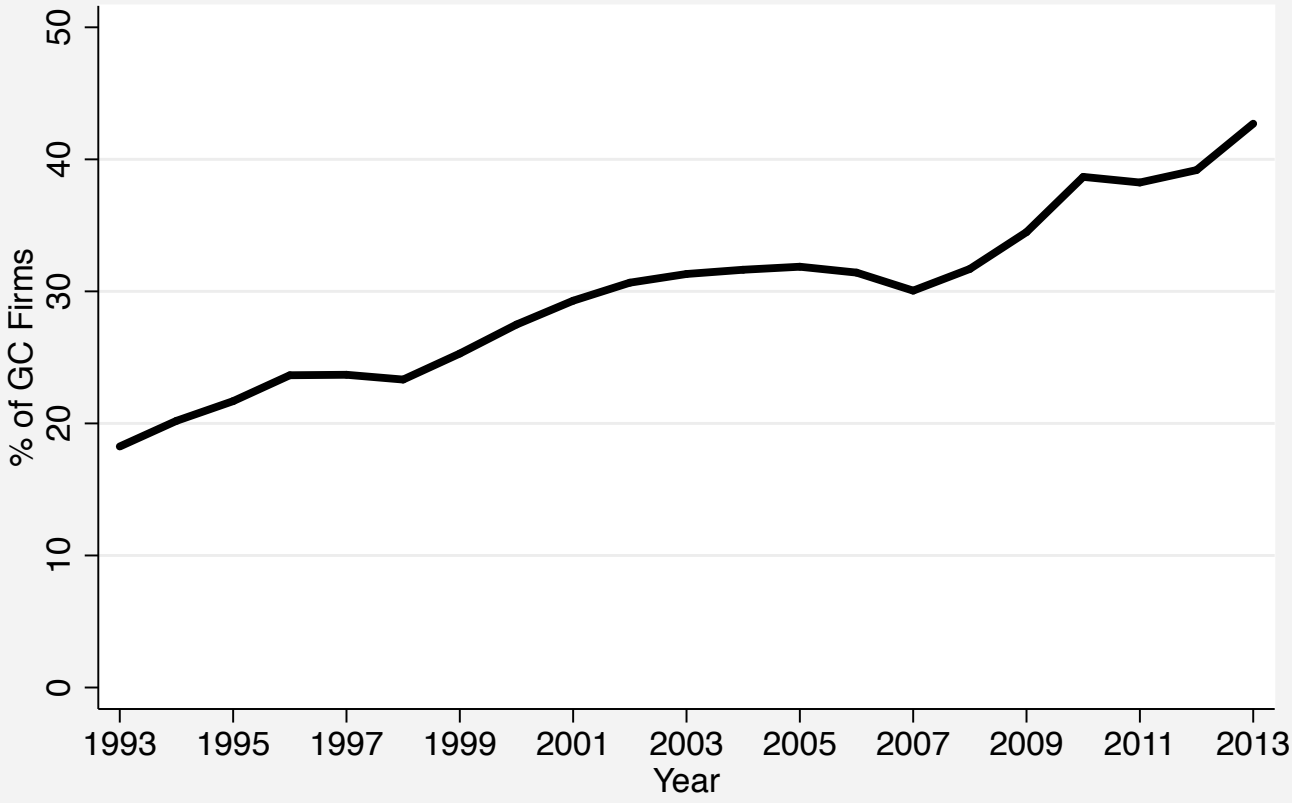

Figure 2
The Prevalence of Highly Paid General Counsel by Firm Size

Figure 3
The Prevalence of Highly Paid General Counsel by Industry

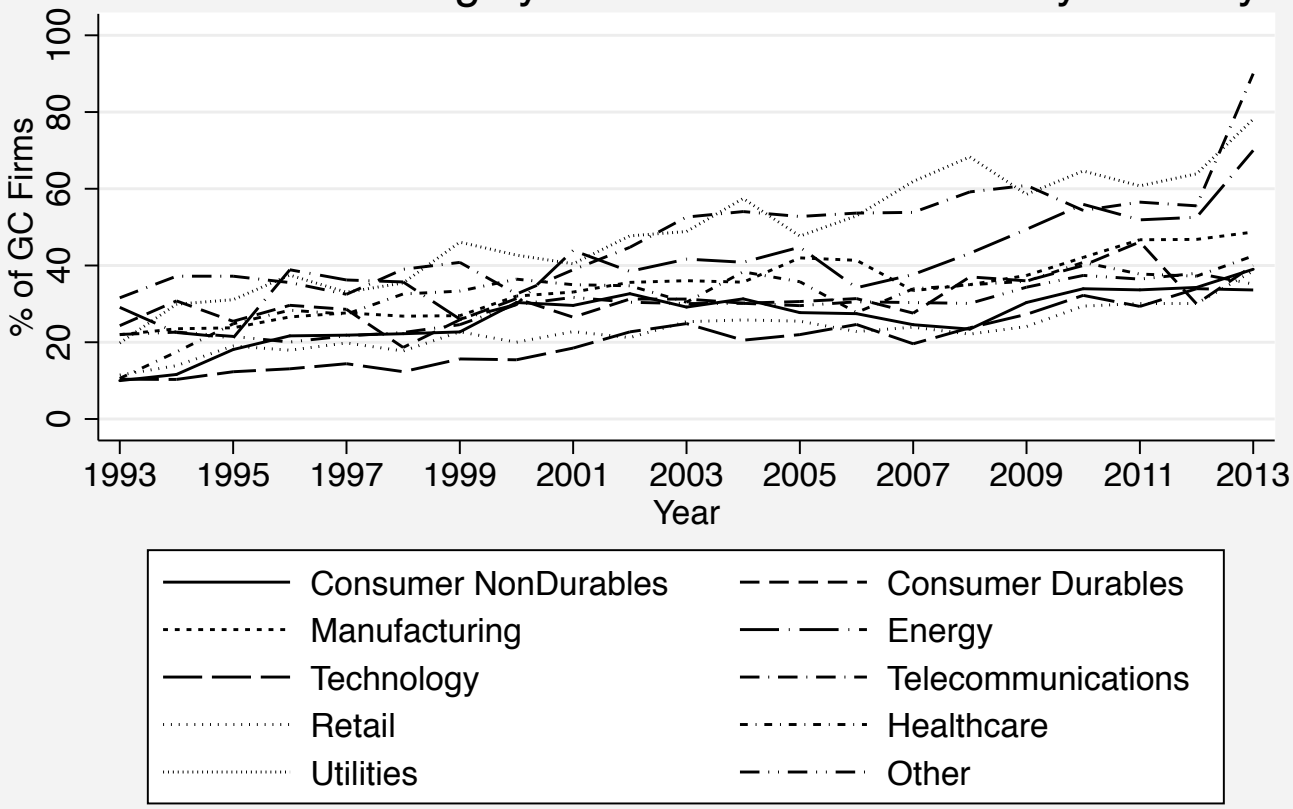

Table 1
Sample Description

Panel A: GC Firms by Year

Year	GC Firms		Non-GC Firms		Total Firms
1992	10	2%	395	98%	405
1993	213	18%	954	82%	1,167
1994	313	20%	1,237	80%	1,550
1995	347	22%	1,253	78%	1,600
1996	389	24%	1,256	76%	1,645
1997	396	24%	1,276	76%	1,672
1998	403	23%	1,325	77%	1,728
1999	457	25%	1,350	75%	1,807
2000	492	27%	1,298	73%	1,790
2001	488	29%	1,178	71%	1,666
2002	512	31%	1,158	69%	1,670
2003	544	31%	1,193	69%	1,737
2004	554	32%	1,197	68%	1,751
2005	557	32%	1,191	68%	1,748
2006	586	31%	1,279	69%	1,865
2007	636	30%	1,480	70%	2,116
2008	646	32%	1,392	68%	2,038
2009	686	34%	1,303	66%	1,989
2010	751	39%	1,191	61%	1,942
2011	719	38%	1,161	62%	1,880
2012	712	39%	1,105	61%	1,817
2013	272	43%	365	57%	637
Total	10,683	29%	25,537	71%	36,220

Panel B: GC Firms by Industry

Industry	% GC Firms	Industry	% GC Firms
Candy & Soda	13%	Healthcare	33%
Fabricated Products	13%	Other	33%
Banking	16%	Insurance	34%
Retail	17%	Precious Metals	34%
Electronic Equipment	18%	Pharmaceutical Products	35%
Computers	19%	Restaurants & Hotels	35%
Textiles	21%	Construction Materials	36%
Business Supplies	22%	Rubber & Plastic Products	36%
Apparel	22%	Shipping Containers	36%
Recreation	22%	Ship & Railroad Equipment	37%
Printing and Publishing	24%	Agriculture	37%
Food Products	24%	Steel	38%
Consumer Goods	26%	Electrical Equipment	38%
Automobiles and Trucks	26%	Oil	39%
Machinery	26%	Real Estate	39%
Business Services	27%	Defense	41%
Personal Services	27%	Beer & Liquor	42%
Wholesale	28%	Construction	44%
Medical Equipment	28%	Aircraft	44%
Coal	28%	Utilities	45%
Lab Equipment	28%	Entertainment	45%
Mining	29%	Communication	46%
Trading	32%	Chemicals	48%
Transportation	33%	Tobacco Products	83%

This table reports the sample description. Panel A reports the number and percentage of firms with a general counsel in top management by fiscal year. Panel B reports the percentage of firm-years with a general counsel in top management by industry using the Fama-French 48 industry classifications.

Table 2
Descriptive Statistics

Panel A: Full Sample

Variable	N	Mean	StdDev	P25	Median	P75	GC=0 Mean	GC=1 Mean	P-Val
Outcome Variables									
AAER	33,942	0.014	0.117	0.000	0.000	0.000	0.015	0.012	0.043
CAPEX	31,891	0.275	0.250	0.121	0.201	0.336	0.286	0.248	0.000
DACC	28,116	0.030	0.106	-0.022	0.027	0.084	0.027	0.038	0.000
MARET	34,519	0.055	0.474	-0.218	-0.010	0.221	0.051	0.064	0.022
RD	33,131	0.044	0.106	0.000	0.000	0.032	0.047	0.037	0.000
REM1	28,252	0.012	0.259	-0.112	0.022	0.154	0.001	0.039	0.000
REM2	28,012	0.065	0.402	-0.128	0.069	0.286	0.049	0.104	0.000
SDRETD	33,403	2.716	1.443	1.705	2.349	3.313	2.752	2.635	0.000
SDRETD_ID	32,775	2.352	1.312	1.430	2.017	2.895	2.395	2.250	0.000
SDROA	28,662	2.553	3.809	0.519	1.157	2.774	2.553	2.565	0.815
Control Variables									
ACIND	22,032	0.841	0.365	1.000	1.000	1.000	0.837	0.851	0.009
AUDTEN	34,990	2.369	0.780	1.792	2.398	3.045	2.351	2.413	0.000
BIG4	34,990	0.944	0.230	1.000	1.000	1.000	0.938	0.957	0.000
BOARDIND	22,032	0.703	0.165	0.600	0.727	0.833	0.691	0.731	0.000
BOARDSIZE	22,032	2.312	0.249	2.079	2.303	2.485	2.311	2.316	0.182
CEODUAL	22,032	0.702	0.458	0.000	1.000	1.000	0.696	0.714	0.007
CFO	35,056	0.104	0.103	0.048	0.096	0.155	0.106	0.099	0.000
CYCLE	35,556	4.813	1.147	4.229	4.688	5.146	4.874	4.670	0.000
INSTOWN	35,367	0.638	0.246	0.494	0.676	0.824	0.629	0.662	0.000
LEV	35,681	0.650	1.489	0.051	0.229	0.613	0.614	0.735	0.000
LITRISK	29,802	0.032	0.032	0.014	0.023	0.039	0.033	0.031	0.000
LOSS	36,200	0.171	0.377	0.000	0.000	0.000	0.169	0.179	0.014
MKTSHR	36,196	0.013	0.028	0.001	0.003	0.010	0.013	0.013	0.014
MTB	35,830	2.894	3.118	1.382	2.104	3.387	2.969	2.714	0.000
MTR	36,198	0.240	0.140	0.060	0.331	0.350	0.247	0.225	0.000
MVE	35,834	7.339	1.632	6.253	7.256	8.380	7.308	7.415	0.000
NOA	35,906	1.240	1.723	0.379	0.675	1.310	1.231	1.264	0.101
NOL	36,246	0.329	0.470	0.000	0.000	1.000	0.310	0.375	0.000
ROE	35,495	0.022	0.164	0.023	0.054	0.078	0.024	0.015	0.000
SDRET	34,880	0.112	0.066	0.066	0.095	0.138	0.113	0.110	0.000
ZSCORE	32,708	0.500	0.500	0.000	0.500	1.000	0.541	0.406	0.000

Panel B: Restatement Sample

Variable	N	Mean	StdDev	P25	Median	P75	GC=0 Mean	GC=1 Mean	P-Value
Outcome Variables									
SUED	1,470	0.089	0.285	0.000	0.000	0.000	0.105	0.059	0.004
DISMISS	131	0.397	0.491	0.000	0.000	1.000	0.353	0.552	0.054
SETTLEMENT	64	104.278	417.734	7.025	15.525	38.046	118.780	34.401	0.546
Control Variables									
BIG4	1,470	0.936	0.245	1.000	1.000	1.000	0.927	0.953	0.057
FPS	1,470	0.335	0.472	0.000	0.000	1.000	0.376	0.255	0.000
ISSUE	1,465	0.329	0.470	0.000	0.000	1.000	0.309	0.366	0.028
MVE	1,431	7.100	1.604	6.111	6.984	8.149	7.104	7.114	0.919
REVENUE	1,470	0.210	0.408	0.000	0.000	0.000	0.207	0.216	0.685
ROE	1,415	-0.025	0.303	-0.002	0.038	0.070	-0.017	-0.037	0.239
SDRET	1,358	0.126	0.079	0.073	0.104	0.147	0.126	0.126	0.970
TURN	1,358	2.634	2.183	1.135	1.926	3.282	2.661	2.590	0.572

This table reports descriptive statistics for the dependent and independent variables. Panel A reports descriptive statistics for the full sample and Panel B reports descriptive statistics for the restatement sample. Variable descriptions are provided in Appendix A.

Table 3
Correlation Matrix
Panel A: Full Sample

		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)
(1)	GC	–															
(2)	AAER	-0.01	–														
(3)	CAPEX	-0.07	0.03	–													
(4)	DACC	0.05	0.02	-0.01	–												
(5)	MARET	0.01	0.00	0.20	0.04	–											
(6)	RD	-0.04	0.03	0.24	-0.01	0.05	–										
(7)	REM1	0.07	0.01	-0.23	0.21	-0.09	-0.19	–									
(8)	REM2	0.06	0.03	-0.14	0.16	-0.04	-0.13	0.92	–								
(9)	SDRETD	-0.04	0.04	0.18	-0.05	-0.01	0.27	-0.05	-0.03	–							
(10)	SDRETD_ID	-0.05	0.05	0.19	-0.07	-0.04	0.28	-0.05	-0.04	0.97	–						
(11)	SDROA	0.00	0.03	0.14	-0.10	-0.05	0.40	-0.05	-0.05	0.45	0.48	–					
(12)	ACIND	0.02	-0.07	0.01	0.00	0.00	0.00	0.00	-0.01	-0.07	-0.11	0.00	–				
(13)	AUDTEN	0.04	-0.01	-0.11	0.02	-0.02	-0.05	0.06	0.04	-0.13	-0.15	-0.10	0.01	–			
(14)	BIG4	0.04	0.01	-0.04	-0.02	0.00	-0.03	0.01	0.02	-0.07	-0.07	-0.08	-0.03	0.22	–		
(15)	BOARDIND	0.11	-0.07	-0.07	0.05	0.00	-0.01	0.01	0.01	-0.14	-0.20	-0.03	0.41	0.05	0.04	–	
(16)	BOARDSIZE	0.01	0.02	-0.22	0.03	-0.03	-0.23	0.07	0.05	-0.27	-0.29	-0.22	-0.05	0.16	0.14	0.10	–
(17)	CEODUAL	0.02	0.04	-0.07	0.02	0.00	-0.06	0.02	0.01	-0.03	-0.02	-0.06	-0.09	0.02	0.05	0.02	0.11
(18)	CFO	-0.03	-0.01	0.20	-0.17	0.15	-0.15	-0.37	-0.21	-0.15	-0.15	-0.19	-0.01	0.06	0.05	-0.03	-0.09
(19)	CYCLE	-0.08	0.01	-0.05	0.07	-0.02	0.03	-0.03	-0.06	-0.04	-0.06	-0.10	-0.01	-0.06	-0.07	0.03	0.22
(20)	INSTOWN	0.06	0.02	0.07	0.06	0.05	-0.01	0.01	0.04	-0.03	-0.07	-0.05	0.11	0.07	0.05	0.22	-0.14
(21)	LEV	0.04	0.01	-0.17	-0.09	-0.11	-0.13	0.12	0.07	0.15	0.15	0.03	-0.04	-0.04	0.00	0.00	0.14
(22)	LITRISK	-0.02	0.08	-0.01	-0.08	0.02	0.08	0.03	0.05	0.11	0.06	0.07	0.00	0.02	0.09	0.07	0.15
(23)	LOSS	0.01	0.01	-0.07	-0.25	-0.09	0.24	0.07	0.02	0.38	0.39	0.39	-0.01	-0.06	-0.06	-0.02	-0.12
(24)	MKTSHR	0.01	0.03	-0.12	-0.03	-0.02	-0.09	0.03	0.03	-0.15	-0.16	-0.09	-0.01	0.19	0.09	0.05	0.26
(25)	MTB	-0.04	0.04	0.27	0.03	0.19	0.18	-0.24	-0.18	0.06	0.05	0.04	-0.04	0.02	0.04	-0.03	-0.02
(26)	MTR	-0.07	0.01	0.01	0.05	0.00	-0.19	-0.05	-0.02	-0.20	-0.19	-0.22	-0.06	0.00	0.04	-0.10	0.12
(27)	MVE	0.03	0.06	-0.03	0.10	0.09	-0.07	-0.06	0.00	-0.36	-0.43	-0.26	0.01	0.20	0.21	0.16	0.45
(28)	NOA	0.01	0.01	-0.03	0.05	-0.01	-0.03	-0.02	0.01	-0.04	-0.07	-0.06	0.00	-0.12	-0.01	-0.01	0.13
(29)	NOL	0.06	0.02	0.02	0.02	0.01	0.13	0.05	0.05	0.11	0.09	0.15	0.06	0.02	-0.02	0.10	-0.11
(30)	ROE	-0.02	-0.01	0.09	0.30	0.11	-0.14	-0.08	-0.03	-0.36	-0.37	-0.34	0.02	0.06	0.07	0.03	0.10
(31)	SDRET	-0.02	0.04	0.14	-0.06	0.15	0.27	-0.04	-0.03	0.62	0.62	0.37	-0.09	-0.11	-0.05	-0.13	-0.28
(32)	ZSCORE	-0.13	-0.01	0.27	0.06	0.10	0.13	-0.20	-0.15	0.01	0.02	-0.05	-0.01	0.03	-0.02	-0.09	-0.19

		(17)	(18)	(19)	(20)	(21)	(22)	(23)	(24)	(25)	(26)	(27)	(28)	(29)	(30)	(31)
(17)	CEODUAL	–														
(18)	CFO	-0.01	–													
(19)	CYCLE	0.03	-0.25	–												
(20)	INSTOWN	-0.05	0.18	-0.05	–											
(21)	LEV	0.04	-0.24	0.21	-0.11	–										
(22)	LITRISK	0.05	-0.07	0.08	0.03	0.19	–									
(23)	LOSS	-0.03	-0.38	-0.02	-0.10	0.24	0.13	–								
(24)	MKTSHR	0.10	0.02	-0.04	0.03	0.05	0.18	-0.06	–							
(25)	MTB	0.02	0.30	-0.09	0.04	-0.20	-0.01	-0.11	0.06	–						
(26)	MTR	0.07	0.19	0.09	-0.08	-0.09	-0.07	-0.38	0.04	0.07	–					
(27)	MVE	0.13	0.23	0.06	0.14	-0.16	0.36	-0.32	0.42	0.26	0.18	–				
(28)	NOA	-0.01	-0.17	0.30	-0.25	0.28	0.04	-0.01	-0.08	-0.09	0.05	0.14	–			
(29)	NOL	-0.05	-0.05	-0.10	0.16	0.00	0.05	0.15	0.05	-0.02	-0.64	-0.03	-0.09	–		
(30)	ROE	0.02	0.30	0.02	0.11	-0.40	-0.12	-0.64	0.04	0.09	0.27	0.31	0.04	-0.11	–	
(31)	SDRET	-0.01	-0.13	-0.06	-0.03	0.15	0.21	0.40	-0.14	0.01	-0.26	-0.37	-0.09	0.13	-0.39	–
(32)	ZSCORE	-0.05	0.37	-0.05	0.14	-0.32	-0.08	-0.24	-0.07	0.27	0.15	0.04	-0.26	-0.06	0.19	-0.01

Panel B: Restatement Sample

		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
(1)	GCANN	–										
(2)	SUED	-0.075	–									
(3)	DISMISS	0.169	–	–								
(4)	SETTLEMENT	-0.077	–	–	–							
(5)	BIG4	0.050	0.004	0.142	-0.306	–						
(6)	FPS	-0.121	0.031	-0.124	0.105	-0.073	–					
(7)	ISSUE	0.057	0.022	0.039	0.113	-0.048	-0.024	–				
(8)	MVE	0.003	0.164	0.173	0.377	0.236	-0.009	-0.061	–			
(9)	REVENUE	0.011	0.009	-0.132	0.001	0.039	0.058	-0.015	0.024	–		
(10)	ROE	-0.031	0.016	-0.118	0.069	0.087	0.011	-0.036	0.334	0.008	–	
(11)	SDRET	-0.001	0.026	0.008	-0.187	-0.064	0.138	0.108	-0.389	0.113	-0.377	–
(12)	TURN	-0.015	0.101	-0.084	-0.151	-0.054	0.215	0.124	0.003	0.048	-0.147	0.398

This table reports pairwise correlations for the dependent and independent variables. Panel A reports correlations for the full sample and Panel B reports correlations for the restatement sample. Variable descriptions are provided in Appendix A.

Table 4
Relation Between General Counsel and Earnings Management

	$DACC_t$	$REM1_t$	$REM2_t$
	(1)	(2)	(3)
GC_t	**0.008*** **	**0.017*** **	**0.025** **
	(0.001)	**(0.005)**	**(0.019)**
MVE_{t-1}	0.002**	0.009**	0.018***
	(0.037)	(0.019)	(0.002)
MTB_{t-1}	0.001***	-0.017***	-0.022***
	(0.002)	(0.000)	(0.000)
ROE_{t-1}	0.024***	-0.013	0.038
	(0.001)	(0.587)	(0.278)
LEV_{t-1}	-0.002	0.011***	0.009
	(0.280)	(0.001)	(0.131)
$MKTSH_{t-1}$	-0.155***	-0.055	-0.173
	(0.000)	(0.711)	(0.504)
$ZSCORE_{t-1}$	-0.001	-0.068***	-0.079***
	(0.563)	(0.000)	(0.000)
$INSTOWN_{t-1}$	-0.001	-0.007	0.039
	(0.923)	(0.676)	(0.227)
MTR_t	0.042***	-0.026	-0.029
	(0.000)	(0.247)	(0.437)
$BIG4_t$	-0.005	0.001	-0.003
	(0.391)	(0.956)	(0.923)
$AUDTEN_t$	0.002	0.009*	0.007
	(0.178)	(0.091)	(0.458)
NOA_t	0.005***	-0.013***	-0.006
	(0.003)	(0.000)	(0.286)
$CYCLE_t$	0.010***	-0.012**	-0.034***
	(0.000)	(0.030)	(0.001)
$CONS_t$	-0.075***	0.042	0.090
	(0.000)	(0.299)	(0.204)
Observations	26,274	26,274	26,274
Adjusted R2	0.049	0.090	0.062

This table reports the regression results of the relation between the presence of general counsel in top management and earnings management. All models include year fixed effects. P-values are reported in parentheses and are based on robust standard errors clustered by firm and year. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively. Variable definitions are provided in Appendix A.

Table 5
Relation Between General Counsel and Accrual vs. Real Earnings Management

Panel A: Percentage of Firms with Positive Earnings Management

	GC_t=0	GC_t=1	Difference	P-Value	Diff-in-Diff	P-Value
$DACC_t$>0	67.813	70.724	2.911	0.099		
$REM1_t$>0	50.692	60.965	10.273	0.000	7.363	0.002
$REM2_t$>0	56.307	63.694	7.387	0.000	4.476	0.065

Panel B: Earnings Management Tradeoff Binary Logit and Ordered Logit Specifications

	$DACC_t$>0	$REM1_t$>0	$REM2_t$>0	$REM1\_DACC_t$	$REM2\_DACC_t$
	(1)	(2)	(3)	(4)	(5)
GC_t	**0.068**	**0.263****	**0.167**	**0.183****	**0.085**
	(0.467)	**(0.014)**	**(0.120)**	**(0.027)**	**(0.308)**
MVE_{t-1}	0.024	0.079*	0.106**	0.052	0.069*
	(0.499)	(0.050)	(0.021)	(0.145)	(0.075)
MTB_{t-1}	0.007	-0.125***	-0.120***	-0.102***	-0.099***
	(0.709)	(0.000)	(0.000)	(0.000)	(0.000)
ROE_{t-1}	-0.266	-0.544	0.076	-0.113	0.337
	(0.474)	(0.352)	(0.873)	(0.800)	(0.373)
LEV_{t-1}	-0.137**	0.134	0.112	0.172**	0.146**
	(0.037)	(0.289)	(0.237)	(0.021)	(0.013)
$MKTSH_{t-1}$	-4.103**	-0.301	-1.725	1.392	0.394
	(0.013)	(0.888)	(0.404)	(0.461)	(0.832)
$ZSCORE_{t-1}$	-0.063	-0.694***	-0.639***	-0.581***	-0.474***
	(0.471)	(0.000)	(0.000)	(0.000)	(0.000)
$INSTOWN_{t-1}$	-0.145	0.672**	0.773***	0.608***	0.688***
	(0.588)	(0.033)	(0.009)	(0.007)	(0.002)
MTR_t	0.312	-0.268	-0.003	-0.405	-0.169
	(0.318)	(0.490)	(0.994)	(0.191)	(0.567)
$BIG4_t$	0.134	0.395*	0.183	0.311	0.117
	(0.467)	(0.076)	(0.448)	(0.102)	(0.562)
$AUDTEN_t$	0.063	-0.045	-0.075	-0.060	-0.076
	(0.182)	(0.488)	(0.215)	(0.279)	(0.118)
NOA_t	0.100*	-0.001	0.084	-0.033	0.019
	(0.088)	(0.983)	(0.153)	(0.441)	(0.660)
$CYCLE_t$	0.246***	-0.094	-0.209***	-0.162***	-0.255***
	(0.001)	(0.181)	(0.005)	(0.005)	(0.000)
$CONS_t$	-1.963***	-0.184	0.332		
	(0.000)	(0.711)	(0.495)		
Observations	3,380	3,380	3,380	3,380	3,380
Pseudo R2	0.0376	0.0790	0.0725	0.0425	0.0348

This table reports the earnings management behavior of firms that narrowly meet or beat at least one of three earnings thresholds: 1) Positive earnings, 2) Positive earnings growth, or 3) Analysts' consensus forecast. Narrowly meeting or beating is defined as greater than or equal to zero and less than or equal to 2*(IQR)*n-1/3. IQR is the interquartile range of the respective earnings threshold and n is the number of observations. Panel A reports the proportion of firm-years with positive values for the corresponding earnings management proxy. Panel B columns 1-3 report binary logit regression results and Panel B columns 4-5 report ordered logit regression results. All models in Panel B include year fixed effects. P-values are reported in parentheses and are based on robust standard errors clustered by firm and year. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively. Variable definitions are provided in Appendix A.

Table 6
Relation Between General Counsel and the Asymmetric Timeliness of Earnings

	ROE_t (1)		ROE_t (2)		ROE_t (3)	
	coefficient	p-value	coefficient	p-value	coefficient	p-value
D_t	0.005	(0.282)	0.003	(0.501)	-0.007	(0.707)
$MARET_t$	-0.053***	(0.007)	-0.049***	(0.007)	-0.117**	(0.015)
D_t*$MARET_t$	0.332***	(0.000)	0.310***	(0.000)	0.670***	(0.000)
GC_t			0.002	(0.517)	0.000	(0.957)
D_t*GC_t			0.007	(0.109)	0.005	(0.260)
$MARET_t$*GC_t			-0.013	(0.106)	-0.011	(0.185)
D_t*$MARET_t$*GC_t			**0.071*** **	**(0.000)**	**0.047*** **	**(0.001)**
MVE_{t-1}					0.009***	(0.000)
MTB_{t-1}					-0.003***	(0.003)
LEV_{t-1}					-0.014**	(0.012)
$LITRISK_{t-1}$					-0.278***	(0.003)
D_t*MVE_{t-1}					-0.001	(0.728)
D_t*MTB_{t-1}					0.002*	(0.100)
D_t*LEV_{t-1}					0.011*	(0.092)
D_t*$LITRISK_{t-1}$					0.154	(0.271)
$MARET_t$*MVE_{t-1}					0.016***	(0.007)
$MARET_t$*MTB_{t-1}					0.002	(0.503)
$MARET_t$*LEV_{t-1}					-0.005	(0.112)
$MARET_t$*$LITRISK_{t-1}$					-0.314***	(0.005)
D_t*$MARET_t$*MVE_{t-1}					-0.079***	(0.000)
D_t*$MARET_t$*MTB_{t-1}					-0.009*	(0.082)
D_t*$MARET_t$*LEV_{t-1}					0.104***	(0.000)
D_t*$MARET_t$*$LITRISK_{t-1}$					2.014***	(0.000)
$CONS_t$	0.084***	(0.000)	0.082***	(0.000)	0.039***	(0.000)
Observations	25,862		25,862		25,862	
Adjusted R2	0.114		0.115		0.246	

This table reports the regression results of the relation between the presence of general counsel in top management and the asymmetric timeliness of earnings. All models include year fixed effects. P-values are reported in parentheses and are based on robust standard errors clustered by firm and year. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively. Variable definitions are provided in Appendix A.

Table 7
Relation Between General Counsel and Detection Risk

	$AAER_t$	$AAER_t$	$AAER_t$	$AAER_t$
	(1)	(2)	(3)	(4)
GC_t	-0.195	0.004	-0.102	-0.006
	(0.335)	(0.986)	(0.603)	(0.974)
$DACC_t$		2.866***		
		(0.001)		
$DACC_t$*GC_t		**-5.626*** **		
		(0.001)		
$REM1_t$			1.960***	
			(0.000)	
$REM1_t$*GC_t			**-1.822** **	
			(0.038)	
$REM2_t$				1.331***
				(0.000)
$REM2_t$*GC_t				**-1.163***
				(0.060)
MVE_{t-1}	0.416***	0.418***	0.420***	0.410***
	(0.000)	(0.000)	(0.000)	(0.000)
MTB_{t-1}	0.031	0.030	0.055***	0.051***
	(0.105)	(0.120)	(0.005)	(0.006)
ROE_{t-1}	-0.622	-0.561	-0.495	-0.574
	(0.477)	(0.494)	(0.566)	(0.501)
LEV_{t-1}	0.237**	0.255**	0.220**	0.225**
	(0.020)	(0.013)	(0.037)	(0.029)
$ACIND_t$	0.014	0.013	-0.011	-0.014
	(0.953)	(0.956)	(0.961)	(0.951)
$BOARDSIZE_t$	-0.761	-0.724	-0.813	-0.760
	(0.258)	(0.272)	(0.236)	(0.273)
$BOARDIND_t$	-1.950***	-1.930***	-1.922***	-1.919***
	(0.005)	(0.006)	(0.006)	(0.006)
$CEODUAL_t$	0.091	0.094	0.092	0.106
	(0.746)	(0.733)	(0.734)	(0.698)
$CONS_t$	-5.164***	-5.340***	-5.271***	-5.380***
	(0.000)	(0.000)	(0.000)	(0.000)
Observations	13,617	13,617	13,617	13,617
Pseudo R2	0.106	0.114	0.122	0.125

This table reports the regression results of the relation between the presence of general counsel in top management and detection risk. All models include year fixed effects. P-values are reported in parentheses and are based on robust standard errors clustered by firm and year. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively. Variable definitions are provided in Appendix A.

Table 8
Relation Between General Counsel and the Severity of Penalties

Panel A: Restatement Announcement Returns

	$GCANN_t = 0$	$GCANN_t = 1$	Difference	P-Value
RET(-1,+1)	-1.320	-1.798	-0.478	0.331
RET(-2,+2)	-1.394	-2.051	-0.657	0.231
MARET(-1,+1)	-1.433	-1.806	-0.373	0.424
MARET(-2,+2)	-1.421	-2.038	-0.618	0.220
ABRET(-1,+1)	-1.495	-1.771	-0.275	0.549
ABRET(-2,+2)	-1.588	-2.140	-0.552	0.276

Panel B: Lawsuit Filings Following Restatement Announcements

	All Suits (1)	All Suits (2)	Excluding Pending Suits (3)	Dismissed Suits (4)	Settled Suits (5)
$GCANN_t$	-0.619***	-0.617***	-0.602**	-0.286	-0.884***
	(0.005)	(0.008)	(0.011)	(0.379)	(0.008)
MVE_{t-1}		0.459***	0.456***	0.618***	0.339***
		(0.000)	(0.000)	(0.000)	(0.000)
ROE_{t-1}		-0.426	-0.469	-0.805	0.069
		(0.322)	(0.275)	(0.114)	(0.922)
$BIG4_t$		-0.562	-0.625	0.285	-0.907**
		(0.175)	(0.132)	(0.785)	(0.045)
MARET(-2,+2)		-0.826	-0.940	0.023	-1.595
		(0.448)	(0.398)	(0.989)	(0.257)
FPS_t		0.037	-0.016	-0.201	0.114
		(0.860)	(0.941)	(0.544)	(0.672)
$ISSUE_{t-1}$		0.353*	0.356*	0.551*	0.245
		(0.089)	(0.093)	(0.078)	(0.372)
$REVENUE_t$		-0.028	-0.058	-0.441	0.152
		(0.906)	(0.816)	(0.282)	(0.617)
$TURN_{t-1}$		0.099**	0.092**	0.045	0.130**
		(0.022)	(0.039)	(0.484)	(0.022)
$SDRET_{t-1}$		2.395	2.253	4.205**	0.668
		(0.109)	(0.143)	(0.048)	(0.750)
$CONS_t$	-2.147***	-5.792***	-5.698***	-8.847***	-5.034***
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Observations	1,465	1,353	1,347	1,280	1,296
Pseudo R2	0.00999	0.0815	0.0780	0.107	0.0674

Panel C: Lawsuit Outcomes

	$GCANN_t = 0$	$GCANN_t = 1$	Difference	P-Value
DISMISS	37.500	57.143	19.643	0.067
SETTLEMENT	118.780	34.401	-84.379	0.546

This table reports the regression results of the relation between the presence of general counsel in top management and the severity of penalties. Panel A reports stock market returns surrounding the restatement announcement dates. Panel B estimates binary logit specifications indicating whether the firm was targeted by a class action lawsuit following the restatement announcement. P-values are reported in parentheses. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively. Panel C reports the outcomes from the lawsuits following the restatement announcements.

Table 9
Controlling for Industry Effects

Panel A: Earnings Management

	$DACC_t$	$REM1_t$	$REM2_t$	$DACC_t$	$REM1_t$	$REM2_t$
	(1)	(2)	(3)	(4)	(5)	(6)
GC_t	**0.002**	**0.017*****	**0.025*****			
	(0.323)	**(0.002)**	**(0.008)**			
$GCINDADJ_t$				**0.001**	**0.018*****	**0.027*****
				(0.426)	**(0.001)**	**(0.005)**
Observations	26,274	26,274	26,274	26,274	26,274	26,274
Adjusted R2	0.126	0.180	0.191	0.126	0.180	0.191

Panel B: Accrual vs. Real Earnings Management

	$DACC_t>0$	$REM1_t>0$	$REM2_t>0$	$REM1\_DACC_t$	$REM2\_DACC_t$
	(1)	(2)	(3)	(4)	(5)
GC_t	**-0.020**	**0.312*****	**0.218****	**0.241*****	**0.143***
	(0.825)	**(0.002)**	**(0.046)**	**(0.002)**	**(0.064)**
Observations	3,380	3,378	3,378	3,380	3,380
Pseudo R2	0.0963	0.150	0.155	0.0694	0.0631

	$DACC_t>0$	$REM1_t>0$	$REM2_t>0$	$REM1\_DACC_t$	$REM2\_DACC_t$
	(6)	(7)	(8)	(9)	(10)
$GCINDADJ_t$	**-0.004**	**0.322*****	**0.238****	**0.241*****	**0.149***
	(0.965)	**(0.002)**	**(0.031)**	**(0.003)**	**(0.067)**
Observations	3,380	3,378	3,378	3,380	3,380
Pseudo R2	0.0963	0.150	0.156	0.0693	0.0631

Panel C: Asymmetric Timeliness of Earnings

	ROE_t (1)	ROE_t (2)	ROE_t (3)	ROE_t (4)
GC_t	0.000	0.001		
	(0.971)	(0.503)		
D_t*GC_t	0.008*	0.005		
	(0.075)	(0.156)		
$MARET_t*GC_t$	-0.014*	-0.013		
	(0.081)	(0.122)		
$D_t*MARET_t*GC_t$	**0.071*** **	**0.051*** **		
	(0.000)	**(0.000)**		
$GCINDADJ_t$			-0.004*	-0.001
			(0.085)	(0.464)
$D_t*GCINDADJ_t$			0.011**	0.008*
			(0.050)	(0.069)
$MARET_t*GCINDADJ_t$			-0.003	-0.005
			(0.616)	(0.428)
$D_t*MARET_t*GCINDADJ_t$			**0.051****	**0.038*** **
			(0.020)	**(0.005)**
Observations	25,862	25,862	25,862	25,862
Adjusted R2	0.128	0.265	0.127	0.265

Panel D: Detection Risk

	$AAER_t$ (1)	$AAER_t$ (2)	$AAER_t$ (3)	$AAER_t$ (4)	$AAER_t$ (5)	$AAER_t$ (6)
GC_t	0.231	0.124	0.203			
	(0.256)	(0.560)	(0.358)			
$GCINDADJ_t$				0.269	0.166	0.260
				(0.186)	(0.426)	(0.232)
$DACC_t$	2.219***			0.943*		
	(0.001)			(0.085)		
$REM1_t$		1.245***			0.845**	
		(0.002)			(0.015)	
$REM2_t$			0.839***			0.583**
			(0.003)			(0.017)
$DACC_t*GC_t$	**-5.575*** **					
	(0.001)					
$REM1_t*GC_t$		**-1.809****				
		(0.014)				
$REM2_t*GC_t$			**-1.132****			
			(0.032)			
$DACC_t*GCINDADJ_t$				**-5.716*** **		
				(0.000)		
$REM1_t*GCINDADJ_t$					**-2.056*** **	
					(0.006)	
$REM2_t*GCINDADJ_t$						**-1.332****
						(0.013)
Observations	11,741	11,741	11,741	11,741	11,741	11,741
Pseudo R2	0.158	0.158	0.159	0.159	0.160	0.160

Panel E: Severity of Penalties

	All Suits	Excluding Pending Suits	Dismissed Suits	Settled Suits
	(1)	(2)	(3)	(4)
GC_t	**-0.602****	**-0.579****	**-0.178**	**-0.921*****
	(0.014)	**(0.020)**	**(0.604)**	**(0.009)**
Observations	1,200	1,194	988	1,100
Pseudo R2	0.111	0.107	0.134	0.103

	All Suits	Excluding Pending Suits	Dismissed Suits	Settled Suits
	(1)	(2)	(3)	(4)
$GCINDADJ_t$	**-0.594****	**-0.548****	**-0.175**	**-0.860****
	(0.016)	**(0.027)**	**(0.611)**	**(0.013)**
Observations	1,200	1,194	988	1,100
Pseudo R2	0.111	0.107	0.134	0.102

This table re-estimates the primary results after also controlling for industry effects. The models with the experimental variable *GC* utilize the corresponding specification from the main table and also include industry fixed effects based on the Fama-French 48 industry classifications. The models with the experimental variable *GCINDADJ* utilize the corresponding specification from the main table, but use *GCINDADJ* in place of *GC*. All models include the corresponding control variables, which are not reported for brevity. P-values are reported in parentheses. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively. Variable definitions are provided in Appendix A.

Table 10
Propensity Matching Procedure

Panel A: First Stage Estimation

	GC_t		
	coefficient	p-value	t-stat
AT_{t-1}	-0.009	(0.438)	-0.776
ΔREV_{t-1}	-0.423***	(0.000)	-6.154
$MARET_{t-1}$	0.009	(0.779)	0.280
$SKEWRET_{t-1}$	-0.042*	(0.072)	-1.800
$SDRET_{t-1}$	0.710**	(0.012)	2.501
$TURN_{t-1}$	0.001	(0.882)	0.148
$FIRMAGE_t$	0.058*	(0.055)	1.922
$GINDEX_{t-1}$	-2.157***	(0.000)	-11.604
$GDUM_{t-1}$	-1.059***	(0.000)	-8.996
$INSIDEOWN_{t-1}$	-1.418***	(0.000)	-5.827
$INSTOWN_{t-1}$	0.507***	(0.000)	6.958
$CEOTURN_{t-1}$	0.178***	(0.000)	3.910
CRO_t	0.460***	(0.010)	2.593
$HISTSUIT_{t-1}$	0.210***	(0.000)	5.308
$CONS_t$	0.093	(0.786)	0.271
Observations		23,427	
Pseudo R2		0.0629	

Panel B: Earnings Management

	$DACC_t$	$REM1_t$	$REM2_t$
	(1)	(2)	(3)
GC_t	**-0.001**	**0.020*** **	**0.033*** **
	(0.698)	**(0.005)**	**(0.005)**
Observations	11,494	11,494	11,494
Adjusted R2	0.036	0.080	0.054

Panel C: Accrual vs. Real Earnings Management

	$DACC_t>0$	$REM1_t>0$	$REM2_t>0$	$REM1\_DACC_t$	$REM2\_DACC_t$
	(1)	(2)	(3)	(4)	(5)
GC_t	**-0.048**	**0.324** **	**0.214**	**0.267***	**0.173**
	(0.708)	**(0.038)**	**(0.288)**	**(0.052)**	**(0.290)**
Observations	1,368	1,368	1,368	1,368	1,368
Pseudo R2	0.0472	0.0807	0.0739	0.0495	0.0405

Panel D: Asymmetric Timeliness of Earnings

	ROE_t	ROE_t
	(1)	(2)
GC_t	-0.004	-0.001
	(0.234)	(0.716)
D_t*GC_t	0.006	0.003
	(0.382)	(0.576)
$MARET_t*GC_t$	-0.008*	-0.009
	(0.094)	(0.175)
$D_t*MARET_t*GC_t$	**0.047**	**0.038**
	(0.217)	**(0.175)**
Observations	14,476	14,476
Adjusted R2	0.117	0.262

Panel E: Detection Risk

	$AAER_t$	$AAER_t$	$AAER_t$	$AAER_t$
	(1)	(2)	(3)	(4)
GC_t	-0.054	0.228	0.197	0.269
	(0.830)	(0.512)	(0.491)	(0.375)
$DACC_t$		3.655**		
		(0.021)		
$DACC_t$*GC_t		**-5.522****		
		(0.014)		
$REM1_t$			2.892***	
			(0.000)	
$REM1_t$*GC_t			**-2.491****	
			(0.033)	
$REM2_t$				1.791***
				(0.002)
$REM2_t$*GC_t				**-1.405***
				(0.072)
Observations	5,784	5,784	5,784	5,784
Pseudo R2	0.0825	0.0909	0.106	0.106

Panel F: Severity of Penalties

	All Suits	Dismissed Suits	Settled Suits
	(1)	(3)	(4)
GC_t	**-0.595****	**-0.460**	**-0.707***
	(0.038)	**(0.265)**	**(0.080)**
Observations	802	769	771
Pseudo R2	0.110	0.236	0.0975

This reports the results of the propensity matching procedure. Panel A reports the first-stage prediction model that estimates the likelihood of having a general counsel on the top management team. Panels B-F report the second stage results on the corresponding matched sample. All models include the corresponding control variables, which are not reported for brevity. P-values are reported in parentheses. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively. Variable definitions are provided in Appendix A.

Table 11
Relation Between General Counsel and Corporate Risk

	$SDRETD_{t+1}$	$SDRETD\_ID_{t+1}$	$SDROA_{t+1,t+4}$	$CAPEX_{t+1}$	RD_{t+1}
	(1)	(2)	(3)	(4)	(5)
GC_t	-0.124***	-0.109***	0.013	-0.029***	-0.009***
	(0.001)	(0.000)	(0.893)	(0.000)	(0.001)
MVE_t	-0.326***	-0.351***	-0.533***	-0.022***	-0.006***
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
MTB_t	0.069***	0.064***	0.170***	0.014***	0.008***
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
CFO_t	-1.407***	-1.242***	-6.134***	0.311***	-0.271***
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
LEV_t	0.151***	0.139***	-0.119**	-0.016***	-0.015***
	(0.001)	(0.001)	(0.015)	(0.000)	(0.000)
NOL_t	0.287***	0.266***	0.968***	0.019***	0.027***
	(0.000)	(0.000)	(0.000)	(0.001)	(0.000)
$MARET_t$	0.162	0.101	-0.187	0.096***	0.005
	(0.243)	(0.337)	(0.535)	(0.000)	(0.538)
$CONS_t$	4.182***	4.308***	5.798***	0.308***	0.084***
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Observations	24,991	24,991	24,991	24,991	24,991
Adjusted R2	0.445	0.448	0.114	0.165	0.132

This table reports the regression results of the relation between the presence of general counsel in top management and corporate risk. All models include year fixed effects. P-values are reported in parentheses and are based on robust standard errors clustered by firm and year. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively. Variable definitions are provided in Appendix A.

Table 12
Stock Market Reaction to General Counsel Appointments to Top Management

	$MARET_t$	$MARET_t$
	(1)	(2)
$GCAPPT_t$	0.031***	0.052**
	(0.008)	(0.014)
ROE_t	0.338*	0.359
	(0.052)	(0.131)
MVE_{t-1}	-0.030**	-0.048**
	(0.016)	(0.020)
MTB_{t-1}	-0.001	0.003
	(0.724)	(0.611)
$LOSS_t$	-0.115**	-0.067
	(0.021)	(0.282)
$SDRET_{t-1}$	1.035**	0.844
	(0.013)	(0.119)
$MARET_{t-1}$	-0.103**	-0.103**
	(0.025)	(0.040)
$CONS_t$	0.157	0.278
	(0.239)	(0.180)
Observations	3,292	1,472
Adjusted R2	0.049	0.041

This table reports the regression results of the stock market reaction to general counsel appointments to top management. P-values are reported in parentheses and are based on robust standard errors clustered by firm and year in model 1 and by year in model 2. ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively. Variable definitions are provided in Appendix A.

References

Altman, E. I. (1968). Financial ratios, discriminant analysis and the prediction of corporate bankruptcy. *The Journal of Finance*, 23(4), 589-609.

Altman, E. I. (2000). Predicting financial distress of companies: Revisiting the Z-score and ZETA models. *Working Paper*.

Armstrong, C., Jagolinzer, A. D., & Larcker, D. F. (2010). Performance-based incentives for internal monitors. *Working Paper*.

Badertscher, B. A. (2011). Overvaluation and the choice of alternative earnings management mechanisms. *The Accounting Review*, 86(5), 1491-1518.

Badolato, P. G., Donelson, D. C., & Ege, M. (2014). Audit committee financial expertise and earnings management: The role of status. *Journal of Accounting and Economics*, 58(2), 208-230.

Baginski, S. P., Hassell, J. M., & Kimbrough, M. D. (2002). The effect of legal environment on voluntary disclosure: Evidence from management earnings forecasts issued in U.S. and Canadian markets. *The Accounting Review*, 77(1), 25-50.

Bagley, C. E. (2008). Winning legally: The value of legal astuteness. *Academy of Management Review*, 33(2), 378-390.

Ball, R., Kothari, S. P., & Robin, A. (2000). The effect of international institutional factors on properties of accounting earnings. *Journal of Accounting and Economics*, 29(1), 1-51.

Bartov, E., D. Givoly, and C. Hayn. (2002). The rewards to meeting or beating earnings expectations. *Journal of Accounting and Economics*, 33(2), 173–204.

Basu, S. (1997). The conservatism principle and the asymmetric timeliness of earnings. *Journal of Accounting and Economics*, 24(1), 3-37.

Beatty, R. P. (1993). The economic determinants of auditor compensation in the initial public offerings market. *Journal of Accounting Research*, 294-302.

Beneish, M. D. (1999). Incentives and penalties related to earnings overstatements that violate GAAP. *The Accounting Review*, 74(4), 425-457.

Beneish, M. D., Press, E., & Vargus, M. E. (2012). Insider trading and earnings management in distressed firms. *Contemporary Accounting Research*, 29(1), 191-220.

Bergstresser, D., & Philippon, T. (2006). CEO incentives and earnings management. *Journal of Financial Economics*, 80(3), 511-529.

Bliss, J. H. (1924). Management through accounts. Ronald Press Company.

Bova, F., Kolev, K. S., Thomas, J. K., & Zhang, F. (2015). Non-executive employee ownership and corporate risk. *The Accounting Review*, 90(1), 115-145.

Brown, L., & Caylor, M. (2005). A temporal analysis of thresholds: Propensities and valuation consequences. *The Accounting Review*, 2, 423-440.

Burgstahler, D., & Dichev, I. (1997). Earnings management to avoid earnings decreases and losses. *Journal of Accounting and Economics*, 24, 99-126.

Casey, L. L. (2010). Twenty-eight words: Enforcing corporate fiduciary duties through criminal prosecution of honest services fraud. *Delaware Journal of Corporate Law*, 35, 1-96.

Chayes, A., & Chayes, A. H. (1985). Corporate counsel and the elite law firm. *Stanford Law Review*, 37(2), 277-300.

Cheng, Q., & Warfield, T. D. (2005). Equity incentives and earnings management. *The Accounting Review*, 80(2), 441-476.

Choudhary, P., Schloetzer, J. D., & Sturgess, J. D. (2013a). Boards, auditors, attorneys and compliance with mandatory SEC disclosure rules. *Managerial and Decision Economics*, 34(7-8), 471-487.

Choudhary, P., Schloetzer, J. D., & Sturgess, J. D. (2013b). Top-tier corporate attorneys and firms' compliance with mandatory SEC disclosure rules. *Working Paper*.

Coffee, J. C. (2003). Attorney as gatekeeper: An agenda for the SEC. *The Columbia Law Review*, 103, 1293-1316.

Cohen, D. A., Dey, A., & Lys, T. Z. (2008). Real and accrual-based earnings management in the pre-and post-Sarbanes-Oxley periods. *The Accounting Review*, 83(3), 757-787.

Cohen, D. A., & Zarowin, P. (2010). Accrual-based and real earnings management activities around seasoned equity offerings. *Journal of Accounting and Economics*, 50(1), 2-19.

Core, J. E. (1997). On the corporate demand for directors' and officers' insurance. *Journal of Risk and Insurance*, 64(1), 63-87.

Core, J. E. (2000). The directors' and officers' insurance premium: An outside assessment of the quality of corporate governance. *Journal of Law, Economics, and Organization*, 16(2), 449-477.

Dechow, P. M., Sloan, R. G., & Sweeney, A. P. (1995). Detecting earnings management. *The Accounting Review*, 70(2), 193-225.

Dechow, P. M., Sloan, R. G., & Sweeney, A. P. (1996). Causes and consequences of earnings manipulation: An analysis of firms subject to enforcement actions by the SEC. *Contemporary Accounting Research*, 13(1), 1-36.

Dechow, P., Ge, W., & Schrand, C. (2010). Understanding earnings quality: A review of the proxies, their determinants and their consequences. *Journal of Accounting and Economics*, 50(2), 344-401.

Dechow, P. M., Ge, W., Larson, C. R., & Sloan, R. G. (2011). Predicting material accounting misstatements. *Contemporary Accounting Research*, 28(1), 17-82.

Degeorge, F., Patel, J., & Zeckhauser, R. (1999). Earnings management to exceed thresholds. *Journal of Business*, 72(1), 1-33.

DeMott, D. A. (2005). Discrete roles of general counsel. *The Fordham Law Review*, 74, 955-981.

Desai, H., Hogan, C. E., & Wilkins, M. S. (2006). The reputational penalty for aggressive accounting: Earnings restatements and management turnover. *The Accounting Review*, 81(1), 83-112.

Donelson, D. C., McInnis, J. M., & Mergenthaler, R. D. (2012a). Rules-based accounting standards and litigation. *The Accounting Review*, 87(4), 1247-1279.

Donelson, D. C., McInnis, J. M., Mergenthaler, R. D., & Yu, Y. (2012b). The timeliness of bad earnings news and litigation risk. *The Accounting Review*, 87(6), 1967-1991.

DuCharme, L. L., Malatesta, P. H., & Sefcik, S. E. (2004). Earnings management, stock issues, and shareholder lawsuits. *Journal of Financial Economics*, 71(1), 27-49.

Duggin, S. H. (2006). The pivotal role of the general counsel in promoting corporate integrity and professional responsibility. *Saint Louis University Law Journal*, 51, 989-1042.

Fama, E. F., & French, K. R. (1997). Industry costs of equity. *Journal of Financial Economics*, 43(2), 153-193.

Fischel, D. R. (1998). Lawyers and confidentiality. *The University of Chicago Law Review*, 65(1), 1-33.

Francis, J., Philbrick, D., & Schipper, K. (1994). Shareholder litigation and corporate disclosures. *Journal of Accounting Research*, 32(2), 137-164.

Goh, B. W., Lee, J., & Ng, J. (2014). The composition of top management with general counsel and tax avoidance. *Working Paper*.

Gompers, P., Ishii, J., & Metrick, A. (2003). Corporate governance and equity prices. *The Quarterly Journal of Economics*, 118(1), 107-155.

Graham, J. R., Harvey, C. R., & Rajgopal, S. (2005). The economic implications of corporate financial reporting. *Journal of Accounting and Economics*, 40, 3-73.

Graham, J. R., & Mills, L. F. (2008). Using tax return data to simulate corporate marginal tax rates. *Journal of Accounting and Economics*, 46(2), 366-388.

Greene, W. H. (1993). Econometric Analysis. Prentice Hall. Upper Saddle River, NJ.

Gunny, K. A. (2010). The relation between earnings management using real activities manipulation and future performance: Evidence from meeting earnings benchmarks. *Contemporary Accounting Research*, 27(3), 855-888.

Hamdani, A. (2003). Gatekeeper liability. *Southern California Law Review*, 77, 53-122.

Healy, P. M., & Palepu, K. G. (2001). Information asymmetry, corporate disclosure, and the capital markets: A review of the empirical disclosure literature. *Journal of Accounting and Economics*, 31(1), 405-440.

Healy, P. M., & Wahlen, J. M. (1999). A review of the earnings management literature and its implications for standard setting. *Accounting Horizons*, 13(4), 365-383.

Heineman Jr., B. W. (2010). The general counsel as lawyer-statesman. *Harvard Law School Program on the Legal Profession Blue Paper*.

Heineman Jr., B. W. (September 27, 2012). The rise of the general counsel. Retrieved from
http://blogs.hbr.org

Hennes, K. M., Leone, A. J., & Miller, B. P. (2008). The importance of distinguishing errors from irregularities in restatement research: The case of restatements and CEO/CFO turnover. *The Accounting Review*, 83(6), 1487-1519.

Hogan & Hartson, LLP (March 11, 2005). SEC update: SEC enforcement actions target internal counsel. Retrieved from http://m.hoganlovells.com

Hopkins, J., Maydew, E., & Venkatachalam, M. (2015). Corporate general counsel and financial reporting quality. *Management Science*, 61(1), 129-145.

Huijgen, C., & Lubberink, M. (2005). Earnings conservatism, litigation and contracting: The case of cross-listed firms. *Journal of Business Finance and Accounting*, 32, 1275-1309.

Jagolinzer, A. D., Larcker, D. F., & Taylor, D. J. (2011). Corporate governance and the information content of insider trades. *Journal of Accounting Research*, 49(5), 1249-1274.

Jiang, J., Petroni, K. R., & Wang, I. Y. (2010). CFOs and CEOs: Who have the most influence on earnings management? *Journal of Financial Economics*, 96(3), 513-526.

Johnson, M. F., Kasznik, R., & Nelson, K. K. (2001). The impact of securities litigation reform on the disclosure of forward-looking information by high technology firms. *Journal of Accounting Research*, 39(2), 297-327.

Jones, J. J. (1991). Earnings management during import relief investigations. *Journal of Accounting Research*, 29(2), 193-228.

Jones, K. L., Krishnan, G. V., & Melendrez, K. D. (2008). Do models of discretionary accruals detect actual cases of fraudulent and restated earnings? An empirical analysis. *Contemporary Accounting Research*, 25(2), 499-531.

Kasznik, R., & McNichols, M. F. (2002). Does meeting earnings expectations matter? Evidence from analyst forecast revisions and share prices. *Journal of Accounting Research*, 40(3), 727-759.

Kim, I., & Skinner, D. J. (2012). Measuring securities litigation risk. *Journal of Accounting and Economics*, 53(1), 290-310.

Kim, S. H. (2010). Lawyer exceptionalism in the gatekeeping wars. *SMU Law Review*, 63, 73-136.

Krishnan, J., Wen, Y., & Zhao, W. (2011). Legal expertise on corporate audit committees and financial reporting quality. *The Accounting Review*, 86(6), 2099-2130.

Kwak, B., Ro, B. T., & Suk, I. (2012). The composition of top management with general counsel and voluntary information disclosure. *Journal of Accounting and Economics*, 54(1), 19-41.

Laux, V., & Stocken, P. C. (2012). Managerial reporting, overoptimism, and litigation risk. *Journal of Accounting and Economics*, 53(3), 577-591.

Lev, B., Ryan, S. G., & Wu, M. (2008). Rewriting earnings history. *Review of Accounting Studies*, 13(4), 419-451.

Levitt, A. (September 28, 1998). The numbers game. Remarks delivered at the NYU Center for Law and Business, New York, NY.

Lewis, C. M. (December 13, 2012). Remarks delivered at the Financial Executives International Committee on Finance and Information Technology.

Liggio Sr., C. D. (1997). The changing role of corporate counsel. *Emory Law Journal*, 46, 1201-1222.

Liggio Sr., C. D. (2002). Look at the role of corporate counsel: Back to the future–or is it the past? *Arizona Law Review*, 44, 621-635.

Lopez, T. J., & Rees, L. (2002). The effect of meeting analyst forecasts and systematic positive forecast errors on the information content of unexpected earnings. *Journal of Accounting, Auditing and Finance*, 17(2), 155-184.

Lowenfels, L. D., Bromberg, A. R., & Sullivan, M. J. (2006). Attorneys as gatekeepers: SEC actions against lawyers in the age of Sarbanes-Oxley. *University of Toledo Law Review*, 37, 877-930.

Nelson, R. L., & Nielsen, L. B. (2000). Cops, counsel, and entrepreneurs: Constructing the role of inside counsel in large corporations. *Law and Society Review*, 34(2), 457-494.

Palmrose, Z. V., Richardson, V. J., & Scholz, S. (2004). Determinants of market reactions to restatement announcements. Journal of Accounting and Economics, 37(1), 59-89.

Palmrose, Z. V., & Scholz, S. (2004). The circumstances and legal consequences of non-gaap reporting: Evidence from restatements. *Contemporary Accounting Research*, 21(1), 139-180.

Parker, C. E., Rosen, R. E., & Nielsen, V. L. (2009). The two faces of lawyers: Professional ethics and business compliance with regulation. *The Georgetown Journal of Legal Ethics*, 22, 201-248.

Qiang, X. (2007). The effects of contracting, litigation, regulation, and tax costs on conditional and unconditional conservatism: Cross-sectional evidence at the firm level. *The Accounting Review*, 82(3), 759-796.

Rogers, J. L., & Stocken, P. C. (2005). Credibility of management forecasts. *The Accounting Review*, 80(4), 1233-1260.

Rogers, J. L., & Van Buskirk, A. (2009). Shareholder litigation and changes in disclosure behavior. *Journal of Accounting and Economics*, 47(1), 136-156.

Rogers, J. L., Van Buskirk, A., & Zechman, S. L. (2011). Disclosure tone and shareholder litigation. *The Accounting Review*, 86(6), 2155-2183.

Roychowdhury, S. (2006). Earnings management through real activities manipulation. *Journal of Accounting and Economics*, 42(3), 335-370.

Sauter, M. B., Allen, A. C., & Poltrack, A. H. (May 17, 2012). Top ten CEOs sent to prison. Retrieved from http://247wallst.com

Schipper, K. (1989). Commentary on earnings management. *Accounting Horizons*, 3(4), 91-102.

Schwarcz, S. L. (2006). Financial information failure and lawyer responsibility. *Journal of Corporation Law*, 31(4), 1097-1123.

Skinner, D. J. (1994). Why firms voluntarily disclose bad news. *Journal of Accounting Research*, 32, 38-38.

Skinner, D. J. (1997). Earnings disclosures and stockholder lawsuits. *Journal of Accounting and Economics*, 23(3), 249-282.

Skinner, D. J., & Sloan, R. (2002). Earnings surprises, growth expectations and stock returns or don't let an earnings torpedo sink your portfolio. *Review of Accounting Studies*, 7(2-3), 289-312.

Spangler, E. (1986). Lawyers for hire: Salaried professionals at work. New Haven, CT: Yale University Press.

Srinivasan, S. (2005). Consequences of financial reporting failure for outside directors: Evidence from accounting restatements and audit committee members. *Journal of Accounting Research*, 43(2), 291-334.

Sullivan & Cromwell LLP (December 18, 2002). Letter to Jonathan G. Katz, Secretary, Securities and Exchange Commission, Re: Proposed Rules Relating to Implementation of Standards of Professional Conduct for Attorneys (File No. S7-45-02).

Taylor, M. H., & Simon, D. T. (1999). Determinants of audit fees: The importance of litigation, disclosure, and regulatory burdens in audit engagements in 20 countries. *The International Journal of Accounting*, 34(3), 375-388.

Tucker, J. W. (2010). Selection bias and econometric remedies in accounting and finance research. *Journal of Accounting Literature*, 29, 31-57.

United States Congress. (July 30, 2002). The Public Company Accounting Reform and Investor Protection Act of 2002 (The Sarbanes-Oxley Act). Public Law No. 107-204, 116 Statute 745. Washington, D.C.: Government Printing Office.

Venkataraman, R., Weber, J. P., & Willenborg, M. (2008). Litigation risk, audit quality, and audit fees: Evidence from initial public offerings. *The Accounting Review*, 83(5), 1315-1345.

Watts, R. L. (2003). Conservatism in accounting part I: Explanations and implications. *Accounting Horizons*, 17(3), 207-221.

Zang, A. Y. (2012). Evidence on the trade-off between real activities manipulation and accrual-based earnings management. *The Accounting Review*, 87(2), 675-703.