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Nava Cohen Zerah

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**DOES CORPORATE PHILANTHROPY MATTER IN
CORPORATE REPORTING? EVIDENCE FROM FIRMS' TAX
STRATEGIES, DISCLOSURES AND AUDIT OUTCOMES**

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in partial fulfillment of the requirements for the degree of

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*Nava Cohen
Paris, April 25th 2018*

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Abstract

This dissertation consists of three stand-alone papers that investigate three consequences of corporate philanthropy, namely: (1) firms' tax strategies, (2) firms' reporting with regard to corporate philanthropy, and (3) the perceptions of firms' financial reporting quality by an important gatekeeper: the auditor.

The first chapter examines whether firms' choices of prosocial activities reflect apparent consistency by studying the relation between corporate philanthropy and tax avoidance, and whether investors reward this consistency. I investigate two forms of tax strategies that differ in their degree of transparency: nonconforming tax avoidance (or tax aggressiveness) and conforming tax avoidance (Badertscher, et al., 2017). I find that corporate philanthropy is negatively related to nonconforming tax avoidance and positively related to conforming tax avoidance. This evidence suggests that philanthropic firms want to avoid paying taxes but do not want to be perceived as "tax avoiders" in order to display a consistent behavior. Next, I present evidence that the market value of inconsistent firms, i.e., those engaging simultaneously in corporate philanthropy and tax avoidance, is lower. Investors view firms' inconsistency between corporate philanthropy and tax avoidance as a costly strategy that reduces firm value. Overall, the first chapter provides evidence on the tax implications of corporate philanthropy.

The second chapter examines firm specific consequences of a regulatory event - the Companies Act 2006 - which represents a regime shift from mandatory to voluntary disclosure on corporate philanthropy (i.e., amounts and purposes of charitable donations) that affected UK firms in 2013. This chapter investigates whether and how the regulatory shift had an effect on corporate disclosure level and levels of CCDs. I assess the quality of the disclosure on corporate philanthropy by extracting scores from UK firms' annual reports using a disclosure index that I developed. I find that firms disclose less information on their

CCDs and decrease their levels of CCDs following the mandatory-to-voluntary disclosure shift. This result indicates that firms do not credibly commit to their CSR-related disclosure, even though they were already initiated to the disclosure of their donations under the mandatory disclosure regime. Moreover, the disclosure shift has implications for the nonprofit sector that could be damaged through the reduction of firms' donations. Overall, the second chapter provides evidence on the social reporting implications of corporate philanthropy.

The third chapter of my dissertation analyzes overlaps between auditors and clients' CCDs to the same nonprofit organizations. Firms, including the audit firms invest significantly in CCDs through direct giving or corporate foundations. This chapter examines the association between audit fees and audit quality (i.e., restatements and discretionary accruals) and overlaps in CCDs between auditors and clients. I posit that overlaps of auditors' and clients' donations capture social capital at the firm-level in an audit setting. In an exploratory analysis of the determinants of these overlaps, I find that firms with a corporate charitable foundation, a higher firm value or a bigger board size are more likely to overlap their CCDs. My main findings document that when clients and their audit firms make CCDs to the same nonprofits, audit fees and audit quality are higher. This suggests that (1) auditors exert more efforts and exercise their professional care in the performance of the audit with clients who share the same charitable values in order to protect their networks, and (2) charitable alignment between audit- and client-firms imply an effective communication, critical to the audit quality. Overall, the third chapter provides evidence on the financial reporting implications of corporate philanthropy.

Résumé

Cette thèse est composée de trois chapitres qui analysent trois effets de la philanthropie d'entreprise: (1) les stratégies fiscales des entreprises, (2) la divulgation des entreprises en matière de philanthropie d'entreprise et (3) la perception des auditeurs de l'information financière des entreprises. Le premier chapitre examine la cohérence des décisions des entreprises en ce qui concerne deux activités: la philanthropie d'entreprise et les stratégies d'évitement fiscal. Cette première étude examine ainsi la cohérence des entreprises en ce qui concerne leurs décisions philanthropiques et leurs différentes stratégies fiscales. J'étudie en particulier deux formes de stratégie d'évitement fiscal qui diffèrent dans leur degré de visibilité: une stratégie non conforme dite « agressive » et une stratégie conforme. Mes résultats démontrent que les entreprises qui s'engagent dans la philanthropie se comportent de manière cohérente dans leurs stratégies fiscales. De plus, je mets en relief le fait que les entreprises qui s'engagent dans la philanthropie sont susceptibles d'utiliser une politique d'évitement fiscal « conforme » plutôt qu'une politique « agressive » qui est plus visible. Ce résultat suggère ainsi que les entreprises philanthropiques sont certes intéressées par des réductions fiscales mais ne veulent pas être perçus comme tels afin d'afficher un comportement cohérent, essentiel au maintien de leur réputation. La deuxième partie de cette étude analyse la valorisation des entreprises au comportement incohérent, c'est-à-dire celles qui s'engagent à la fois dans la philanthropie d'entreprise et dans une politique d'évitement fiscal « agressive ». Je trouve que l'incohérence du comportement social des entreprises réduit la valeur de l'entreprise. Le deuxième chapitre de cette thèse examine les conséquences d'un événement réglementaire au Royaume-Uni – le Companies Act 2006 - qui représente le passage d'un régime obligatoire à un régime volontaire concernant la divulgation de la philanthropie d'entreprise (montants et objectifs des dons de bienfaisance). Ce chapitre examine l'impact du changement réglementaire sur le niveau de divulgation des sociétés et le

montant de leurs dons. J'évalue la qualité de l'information sur la philanthropie d'entreprise en extrayant des notes des rapports annuels des entreprises à l'aide d'un indice de divulgation que j'ai développé dans le cadre de cette étude. Mes résultats montrent que les entreprises divulguent moins d'informations sur leurs dons et diminuent les montants de leurs dons à la suite du changement réglementaire. Ce résultat suggère que les entreprises ne s'engagent pas de façon crédible sur la communication de leur philanthropie, malgré y avoir été initiées dans le cadre du régime de divulgation obligatoire. En outre, le changement de régime de divulgation affecte le secteur sans but lucratif qui pourrait souffrir d'une réduction des dons des entreprises. Le dernier chapitre de cette thèse analyse les dons d'entreprise communs aux cabinets d'audit et à leurs clients, c'est à dire, les dons faits aux mêmes organismes de charité. Les entreprises, y compris les cabinets d'audit, versent des dons de manière significative de manière directe ou via leurs fondations d'entreprise. Cette étude part du postulat que les dons communs aux cabinets d'audit et à leurs clients permettent de saisir la notion de capital social des entreprises. Mes principales analyses indiquent que lorsque les clients et leurs cabinets d'audit font des dons aux mêmes organismes de charité, les honoraires et la qualité d'audit sont plus élevés. Les auditeurs font plus d'efforts et exercent leur professionnalisme dans l'exécution de l'audit des clients qui partagent les mêmes valeurs et soutiennent les mêmes causes afin notamment de protéger leurs réseaux. En outre, les dons communs entre cabinets d'audit et clients impliquent une communication efficace, essentielle à la qualité de l'audit.

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LIST OF ABBREVIATIONS

ACR	Companies Act Regulations
CCD	Corporate Charitable Donation
CP	Corporate Philanthropy
CSR	Corporate Social Responsibility

Résumé Substantial en Français

Cette thèse s'inscrit dans les champs de la responsabilité sociale des entreprises (RSE) et de la comptabilité financière, et explore l'effet de la philanthropie d'entreprise sur le reporting d'entreprise. Cette thèse s'appuie sur trois articles indépendants qui explorent trois conséquences sur le reporting d'entreprise. Les conséquences examinées dans cette thèse concernent : (1) les stratégies fiscales, (2) les informations sociales de l'entreprise et (3) la perception de la qualité de l'information financière des entreprises par les auditeurs.

Cette thèse propose trois articles qui traitent de la question de recherche générale suivante : La philanthropie d'entreprise est-elle importante pour le reporting d'entreprise ?

Le premier article étudie la cohérence entre la philanthropie d'entreprise et les stratégies fiscales des entreprises. Les entreprises engagées dans la philanthropie choisissent leurs stratégies d'évitement fiscal de manière à paraître cohérentes avec leur politique prosociale.

Le second article explore la divulgation de la philanthropie d'entreprises après un changement réglementaire de divulgation. On passe d'un régime obligatoire à un régime volontaire. Ce document explore différents niveaux de divulgation concernant la philanthropie d'entreprise dans les rapports annuels avant et après le changement réglementaire.

Le troisième article étudie la philanthropie d'entreprise lorsque les auditeurs et les clients donnent des dons de bienfaisance aux mêmes organismes sans but lucratif et analyse comment ces dons communs affectent la perception de la qualité de l'information financière par les auditeurs. Plus précisément, cet article analyse l'influence de l'alignement des donations des auditeurs et de leurs clients sur deux résultats d'audit majeurs : les honoraires et la qualité de l'audit. La qualité de l'audit et les honoraires d'audit reflètent l'évaluation par les auditeurs de l'information financière des entreprises et leur perception du risque.

Cette thèse se concentre sur la philanthropie d'entreprise qui représente un type spécifique de dépenses caractérisées par une grande discrétion managériale et une grande asymétrie d'information. Selon le Financial Accounting Standards Board (FASB, 1993), la philanthropie d'entreprise se définit comme un « transfert inconditionnel de liquidités ou d'autres actifs à une entité par un transfert volontaire non réciproque par une autre entité agissant autrement que comme propriétaire ».

Bien que les dons représentent une part négligeable des bénéfices des entreprises avant impôts, la philanthropie d'entreprise représente des dépenses importantes à analyser et théoriquement attrayantes. Les dons offrent plusieurs caractéristiques uniques, développées ci-dessous.

Même si la pratique de la philanthropie d'entreprise est actuellement répandue, le débat sur sa légitimité se poursuit. Les lois sur l'impôt des sociétés comprennent des propositions visant à renforcer les incitations fiscales pour les dons de bienfaisance, dans l'objectif d'encourager la philanthropie. Les dons, en augmentant le bien-être social, deviennent alors une dépense légitime (Lev et al., 2010). Cependant, d'autres lois (par exemple, les premières versions de la loi Sarbanes-Oxley de 2002 et une proposition du Comité des finances du Sénat américain en 2004) ont demandé de placer des contrôles sur la philanthropie d'entreprise, qui est perçue comme préjudiciable aux actionnaires. En effet, les dons peuvent être difficiles à observer et donc à évaluer et surveiller (Himmelberg et al., 1999). Les points de vue contradictoires sur la légitimité de la philanthropie d'entreprise démontrent la nécessité d'une compréhension approfondie de ses conséquences.

Les dons de bienfaisance peuvent être considérés comme négligeables du point de vue des entreprises (côté offre), mais sont généralement essentiels pour les bénéficiaires (côté demande), qui sont en concurrence avec d'autres acteurs pour attirer les dons (Webb 1996). Compte tenu d'un environnement de ressources limitées, il est donc possible que les

entreprises prennent des décisions stratégiques sur le type de destinataires de leurs dons. L'orientation des entreprises pourrait correspondre à leurs besoins (Lev et al., 2010). Par exemple, les entreprises « technologiques » sont les plus grands donateurs des initiatives éducatives et concentrent la plus grande partie de leur budget de philanthropie dans l'enseignement supérieur, afin d'attirer des employés bien formés et d'avoir accès à la recherche universitaire. De même, les entreprises dans le secteur de la santé sont plus susceptibles de soutenir les organismes de santé et de services sociaux afin de bénéficier de la recherche scientifique, dans le but d'améliorer leurs propres produits.

Des recherches antérieures considèrent la philanthropie d'entreprise comme théoriquement importante (par exemple, Jensen et Meckling 1976, Fama 1980) car même un niveau faible de dons reflète les décisions des directeurs et des gestionnaires d'entreprise et représente également une certaine culture d'entreprise. La philanthropie d'entreprise présente un intérêt théorique en montrant la coexistence de théories concurrentes telles que la théorie des actionnaires ou « *shareholder theory* » (Friedman 1970), la théorie de l'agence (Jensen et Meckling 1976) et la théorie des parties prenantes (Freeman 1984). Ces théories ne sont pas mutuellement exclusives (Brown et al., 2006). Alors que la philanthropie d'entreprise peut être un bon moyen d'améliorer la réputation de l'entreprise, elle peut aussi être source d'avantages indirects pour les dirigeants et les administrateurs.

Enfin, la philanthropie d'entreprise présente un enjeu réglementaire. Mes résultats sont pertinents pour le débat sur la gouvernance de la philanthropie d'entreprise et sur la question réglementaire de la divulgation des dons. Les entreprises publiques des États-Unis et du Royaume-Uni ne sont actuellement pas tenues de divulguer des informations concernant leurs dons à des organisations caritatives bien que, les législateurs et les régulateurs ont fait quelques tentatives pour exiger la divulgation des dons. La première version de Sarbanes-Oxley de 2002 exigeait des entreprises américaines qu'elles divulguent tous leurs dons de

bienfaisance. Cependant, cette exigence a été supprimée dans la version finale. Récemment, le NYSE et le NASDAQ ont adopté des règles plus strictes concernant l'indépendance des directeurs par rapport aux pratiques philanthropiques. Au Royaume-Uni, depuis la création de la Companies Act de 2006, le rapport annuel doit contenir des détails sur les noms des organismes de bienfaisance, les montants pertinents et l'objet des dons (Règlement sur les comptes, paragraphe 7). Cependant, en 2013, l'obligation de déclarer tout don de bienfaisance de plus de 2 000 livres sterling et l'objectif des dons a été supprimée afin de simplifier les rapports annuels des entreprises rendant le régime de divulgation des dons au Royaume-Uni volontaire.

Les trois articles qui composent ma thèse utilisent des méthodes de recherche quantitative et combinent des données d'archives provenant de différentes sources - à la fois des sources de données couramment disponibles et des données collectées à la main. Cette thèse se concentre sur les données américaines et britanniques où le secteur à but non lucratif est particulièrement important. En 2016, les dons d'entreprise ont été estimés à 18,5 milliards de dollars aux États-Unis (Foundation Center, 2017) et à 420 millions de livres sterling au Royaume-Uni (DSC, 2017). Même s'il existe plusieurs études antérieures sur la philanthropie d'entreprise au Royaume-Uni (Arulampalam et Stoneman 1995, Brammer et Millington 2008, Adams et Hardwick 1998, Campbell et al., 2002), il existe moins de données disponibles sur les dons au Royaume-Uni qu'aux États-Unis.

Le premier chapitre de ma thèse cherche à déterminer si les activités prosociales des entreprises reflètent une apparente cohérence, en examinant (1) si les décisions relatives à la philanthropie d'entreprise sont cohérentes avec deux stratégies d'évitement fiscal et (2) si les investisseurs récompensent cette cohérence.

J'étudie la relation entre la philanthropie d'entreprise et deux stratégies fiscales différentes. Premièrement, j'examine une stratégie fiscale agressive : l'évasion fiscale, c'est-à-dire les manœuvres stratégiques visant à payer un montant limité ou inexistant d'impôt dans les limites juridiques (Lennox et al., 2013). Deuxièmement, j'examine la relation avec une stratégie fiscale moins transparente : l'évitement fiscal conforme, c'est-à-dire « toutes les transactions qui réduisent la responsabilité fiscale explicite d'une entreprise » (Badertscher, et al., 2017). L'évitement fiscal conforme consiste à réduire les paiements d'impôts en réduisant à la fois le revenu économique et le revenu fiscal.

Pour effectuer mes analyses, je mesure la philanthropie d'entreprise à l'aide du montant des donations que j'ai collecté pour les 700 plus grandes entreprises américaines (basée sur les revenus totaux de 2015) en utilisant la base Foundation Center (Foundation Directory Online) et la base NOZAsearch. Je mesure la présence d'évasion fiscale non conforme en adoptant quatre mesures d'agressivité fiscale tirées d'études antérieures: deux mesures basées sur le taux d'imposition effectif et deux mesures basées sur l'écart entre le revenu comptable et fiscal. Pour mesurer la présence de l'évitement fiscal conforme, je reproduis la mesure définie par Badertscher et al. (2017).

Je conclus que la philanthropie d'entreprise est négativement liée à mes mesures d'évitement fiscal non conforme et positivement liée à la mesure d'évitement fiscal conforme. Mes données empiriques suggèrent ainsi que les entreprises qui pratiquent la philanthropie d'entreprise semblent être cohérentes dans leurs activités prosociales et sont donc moins susceptibles de se livrer à de l'évitement fiscal non conforme. Ces éléments suggèrent que les gestionnaires qui s'engagent dans la philanthropie d'entreprise veulent maintenir les avantages de réputation de leur engagement prosocial. Je tente de contrôler une partie de l'endogénéité et d'atténuer les effets des variables omises en employant des effets fixes pour les entreprises et un échantillon apparié selon le score de propension.

L'objectif du second article est de mettre en lumière l'engagement des entreprises concernant leurs activités liées à la RSE et leur divulgation lorsque le régime de divulgation obligatoire devient volontaire. Alors que la recherche en RSE explore l'application des exigences des régimes de divulgation obligatoire (Ioannou et Serafeim 2016, Manchiraju et Rajgopal 2017), cet article examine les conséquences d'un événement réglementaire – le passage d'un régime de divulgation obligatoire à volontaire. Le *Companies Act* de 2006 oblige les entreprises britanniques à divulguer dans leurs rapports annuels (rapports stratégiques et rapports des administrateurs) les objectifs et le montant des dons accordés aux organismes de bienfaisance. Mais en 2013, en dépit de la tendance mondiale à imposer une divulgation liée à la RSE (Chine, Danemark, Malaisie, Afrique du Sud), le *Companies Act* (ACR) modifie l'ancienne loi et omet les obligations de divulgation des dons. Mon article tente d'examiner dans quelle mesure le changement de réglementation a un effet sur le niveau de divulgation de l'entreprise et sur le niveau des dons. Contrairement à la plupart des études qui analysent la divulgation des entreprises après un changement de la réglementation de volontaire à obligatoire, ce changement me permet d'identifier l'engagement des entreprises à divulguer leur philanthropie lorsque la divulgation obligatoire devient volontaire.

Pour effectuer mes analyses, j'utilise un test utilisant un échantillon de 150 entreprises britanniques avant et après le choc réglementaire de 2013 (2011-2015). Pour examiner si le passage de la divulgation obligatoire à volontaire affecte la qualité des rapports des entreprises sur leur philanthropie, j'évalue la qualité de la divulgation en extrayant des notes des rapports annuels des entreprises britanniques en utilisant un indice de divulgation sur la philanthropie d'entreprise (Plumlee, Brown, Hayes et Marshall 2015 et Clarkson, Fang, Li et Richardson 2013).

Je trouve que les entreprises divulguent moins d'informations sur leurs dons à la suite du changement de divulgation obligatoire-volontaire. Ce résultat est important, car il suggère que les entreprises ne s'engagent pas à divulguer leur responsabilité en matière de RSE, alors même qu'elles ont déjà été initiées à la divulgation de leurs dons dans le cadre du régime obligatoire. En outre, je trouve que lorsque la divulgation obligatoire sur la philanthropie d'entreprise devient volontaire, les entreprises diminuent leurs dons. Cette constatation donne à penser que le secteur sans but lucratif pourrait être touché par le passage à la divulgation volontaire, qui dissuade les entreprises de maintenir leurs dons de bienfaisance. Cependant, les lecteurs doivent interpréter ce dernier résultat avec prudence, compte tenu de la moindre fiabilité des données sur les dons dans le cadre d'un régime de divulgation volontaire.

Le troisième chapitre de ma thèse analyse l'alignement des dons entre les auditeurs et leurs clients vis-à-vis des mêmes organismes à but non lucratif. Les entreprises, y compris les cabinets d'audit, s'engagent dans des dons directs ou via leurs fondations d'entreprise. La littérature existante montre que les dons reflètent souvent les croyances personnelles et les valeurs des gestionnaires (Porter et Kramer 2002), les normes corporatives (Genest 2005) et aident les entreprises à établir des relations avec leurs parties prenantes (Galaskiewicz 1997). Cette étude utilise la théorie du capital social pour analyser l'alignement des dons entre auditeurs et clients dans un contexte d'audit. Dans cet article, j'étudie si le capital social des cabinets d'audit et leurs clients découlant de l'alignement de leurs dons dans les mêmes organisations caritatives affecte les honoraires d'audit et la qualité de l'audit.

L'alignement caritatif des clients et de leurs auditeurs permet de saisir les effets de la convergence des normes civiques communes, des valeurs caritatives et des réseaux à but non lucratif.

Tout d'abord, je développe un modèle de déterminants exploratoires de l'alignement des dons entre les auditeurs et les clients pour d'abord examiner pourquoi les entreprises

clientes et les cabinets d'audit font des dons de bienfaisance dans les mêmes organisations à but non lucratif. Il semble que la probabilité pour que les sociétés d'audit et leurs clients accordent des dons aux mêmes organismes sans but lucratif (et le montant) soit plus élevée pour les entreprises ayant une fondation caritative, une valeur d'entreprise plus élevée ou une taille de conseil d'administration plus importante.

Deuxièmement, mon test principal examine l'association entre les honoraires d'audit ou la qualité de l'audit et l'alignement des dons entre les auditeurs et leurs clients. Pour ce faire, j'utilise deux mesures largement utilisées pour mesurer la qualité de l'audit: les retraitements financiers et les *accruals* discrétionnaires. Mes conclusions montrent que lorsque les clients et leurs cabinets d'audit soumettent des dons aux mêmes organismes sans but lucratif, les honoraires d'audit sont plus élevés. Cela suggère que les auditeurs font plus d'efforts et exercent leur professionnalisme dans l'exécution de l'audit auprès de clients qui partagent les mêmes valeurs caritatives. Je trouve que les entreprises qui soutiennent les mêmes organismes sans but lucratif que leurs cabinets d'audit ont une qualité d'audit plus élevée. Ces éléments suggèrent que l'alignement charitable entre l'audit et les entreprises clientes implique une communication efficace, essentielle à la qualité de l'audit. Cet article offre de nouvelles conclusions sur la dimension du capital relationnel et social de la philanthropie d'entreprise et ses conséquences critiques sur la qualité de l'audit et la tarification des audits financiers.

Cette thèse apporte plusieurs contributions, car l'accent mis sur la philanthropie d'entreprise et ses effets est rare. Il y a eu un important corpus de recherche sur la relation entre la philanthropie d'entreprise et la valeur de l'entreprise. Certaines études documentent une relation positive entre les dons et la performance financière de l'entreprise (Lev et al 2010, Liang et Renneboog 2016, Wang et Qian 2011 et Patten 2008). D'autres études

démontrent que les dons sont liés à des problèmes d'agence (Brown et al., 2006, Masulis et Reza 2015, Fich et al., 2009, Petrovits, 2006, Yermack, 2009). Cependant, il y a peu de preuves que la philanthropie d'entreprise a de l'importance dans le contexte du reporting financier et non financier des entreprises. Pour éclairer cette question, j'étudie comment la philanthropie d'entreprise influence (1) deux formes de stratégies fiscales des entreprises, (2) le *reporting* social des entreprises et (3) la perception par les auditeurs de la qualité de l'information financière. Ce faisant, j'espère souligner l'importance de la philanthropie d'entreprise, une pratique répandue qui n'a pas été beaucoup examinée dans la recherche comptable.

Le premier chapitre examine la cohérence des décisions des entreprises en matière de philanthropie et de stratégies d'évitement fiscal. L'objet de cet article sur le comportement fiscal des entreprises met en évidence l'importance de la cohérence dans les pratiques des entreprises. Cet article contribue à la littérature sur la fiscalité en explorant plusieurs stratégies fiscales. La littérature a jusqu'à présent sous-estimé la stratégie conforme d'évitement fiscal.

Le deuxième chapitre propose une contribution à la littérature existante sur la divulgation sociale. Alors que des études antérieures ont porté sur les niveaux de divulgation des entreprises en matière de RSE (Ioannou et Serafeim 2016, Manchiraju et Rajgopal 2017) suite à une réglementation obligatoire, cet article analyse les rapports annuels des entreprises lorsqu'elles ne sont plus tenues de divulguer sur leur philanthropie. Cet article attire l'attention sur le manque d'engagement des entreprises dans leurs *reporting* social.

Le dernier chapitre propose une analyse d'une dimension sous-explorée de la philanthropie - la dimension relationnelle - dans un cadre d'audit. Les interactions répétées entre les clients et les auditeurs sont une caractéristique clé de la relation entre l'auditeur et le client qui modifie la perception des auditeurs à l'égard des rapports financiers de l'entreprise. Dans cette étude, je développe une mesure au niveau de l'entreprise, plutôt qu'une mesure

régionale du capital social de l'entreprise, basée sur la philanthropie. Les études antérieures ont principalement porté sur les liens scolaires ou professionnels entre individus (par exemple, Guan, Su, Wu et Yang, 2015) ou sur le capital social des régions (par exemple, Jha et Chen, 2014) et leurs effets sur les résultats d'audit.

General Introduction

1. Overview and structure of the dissertation

This dissertation fits into the overlapping fields of corporate social responsibility (CSR) and financial accounting, and explores the effect of the specific activity of corporate philanthropy¹ (CP) on corporate reporting. This dissertation builds upon three stand-alone papers that explore three different financial and non-financial reporting consequences of CP. The consequences explored across these papers are: (1) the firms' tax strategies, (2) the firms' social disclosures, and (3) the auditors' perception of firms' financial reporting quality.

The titles of the papers are:

- “Consistency in corporate prosocial activities: Does corporate philanthropy articulate with a firm’s tax strategies?”
- “How do firms respond to a shift from mandatory to voluntary disclosure? Evidence from corporate charitable donations disclosures in the UK”
- “Overlaps between auditors’ and clients’ corporate charitable donations and audit outcomes”

This dissertation proposes three papers that address the following general research question: Does corporate philanthropy matter in corporate reporting?

The first essay studies the consistency of CP with regard to firms' tax strategies – i.e., *a tax implication*. There is a spotlight on firms reporting financial statement income that is substantially higher than the income reported to tax authorities (Frank et al. 2009; Murray 2002). Firms engaged in CP choose their tax avoidance strategies in order to appear consistent with their prosocial policy.

¹ It should be specified that CSR is not the focus of this dissertation even though corporate philanthropy policies are very often associated with CSR policies.

The second essay explores firms' disclosure of CP around a shift from a mandatory to a voluntary disclosure regime – i.e., *a social reporting implication*. In order to get image benefits from CP, firms would need to make this activity visible. This paper explores different reporting levels regarding CP on annual reports under mandatory and voluntary disclosures. I also analyze other firms' responses to the regulatory shift such as firms' levels of donations and agency conflicts.

The third essay studies corporate philanthropy when auditors and clients give corporate charitable donations (CCDs) to the same nonprofit organizations and its effect on auditors' perceptions of financial reporting quality – i.e., *a financial reporting implication*. Specifically, this paper analyzes the influence of overlaps in auditors' and clients' CP on two major audit outcomes: audit pricing and audit quality. Audit quality and audit fees reflect the auditors' assessment of firms' financial reporting and their perceived risk. This paper highlights overlaps of corporate donations that mediate the link between social capital and audit outcomes.

These three essays use quantitative research methods and combines archival data from different sources – both commonly available data sources as well as hand-collected data. This dissertation focuses on US and UK data where the non-profit sector is particularly important. In 2016, corporate giving was estimated at \$18.5 billion in the US (Foundation Centre, 2017) and £420 million in the UK (DSC, 2017). Even though there are several prior studies examining CP in the UK (Arulampalam and Stoneman 1995; Brammer and Millington 2008; Adams and Hardwick 1998; Campbell et al. 2002), there is less available data on CP in the UK than in the US.

This dissertation makes several contributions, since a focus on the multifaceted CP and its effects is scarce. There has been an important body of research on the relation between CP and firm value. Some studies document a positive relation between donations and

corporate financial performance (Lev et al. 2010; Liang and Renneboog 2016; Wang and Qian 2011; Patten 2008). Other studies present evidence that donations are related to agency problems (Brown et al. 2006; Masulis and Reza 2015; Fich et al. 2009; Petrovits 2006; Yermack 2009). However, there has been little evidence that CP matters in the context of firms' financial and non-financial reporting. To shed some light on this question, I study how CP influences (1) two forms of firms' tax strategies, (2) firms' social disclosures of their charitable activities, and (3) auditor perception of firms' financial reporting quality. In doing so, I hope to highlight the importance of CP, a prevalent corporate practice that has not been much examined in the accounting literature.

The first study investigates the consistency of firms' decisions with regard to CP and two types of tax avoidance strategies, namely tax avoidance and conforming tax avoidance. The focus of this study on corporate tax behavior highlights the importance of consistency in corporate practices. This paper contributes to the literature on tax by exploring several tax strategies with different levels of transparency. The literature has so far understates the extent to which firms engage in different tax avoidance strategies.

The second study proposes a contribution to existing literature on social disclosure. Whereas prior studies looked at corporate disclosure levels on CSR (Ioannou and Serafeim 2016; Manchiraju and Rajgopal 2017) following mandatory regulation, this paper analyzes firms' reporting when they are no more required to disclose on their CP. This paper brings attention to firms' lack of commitment to their reporting on CP.

The last study proposes an analysis of an under-explored dimension of CP – the relational and, more especially, social capital dimension – in an audit setting. Repeated interactions between clients and auditors are a key feature of the auditor-client relation that modify auditors' perceptions of corporate financial reporting. In this study, I develop a firm-level measure, rather than a regional measure of firm's social capital, based on CP. Prior

studies have mainly focused on school or professional connections between individuals (e.g., Guan, Su, Wu, & Yang, 2015) or on the regions' social capital (e.g., Jha & Chen, 2014) and their effect on audit outcomes.

The remaining of this introductory chapter presents the theoretical background, and research motivations of this dissertation and then provides a more detailed summary of the three papers. Subsequently, the full text of the three papers is presented as individual chapters. The final chapter of this dissertation summarizes the main findings, provides a discussion of the limitations of this research and suggests areas of future research.

2. Theoretical background

The chapters of this dissertation propose a better understanding of the occurrence of CP and its effects on firms' practices. CP is defined by Wartick et al. (1998) as "a discretionary responsibility of a firm involving choosing how it will voluntarily allocate its slack resources to charitable or social service activities that are not business related and for which there are no clear social expectations as to how the firm should perform". In that sense, CP represents managerial discretionary expenses. Managers have discretion in using corporate resources. There has been a continuing debate about whether the discretion is used efficiently or opportunistically and what the purpose of the modern firm should be. On the one hand, the shareholder theory, originally proposed by Milton Friedman (1962), sets the purpose of the firm as the maximization of financial returns for shareholders. It is based on the premise that a manager is hired as the agent of the shareholders to run the firm for their benefit, and therefore the manager is legally and morally obligated to serve shareholders' interests. Some scholars claim that CP is a facet of profit maximization (Leclair and Gordon 2000). Many firms exploit their CP as a good means to improve the firm' image and increase profits (Boatsman and Gupta 1996).

However, “when managers exercise discretion it can be because [it] increased the wealth of all contracting parties or [because it] makes the manager better off at the expense of some other contracting party”, e.g., shareholders (Watts and Zimmerman 1990). Several authors have started to associate CP with agency problems (Bartkus et al. 2002; Fich et al. 2009; Masulis and Reza 2015). Agency theory asserts that some of the interests of principals (i.e., shareholders) and agents (i.e., managers) are incompatible (Bartkus et al. 2002). In the absence of proper monitoring and control, managers expropriate organizational resources in a manner unacceptable to shareholders (Fama 1980). Agency problems arise from conflicting goals and information asymmetry, which result in opportunistic behavior and stem from the fact that it might be too difficult or costly for shareholders to verify specific managerial actions (Eisenhardt 1989). Therefore, there are several reasons to link CP with agency problems. First, the obscurity of the financial returns from CP can be related to inefficiency. Second, since most firms do not disclose their philanthropy in great detail, there is a transparency issue. Finally, scholars have frequently linked donations with the CEO’s self-interest at the expense of shareholders (Bartkus et al. 2002; Atkinson and Galaskiewicz 1988; Haley 1991). Boatsman and Gupta (1996) state that the cost of monitoring CP is prohibitively high for stockholders, and so they allow over-investment in CP. Masulis and Reza (2015) document that CP is a resources’ misallocation. Firms are more likely to donate to charities that are associated with the CEO suggesting that CP serves leaders’ private interests. Then, the managerial behavior related to CP may lead to problems with regards to the efficient allocation of corporate resources.

Shareholder theory is then contrasted with stakeholder theory. Stakeholder theory asserts that a firm owes a responsibility to a wider group of stakeholders, other than just shareholders (Freeman 1984). A stakeholder is defined as any person or group, which can affect or be affected by the actions of a firm. It includes employees, customers, suppliers,

creditors and even the wider community and competitors. Stakeholder theory suggests that the purpose of the firm is to serve broader societal interests beyond economic value creation for shareholders alone. The stakeholder theory is an important element of Corporate Social Responsibility (CSR), a concept that recognizes the responsibilities of firms, whether they are economic, legal, ethical or philanthropic.

In this dissertation, the approach taken has been that these different views of the firm can overlap and that I should not get bogged down into a binary debate between the shareholder-centric and the stakeholder-centric visions. This dissertation adopts a more complex view of the firm and analyzes CP as a corporate strategy while considering the ethical or cultural motives that led to the establishment of CP policies. The relationships between the nonprofit world and the corporate world imply some modifications of firms' practices and in particular firms' reporting, which is the focal point of this dissertation.

3 Research Motivations

Why accounting research should care about corporate philanthropy?

There are several ways in which managers can exercise their discretion. Past literature has focused too narrowly on choices among accounting practices (Healy 1985; DeAngelo 1986), but in most instances these choices have no direct cash-flow consequences. The scope of managerial discretion also includes business expenses that alter cash flow and income such as R&D, advertising and capital expenditures but also expenses such as managerial perquisites and charitable donations. Some discretionary expenses are more vulnerable to managerial discretion than others, especially when they are not directly business-related.

This dissertation focuses on CP - one specific type of corporate expenses with high managerial discretion and great information asymmetry. CP is defined by the Financial Accounting Standards Board (FASB, 1993) as "an unconditional transfer of cash or other

assets to an entity or a settlement or cancellation of its liabilities in a voluntary non-reciprocal transfer by another entity acting other than as an owner”.

Although, CCDs represent a negligible part of pretax corporate profits, CP represents specific expenses that make them important to analyze, theoretically attractive and timely. The CCDs offer a setting that provides several unique features, as developed below.

Even if the practice of CP is currently prevalent, the debate over its legitimacy continues. Corporate tax legislations include proposals enhancing tax incentives for charitable donations, presumably to encourage philanthropy. Donations, by increasing the social wellbeing, become a legitimate expense (Lev et al. 2010). However, some other legislation (e.g., early versions of the Sarbanes-Oxley Act of 2002, and a Senate Finance Committee proposal in 2004) requested to place controls over CP under the belief that is detrimental to shareholders. CCDs are difficult to observe, and therefore hard to assess and monitor (Himmelberg et al. 1999). The contradictory views of the legitimacy of CP demonstrate the need for a thorough understanding of the consequences of CP.

CCDs can be seen as negligible from the firms' perspective (offer side), but are usually vital to the recipients of these donations (demand side), which compete against other actors to attract CP (Webb 1996). Given an environment of limited resources, it is therefore possible that actors make strategic decisions about the type of recipients of their CCDs. The firms' focus could be consistent with their need (Lev et al. 2010). For instance, “tech” firms are the largest funders of educational initiatives and focus the greatest part of their budget for philanthropy on higher education, in order to attract well-trained employees and to have access to university research. Similarly, health care firms are more likely to support health and human service organizations to benefit from the health and scientific research, with the purpose of improving their own products.

Prior research views CP as theoretically important (e.g., Jensen and Meckling 1976; Fama 1980) because even a small amount of donations reflects directors' and managers' decisions and represents a certain corporate culture. CP is of theoretical interest, in showing the coexistence of competing theories such as the shareholder theory (Friedman 1970), the agency theory (Jensen and Meckling 1976) and the stakeholder theory (Freeman 1984). Those theories are not mutually exclusive (Brown et al. 2006). Then, while CP may be a way to create goodwill and enhance the firm's reputation, it can also represent a form of perquisite consumption for managers and directors.

Lastly, CP is a regulatory issue. My results could be relevant for the debate on the governance of CP and to the regulatory issue about disclosure of CCDs. Public firms in the US and UK are not presently required to disclose any information regarding their donations to charitable organizations. Though, legislators and regulators have made some attempts to mandate disclosure on CP. The first version of Sarbanes-Oxley of 2002 required US firms to disclose all CCDs. However, that requirement was dropped in the final version. Recently, both the NYSE and NASDAQ have adopted stricter rules regarding director independence in relation to philanthropic practices. In the UK, since the inception of the Companies Act 2006, the directors' report must contain details of the names of the charities, the relevant amounts and the purpose of the donations (Accounts Regulation Sch 7 para 5). However, in 2013, the requirement to report on any CCD made above £2,000 and the purpose of the donations is being deleted to simplify firms' annual reports making the disclosure regime in the UK on CP voluntary.

Why studying corporate philanthropy rather than CSR?

This dissertation analyzes CP particularly rather than CSR, which was extensively studied. CSR refers to “company activities – voluntary by definition – demonstrating the inclusion of

social and environmental concerns in business operations and in interactions with stakeholders” (Van Marrewijk 2003). Carroll (2004) argues that “the social responsibility of businesses encompasses the economic, legal, ethical, and discretionary philanthropic expectations that society has of organizations at a given point in time”. Like other CSR activities, CP represents a way to give back to communities (Gautier and Pache 2015). CP is a key dimension of CSR practices (Porter and Kramer 2002; Saiia et al. 2003) and “a more valid proxy for CSR than other single dimension measures” (Du 2014, p. 344). Studying CP offers several advantages over the examination of CSR activities thanks to the specific characteristic of CP.

First, CP is a voluntary and discretionary form of CSR (Logsdon and Wood 2002) and can be considered as the “purest form of corporate social responsibility” (Carroll 1979). Several other CSR activities are influenced by regulations and industry practices (e.g., environmental regulations, labor laws) which are not under the control of management.

Second, CP is the most discretionary kind of CSRs (Carroll 1979). CP practices are disconnected from the core business of firms (Halme and Laurila 2009). Compared to other CSR initiatives, such as environmental investments, it is relatively easy for a firm to increase or decrease their CCDs in a given year, which could give CP more variability over time and provide more power to identify causality (Lev et al. 2010).

Third, using CP leads to less measurement error with regard to CSR activities because there is no need for third party assessments of CSR activities (e.g., CSR ratings from MSCI KLD or Thomson Reuters Asset 4). CSR ratings are subjective and often do not converge across external raters (Chatterji, et al., 2016) which may explain the difficulty in finding consistent results across studies that use different samples and time periods. Using CP data mitigates this issue because philanthropy can be measured with the dollar amount of donations to charities (Lev, et al., 2010).

Lastly, compared to other CSR initiatives, the darkness surrounding CCDs promotes the creation of invisible networks of background social ties among corporate elites – affiliations that potentially compromise the executives’ independence in corporate decision-making.

Those points lead me to focus the attention on CP rather than the broader concept of CSR.

The role of corporate philanthropy on firms’ practices

This subsection summarizes the current state of knowledge about the role of CP on firms’ practices and motivates the three chapters. Prior studies explore some consequences of CP at the firm-level.

Empirical research has largely focused on establishing a positive connection between CP and firm financial performance. Whether CP actually contributes to the firm’s financial performance remains disputed (M Orlitzky et al. 2003; Patten 2008; Saiia et al. 2003; Seifert et al. 2004). According to Margolis and Walsh's (2003) review on the relationship between CP and financial performance, results document mainly a positive relationship between corporate social performance and financial performance and there is little evidence of a negative association. Lev et al. (2010) find a positive relationship between donations and customer satisfactions and this customer satisfaction mediates the relationship between CP and sales. Wang and Qian (2011) in examining Chinese listed firms, find that the positive philanthropy performance relationship is stronger for firms with greater public visibility and for those with better past performance, as CP gains more positive stakeholder responses. In contrast, some scholars do not find the same positive relationship between CP and financial performance. Griffin and Mahon (1997) and Seifert et al. (2004) do not find a significant relationship between CP and firm profit. Similarly, Berman and Wicks (1999) find that CP

activities have little influence on financial performance. Other scholars argue that CP is resource consuming (Williams and Barrett 2000; Dentchev 2004). Managers' philanthropic initiatives can send a negative signal to stakeholders and in particular raises shareholders' fears. Masulis and Reza (2015) find that as CCDs increase, shareholders reduce their valuation of firm cash holdings. Their findings also suggest that CP represents misuses of corporate resources by managers. Some studies have explored the possibility of non-linear relationships between CP and financial performance. Brammer and Millington (2008) study UK listed firms and find that firms with both unusually high and low level of CCDs have better financial performance than those making an intermediate level of philanthropy. Wang et al. (2008) find evidence that CP enhances a firm's financial performance by enabling the firm to gain greater control over stakeholder resources. But, as the amount of CCDs continues to increase, agency costs and direct costs become dominant. Overall, from the previous studies there is no agreement on the subsequent better financial performance following CP. These prior studies do not pay attention to another element that differentiates firms engaged in CP. The consistency of firms' practices with an effect on the society can influence the financial performance of firms engaged in CP. This has been overlooked in the existing literature. Instead of evaluating CP in isolation, investors would also value firms' consistency in their practices. In the first chapter of this dissertation, I analyze whether investors penalize firms' inconsistency in their activities with a social impact. More specifically, it investigates the association between firm value and the consistency of CP and two types of tax strategies.

Some studies have focused on the relationship between CP and corporate misconduct. A recent working paper, Bereskin, Campbell, & Kedia (2016) documents that CP is associated with less misconduct. They find that relatively generous firms are less likely to be involved in financial misconduct, consistent with their CP reflecting a corporate culture that makes wrongdoing less likely. Moreover, they find that employees at firms engaged in CP are

more likely to whistle blow when they observe wrongdoing. This dissertation studies the relations between CP and other firms' practices that may be perceived by stakeholders as inappropriate: firms' tax strategies. There is no paper that explores the association between firms' tax strategies and CP. It appears that further research on the relation between CP and tax aspects is much needed to understand the role of CP on business practices. The first chapter of this dissertation examines whether decisions about CP articulate with firms' tax strategies.

Many studies provide empirical support for a positive relationship between CCDs and corporate reputation (Fombrun and Shanley 1990; Brammer and Millington 2005; Himmelstein 1997; Godfrey et al. 2009). Gardberg and Fombrun (2006) argue that CP can create reputational capital. CP influences the perceptions of the firm in the eyes of a variety of stakeholders (Brammer and Millington 2005). Hence, firms would provide a high level and detail of voluntary disclosure on their CP in order to gain reputational benefits. Being the statutory communication with shareholders, the corporate annual report and the CSR report would be the most appropriate vehicles for such disclosures. Despite the importance of the potential gains obtained through firms' communication of their philanthropy, the literature is largely silent about whether and how firms disclose their CP. There is also a need for more research on how the disclosure regime would affect corporate social disclosure. An original research setting used in this dissertation i.e., the analysis of a regime shift from mandatory to voluntary allows me to investigate firms' commitments to their social disclosure. The second chapter of this dissertation investigates in particular firms' disclosure on CP following a shift in the reporting regimes in this area.

Finally, Masulis and Reza (2015) and Cai, Xu, & Yang (2016) analyze the consequences of the relational dimension of CP on firms' monitoring. Masulis and Reza (2015) examine whether corporate supported charitable causes overlap with independent

director charitable interests and then they evaluate the effect of this alignment on CEO compensation. They find that this particular alignment of charitable interests is positively associated with excess CEO compensation. Similarly, Cai et al. (2016) show that overlaps of CCDs and independent directors' charitable affiliations are associated with less effective monitoring. These original and interesting findings show that there is a need to further investigate the relational dimensions of CP and its effects on firms' monitoring. More research on whether firms' charitable alignment affects audit process is needed. Analyzing the audit setting allows to explore the critical effect of these important charitable relations between auditors and clients on auditors' perceptions of financial reporting quality. Additionally, there has been little attention devoted to the influence of CP on firms' financial reporting. Petrovits (2006) studies the use of corporate-sponsored foundations, which offer an opportunity for managers to exercise discretion to influence reported earnings without necessarily affecting the level of donation to outside charities. This study shows that corporate managers strategically time the funding of their firms' charitable foundations to increase earnings in order to report small positive earnings changes. Firms that make large, income-decreasing discretionary donations to their foundations are more likely to achieve financial reporting objectives in subsequent periods. The last chapter of this dissertation proposes an examination of overlaps between auditors' and clients' CCDs and their influence on audit pricing and audit quality, which reflects the auditors' assessment of firms' financial reporting quality (ex-post).

Overall, in the next three chapters of the dissertation, I attempt to answer the following three research questions:

- Does corporate philanthropy is consistent with firms' tax strategies? How do investors value inconsistency between corporate philanthropy and tax avoidance strategies?

- Do firms change their disclosures about corporate philanthropy and their charitable donation amounts following a shift from mandatory to voluntary reporting regime?
- Do overlaps in corporate charitable donations between auditors and clients influence audit pricing and audit quality?

4. Overview of the three research papers

Chapter 1: Consistent prosocial activities: Does corporate philanthropy articulate with a firm's tax strategies?

This first chapter investigates if firms' choices of prosocial activities reflect apparent *consistency*, by examining (1) whether decisions about CP are consistent with two forms of corporate tax avoidance strategies and (2) whether investors reward this consistency.

I investigate the relation between CP and two different tax strategies. First, I examine a more transparent tax strategy: tax avoidance, i.e., strategic maneuvering to pay limited or no taxes within legal boundaries (Lennox et al. 2013).² Second, I examine the relation with a less transparent tax strategy: conforming tax avoidance, i.e., "all transactions that reduce a firm's explicit tax liability" (Badertscher, et al., 2017). Conforming tax avoidance consists in reducing tax payments by reducing both economic (book) income and tax income (e.g., use of the LIFO inventory method, accelerating of certain discretionary expenses, prepayment of financing costs).

To carry out my analyses, I measure CP using a hand-collected dataset of cash charitable donations from the 700 largest U.S. firms (based on 2015 total revenue) using the

² Tax avoidance includes a wide range of actions such as transferring economic income from high tax jurisdictions to tax havens (Dyreg and Lindsey 2009), exploiting complex hybrid securities (Engel et al. 1999) and participating in different tax shelters (Wilson 2009). I refer to "tax avoidance" to describe the different levels of legal tax minimization strategies, ranging from tax avoidance to the relatively more extreme use of tax havens (Dyreg and Lindsey 2009).

Foundation Center online database (i.e., the Foundation Directory Online) and NOZAsearch database. I measure the presence of nonconforming tax avoidance by adopting four measures of tax aggressiveness drawn from prior studies: the effective tax rate, the cash-effective tax rate and two measures based on book-tax differences. To measure the presence of conforming tax avoidance, I replicate the measure defined by Badertscher et al. (2017). I run my analyses on a panel sample of 4,521 firm-year observations covering a sample period from 2003 to 2014.

I find that CP is negatively related to my measures of nonconforming tax avoidance and positively related to the measure of conforming tax avoidance. My empirical evidence suggests that firms that engaged in CP appear consistent across their prosocial activities and therefore are less likely to engage in both nonconforming tax avoidance and conforming tax avoidance. This evidence suggests that firms are consistent in their choices of prosocial activities in order to maintain reputational benefits from their prosocial engagement. I attempt to control for some of the endogeneity and mitigate the effects of omitted variables by employing a firm fixed effects model and a propensity-score-matched sample.

In two cross sectional tests, I find that (1) firms engaged in CP with low reputation are more likely to use nonconforming tax avoidance than firms with higher reputation and (2) firms engaged in CP are even less likely to use nonconforming tax avoidance in the wake of hurricane Katrina when the public attention to CP is the highest rather than during other periods (Mishra, 2006). These findings are consistent with the argument that firms are concerned with reputation risks associated with inconsistent prosocial activities (Vergne and Brenner 2017).

The second set of results present evidence that the market value of firms engaged in CP is lower if they also engage in nonconforming tax avoidance. Investors consider that CP does not mitigate the reputational damages of nonconforming tax avoidance. My findings

suggest that investors view firms' inconsistency between tax strategies and CP as a costly strategy that ultimately reduces firm value.

Chapter 2: How do firms respond to a shift from mandatory to voluntary disclosure?

Evidence from corporate charitable donations disclosures in the UK

The purpose of this paper is to shed some light on firms' credible commitment to CSR-related activities and disclosure when mandatory disclosure becomes voluntary. While CSR research explores the enforcement of mandatory disclosure requirements (I Ioannou and Serafeim 2016; Manchiraju and Rajgopal 2017), this paper examines firm specific consequences of a rare regulatory event that represents a regime shift from mandatory to voluntary disclosure that affected UK firms in 2013. The Companies Act 2006 mandates UK firms to disclose in their annual reports (Strategic and directors' reports) on the purposes and amount of money given to charities. But in 2013, despite the worldwide trend to mandate CSR-related disclosure (i.e., China, Denmark, Malaysia, South Africa), the Companies Act Regulations (ACR) amends the former act and leaves out the disclosure requirements, making disclosure on CCDs voluntary. My paper attempts to investigate whether and to which extent the regulatory shift has an effect on corporate disclosure level and to some extent on donations level. This regulation change provides appealing features with which to study my research question. In contrast to most studies that analyze firms' disclosure after a regulatory change from voluntary to mandatory, this shift allows me to identify firms' commitment to CP disclosure when mandatory disclosure becomes voluntary.

To conduct my analyses, I employ a pre-post test using a sample of 150 UK firms before and after the 2013 regulatory shock (2011-2015). To explore whether the shift from mandatory to voluntary disclosure affects firms' reporting quality on their CP, I assess the

quality of the disclosure on CP by extracting scores from UK firms' annual reports using a disclosure index on CP designed along the same lines as in Plumlee, Brown, Hayes, & Marshall (2015) and Clarkson, Fang, Li, & Richardson (2013). To do so, in each report I hand-code 47 different data items that record if the data item is present in the report. I document the types of disclosures including soft and hard disclosure that firms make in their reports and seek to explain variation in corporate disclosure related to firms' charitable activities across reports and over time. My index is an overall measure of the granularity of information about CP presented in firms' reports.

I find that firms disclose less information on their CCDs following the mandatory-to-voluntary disclosure shift. This result is important because it suggests that firms do not credibly commit to their CSR-related disclosure, even though they were already initiated to the disclosure of their donations under the mandatory disclosure regime. In addition, I find that when mandatory disclosure on CP becomes voluntary, firms decrease their CCDs. This finding suggests that stakeholders and, in particular, the nonprofit sector could be damaged from the shift to voluntary disclosure, which deters firms to maintain their CCDs. However, readers should interpret this last result on donations levels with caution given the less reliability of the data on donations under a voluntary disclosure regime.

I perform a cross-sectional analysis to examine whether the quality of firms' governance moderates the relationship between the mandatory-to-voluntary disclosure shift and the disclosure levels on CP. The results suggest that the existence and role of governance mechanisms indicate the positive effect of firms' governance mechanisms on CP level.

In further analysis, I find that agency conflicts arise from the decline of mandatory disclosure levels. Moreover, I find that when firms have agency problems related to CP measured as board members' connections to nonprofit organizations, firms disclose much less information on their CP after the regulatory shift. This suggests that when managers

strategically decrease such disclosure when they are more likely to reap private benefits from donations.

Chapter 3: Overlaps of auditors' and clients' corporate charitable donations and audit outcomes

This paper analyzes overlaps between auditors and clients' CCDs to the same nonprofit organizations. Firms, including the audit firms invest significantly in CCDs through direct giving or corporate foundations. The existing literature shows that CCDs often reflect personal beliefs and values of managers (Porter and Kramer 2002), corporate norms (Genest 2005) and help firms building relationships with their stakeholders (Galaskiewicz 1997). I posit that overlaps of auditors' and clients' CCDs capture social capital at the firm-level in an audit setting. In this paper, I investigate whether social capital between audit- and client-firms stemming from overlaps of their CCDs affect audit pricing and audit quality.

My sample consists of the Fortune 500 US firms and their audit firms at the national level over the 2003-2014 period. I recognize cash CCDs by hand-collecting data from the Foundation Center online database (i.e. the Foundation Directory Online) and the NozaSearch Database. The overlaps of CCDs given by clients and auditors allow to capture the convergence of effects from common civic norms, charitable values, and nonprofit networks. In particular, I use a dummy variable that indicates whether audit-firms and their clients have made CCDs to the same nonprofit organizations during a six- year window.

First, I develop an exploratory determinants model of overlaps of donations between auditors and clients to first examine whether and why client-firms and audit-firms make charitable donations to the same nonprofit organizations. It appears that the likelihood for audit firms and their clients to make CCDs to the same nonprofits (and the amount) is higher

for firms with a corporate charitable foundation, with a higher firm value or with a bigger board size.

Second, my main test examines the association between audit fees/audit quality and overlaps of CCDs between auditors and clients. In order to do so, I employ two widely used measures to capture audit quality: financial restatements and discretionary accruals. My findings document that when clients and their audit firms make CCDs to the same nonprofits, audit fees are higher. This suggests that auditors exert more efforts and exercise their professional care in the performance of the audit with clients who share the same charitable values in order to protect their networks. I find that firms that support the same nonprofits as their audit firms have higher audit quality as demonstrated by their lower likelihood of restatements and lower discretionary accruals. This evidence suggests that the charitable alignment between audit- and client-firms imply an effective communication, critical to the audit quality. In a further analysis, I find that the effect of overlaps of donations between audit- and client-firms is much stronger for clients with longer auditor tenure when the auditors can benefit of a better knowledge of the firms' operations and accounts. This reinforces my argument that transfer information is more effective when there is a charitable alignment between auditors and clients. This paper offers new findings on the relational and social capital dimension of CP and its critical consequences on audit quality and audit pricing.

Chapter 1

Consistency in corporate prosocial activities: Does corporate philanthropy articulate with a firm's tax strategies?

Abstract

This paper examines if firms' choices of prosocial activities reflect apparent consistency by studying the relation between corporate philanthropy (CP) and tax avoidance, that both involve a firm contribution to society. I distinguish between two types of tax avoidance: (1) nonconforming tax avoidance that reduces income tax liabilities but not financial statement (captured by tax aggressiveness measures) and (2) conforming tax avoidance that reduces both financial and taxable income but that is less visible. I find that philanthropic firms are less likely to engage in both nonconforming and conforming tax avoidance. This evidence suggests that firms are consistent in their choices of prosocial activities. In cross sectional tests, I also find that (1) firms engaged in CP with low reputation are more likely to use nonconforming tax avoidance than firms with higher reputation and (2) firms engaged in CP are even less likely to use nonconforming tax avoidance in the wake of hurricane Katrina when the public attention on corporate philanthropy is the highest rather than during other periods. Finally, I find that investors negatively (positively) value inconsistency (consistency) between CP and nonconforming tax avoidance. Overall, my results contribute to the understanding of the relation between the inconsistency of prosocial corporate activities and their effect on firm value.

1.1 Introduction

Whether firms should engage in prosocial activities has been the source of debate among academics, corporate stakeholders, and lawmakers, among others, for several decades (Berle 1931; Dodd 1932; Friedman 1970). Prosocial activities are actions whose primary objective is not to maximize shareholders' wealth but to generate benefits for the society at large (e.g., Bénabou and Tirole 2010). Such actions are often seen as part of a firm's Corporate Social Responsibility (CSR) and include, but are not restricted to, protecting the environment, recruiting, training and maintaining a diverse employee-base, paying taxes or engaging in philanthropy. The debate around these prosocial actions centers around the question whether there is a 'business case' for this type of corporate behavior as individual prosocial actions by their nature often destroy shareholder value (e.g., Margolis et al. 2009; Moser and Martin 2012). Despite this ongoing debate, firms do (increasingly) engage in prosocial activities. Moreover, they often engage in different types of prosocial activities.

The starting point in this paper is that firms will want to appear *consistent* in their choices of prosocial activities to present stakeholders with an unambiguous picture of their prosocial engagement. To examine if firms' choices of prosocial activities reflect *consistency*, I study the relation between corporate philanthropy (CP) and tax avoidance, that both involve a firm contribution to society.

Each prosocial activity sends a signal about the 'type' of the firm (i.e., prosocial or not). Incongruence between the firm's signals will negatively affect the ability of the firm to establish a prosocial reputation and by extension reap the benefits of a prosocial strategy. Moreover, in order to achieve economic benefits, the prosocial activities need to be 'costly' in

monetary terms and they need to be perceived as ‘authentic’, thus underlining the need for *consistency* across activities (Henderson and Van den Steen 2015).

I build on recent research by Badertscher et al. (2017) to distinguish between two types of tax avoidance in the research design, namely conforming and nonconforming tax avoidance. Starting from the broad definition that tax avoidance comprises “all transactions that have any effect on the firm’s explicit tax liability”, Badertscher et al. (2017) introduce *conforming* tax avoidance as “all book-tax conforming transactions that reduce a firm’s explicit tax liability.” While previous research has studied the relation between broad CSR activities and tax avoidance with mixed results, the specific focus on CP and these distinct forms of tax avoidance allows a more direct evaluation of apparent consistency between these activities for two reasons.

First, my focus on CP mitigates empirical challenges in measuring CSR activities by firms. To start, CP is a voluntary and discretionary form of CSR that arguably represents the “purest form of corporate social responsibility” (Carroll 1979). By contrast, other CSR activities are often influenced by regulations and industry practices (e.g., environmental regulations, labor laws) which are not under the control of management. Further, measures of CP do not require third party assessments (e.g., CSR ratings from MSCI KLD or Thomson Reuters Asset 4), that are subjective and often do not converge across external raters (Chatterji et al. 2009). These measurement challenges potentially explain the difficulty in finding consistent results across studies that use different samples and focus on different time periods (e.g., Davis et al., 2016; Hoi et al., 2013). CP data mitigates this issue because donations to charities are measured in dollar amounts (e.g, Lev et al., 2010; Masulis and Reza, 2015).

Second, Badertscher et al. (2017) argue that while nonconforming tax avoidance, traditionally the subject of tax avoidance studies, is likely a dominant tax planning strategy, it

is not the *only* tax strategy available to firms. They posit that traditional measures of nonconforming tax strategy, e.g., the effective tax rate or book-tax difference-based measures, are *unable to detect* conforming tax avoidance activities. A sole focus on traditional tax avoidance metrics therefore likely understates the extent to which firms engage in tax avoidance strategies. Importantly, this implies that, to the extent that stakeholders of the firm assess tax avoidance using readily available nonconforming strategy measures only, conforming tax avoidance by the firm will go unnoticed.

Whether firms will engage in conforming or nonconforming tax avoidance transactions depends on a number of factors. First, not all firms will engage in tax avoidance to the same extent (Weisbach 2002). Previous research discusses how the extent to which firms engage in tax avoidance is a function of the environment in which firms operate. For example, Hasan et al. (2017) discuss the role of perceived civic duty to pay taxes in the society, or the so-called tax-mindedness of firms as forces that affect tax avoidance. Further, when firms engage in tax avoidance, their choice between different types of transactions will be a function of the relative costs and benefits of these conforming and nonconforming tax activities. One obvious cost of conforming tax avoidance is the financial reporting cost. Reputational costs and, in some cases, important penalties imposed by tax authorities of nonconforming and conforming tax avoidance are other important costly elements to consider when firms' executives decide their tax strategies (Graham et al. 2012).

My central hypothesis in this paper is that a firm's desire to solidify its prosocial reputation by appearing consistent across (prosocial) activities will affect its propensity to engage in conforming or nonconforming tax avoidance transactions, given their different levels of transparency. That is, I predict a negative (positive) relation between a firm's engagement in CP and a propensity for nonconforming (conforming) tax avoidance

transactions, *ceteris paribus*.³ My prediction relies crucially on three assumptions: 1) firms will want to appear consistent across prosocial activities; 2) tax avoidance is perceived sufficiently negatively by the firm's stakeholders; 3) detecting conforming tax avoidance is harder than nonconforming tax avoidance.

To evaluate my prediction, the first set of analyses evaluates the relation between CP and measures of conforming and nonconforming tax avoidance, controlling for variables of relevance. In a second set of analyses, I also investigate the value implications of apparent inconsistency of prosocial activities. Existing research documents mixed evidence of the effects of nonconforming tax avoidance and CP on firm value (i.e., Lev et al. 2010; Desai and Dharmapala 2009; Wilson 2009; Drake et al. 2014; Guenther et al. 2013; Gallemore et al. 2014). Stakeholders may perceive firms' engagement in CP as untruthful if their actions are inconsistent and, therefore, investors may consider that charitable donations are insufficient to prevent firms engaged in nonconforming tax avoidance from reputational costs. Anecdotal evidence suggest examples of firms' inconsistency which lead to negative corporate reputation such as Walmart donating to anti-hunger groups while many of its workers rely on food stamps⁴. Conversely, CP could instill greater confidence in stakeholders (Muller and Kräussl 2011) and provide an insurance to protect firms from reputational damages of nonconforming tax avoidance. Then, investors may see the coincidence of these two activities as beneficial to the firm. Therefore, the value of firms that appear inconsistent in their CP and tax avoidance remains an open empirical question.

To carry out my analyses, I measure CP using a hand-collected dataset of cash charitable donations from the 700 largest U.S. firms (based on 2015 total revenue) using the Foundation Center online database (i.e., the Foundation Directory Online) and NOZAssearch

³ CP by itself is a conforming tax avoidance transaction as donations are tax-deductible. Therefore, I remove from the tax avoidance variables the effect of tax deductions related to CP.

⁴ <https://www.insidephilanthropy.com/home/2014/10/2/huh-walmart-foundation-battles-hunger-as-walmart-workers-tur.html>

database. I measure the presence of nonconforming tax avoidance by adopting four measures of tax aggressiveness drawn from prior studies: the effective tax rate, the cash-effective tax rate and two measures based on book-tax differences. To measure the presence of conforming tax avoidance, I replicate the measure defined by Badertscher et al. (2017). I run the analyses on a panel sample of 4,521 firm-year observations covering a sample period from 2003 to 2014.

I find a negative relation between CP and measures of nonconforming tax avoidance. Firms that spend \$2.6 million on charitable donations have, on average, an effective tax rate (cash effective tax rate) of 21 (39) basis points *higher* than firms that do not engage in CP, suggesting an increase in annual tax payment of \$2.94 million per firm. I also find a negative relation between CP and the measure of conforming tax avoidance. My empirical evidence suggests that firms that engaged in CP are consistent across their prosocial activities and are less likely to engage in nonconforming tax avoidance but also in the less visible conforming tax avoidance. CP puts the light on firms' actions and therefore even a less visible tax strategy such as conforming tax avoidance can be risky to maintain reputational benefits from firms' prosocial engagement. This evidence suggests that managers that engage in CP display a truly consistent behavior and do not want to be perceived as "tax avoiders".

I perform two cross-sectional tests on nonconforming tax avoidance. First, I find that firms engaged in CP with lower reputation are more tax aggressive than firms with higher reputation. This corroborates the argument that firms consider their reputation when taking philanthropic and tax decisions. Second, I find that the negative association between CP and tax aggressiveness is stronger in the wake of the 2005 hurricane Katrina when the public attention to prosocial activities arguably increased relative to other time periods (Mishra, 2006). This period created an opportunity for firms to increase their prosocial activities such as CP and increased the costs of antisocial activities (Muller and Whiteman, 2009, Muller and

Kräussl, 2011). This finding is also consistent with the argument that firms are concerned with reputation risks associated with inconsistent prosocial activities (Vergne and Brenner 2017).

Although I aim only to document evidence on association, not causation, I recognize that CP and tax avoidance strategies are firm choices and thus endogenous. I attempt to control for some of this endogeneity and mitigate the effects of omitted variables. First, I employ a firm fixed-effect model in attempt to control for differences in time-constant firm characteristics while estimating the CP's association to tax avoidance strategies. Second, I employ a propensity-score-matched sample to control for differences in observable firms' characteristics between giving firms and non-giving firms while estimating the donations' association on tax avoidance. These alternative specifications yield again a negative (positive) relation between nonconforming (conforming) tax avoidance and CP.⁵

The second set of results present evidence that the market value of firms engaged in CP is lower if they also engage in nonconforming tax avoidance. Investors consider that CP does not mitigate the reputational damages of nonconforming tax avoidance. These findings suggest that investors view that firms' inconsistency between tax avoidance strategies and CP as a costly strategy that ultimately reduces firm value.

Taken together, my results provide new evidence linking CP with different forms of corporate tax strategies. The importance of the particular linkage between corporate tax decisions with CP, rather than with CSR or social capital, lies also on the tax incentives of CP that modify stakeholders' perceptions of prosocial acts. CP offers important tax benefits that may come at a cost for the society by lowering tax revenues and depriving firms' communities. Bénabou and Tirole (2010) argue that a reward of a prosocial activity destabilizes the public's opinion about whether firms' intentions are authentic. As material

⁵ Moreover, my baseline results are robust to alternative measures of tax aggressiveness and CP, and are incremental to the effect of managerial ability, firms' social score and social capital.

incentives of CP become more substantial with the tax deductions, the meaning of CP may change in the eye of the stakeholders. Prior literature on CP shows that firms are strongly influenced by their tax environment and incentives in their giving strategies (e.g., Johnson 1966; Arulampalam and Stoneman 1995; Carroll and Joulfaian 2005; Navarro 1988; Webb 1996; Petrovits 2006; Boatsman and Gupta 1996). However, the relationship between CP and corporate tax decisions remains largely unexplored in the existing research streams on both corporate tax and CP. This study provides comprehensive empirical evidence to fill this gap by documenting that there is a relation between CP and corporate tax avoidance, which differ depending on the type of tax avoidance and its transparency level.

This study contributes to the literature on CP and more broadly to firms' prosocial behavior (Hasan et al. 2017; Lee et al. 2014) by suggesting that managers that engage in CP behave consistently with regard to the set of tax strategies offered to them.

My findings also contribute to the literature on tax avoidance by providing evidence of why some firms take more tax avoidance stances than others (Hanlon and Heitzman 2010; Shackelford and Shevlin 2001). Past studies have focused on management and firm characteristics (e.g., Desai and Dharmapala 2006), but I show that firms' desire to be consistent in their prosocial behaviors affects negatively their corporate tax strategies. I respond to Badertscher et al. (2017) calls to consider a broader set of corporate tax strategies than those examined in prior research. Moreover, these results contribute to an understanding of the under-sheltering phenomena (Weisbach 2002), according to which some firms are willing to forego tax avoidance opportunities (Hanlon and Heitzman 2010).

Finally, these results have important implications for the theoretical debate on whether corporate tax avoidance strategies and CP are beneficial or detrimental to shareholders (Desai and Dharmapala 2009; Masulis and Reza 2015). I show that investors do not value tax strategy or CP in isolation, but consider the consistency of firms' transparent actions. My

findings contribute to the theoretical view that visible prosocial behavior such as CP and nonconforming tax avoidance can provide easy targets for public criticism (McDonnell et al. 2015; Rhee and Haunschild 2006).

The remainder of the paper is organized as follows. In section 2, I outline prior relevant research and discuss the hypotheses. Section 3 describes the data, the measurement of key variables and the research design. Section 4 and 5 present the results. Section 6 provides additional analyses and several robustness checks. Section 7 concludes the paper.

1.2 Prior literature and hypotheses

1.2.1 Prior empirical research on the relation between prosocial activities and tax avoidance

Prior studies examine the relationship between a firm's tax avoidance and social responsibility, and find mixed results (e.g., Davis et al. 2016; Hoi et al. 2013; Hasan et al. 2016). Some studies document that firms engaged in CSR activities are likely to be ethical and unlikely to avoid taxes (Lanis and Richardson 2012; Hoi et al. 2013; Huang et al. 2015). Muller and Kolk (2012) show that multinational firms' subsidiaries with the best reputation for CSR pay higher corporate taxes than those with a bad CSR reputation. Lanis and Richardson (2012) examines the relationship between tax avoidance and disclosure index of CSR on a sample of Australian firms and find that the higher the level of CSR disclosure of a firm, the lower is the level of corporate tax avoidance. Similarly, Hoi et al. (2013) demonstrate that socially irresponsible firms (i.e., firms with negative social ratings) are more aggressive in avoiding taxes. Jones et al. (2017) find that the mixed results in the literature are due to the different proxies used in prior studies for CSR and tax avoidance but also to the region.

Recent studies document also the role of social capital on corporate decisions (i.e., Hasan et al. 2016; Lins et al. 2017; Berglund and Kang 2013). Hasan et al.'s (2016) findings indicate that firms headquartered in counties with higher levels of social capital (i.e., strong civic norms and dense social networks) pay higher taxes. Similarly, Lee et al. (2014) find that societal trust is negatively associated with tax avoidance. Lastly, some studies have also documented that religious social norms play a role in constraining tax avoidance (Dyrenge et al. 2012; Boone et al. 2012).

Yet, other studies find opposite evidence. Sikka (2010, p.153) proposes that firms “legitimize their social credentials by making promises of responsible and ethical conduct, but organizational culture and practices have not necessarily been aligned with publicly espoused claims”. Huseynov and Klamm (2012) show that although firms may shine on some CSR dimensions, they may still attempt to reduce their taxes. Davis et al. (2016) find evidence that CSR is negatively related to cash effective tax rate, suggesting a positive relation between CSR and tax avoidance. Further, Lanis and Richardson (2013) find that tax avoiders disclose more CSR information on their annual reports to mitigate public negative opinion related to tax avoidance. Some qualitative studies (Preuss 2010; Sikka 2010) demonstrate that firms may appear to act ethically and in a socially responsible manner while they engage in tax avoidance practices.

Overall, prior evidence on the relationship between corporate tax avoidance and firms’ prosocial behaviors (i.e., firms’ social responsibility or social capital) is mixed and neglect the characteristics of CP and the different forms of tax avoidance based on their apparent transparency level. These studies focus on the nonconforming form of tax avoidance.

1.2.2 Relation between CP and two forms of tax avoidance

Calls for firms to contribute to society and charitable causes have become more prominent, especially with the rise of the CSR tendency, the more available information about firms’

activities and the empowerment of the civil society (Bénabou and Tirole 2010). Managers are influenced by society's expectations and increasing demands for prosocial behavior. Prosocial activities such as CP sends a signal about the prosocial type of the firm and informs stakeholders of the firm's larger interests and of its accountability to behave in a socially responsible manner (Brammer and Millington 2005)⁶. Therefore, firms can reap reputational benefits of a prosocial strategy. A firm that engage in CP can be perceived as a good citizen toward its stakeholders and is more profitable (Fombrun and Shanley 1990; Brammer and Millington 2005; Himmelstein 1997; Godfrey 2005; Godfrey et al. 2009; Patten 2008). A recent work by Servaes and Tamayo (2013) underlines the role of between the firm's CSR efforts and its overall reputation to observe a positive CSR-value relation (see also Schuler and Cording 2006; Du et al. 2010).

However, incongruence between firms' signals will negatively affect the ability of the firm to establish a prosocial reputation and by extension reap the benefits of a prosocial strategy (e.g., Stern, Dukerich, & Zajac, 2014; Vergne & Brenner, 2017). The consistency argument relates to a recent work by R. Henderson & Van den Steen (2015) who posit that many firms aim to publicly espouse a 'purpose' beyond profit maximization to ultimately achieve economic benefits. Henderson and Van den Steen (2015) argue that this 'purpose' is typically directed towards prosocial goals and relies on two key features: the prosocial activities to establish the firm's purpose need to be 'costly' in monetary terms and they need to be perceived as 'authentic', thus underlining the need for consistency across activities.

The perceived genuine motivations of firms' prosocial activities may be balanced by the material incentives and rewards related to these activities. One important material reward of CP is the tax deductions related to CCDs (e.g., Johnson 1966; Arulampalam and Stoneman 1995; Carroll and Joulfaian 2005). Firms give at particular moments and use specific forms of

⁶ Walmart in their 2016 report emphasizes their role as philanthropists to "deliver greater societal impacts".

contributions as to diminish the after-tax cost of a given gift (Johnson 1966; Arulampalam and Stoneman 1995)⁷. Then, CP offers important tax benefits that may come at a cost for the society by lowering tax revenues and depriving firms' communities. As material benefits of CP become more substantial with the tax deductions, the meaning of CP may change: it becomes more difficult to know to what extent it is motivated by altruism or by greed since stakeholders also differ along both dimensions (Bénabou and Tirole 2010). Therefore, I posit that stakeholders do not interpret firms' intentions of one prosocial activity in isolation but rather refer to the whole picture of firms' activities that have a social impact, in order to assess the consistency of firms' prosocial activities.

While firms that engage in CP are expected to comply with social norms (Bicchieri and Muldoon 2014), firms' tax avoidance behavior does not conform to stakeholders' social expectations. US public opinion is that corporate tax payment is a civic duty and that firms should take part of the collective efforts⁸. Recently, in their CSR reports, firms tend to provide information on their tax policy and tax rates to show their efforts to contribute to society through their tax payments⁹. The reputational costs for engaging in tax avoidance may be significant (Graham et al. 2013; Chen et al. 2010; Austin and Wilson 2017) but potentially differ depending on the type of the tax strategy. The overall firm's tax strategy combines different ways of reducing corporate taxes: nonconforming and conforming tax strategies. Nonconforming tax avoidance reduces the tax accounting profit and the tax liability of the firm without affecting the pre-tax financial accounting profit. Conforming tax avoidance strategies offer firms another possibility to save corporate taxes but are less visible and more difficult to detect (Badertscher et al. 2017). Conforming tax planning does not only reduce the

⁷ One official of the Duke Power foundation has justified the establishment of their charitable foundation 15 years ago "because of the tax benefits that the company derives from giving" as reported in St. John (2000) (Petrovits 2006).

⁸ According to the last annual IRS Taxpayer Attitude Surveys.

⁹ For instance, McDonald's published in its 2010 Worldwide Corporate Social Responsibility Report an important figure of \$1.1 billion for "business taxes, licenses and payroll taxes".

tax accounting profit, but also the financial accounting profit. To the extent that stakeholders of the firm assess tax avoidance using readily available nonconforming strategy measures only, conforming tax avoidance by the firm will go unnoticed.

Inconsistency between firms' nonconforming tax avoidance and CP may lead the public to perceive these firms' intentions as not "authentic"¹⁰ (Effron et al. 2015). Firms' stakeholders may detect such inconsistency and view them as less credible (Wagner et al. 2009; Janney and Gove 2011; Carlos and Lewis 2017). Prior studies show that firms send incongruent signals when they engage in inconsistent actions that may be interpreted as opportunistic or cynical managerial attempts to distort information about the firm (Stern et al. 2014). Incongruent signals will confuse its stakeholders and can lead to long-term adverse consequences, including reputational damage and reduced financial performance (Deephouse 2000). I expect that firms engaged in CP want to maintain their reputations and appear consistent and thus are less likely to engage in nonconforming tax avoidance practices. However, I expect that firms engaged in CP still want to avoid paying their taxes while preserving their image so they will be more likely to engage in less visible tax planning strategies.

For these above reasons, I may observe a negative (positive) relation between CP and firms' nonconforming (conforming) tax avoidance. This leads to my first hypothesis on the relation between CP and the two types of tax avoidance:

H1a: CP is negatively related to nonconforming tax avoidance.

H1b: CP is positively related to conforming tax avoidance.

¹⁰ CEOs are aware of the audiences watching their firm. In a recent PwC survey, CEOs indicate that stakeholders such as customers, government and local communities influence their tax strategy in some way (16th PwC Annual Global CEO Survey 2013).

1.2.3 Economic implications of CP and tax avoidance

I next investigate the implications of joint tax avoidance and CP for firm value. Prior literature document mixed evidence on the relation between CCDs and firm value (Marc Orlitzky et al. 2003), as well as between tax aggressiveness and firm value (Hanlon and Heitzman 2010).

Several studies find evidence that CP contribute to firm performance (Patten 2008; Saiia et al. 2003; Seifert et al. 2004). CCDs can provide greater revenues and bigger profits by increasing firms' sales and bringing advertising values (Patten 2008; Lev et al. 2010). By increasing the corporate reputation and its brand image, CCDs may be perceived by investors¹¹ as profitable projects (Porter and Kramer 2002). In contrast, based on shareholder theory, CP takes away value from shareholders and could have negative long-term effects on firms' financial performance (Friedman 1970; Jensen and Meckling 1976). Investors may consider corporate CCDs as less profitable uses of firm's resources compared to investments in firms' conventional business operations (Williams and Barrett 2000; Dentchev 2004). Masulis and Reza (2015) show that as firms engage more in CP, their corporate cash holdings become less valuable to shareholders.

Existing research documents also mixed evidence relating corporate tax aggressiveness to firm value (Drake et al. 2014; Guenther et al. 2013; Gallemler et al. 2014). Aggressive tax practices generate tax savings that can benefit shareholders (Desai and Dharmapala 2009) by increasing after-tax cash flow as well as after-tax net income (Wilson 2009). These benefits occur only in firms with good corporate governance mechanisms (Desai and Dharmapala 2009; Hanlon and Slemrod 2009). The agency literature argues that

¹¹ There is an increasing interest generated from shareholders on firms' charitable donations. Investors of large firms such as General Electric, The Home Depot, Starbucks, Target, Procter and Gamble, and Wells Fargo have requested, in their proposals, disclosure of all firms' charitable donations (Conference Board Director Note by Baruch Lev, 2011 available on <https://corp.gov.law.harvard.edu/2011/08/20/making-the-business-case-for-corporate-philanthropy/#25>).

shareholders do not desire tax avoidance activities because the benefits of these tax strategies may not outweigh their costs (i.e., Internal Revenue Service (IRS) audit risk, penalties and reputational costs). Tax aggressive firms may face important penalties imposed by tax authorities and are likely to be challenged by the IRS (Wilson 2009). Investors are also sensitive to a potential future loss of corporate reputation associated with riskier tax strategies (Hanlon and Slemrod 2009; Drake et al. 2014). Reputational costs is an important element to consider when firms' executives decide their tax strategies (Graham et al. 2012). Hanlon and Slemrod (2009) find abnormal negative returns following an announcement that firms use tax shelters.

Tax avoidance practices could affect firm valuation of CP based on investors' perception about consequences of tax strategies. Some studies suggest that engaging simultaneously in socially responsible and irresponsible corporate initiatives can be an effective strategy for firms to deal with public criticism and mitigate reputational threats (e.g., Greenwashing) (Lyon and Maxwell 2011). Firms can manage their image by engaging in CSR actions that provide firms with insurance and protection against potential damages (Godfrey 2005, 2009). Therefore, investors can perceive the simultaneous use of tax aggressiveness and CP as beneficial to the firm because donations may offset the potential reputational cost of aggressive tax activities (Drake et al. 2014).

In contrast to the insurance view of CP, another theory suggests that visible prosocial actions provide also easy targets for public criticism (McDonnell et al. 2015; Rhee and Haunschild 2006). Involvement in CP can make firms vulnerable in terms of attracting more criticism, if firms' actions are not consistent. Negative media coverage related to tax can threaten a firm by generating negative perceptions from the public and higher risk perceived by investors (Bansal and Clelland 2004). Therefore, investors may perceive the use of nonconforming tax avoidance strategies for firms engaged in charitable activities inconsistent

leading to a higher risk of negative implications for firms' reputation. Perceptions of corporate inconsistency will confuse its stakeholders and can lead to long-term adverse consequences, including reputational damage and reduced financial performance (Deepphouse 2000).

Investors may not observe a firm's conforming tax avoidance strategy given its low level of transparency. Firms are not concerned by reputational threats of their tax avoidance strategy. Consequently, I expect that investors do not perceive the use of conforming tax avoidance strategy for firms engaged in CP as leading to negative implications for firms' reputation and value. The effect of the two concurrent firms' practices – CP and conforming tax avoidance - will be either positive or negative on firm value depending on investors' view of CP.

Taken together, I expect that investors view positively or negatively firms that engage simultaneously in CP and tax avoidance strategy. This leads to the following second hypothesis (stated in the null form):

H2: CP does not affect the relation between tax avoidance strategies and firm value.

1.3 Research design and data

1.3.1 Corporate philanthropy and tax avoidance measures

I follow prior literature in order to measure my key variables i.e., CP, my main independent variable (Masulis and Reza 2015) and tax avoidance (H1) and firm value (H2), my two dependent variables (Hanlon and Heitzman 2010).

Measure of corporate philanthropy

The measure of CP consists of the amount of cash charitable donations. It includes both direct donations from firms to not-for-profits organizations and donations from corporate

foundations to not-for-profits organizations. My measure of corporate donation $CP_{i,t}$ is the natural logarithm of one plus corporate cash donations of firm I in year t scaled by total assets and multiplied by 10^3 as in Masulis and Reza (2015).

Measure of nonconforming tax avoidance by using tax aggressiveness

Prior studies have studied and employed several measures of nonconforming tax avoidance. I use four proxies for firms' tax aggressiveness to measure nonconforming tax avoidance in the main test: the effective tax rate, the cash effective tax rate and two measures of book-tax difference. Below, I explain the choice and specification of each measure (I also define all variables in Appendix 1-A).

The first measure is the GAAP effective tax rate (ETR) calculated as the sum of a firm's total tax expense divided by pretax income. A lower effective tax rate indicates tax aggressiveness. I multiply the effective tax rate by negative one so that greater values for ETR indicate higher tax aggressiveness.

The second measure of tax aggressiveness is the cash effective tax rate ($CETR$) measured as cash taxes paid divided by pretax income. This measure is not affected by tax-related accruals such as deferred tax asset and liability. I multiply the cash effective tax rate by negative one so that greater values for $CETR$ indicate higher tax aggressiveness.

The third and fourth measures of tax aggressiveness are the total book-tax differences BTD based on Dunbar et al. (2010) and the Manzon-Plesko total book-tax difference $MPBT$ based on Manzon and Plesko (2002). Book-tax differences are the differences between the firms' reported taxable income and reported financial accounting income. BTD is measured as the difference between pretax income and an estimate of taxable income, divided by lagged total assets. Taxable income is estimated by grossing up the sum of federal tax expense and

foreign tax expense by the US statutory tax rate. Large *BTD* indicates high tax aggressiveness.

MPBT is calculated as the following:

$$MPBT_{i,t} = DOM_INC_{it} - DOM_TAXINC_{it} - S_INCTAX_{it} - O_INCTAX_{it} - EQINC_{it} \quad (1)$$

Where: DOM_INC_{it} = US domestic financial income of firm i in year t , scaled by lagged assets; DOM_TAXINC_{it} = US domestic taxable income of firm i in year t , scaled by lagged assets; S_INCTAX_{it} = State Income Taxes of firm i in year t , scaled by lagged assets; O_INCTAX_{it} = Other Income Taxes, scaled by lagged assets and $EQINC_{it}$ = equity income in earnings for firm i in year t , scaled by lagged assets.

Because CCDs allow for tax deductions and therefore affect the tax aggressiveness measures, I adjust the measures accordingly. Indeed, tax deductions from CCDs reduce the firm's taxable income, cash tax payment, and income tax expense¹². Thus, tax deductions from CCDs make the giving firms to appear to be more tax aggressive. I address this mechanical relation in order to measure a firm's tax aggressiveness before the firm gets tax deductions from their donations. For the measures *ETR*, *CETR*, *BTD* and *MPBT*, I add to firm's taxable income the tax deductions obtained from CCDs measured as the amount of cash CCDs multiplied by the US statutory tax rate.

Other than the four main variables (*ETR*, *CETR*, *BTD*, and *MPBT*), I also use seven alternative measures of tax aggressiveness in robustness tests that I discuss in section 7.

Measure of conforming tax avoidance

I also analyze whether firms engaged in CP attempt to be perceived as consistent and maintain their reputation of having a prosocial behavior. I test whether firms engaged in CP use less visible tax strategies i.e., conforming tax avoidance rather than tax aggressiveness

¹² I only adjust the tax aggressiveness by the amount of the tax deductions allowed by CCDs. I do not remove from the book income the amount of the CCDs.

consistently with their charitable activities. For this purpose, I use the measure of conforming tax avoidance developed by Badertscher et al. (2017), which captures book-tax conforming transactions. Conforming tax strategies are defined as “all book-tax conforming transactions that reduce a firm’s explicit tax liability” (Badertscher et al. 2017). One example of conforming tax avoidance is firms’ tax deductions from CCDs because donations decrease both book income and taxable income. I expect that the relation between conforming tax avoidance and CP is positive.

The measure *CONFORM_TAX* is calculated as the residual from the following regression, which I estimate by 2-digit SIC code and fiscal-year combinations. I follow Badertscher et al. (2017) and require at least 10 observations to be available for each industry and fiscal year combination:

$$\begin{aligned}
 TAXES_PAID_TO_ASSETS_{it} = & b_0 + b_1 BTD_{it} + b_2 NEG_{it} + b_3 BTD_{it} \times NEG_{it} + b_4 NOL_{it} \\
 & + b_5 \Delta NOL_{it} + b_6 SALES_TO_NOA_{it} \\
 & + Industries\ Fixed\ Effects_i + Year\ Fixed\ Effects_t + \varepsilon_{i,t} \quad (2)
 \end{aligned}$$

Where: *TAXES_PAID_TO_ASSETS_{it}* is the ratio of cash taxes paid to lagged total assets; *BTD_{it}* is book-tax differences; *NEG_{it}* is an indicator variable set to one for observations with negative book-tax differences (and 0 otherwise); *NOL_{it}* and *ΔNOL_{it}* capture the level and change in net operating loss carryforwards; *SALES_TO_NOA_{it}* is the ratio of sales to net operating assets. A higher value of *CONFORM_TAX* should be interpreted as a lower conforming tax avoidance.

Measure of firm value

Consistent with prior literature (Desai and Dharmapala 2009), I measure *Firm_Value_{it+1}* using the Tobin’s Q ratio of firm *i* in year *t+1*. Tobin’s Q is the valuation placed on a firm’s assets by the market relative to their book value (i.e., replacement cost of assets). I calculate *TOBIN*

as the sum of the book value of current debt, long-term debt and market value of equity, divided by the book value of total assets.

1.3.2 The association between corporate philanthropy and nonconforming and conforming tax avoidance

To investigate whether the association between CP and nonconforming and conforming tax avoidance (H1), I estimate the following regression model:

$$\begin{aligned}
 TAX_AVOID_{it} = & b_0 + b_1 CP_{it} + b_2 SIZE_{it} + b_3 LEV_{it} + b_4 NOL_Dummy_{it} + b_5 NOL_{it} + b_6 FI_{it} \\
 & + b_7 CASH_{it} + b_8 RD_{it} + b_9 GW_{it} + b_{10} SALES_{it} + b_{11} MB_{it} + b_{12} XSGA_{it} + b_{13} ROA_{it} \\
 & + b_{14} PPE_{it} + b_{15} CAPEX_{it} + b_{16} INTAN_{it} + b_{17} TAXBEN_{it} + b_{18} EQINC_{it} \\
 & + b_{19} CG_score_{it} + Industry\ or\ Firm\ fixed\ effects_i + Year\ fixed\ Effects_t + \varepsilon_{i,t} \quad (3)
 \end{aligned}$$

Where:

$TAX_AVOID_{i,t}$ = one of the four measures of tax aggressiveness to proxy for nonconforming tax avoidance TAX_AGG or the measure of conforming tax avoidance $CONFORM_TAX$ for firm i in year t presented in Section 4.1;

$SIZE_{it}$ = natural logarithm of total assets;

LEV_{it} = financial leverage at the end of the year, calculated as long-term debt scaled by lagged total assets;

NOL_Dummy_{it} = 1 if loss carry forward is positive, 0 otherwise;

NOL_{it} = tax loss carry forward scaled by lagged assets;

FI_{it} = 1 if a firm has foreign pretax income and 0 otherwise;

$CASH_{it}$ = cash holdings at the end the year, scaled by lagged total assets;

RD_{it} = research and development expenses at the end of the year scaled by lagged total assets;

GW_{it} = goodwill scaled by lagged total assets;

$SALES_{it}$ = sales growth over the prior year;

MB_{it} = market-to-book ratio at the end of the year, calculated as the market value of equity divided by the book value of equity;

$XSGA_{it}$ = selling, general and administrative expenses scaled by lagged total assets;
 ROA_{it} = return on assets measured as operating income scaled by lagged total assets;
 PPE_{it} = net property, plant, and equipment at the end the year, scaled by lagged total assets;
 $CAPEX_{it}$ = capital expenditures at the end of the year scaled by lagged total assets;
 $INTAN_{it}$ = intangible assets at the end of the year scaled by lagged total assets;
 $TAXBEN_{it}$ = tax benefit of stock options divided by lagged total assets;
 $EQINC_{it}$ = equity income in earnings scaled by lagged total assets;
 CG_score_{it} = corporate governance score of ASSET4 Thomson Reuters, a provider of environment, social and governance data. The corporate governance score includes board functions, board structure, compensation policy, shareholders' policy, and vision-and-strategy.

The main independent variable is the measure of *CP*. Coefficient b_1 captures the relation between tax avoidance (i.e., nonconforming and conforming strategies) and *CP* (*HI*). I also include year, industry and firm fixed-effects to control for the variability of tax aggressiveness across time, across industries and firms. All t-statistics are calculated using standard errors clustered by firm.

1.3.3 The association between CP, tax avoidance and firm value

I investigate whether firms engaging simultaneously in *CP* and tax avoidance have different firm value relative to other firms by estimating the following OLS regression:

$$\begin{aligned}
 TOBIN_{it+1} = & b_0 + b_1 CP_Dummy_{it} + b_2 TAX_AVOID_{it} + b_3 TAX_AVOID_{it} \times CP_Dummy_{it} \\
 & + b_4 LEV_{it} + b_5 MKT_SHARE_{it} + b_6 CAPXPPE_{it} + b_7 GROWTH_{it} + b_8 FI_{it} \\
 & + b_9 MKTCAP_{it} + b_{10} ADV_{it} + b_{11} RD_{it} + b_{12} DIV_{it} + b_{13} CG_Score_{it} \\
 & + Industry\ Fixed\ Effects_i + Year\ Fixed\ Effects_t + \varepsilon_{i,t}
 \end{aligned} \tag{4}$$

where:

$CP_Dummy = 1$ if a firm makes charitable donations in a given year to nonprofits and 0 otherwise;

LEV_{it} = long-term debt scaled by total assets;
 MKT_SHARE_{it} = Market share for a firm in a given year calculated as the sales divided by the total sales of the firm's industry.
 $CAPXPPE_{it}$ = capital expenditures divided by net property, plant and equipment;
 $GROWTH_{it}$ = average sales growth over the two prior years;
 FI_{it} = 1 if a firm has foreign pretax income and 0 otherwise;
 $MKTCAP_{it}$ = market capitalization calculated as the logarithm of the market value of equity;
 ADV_{it} = advertising expenditures divided by lagged total assets;
 RDI_{it} = 1 if a firm has foreign pretax income and 0 otherwise;
 DIV_{it} = dividends scaled by book value of equity;
 CG_score_{it} = corporate governance score of ASSET4 Thomson Reuters.

My coefficient of interest is b_3 . A positive and significant b_3 suggests that the simultaneity of one of the tax avoidance strategies and corporate charitable donation has a positive impact on firm value.

1.3.4 Data and sample selection

I identify cash CCDs by hand-collecting data from two sources: the Foundation Center online (i.e. the Foundation Directory Online, FDO)¹³ and NOZAs¹⁴. The Foundation Center collected the data from a combination of surveys and public records including IRS information returns (Forms 990 and 990-PF), grant-makers' websites, annual reports, philanthropic press and other sources. Generally, all grants of over \$10,000 are included for all foundations. Moreover, the FDO only includes corporate donations that are verified by firms themselves or compiled from reliable public records (the database relies on more than 35 diverse information sources). While disclosure of corporate donations through firms' foundations is mandatory, the disclosure of direct charitable donations is voluntary which creates a potential self-selection issue for this type of donation.

¹³ For more information, see: www.foundationcenter.org/fdo

¹⁴ For more information, see: www.nozasearch.com

In order to ensure accuracy of my compiled database and alleviate the potential self-selection of direct donations, I crosscheck and complete the data with a second source of donations data, i.e., NOZAsearch that provides amounts of corporate donations mostly from nonprofits sources (i.e., nonprofits' websites). Obtaining data from the recipients of donations allow to address the issue of firms that want to withhold the information about their direct donations. This search engine is the world's largest searchable database for charitable donation records. It is comprised of detailed charitable donations that have been collected from publicly available Internet locations such as nonprofits' websites. When FDO does not display the donation amount for a firm-year observation, I use the amount displayed in NOZAsearch, if available¹⁵. NOZAsearch provides a donation range for each donation. I adopt a conservative approach by taking the lower bound for each donation record because sometimes the upper bound is specified as "And up" (i.e., higher unknown amount). I exclude donation amounts recorded as "Not specified". Finally, to be consistent with the FDO database, I include only donations of over \$10,000.

The initial sample consists of Fortune 700 US firm-year observations for the years 2003 through 2014 (7,317 observations) (see Table 1-1 below). These are the 700 largest firms in terms of total revenues comprised in the Fortune ranking of 2015. I require that all necessary accounting and financial data be available in Compustat. I also require necessary data for the control variables. I exclude financial institutions (SIC codes 6000-6999) due to the different nature of the specificities of this industry. Depending on the tax avoidance measure used, my final sample varies between 3,875 and 4,187 firm-year observations (between 409 and 423 firms). Table 1-1 provides details on the composition of the sample. As Table 1-1 shows, 3,035 out of 4,521 firm-year observations in the dataset have non-zero

¹⁵ When the firm-year donation is missing in NOZAsearch, I assumed a zero donation.

charitable donations. To mitigate the influence of outliers, I winsorize all continuous variables at the 1% and 99% percentiles.

[Insert Table 1-1 here]

1.3.5 Descriptive statistics

Panel A of Table 1-2 provides summary statistics of the variables used in the baseline regressions and auxiliary analyses. The mean (median) values of effective tax rate and cash effective tax rate are 31% (32%) and 26% (25%) respectively. The mean values of book-tax differences *BTD* and *MPBT* are 0.021 and 0.009 respectively. The average annual amount of CCDs of the Fortune 700 firms is about \$2.9 million. The average annual amount of CP through corporate charitable foundation is about \$2.3 million, compared to the average of \$0.522 million given through direct giving programs. The sample statistics for variables capturing firm characteristics are in the range of those in the extant literature (Davis et al. 2016). For instance, the mean (median) market-to-book ratio is 4.450 (2.505) and the mean (median) size is 9.131 (9.012). The standard deviation of my measure of CCDs is \$0.24 million and the inter-quartile spread ranges from 0 to 0.141, suggesting variations in the levels of donations.

Panel B of Table 1-2 presents summary and univariate statistics of tax aggressiveness measures and firms' characteristics. I partition the sample into the giving firms and the non-giving firms. I compare firm financial and tax variables between these two subsamples by using Student's t-test. Giving firms have systematically better performance (mean *ROA* of 0.106 against 0.096), greater size (mean *SIZE* of 9.316 against 8.753), greater level of R&D (mean *RD* of 0.023 against 0.019), PPE (mean *PPE* of 0.323 against 0.300) and capital expenditures (mean *CAPEX* of 0.056 against 0.053) and better corporate governance (mean *CG_Score* of 68.712 against 54.848) than non-giving firms. The univariate t-tests provide

limited empirical support for a negative relation between CP and tax aggressiveness: the mean of cash effective tax rate is significantly higher for the giving firms than for the non-giving firms (t-test=-1.84), suggesting that firms engaged in CP pay more taxes relative to firms not engaged in CP. However, the other measures of tax aggressiveness are not significantly different between the giving firms and the non-giving firms (t-stat for *ETR_RAW* and *MPBT* are equal to 1.57 and 0.95, respectively) or suggest that giving firms are more tax aggressive than non-giving firms (t-stat for *BTD* is -2.17). Multivariate tests performed in the subsequent section allow me to control for a number of factors that can complicate statistical inferences from univariate tests.

Panel C presents the industrial composition of the sample based on the two-digit Standard Industrial Classification (SIC) code. Panel C shows that manufacturing (52%), services (11.7%) and retail trade (11.6%) are the top three industries most likely to make charitable donations. Panel D provides the Pearson correlation matrix between variables. The Pearson correlation between *CP* and the measure of cash effective tax rate *CETR* is negative and significant (coef.=-0.050) indicating a negative association between CP and tax aggressiveness.

[Insert Table 1-2 here]

1.4 The association between corporate philanthropy and nonconforming /conforming tax strategies

1.4.1 Baseline model: results

Table 1-3 presents the regression results for the test of the first hypothesis on the association between corporate nonconforming tax avoidance and CP. I conduct the analyses using four proxies of tax aggressiveness. The coefficients on *CP* are negative and significant across all

models. When I use *ETR* in column (1), the coefficient of *CP* is -0.015, significant at the 10% level. This result is economically significant. The *CP* estimate in the *ETR* regression suggests that an increase of *CP* from the 25th percentile to 75th percentile in the data i.e., an increase of charitable donations from 0 to \$2.6 million (i.e., increase of *CP* from 0 to 0.141) is related to an increase of the effective tax rate of 0.21 percentage point ($= 1.5\% \times (0.141 - 0)$). Given that the mean value of pretax income is \$1.39 billion, the increase in annual tax expense amounts to \$2.94 million. When I use *CETR* in column (2), the coefficient of *CP* is negative and significant at the 5% level (coef. = -0.028). This result suggests that an increase of charitable donations from 0 to \$2.6 million is related to an increase of the cash effective tax rate of 0.39 percentage point ($= 2.8\% \times (0.141-0)$). When I use *BTD* in column (3) and *MPBT* in column (4), the coefficients of *CP* are negative and significant at the 5% level 10% level respectively (coef. = -0.012 and -0.010 respectively). Overall, these results show that firms' nonconforming tax strategy is significantly and negatively associated with the levels of CP after controlling for firm characteristics, industries and years effects¹⁶.

Both tax avoidance and CP are firm choices. Even though I do not try to document causality, some unidentified factors can drive both tax activities and corporate charitable contributions. To address this issue, I run the main test with firm fixed-effects. Panel B of Table 1-3 reports the corresponding results when I add firm fixed-effects. Adding firm fixed effects allow to capture the within firm relation between variation of tax aggressiveness and CP. The coefficients on *CP* are negative and significant across all models, supporting the results from the baseline regressions. The coefficients are -0.016, -0.032, -0.013 and -0.012 when I use *ETR*, *CETR*, *BTD* and *MPBT* as the dependent variable, respectively. Because firm fixed-effects are controlled for, the results are unlikely to be driven solely by omitted variables.

¹⁶ I also perform these tests on a sample of giving firms only (i.e., CCDs higher than zero) in order to reduce the self-selection bias. The results (not tabulated) are qualitatively identical.

[Insert Table 1-3 here]

Table 1-4 reports the results of the regression testing the association between CP and conforming tax avoidance. Columns (1) and (2) reports the results with industry and firm fixed-effects, respectively. The coefficients on *CP* are positive and significant across the models. The coefficients of *CP* are 0.690 and 1.374 when I have industry and firm fixed-effects, respectively. This result contradicts my prediction. Similarly to my previous findings, these results mean that firms engaged in CP are also less likely to engage in a less easily detectable tax avoidance strategy. While the conforming tax avoidance does not appear inconsistent in the eye of the public, firms choose not to engage in inconsistent practices with their prosocial behavior of giving donations to charities. The conforming tax avoidance is less visible but given that the presence of CP puts some light on these firms, they are not enticed to engage in any form of tax avoidance. My finding reveals the importance of firms' self-image of consistency and also that prosocial firms are averse to any risk that may affect their prosocial reputation and the associated benefits.

Taken together, the empirical evidence suggests that firms that make charitable donations are truly consistent across their prosocial activities and therefore are less likely to engage in any form of tax avoidance, potentially detrimental to the corporate reputation.

[Insert Table 1-4 here]

1.4.2 Cross-sectional tests

In this section, I exploit cross-sectional variations to explore whether differences in firms' characteristics or time periods influence the negative relation between nonconforming tax avoidance strategies and CP in a manner consistent with my main findings.

First, I exploit cross-sectional variations in firms' negative reputation. A firm's current reputation reflects the public opinion formed, either directly from interactions with the firm or via other information channels such as the media. I posit that firms with lower reputation may moderate positively the relation between tax aggressiveness and CP. Indeed, a firm with a lower reputation, for instance due to controversies published in the media, may lead manager to undertake socially irresponsible actions such as tax aggressive strategies even if they are likely to deteriorate further corporate reputation. For instance, Hoi et al. (2013) find that irresponsible corporate social activities are positively related to firms' tax avoidance. Hence, I predict that the relation between tax aggressiveness and CP is positive or less negative for firms with lower reputation relative to other firms. However, I predict that the relation between conforming tax avoidance and CP is positive or non significant for firms with a low reputation since firms with a low reputation do not need to engage in less visible tax planning.

I measure "low corporate reputation" with a dummy variable coded as 1 if firms receive more than 8 controversies published in the media (which corresponds to the highest quintile of the sample), and 0 otherwise. I obtain firms' controversies published in the media from the ASSET4 Thomson Reuters database. To examine how the firm's low reputation influences the relation between tax aggressiveness and CP, I estimate the following model:

$$TAX_AGG_{it} = b_0 + b_1 CP_{it} + b_2 LOW_REPUT_{it} + b_3 CP_{it} \times LOW_REPUT_{it} + Controls + Industry\ Fixed\ Effects_i + Year\ Fixed\ Effects_t + \varepsilon_{i,t} \quad (5)$$

Where:

LOW_REPUT = 1 if the firm has a low reputation i.e., if a firm receives more than 8 controversies published in the media, and 0 otherwise.

Table 1-5 reports the results. Across three models, the coefficients on $CP \times LOW_REPUT$ are positive and significant in columns (1), (2) and (3) when using ETR (coef. = 0.055), $CETR$ (coef. = 0.095) and BTD (coef. = 0.045) as the measures of tax

aggressiveness. This finding indicates the positive effect of firms' low reputation on the level of tax aggressiveness for giving firms. The results provide evidence that firms engaged in CP but with lower reputation are more likely to be tax aggressive than other firms because the incremental reputation costs of such actions are lower relative to firms with better reputation. However, in accordance with my expectation, the coefficient on $CP \times LOW_REPUT$ is not significant in columns (6) when using conforming tax avoidance.

Similarly, these findings are in line with the arguments previously developed for *HI* that a good corporate reputation deters charitable firms from engaging in tax aggressiveness but once a firm has a poor reputation they do not need to hide their nonconforming tax avoidance in order to be perceived as consistent and maintain the firm reputation.

[Insert Table 1-5 here]

Second, I exploit cross-sectional variations in the period following hurricane Katrina in 2005, to explore whether this period susceptible to firms' overexposure alter the negative relation between nonconforming tax avoidance and CP. In periods following natural disasters, the public and media attention to CP is the highest leading CP to be overexposed (Mishra 2006). Communities expect that firms engage in CP to help the community, especially the large firms included in the sample. Firms failing to help the community are likely to appear as insensitive and may suffer from important reputation risks. Following hurricane Katrina, CCDs were heavily covered in the media and received large amounts of public attention¹⁷. Visible prosocial actions provide also easy targets for public criticism (McDonnell et al. 2015; Rhee and Haunschild 2006). Involvement in CP can make firms vulnerable in terms of attracting more criticism, if firms' actions are not coherent. The desires to be consistent and mitigate reputational concerns explain why firms do not adopt a potential nonconforming tax

¹⁷ <http://www.nytimes.com/2007/12/23/jobs/23mgmt.html>

avoidance strategy. I posit that following hurricane Katrina, the public scrutinizes firms' behaviors that affect communities, whether in terms of firms' charitable donations or tax strategies. I then predict that the effect of firms' overexposure in the wake of hurricane Katrina has an incremental negative (positive) effect on the relation between nonconforming (conforming) tax avoidance and CP. Therefore, I create a dummy variable that indicates years following hurricane Katrina. It is coded as 1 for years 2005 and 2006 and 0 otherwise. To examine how the firm's overexposure following Katrina influences the relation between tax aggressiveness and CP, I estimate the following model:

$$TAX_AGG_{it} = b_0 + b_1 CP_{it} + b_2 KATRINA_{it} + b_3 CP_{it} \times KATRINA_{it} + Controls + Industry\ Fixed\ Effects_i + Year\ Fixed\ Effects_t + \varepsilon_{i,t} \quad (6)$$

Where: *KATRINA* = 1 for the year of hurricane Katrina (2005) and the year after (2006) and zero otherwise.

Table 1-6 reports the results. Across three models, the coefficients on *CP* × *KATRINA* are negative and significant in columns (2), (3) and (4) when using *CETR* (coef. = -0.046), *BTD* (coef. = -0.020) and *MPBT* (coef. = -0.013) as dependent variables. This finding indicates the negative incremental effect of firms' high exposure on the level of tax aggressiveness for giving firms. The results provide evidence that firms engaged in CP are even less likely to adopt a nonconforming tax avoidance behavior when the public attention on CP is the highest rather than during other periods. These results are consistent with my main finding for the negative association between charitable donation and nonconforming tax avoidance (*HI*). However, I find non-significant results for *CONFORM_TAX*.

[Insert Table 1-6 here]

1.5 Implications of tax avoidance strategies and CP for firm value

I empirically examine the impact of nonconforming and conforming tax avoidance on the relation between CP measured by *CP_Dummy* and firm value measured by the Tobin's Q (*TOBIN*).

Table 1-7 Panel A reports the results of estimating Equation (2). The coefficient of *CP_Dummy* is negative and significant across two tax aggressiveness measures *ETR* (coef. = -0.532) and *CETR* (coef. = -0.248). This result suggests that investors negatively value firms engaged in CP. I also observe positive results for the effect of nonconforming tax avoidance on firm value when I use *BTD* (coef.= 2.230) and *MPBT* (coef.= 2.396) as tax aggressiveness measures.

I am specifically interested in the coefficients of interaction terms between *CP* and the nonconforming tax avoidance measures because they allow me to analyze how investors value inconsistency between tax aggressiveness and CP. The coefficients on the interaction variable are statistically significant and negative across the models (*ETR*, coef. = -1.392; *CETR*, coef. = -0.566; *BTD*, coef. = -1.517; *MPBT*, coef. = -1.523), suggesting that firm value is lower for firms engaged in CP that also engage in tax aggressiveness.

These results are economically significant. The *CP* estimate in the *ETR* regression in column (1) suggests that an increase of *CP* and *ETR* from the 25th percentile to 75th percentile in the data is related to a decrease of firms' Tobin's Q of 2.16 percentage point ($= -1.392 \times (0.141 - 0) \times (-0.026 + 0.037)$). In column (2), an increase of *CP* and *CETR* from the 25th percentile to 75th percentile in the data is related to a decrease of firms' Tobin's Q of 1.52 percentage point ($= -0.566 \times (0.141 - 0) \times (-0.145 + 0.336)$). This evidence suggests that tax aggressive firms engaged in CP send contradictory signals to investors about their prosocial behavior increasing reputation risks and ultimately reducing firm value. These findings do not

support the argument according to which CP may mitigate the negative image associated with tax aggressiveness. Instead, the results indicate that firms' behavior inconsistency deteriorate firm value.

Table 1-7, Panel B reports the results of estimating Equation (2). The coefficient of *CP_Dummy* is positive and significant suggesting that investors negatively value firms' consistency of prosocial behaviors.

[Insert Table 1-7 here]

1.6 Robustness tests

1.6.1 Robustness tests for the relation between tax avoidance and CP

Alternative measures of nonconforming tax avoidance

I perform several sensitivity tests for *HI* using seven alternative measures for tax aggressiveness including a factor derived from a principal component analysis from the main four measures of tax aggressiveness to address potential measurement errors of each individual proxy.

First, I use the adjusted versions of the four main tax aggressiveness measures *ETR*, *CETR*, *BTD* and *MPBT*. Following Balakrishnan et al. (2012), I adjust these measures by the same period's tax aggressiveness measure for the portfolio of firms in the same quintile of total assets and in the same industry (defined as two-digit SIC code). Their adjusted versions of the four main measures are labeled *ETR_adj*, *CETR_adj*, *BTD_adj* and *MPBT_adj*. Second, I use a principal component analysis to extract the principal component *FACTOR_TAX* from the four measures that I employ in my main analysis (*ETR*, *CETR*, *BTD*, and *MPBT*). Third, I use the abnormal book-tax difference *ABNBTD*. This proxy attempts to separate total book-tax differences into those that are not attributable to tax planning (normal *BTD*) and those that

are attributable to tax planning (abnormal *BTD*). As the book-tax difference can be a result of earnings management and tax planning, this measure is robust to book-tax differences caused by earnings management activities. Fourth, I capture another range of tax aggressiveness with a tax sheltering measure. *SHELTER* is the predicted probability that the firm uses tax shelters, based on Wilson's (2009) model.

In Table 1-8, Panel A reports the regression results using seven alternative measures of tax aggressiveness. The coefficients of *CP* are negative and significant across all alternative measures. Overall, the results corroborate my previous findings that firms with higher levels of CCDs are less likely to engage in tax aggressiveness.

[Insert Table 1-8 here]

Alternative measures of corporate charitable donations

I conduct additional tests to examine whether the results are also robust to alternative CCDs measures, other than the amount of CCDs. First, I employ a dummy measure of CP coded as 1 if a firm makes charitable donations in a given year and 0 otherwise. Second, I employ a measure of excess CP i.e., unexpected CCDs following Chang et al. (2016). CP can be decomposed into two components: the one that can be explained by firms' characteristics such as industry or profitability, and the one that is unexpected. The variable *ExcessCP* is measured as a residual of the following model:

$$\begin{aligned}
 \text{Corporate cash donations} = & b_0 + b_1 \text{Size}_{it} + b_2 \text{Leverage}_{it} + b_3 \text{Cash Ratio}_{it} \\
 & + b_4 \text{ROA}_{it} + b_5 \text{R\&D ratio}_{it} + b_6 \text{Advertising intensity}_{it} \\
 & + b_7 \text{Non-dividend dummy}_{it} + b_8 \text{Corporate Governance} \\
 & + \text{Industries Fixed Effects}_i + \text{Year Fixed Effects}_t + \varepsilon_{i,t} \quad (7)
 \end{aligned}$$

The residuals of the model represent excess or unexpected CP *Excess_CP*.

Panel B of Table 1-8 presents the regression results using these two alternative measures of CP: *CP_Dummy* and *Excess_CP* as the main independent variables. I find that across three models the coefficients on *CP_Dummy* are significantly negative. In columns (1), (2) and (4), the coefficients are -0.009, -0.017 and -0.004 when I use respectively *ETR*, *CETR* and *MPBT*. When I use *Excess_CP* as alternative measure of CP, all the coefficients are significant either at 10% and 5% levels and negative across the tax aggressiveness measures. These results are consistent with the main findings. The negative relation between tax aggressiveness and CP holds even when firms give excess donations.

Additional control variables of tax aggressiveness

In further tests, I include three additional control variables that might affect firms' tax aggressiveness: managerial ability, the firm's score of their social activities and the firm's social capital. Managerial ability could explain my results since high ability managers can maximize tax avoidance in order to increase firm value (Francis et al. 2013). Managerial ability is the relative efficiency which maximizes the firm output compared to peers in the same industry (Demerjian et al. 2012). To measure managerial ability, I use the *MA_SCORE* developed in Demerjian et al. (2012)¹⁸. This score assigns a higher score to managers who can produce more revenues given a certain set of inputs, after controlling for firm effects such as firm size, market share and organizational complexity. Moreover, the corporate social activities and firms' social capital have been shown to affect firms' tax aggressiveness. I control for the social pillar of the CSR score from ASSET4 Thomson Reuters. Following Rupasingha et al. (2006), I capture the levels of social capital in US counties by strength of civic norms and density of social networks in the counties where corporate headquarters are located. I use the county-level social capital measure based on the data provided by the Northeast Regional Center for Rural Development (NRCRD) at the Pennsylvania State

¹⁸ The dataset are available here: <http://faculty.washington.edu/pdemerj/data.html>

University. The social capital measure includes voter turnouts in presidential elections, response rates in US census surveys, the total numbers of non-profit organizations, and the total numbers of ten types of social organizations for all US counties in the years of 2005, 2009 and 2014. Therefore, I re-estimate equation (1) by including controls for managerial ability, social score and social capital.

As reported in Table 1-8 Panel C, the coefficients on *CP* are significant and negative across the tax aggressiveness measures. This result suggests that the documented relation between *CP* and tax aggressiveness is unlikely to be driven by managerial ability, firms' social activities or social capital.

Propensity score matched sample

Both tax avoidance and *CP* result from managerial choices. I interpret the results as evidence that managers exhibit a consistent behavior when they make donations and tax decisions. Even though I do not try to document causality, other unidentified firm-specific characteristics can drive both tax avoidance and *CP*. To address this issue, I run the main test on a sample of propensity-matched firms.

The propensity score matching technique allows to control for differences in observable firm characteristics between giving firms and non-giving firms while estimating the donations' impact on tax avoidance. I select a control sample of firms classified as non-giving firms (*CP_Dummy* = 0) to match against firms that are classified as giving firms (*CP_Dummy* = 1). This procedure reduces the possibility that the comparison of subjects that are inherently different could bias the results. My treatment group includes the "giving firms" that make large donations to charities, whereas the control group includes "non-giving firms" that make low or do not make charitable donations. Specifically, following prior studies, I match on firms' return on assets (*ROA*), cash holdings (*CASH*), size (*SIZE*) and R&D expenses (*RD*), (Brown et al. 2006; Gautier and Pache 2015). I also match on industries (2-

digit SIC codes) to control for fundamental differences in CP that may exist across industries.

The logistic propensity score model is as follows:

$$CP_Dummy_{it} = b_0 + b_1 ROA_{it} + b_2 CASH_{it} + b_3 SIZE_{it} + b_4 RD_{it} + b_5 SIC2_t + \varepsilon_{it} \quad (8)$$

Panel A of Table 1-9 presents the selection model that predicts the decision for a firm to make charitable donations. I obtain the propensity score for each firm-year as the predicted value of equation (7) and then match with replacement each treatment firm (giving firm) with a control firm (non-giving firm) that has the closest score within a caliper distance of 0.03 from the treatment firm's propensity score. In Panel B, I compare the average treatment effects on tax avoidance levels between giving and non-giving firms for the four main tax aggressiveness measures and the conforming tax avoidance measure before and after the matching. I observe the reduction of bias after the matching. The matching allows eliminating or reducing some of the differences between giving and non-giving firms in terms of firm size (difference insignificant), R&D expense (the difference is significant at 10%). Because I draw matched non-giving firms from a relatively small pool of observations, I am unable to eliminate the differences in firm profitability and industry between treated and control firms.

Panel C of Table 1-9 presents the results of the regression using the propensity-score matched sample. Similarly to my previous results in Table 3, the coefficients for *CP_Dummy* are negative and significant for *ETR* (coef.= -0.010), *CETR* (coef.= -0.016), and *MPBT* (coef.= -0.005) consistent with a lower propensity to be tax aggressive among firms engaged in CP and positive and significant for *CONFORM_TAX* (coef.= 0.005). Taken together, these results present evidence that firms that engage in CP are less likely to be tax aggressive, compared to firms that do not engage in CP.

[Insert Table 1-9 here]

1.6.2 Robustness tests for the relation between tax avoidance strategy, CP and firms value

Alternative measures of tax aggressiveness

I perform several sensitivity tests for *H2* using the same alternative measures for nonconforming tax avoidance than in the previous subsection.

In Table 1-10, Panel A reports the regression results using the seven alternative measures of tax aggressiveness. The coefficients of the interaction term $TAX_AGG \times CP_Dummy$ are negative and significant for *ABNBTD*, and the adjusted versions of *ETR*, *BTD* and *MPBT*. Overall, the results corroborate my previous findings that tax aggressive firms engaged in CP send contradictory signals to investors about their prosocial behavior resulting in a lower firm value

Alternative measures of firm value

I conduct additional tests to examine whether the results are also robust to an alternative measure of firm value. I employ the logarithm of market to book to measure firm value

Panel B of Table 1-10 presents the regression results using this alternative measures of firm value $Log(MB)$ as my dependent variable. I find that across three models the coefficients on $TAX_AGG \times CP_Dummy$ are significantly negative for *ETR*, *BTD* and significantly positive for *CONFORM_TAX*. These results are consistent with the main findings. The negative relation between tax avoidance strategies, CP and firm value holds.

[Insert Table 1-10 here]

1.7 Conclusion

This paper investigates whether firms are *consistent* in their choices of prosocial activities to maintain benefits of their prosocial engagement. I investigate in particular firms' behavior with regard to CP and two types of tax avoidance: nonconforming tax avoidance and conforming tax avoidance. I provide an empirical analysis on the relation between CP, measured by US firms' charitable donations, and tax avoidance and on the implications of these two concurrent practices for firm value. My results show that firms with higher levels of charitable donations exhibit lower nonconforming tax avoidance, suggesting that firms behave consistently with their prosocial objectives when making tax decisions.

This study adds to a recent research that finds that corporate social responsibility and social capital influence corporate tax avoidance (Davis et al. 2016; Hoi et al. 2013; Hasan et al. 2017) by documenting that firms engaged in CP prefer not using tax avoidance strategy which could alter their prosocial reputation. I also find that investors assign lower values to firms engaged in CP when they also engage in tax aggressiveness. This is consistent with the argument that investors consider that the coincidence of these two practices reflect inconsistent corporate behavior and that CP is not able to alleviate the reputational damage of tax aggressiveness. This study's evidence provides an important step toward a better understanding of the implementation of firms' practices with inconsistent social impacts and of the implications of corporate inconsistent behaviors on shareholder wealth (Rao and Brooke Hamilton 1996; Godfrey et al. 2009; Carlos and Lewis 2017).

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Appendix 1-A: Variables definitions

Variable name	Definition / Calculation	Data Source
Corporate philanthropy variables		
CP	The amount of donations given by a firm in a given year, measured as the natural log of one plus cash contributions deflated by total assets and multiplied by 10^3 .	FDO / Noza
CP_Dummy	A dummy variable coded as 1 if a firm in a given year makes charitable donation to non-profits organizations and 0 otherwise.	FDO / Noza
Excess_CP	Excess or unexpected corporate charitable donations for a firm in a given year measured as the residuals of the following model: <i>Corporate cash donations</i> = $b_0 + b_1Size + b_2Leverage + b_3CashRatio + b_4ROA + b_5R\&DRatio + b_6Advertising\ intensity + b_7Non-dividend\ dummy_i + b_8Corporate\ Governance + Industries\ Fixed\ Effects + Year\ Fixed\ Effects$.	FDO / Noza
Tax aggressiveness measures		
ETR	Effective tax rate (ETR_Raw) is total tax expense divided by pretax income less tax deductions related to corporate charitable donations. ETR is set as missing when the denominator is zero or negative. I truncate ETR to the range [0,1]. ETR is defined as ETR_Raw multiplied by -1.	Compustat
ETR_adj	Effective tax rate adjusted by size and industry. I adjust each <i>ETR</i> by the same year's <i>ETR</i> for the portfolio of firms in the same quintile of total assets and the same industry.	Compustat
CETR	Cash effective tax rate (CETR_Raw) is defined as cash tax paid divided by pre-tax book income less tax deductions related to corporate charitable donations. CETR is set as missing when the denominator is zero or negative. I truncate CETR to the range [0, 1]. <i>CETR</i> is defined as CETR_Raw multiplied by -1.	Compustat
CETR_adj	Cash effective tax rate adjusted by size and industry. I adjust each <i>CETR</i> by the same year's <i>CETR</i> for the portfolio of firms in the same quintile of total assets and the same industry.	Compustat
BTD	Total book tax differences computed as the difference between book income less minority interest and an estimate of taxable income. Taxable income is estimated by grossing up the sum of federal tax expense and foreign tax expense by the statutory rate (35%). <i>BTD</i> is scaled by beginning of the year total assets.	Compustat
BTD_adj	Total book tax difference adjusted by size and industry. I adjust each <i>BTD</i> by the same year's <i>BTD</i> for the portfolio of firms in the same quintile of total assets and the same industry.	Compustat
MPBT	Manzon and Plesko (2002) book-tax difference measured as: US domestic financial income – US domestic taxable income – Income Taxes State – Income Taxes Other – Equity in Earnings / lagged assets.	Compustat
MPBT_adj	Manzon and Plesko (2002) book-tax difference adjusted by size and industry. I adjust each <i>MPBT</i> by the same year's <i>MPBT</i> for the portfolio of firms in the same quintile of total assets and the same industry.	Compustat
CONFORM_TAX	Badertscher et al. (2017) conforming tax avoidance proxy calculated as the residual from the following regression, which I estimate by 2-digit SIC code and fiscal year combinations:	Compustat

	<p>$TAXES\ PAID\ TO\ ASSETS = b_0 + b_1BTD + b_2NEG + b_3BTD*NEG + b_4NOL + b_5DNOL + b_6 SALES\ TO\ NOA + Industries\ Fixed\ Effects + Year\ Fixed\ Effects.$</p> <p>I require at least 10 observations be available for each industry and fiscal year combination. <i>TAXES PAID TO ASSETS</i> is the ratio of cash taxes paid to lagged total assets; <i>BTD</i> is book-tax differences; <i>NEG</i> is an indicator variable set to one for observations with negative book-tax differences (and 0 otherwise); <i>NOL</i> and <i>DNOL</i> capture the level and change in net operating loss carryforwards; <i>SALES TO NOA</i> is the ratio of sales to net operating assets.</p>	
SHELTER	<p>The probability of sheltering introduced by Wilson (2009) is calculated as: $SHELTER_P = -4.86 + 5.20 \times BTD_SHELTER + 4.08 \times DA - 1.41 \times LEV + 0.76 \times LAT + 3.51 \times PRETAXINC + 1.72 \times FI + 2.42 \times R\&D$</p> <p>Where <i>BTD_SHELTER</i> is the book-tax difference (measured as the difference between book income and an estimate of taxable income. Taxable income is estimated by grossing up the sum of federal tax expense and foreign tax expense by the statutory rate (35%) and subtracting the change in the net operating loss carryforward. <i>BTD_SHELTER</i> is scaled by beginning of the year total assets.); <i>DA</i> is the absolute value of discretionary accruals from the performance-adjusted modified cross-sectional Jones model; <i>LEV</i> is long-term debt divided by total assets; <i>LAT</i> is the log of total assets; <i>ROA</i> is pre-tax earnings divided by lagged total assets; <i>FI</i> is an indicator variable set equal to one for firm observations reporting foreign income and zero otherwise; and <i>R&D</i> is R&D expenses divided by lagged total assets.</p> <p><i>SHELTER</i> is the predicted probability of sheltering with this transformation: $SHELTER = \exp(SHELTER_P) / (1 + \exp(SHELTER_P))$.</p>	Compustat
ABNBTD	<p>Measure of abnormal book-tax difference computed as the residuals obtained from estimating the following pooled-cross sectional regression: $BTD_{it} = a_1 TACC + Firm\ Fixed\ Effects + e_{it}$</p> <p>Where: <i>BTD</i> is the total book-tax differences (see <i>BTD</i>) and <i>TACC</i>, the total accruals, computed using data from the statement of cash flows (Hribar and Collins 2002) and computed on a pre-tax basis (Frank et al. 2009). Specifically, total accruals are calculated as income before extraordinary items plus total tax expense less the sum of cash flows from operating activities and cash taxes paid adjusted for extraordinary items and discontinued operations.</p>	Compustat
FACTOR_TAX	<p>The principal component extracted from a principal component analysis of the main four measures of tax aggressiveness: <i>ETR</i>, <i>CETR</i>, <i>BTD</i> and <i>MPBT</i>.</p>	Compustat
Firm characteristics variables		
ADV	Advertising expenditures divided by lagged total assets.	Compustat
ACQ	New acquisitions divided by lagged total assets.	Compustat
LOW_REPUT	Number of controversies of a firm in a given year published in the media.	ASSET4
CAPEX	Capital expenditures divided by lagged total assets.	Compustat

<i>CAPXPPE</i>	Capital expenditures divided by property, plant and equipment.	Compustat
<i>CASH</i>	Cash holdings for a firm in a given year, defined as cash and marketable securities scaled by lagged total assets.	Compustat
<i>CG_Score</i>	The score from the governance pillar from the ASSET4 ESG KPI. This pillar has five categories: board functions, board structure, compensation policy, shareholders policy, and vision-and-strategy.	ASSET4
<i>DIV</i>	Dividends scaled by book value of equity.	Compustat
<i>EQINC</i>	Equity income in earnings for a firm in a given year, scaled by lagged total assets.	Compustat
<i>FI</i>	Foreign income dummy variable coded as 1 if a firm has foreign pretax income and 0 otherwise.	Compustat
<i>GROWTH</i>	The average sales growth over the prior two years.	Compustat
<i>GW</i>	Goodwill at the end of the year scaled by lagged total assets.	Compustat
<i>INTAN</i>	Intangible assets for a firm in a given year scaled by lagged total assets.	Compustat
<i>KATRINA</i>	Hurricane Katrina dummy variable coded as 1 for years 2005 (year of the natural disaster) and 2006 (the year following the disaster) and 0 otherwise.	
<i>LEV</i>	Financial leverage at the end of the year, calculated as long-term debt scaled by total assets.	Compustat
<i>MA_Score</i>	Managerial ability score developed in Demerjian et al. (2012).	Demerjian et al. (2012)
<i>MB</i>	Market-to-book ratio at the end of the year, calculated as the market value of equity divided by the book value of equity.	Compustat
<i>MKTCAP</i>	Market capitalization calculated as the logarithm of the market value of equity.	Compustat
<i>MKT_SHARE</i>	Market share for a firm in a given year calculated as the sales divided by the total sales of the firm's industry.	Compustat
<i>NOL</i>	Loss carry forward for a firm in a given year scaled by lagged total assets.	Compustat
<i>NOL_Dummy</i>	Loss carry forward dummy variable coded as 1 if loss carry forward for a firm in a given year is positive and 0 otherwise.	Compustat
<i>PPE</i>	Net property, plant, and equipment for a firm in a given year, scaled by lagged total assets.	Compustat
<i>RD</i>	Research and development expenses at the end of the year scaled by lagged total assets.	Compustat
<i>ROA</i>	Return on assets measured as operating income scaled by lagged assets.	Compustat
<i>SALES</i>	The sales growth over the prior year.	Compustat
<i>SIZE</i>	Log of total assets.	Compustat
<i>SOCIAL_CAPITAL</i>	Social capital index reported in NRCRD for the years 2005, 2009, and 2014. It is the first principal component from a factors analysis based on the percentage of voters in presidential elections, response rates in US census surveys, the total numbers of non-profit organizations, and the total numbers of ten types of social organizations (religious organizations, civic and social associations, business associations, political organizations, professional organizations, labor organizations, bowling centers, physical fitness facilities, public golf courses and sport clubs).	NRCRD
<i>SOCIAL_Score</i>	The ASSET4 unit of Thomson Reuters provides the data used to calculate the environment, social and governance (ESG) ratings. Ratings are derived by company comparisons for a total of 226	ASSET4

	Key Performance Indicators (“KPI”). The KPI fall into three pillar: environment, social and governance. SOCIAL_score is from the social pillar, which includes seven categories: community, diversity, employment quality, health-and-safety, human rights, product responsibility, and training-and-development.	
TAXBEN	Tax benefit of stock options (TXBCOF) divided by lagged total assets (AT).	Compustat
TOBIN	Tobin’s q, measured as the sum of the book value of current debt, long-term debt and market value of equity, divided by the book value of total assets.	Compustat
XSGA	Selling, general and administrative expenses for a firm in a given year scaled by lagged total assets	Compustat

Appendix 1-B: Tables

Table 1-1: Sample composition

This table presents the sample selection process. Panel A lists the data steps to construct the sample from the Compustat sample and the hand-collected sample of charitable donations from FDO (Foundation Directory Online) and NOZAssearch. I retain non-financial firms and I require non-missing data to construct the control variables used in the baseline regressions. Panel B lists the number of observations in 2003-2014 available in the different datasets that I employ to construct the variables used in the analyses.

Panel A: Sample selection

	No. of obs. dropped	No. of obs. remaining
Fortune 700 firms in Compustat, 2003-2014		7,317
Less: Observations from the financial sector	(1,052)	6,265
Less: Observations with missing data necessary to calculate controls	(1,744)	4,521
<i>Composition by corporate philanthropy</i>		
Giving observations		3,035
Non-giving observations		1,486

Panel B: Observations on each dataset

	No. of available obs.
Fortune 700 firms in Compustat (2003-2014)	7,317
Fortune 700 firms in FDO/NOZAssearch sample (2003-2014)	7,865
Firm-year observations in ASSET4 to calculate some specific variables (i.e., <i>LOW_REPUT</i> , <i>CG_score</i> , ...) (2003-2014)	6,490
Firm-year observations in Demerjian et al. (2012) to calculate <i>MA_score</i> (2003-2014)	65,428
Firm-year observations in NRCRD to calculate <i>SOCIAL CAPITAL</i> (2003-2014)	6,910

Table 1-2: Descriptive statistics and correlation between variables

This table provides descriptive statistics of the variables and correlations between the variables used in the baseline regressions. Panel A provides summary statistics for each variable. Panel B compares firm characteristics and the four tax aggressiveness measures between the giving firms (i.e., firms that make charitable donations in the period) and the non-giving firms (i.e., firms that do not make charitable donations on the period). Panel C presents the number of observations per industry. Panel D provides Pearson's correlation coefficients between variables. All continuous variables are winsorized at the 1% and 99% level. The superscripts ***, **, and * indicate two-tailed statistical significance at the 1%, 5%, and 10% levels, respectively. See the Appendix 1-A for the definition of variables.

Panel A: Summary statistics

Variables	N	Mean	SD	Min	25th	50th	75th Pctl	Max
<u>Corporate philanthropy variables</u>								
<i>Total donations (millions)</i>	4,521	2.867	7.348	0.000	0.000	0.138	1.586	44.016
<i>Found. donations (millions)</i>	4,521	2.262	6.856	0.000	0.000	0.000	0.426	41.372
<i>Direct donations (millions)</i>	4,521	0.522	1.426	0.000	0.000	0.000	0.262	9.251
<i>CP</i>	4,521	0.129	0.238	0.000	0.000	0.019	0.141	1.186
<i>CP_Dummy</i>	4,521	0.671	0.470	0.000	0.000	1.000	1.000	1.000
<i>CP_Excess</i>	4,521	-0.015	0.220	-0.421	-0.131	-0.054	0.039	0.949
<u>Tax avoidance variables</u>								
<i>ETR_RAW</i>	3,896	0.310	0.104	0.000	0.262	0.322	0.368	0.998
<i>CETR_RAW</i>	3,875	0.258	0.143	0.000	0.161	0.255	0.337	0.989
<i>BTD</i>	4,187	0.021	0.065	-1.131	0.001	0.021	0.044	0.999
<i>MPBT</i>	4,187	0.009	0.060	-0.996	-0.000	0.010	0.029	1.012
<i>ABNBTD</i>	4,186	0.001	0.052	-0.911	-0.016	0.003	0.020	0.851
<i>SHELTER</i>	1,351	0.546	0.497	0.000	0.000	1.000	1.000	1.000
<i>CONFORM_TAX</i>	4,521	0.001	0.290	-4.598	-0.054	-0.006	0.039	7.598
<u>Control variables</u>								
<i>SIZE</i>	4,521	9.131	1.191	5.969	8.328	9.012	9.952	12.180
<i>LEV</i>	4,521	0.223	0.157	0.000	0.115	0.202	0.308	1.555
<i>NOL_Dummy</i>	4,521	0.548	0.498	0.000	0.0000	1.000	1.000	1.000
<i>NOL</i>	4,521	0.048	0.124	0.000	0.000	0.001	0.041	1.696
<i>FI</i>	4,521	0.745	0.436	0.000	0.000	1.000	1.000	1.000
<i>CASH</i>	4,521	0.130	0.171	0.000	0.035	0.082	0.168	3.898
<i>RD</i>	4,521	0.022	0.046	0.000	0.000	0.000	0.024	0.740
<i>GW</i>	4,521	0.184	0.227	0.000	0.033	0.141	0.273	8.007
<i>SALES</i>	4,521	0.098	0.252	-0.814	0.005	0.071	0.152	7.515
<i>MB</i>	4,521	4.450	41.922	-688.456	1.638	2.505	4.041	1539.983
<i>XSGA</i>	4,521	0.206	0.190	-0.002	0.075	0.152	0.282	1.716
<i>ROA</i>	4,521	0.103	0.105	-0.549	0.047	0.092	0.150	1.138
<i>PPE</i>	4,521	0.316	0.267	0.002	0.122	0.244	0.442	4.771
<i>CAPEX</i>	4,521	0.055	0.060	0.000	0.022	0.040	0.066	0.823
<i>INTAN</i>	4,521	0.253	0.310	0.000	0.054	0.195	0.371	9.914
<i>TAXBEN</i>	4,521	0.002	0.005	-0.001	0.000	0.000	0.001	0.092
<i>EQINC</i>	4,521	0.002	0.007	-0.024	0.000	0.000	0.001	0.150
<i>CG_Score</i>	4,521	64.155	31.850	0.000	57.020	77.020	86.620	97.790

Table 1-2 (Continued)

Variables	N	Mean	SD	Min	25 th	50 th	75 th Pctl	Max
Auxiliary variables								
<i>TOBIN</i>	4,521	2.168	1.106	0.798	1.507	1.858	2.464	15.884
<i>MKTS</i>	4,521	9.075	1.325	4.201	8.142	9.024	9.906	13.239
<i>GROWTH</i>	4,513	0.107	0.589	-0.814	0.03	0.073	0.155	35.627
<i>ADV</i>	4,521	0.017	0.040	0.000	0.000	0.000	0.019	0.590
<i>DIV</i>	4,515	50.626	638.140	-2,607.	0.000	3.867	20.339	37430.290
<i>MA_Score</i>	4,271	0.037	0.177	-0.295	-0.079	-0.018	0.114	0.634
<i>SOCIAL_Score</i>	4,521	47.694	33.202	0.000	16.810	49.400	79.170	98.940
<i>SOCIAL_CAPITAL</i>	971	-0.483	0.815	-2.521	-1.105	-0.468	0.143	3.609

Panel B: Descriptive statistics of firms' characteristics and tax aggressiveness measures separately for giving firms and non-giving firms

Variable	Giving firms			Non-giving firms			Difference in Means
	N	Mean	Median	N	Mean	Median	t-statistic
<i>ETR_Raw</i>	2,635	0.309	0.320	1,261	0.314	0.329	1.572
<i>CETR_Raw</i>	2,615	0.261	0.256	1,260	0.252	0.251	-1.836*
<i>BTD</i>	2,836	0.022	0.022	1,351	0.018	0.021	-2.170**
<i>MPBT</i>	2,836	0.009	0.010	1,351	0.011	0.010	0.953
<i>SIZE</i>	3,035	9.316	9.191	1,486	8.753	8.708	-15.289***
<i>LEV</i>	3,035	0.213	0.196	1,486	0.242	0.226	5.888***
<i>NOL_Dummy</i>	3,035	0.545	1.000	1,486	0.555	1.000	0.625
<i>NOL</i>	3,035	0.047	0.002	1,486	0.050	0.001	0.638
<i>FI</i>	3,035	0.760	1.000	1,486	0.714	1.000	-3.371***
<i>CASH</i>	3,035	0.129	0.087	1,486	0.132	0.074	0.530
<i>RD</i>	3,035	0.023	0.003	1,486	0.019	0.000	-2.657***
<i>GW</i>	3,035	0.168	0.125	1,486	0.216	0.175	6.816***
<i>SALES</i>	3,035	0.092	0.070	1,486	0.111	0.076	2.458***
<i>MB</i>	3,035	4.203	2.646	1,486	4.955	2.263	0.566
<i>XSGA</i>	3,035	0.206	0.149	1,486	0.207	0.161	0.248
<i>ROA</i>	3,035	0.106	0.095	1,486	0.096	0.088	-3.015***
<i>PPE</i>	3,035	0.323	0.254	1,486	0.300	0.227	-2.817***
<i>CAPEX</i>	3,035	0.056	0.041	1,486	0.053	0.037	-1.926**
<i>INTAN</i>	3,035	0.231	0.172	1,486	0.297	0.242	6.789***
<i>TAXBEN</i>	3,035	0.002	0.000	1,486	0.002	0.000	-1.044
<i>EQINC</i>	3,035	0.002	0.000	1,486	0.001	0.000	-3.505***
<i>CG_Score</i>	3,035	68.712	79.150	1,486	54.848	70.015	-14.043***

Panel C: Industry distribution

	Non-giving firms	% Non-giving firms	Giving firms	% Giving firms	Total
Mining	109	7,3%	194	6,4%	303
Construction	56	3,8%	72	2,4%	128
Manufacturing	671	45,2%	1583	52,2%	2254
Transportation and public utilities	148	10,0%	345	11,4%	493
Wholesale trade	93	6,3%	120	4,0%	213
Retail trade	182	12,2%	353	11,6%	535
Services	215	14,5%	356	11,7%	571
Public administration	12	0,8%	12	0,4%	24
Total	1,486		3,035		4,521

Table 1-2 (Continued)

Panel D: Pearson correlation matrix

The superscript * indicates two-tailed statistical significance at the 5% level.

	<i>CP</i>	<i>ETR</i>	<i>CETR</i>	<i>BTD</i>	<i>MPBT</i>	<i>SIZE</i>	<i>LEV</i>	<i>NOL_dummy</i>	<i>NOL</i>	<i>FI</i>	<i>CASH</i>	<i>RD</i>	<i>GW</i>	<i>SALES</i>	<i>MB</i>	<i>XSGA</i>	<i>ROA</i>	<i>PPE</i>	<i>CAPEX</i>	<i>INTAN</i>	<i>TAXBEN</i>	<i>EQINC</i>	<i>CG_Score</i>		
<i>CP</i>	1,0																								
<i>ETR</i>	0.016	1,0																							
<i>CETR</i>	-0.050*	0.347*	1,0																						
<i>BTD</i>	0.036*	0.299*	0.459*	1,0																					
<i>MPBT</i>	-0.011	0.111*	0.339*	0.840*	1,0																				
<i>SIZE</i>	0.085*	0.124*	0.053*	0.037*	-0.001	1,0																			
<i>LEV</i>	-0.089*	0.013	0.038*	-0.107*	-0.008	0.080*	1,0																		
<i>NOL_dummy</i>	0.013	0.074*	0.009	0.007	-0.024	-0.057*	0.037*	1,0																	
<i>NOL</i>	-0.034*	0.149*	0.125*	0.0132	-0.0157	-0.078*	0.123*	0.326*	1,0																
<i>FI</i>	0.059*	0.140*	-0.033*	0.0033	-0.130*	0.102*	-0.139*	0.168*	0.034*	1,0															
<i>CASH</i>	0.019	0.070*	0.099*	0.044*	-0.142*	-0.102*	-0.269*	0.027	0.117*	0.112*	1,0														
<i>RD</i>	0.100*	0.218*	0.152*	-0.075*	-0.231*	0.010	-0.192*	0.056*	0.165*	0.214*	0.512*	1,0													
<i>GW</i>	-0.076*	0.012	-0.066*	-0.151*	-0.110*	0.011	0.058*	0.066*	-0.063*	0.095*	0.098*	0.151*	1,0												
<i>SALES</i>	-0.048*	-0.075*	0.085*	0.085*	0.035*	-0.052*	-0.067*	0.025	0.033*	-0.027	0.298*	0.100*	0.204*	1,0											
<i>MB</i>	-0.024	-0.001	-0.002	0.031*	0.030*	0.000	0.044*	-0.005	-0.000	0.002	0.021	0.005	0.000	-0.002	1,0										
<i>XSGA</i>	0.148*	-0.110*	-0.154*	-0.047*	-0.126*	-0.322*	-0.205*	0.007	0.020	0.005	0.295*	0.190*	0.051*	0.102*	0.023	1,0									
<i>ROA</i>	0.150*	-0.029	0.007	0.569*	0.432*	-0.119*	-0.291*	-0.075*	-0.114*	0.038*	0.267*	0.049*	0.000	0.205*	0.037*	0.294*	1,0								
<i>PPE</i>	-0.032*	-0.104*	0.080*	0.049*	0.121*	0.131*	0.201*	-0.118*	-0.005	-0.228*	-0.184*	-0.207*	-0.237*	0.134*	-0.007	-0.199*	0.00	1,0							
<i>CAPEX</i>	-0.006	-0.120*	0.095*	0.143*	0.159*	-0.014	0.009	-0.070*	-0.025	-0.128*	0.004	-0.033*	-0.206*	0.174*	0.002	-0.016	0.162*	0.673*	1,0						
<i>INTAN</i>	-0.072*	0.016	-0.081*	-0.150*	-0.132*	0.0664	0.087*	0.0691	-0.041*	0.105*	0.150*	0.173*	0.929*	0.289*	-0.000	0.083*	-0.022	-0.242*	-0.206*	1,0					
<i>TAXBEN</i>	0.045*	-0.06*	0.048*	-0.013	-0.089*	-0.177*	-0.157*	-0.027	-0.027	0.328*	0.249*	0.008	0.115*	0.030*	0.251*	0.304*	-0.077*	0.080*	0.003	1,0					
<i>EQINC</i>	0.035*	0.100*	0.074*	0.091*	-0.052*	0.099*	-0.060*	-0.032*	0.053*	0.062*	-0.036*	-0.009	-0.046*	0.008	-0.000	-0.106*	0.067*	0.021	0.007	-0.038*	-0.051*	1,0			
<i>CG_Score</i>	0.145*	0.106*	-0.027	0.041*	-0.025	0.440*	-0.057*	0.054*	-0.016	0.177*	0.009	0.100*	-0.024	-0.101*	0.022	-0.011	0.077*	-0.013	-0.036*	-0.019	0.011	0.027	1,0		

Table 1-3 Association between corporate philanthropy and nonconforming tax avoidance

This table reports the results of regressions examining the association between CP and firms' nonconforming tax avoidance i.e., aggressiveness. The dependent variable is *ETR*, *CETR*, *BTD* or *MPBT*. *ETR* is effective tax rate multiplied by -1. *CETR* is cash effective tax rate multiplied by -1. *BTD* is the total book-tax difference. *MPBT* is the Manzon and Plesko (2002) book-tax difference. All dependent variable are adjusted for donations. Panel A reports the results with industry fixed-effects based on two-digit SIC codes. Panel B reports the results with firm fixed-effects to control for the influence of unknown time-invariant firm-level factors. Standard errors are clustered at the firm level. The superscripts ***, **, and * indicate two-tailed statistical significance at the 1%, 5%, and 10% levels, respectively. All variables are as defined in appendix 1-A.

Panel A: Association between corporate philanthropy and tax aggressiveness (Industry fixed effect specifications)

Variables	(1) <i>ETR</i>	(2) <i>CETR</i>	(3) <i>BTD</i>	(4) <i>MPBT</i>
<i>CP</i>	-0.015* (0.009)	-0.028** (0.012)	-0.012** (0.006)	-0.010* (0.005)
<i>SIZE</i>	0.009*** (0.003)	0.009** (0.004)	0.004*** (0.002)	0.001 (0.002)
<i>LEV</i>	0.012 (0.024)	0.039 (0.030)	0.006 (0.012)	0.005 (0.012)
<i>NOL_Dummy</i>	-0.001 (0.005)	-0.005 (0.007)	0.003 (0.002)	0.002 (0.003)
<i>NOL</i>	0.100*** (0.035)	0.136*** (0.032)	0.042*** (0.013)	0.043*** (0.011)
<i>FI</i>	-0.002 (0.008)	-0.022** (0.010)	-0.004 (0.003)	-0.016*** (0.004)
<i>CASH</i>	0.017 (0.029)	0.030 (0.029)	-0.020 (0.019)	-0.060*** (0.018)
<i>RD</i>	0.384*** (0.121)	0.455*** (0.125)	-0.086 (0.079)	-0.190** (0.078)
<i>GW</i>	0.023 (0.054)	0.100 (0.063)	-0.046 (0.032)	-0.016 (0.028)
<i>SALES</i>	-0.026** (0.012)	0.057*** (0.016)	0.007 (0.007)	0.004 (0.007)
<i>MB</i>	-0.000 (0.000)	0.000 (0.000)	0.000 (0.000)	0.000 (0.000)
<i>XSGA</i>	-0.038** (0.017)	-0.095*** (0.023)	-0.052*** (0.014)	-0.051*** (0.014)
<i>ROA</i>	0.053 (0.038)	0.058 (0.050)	0.456*** (0.055)	0.367*** (0.052)
<i>PPE</i>	-0.006 (0.019)	-0.015 (0.026)	-0.042* (0.025)	-0.032** (0.016)
<i>CAPEX</i>	-0.040 (0.102)	0.263** (0.104)	0.165*** (0.061)	0.129*** (0.048)
<i>INTAN</i>	-0.031 (0.041)	-0.138*** (0.041)	-0.000 (0.018)	-0.002 (0.017)
<i>TAXBEN</i>	-1.849*** (0.679)	2.281*** (0.571)	-2.042*** (0.370)	-1.784*** (0.381)
<i>EQINC</i>	0.995*** (0.309)	1.164** (0.457)	0.010 (0.195)	-1.200*** (0.187)
<i>CG_Score</i>	-0.000 (0.000)	-0.000* (0.000)	-0.000* (0.000)	-0.000* (0.000)
Constant	-0.393*** (0.029)	-0.381*** (0.061)	-0.023 (0.021)	0.002 (0.019)
Industry FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes

Observations	3,896	3,875	4,187	4,187
Adjusted R ²	0.169	0.157	0.488	0.420

Table 1-3 (continued)

Panel B: Association between corporate philanthropy and tax aggressiveness (Firm fixed effect specifications)

Variables	(1) <i>ETR</i>	(2) <i>CETR</i>	(3) <i>BTD</i>	(4) <i>MPBT</i>
<i>CP</i>	-0.016* (0.009)	-0.032** (0.013)	-0.013* (0.007)	-0.012*** (0.005)
<i>SIZE</i>	-0.008 (0.007)	-0.025** (0.011)	-0.001 (0.003)	-0.007* (0.004)
<i>LEV</i>	0.025 (0.025)	-0.005 (0.039)	0.014 (0.018)	0.010 (0.020)
<i>NOL_Dummy</i>	-0.004 (0.005)	-0.004 (0.008)	-0.002 (0.003)	-0.000 (0.003)
<i>NOL</i>	0.064* (0.033)	0.029 (0.031)	0.026** (0.010)	0.025 (0.015)
<i>FI</i>	-0.019** (0.008)	0.008 (0.013)	0.005 (0.006)	-0.012** (0.005)
<i>CASH</i>	-0.002 (0.024)	0.015 (0.026)	-0.035* (0.018)	-0.049*** (0.018)
<i>RD</i>	-0.497** (0.195)	-0.705** (0.294)	-0.401*** (0.061)	-0.427*** (0.055)
<i>GW</i>	0.022 (0.042)	0.051 (0.072)	-0.097*** (0.034)	-0.054* (0.030)
<i>SALES</i>	-0.019** (0.010)	0.040** (0.017)	-0.004 (0.006)	-0.004 (0.006)
<i>MB</i>	-0.000 (0.000)	-0.000 (0.000)	0.000 (0.000)	0.000 (0.000)
<i>XSGA</i>	-0.030 (0.039)	-0.085 (0.058)	-0.032 (0.033)	-0.043 (0.032)
<i>ROA</i>	0.056 (0.041)	0.280*** (0.061)	0.555*** (0.062)	0.448*** (0.068)
<i>PPE</i>	0.016 (0.014)	-0.036 (0.026)	-0.040 (0.045)	-0.023 (0.031)
<i>CAPEX</i>	0.026 (0.047)	-0.004 (0.102)	0.070 (0.052)	0.066 (0.043)
<i>INTAN</i>	-0.024 (0.029)	-0.092** (0.041)	0.046** (0.019)	0.030 (0.018)
<i>TAXBEN</i>	-1.592** (0.718)	1.459*** (0.408)	-1.693*** (0.353)	-1.524*** (0.347)
<i>EQINC</i>	1.245* (0.643)	1.461** (0.644)	0.050 (0.202)	-1.092*** (0.219)
<i>CG_Score</i>	0.000** (0.000)	0.000 (0.000)	-0.000** (0.000)	-0.000** (0.000)
Constant	-0.254*** (0.065)	0.003 (0.098)	0.015 (0.029)	0.078** (0.036)
Firm FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Observations	3,896	3,875	4,187	4,187
Number of firms	423	423	409	409
Adjusted R ²	0.422	0.354	0.642	0.567

Table 1-4 Association between corporate philanthropy and conforming tax avoidance

This table reports the results of regressions examining the association between CP and a measure of conforming tax avoidance. The dependent variable *CONFORM_TAX* is the measure of conforming tax avoidance developed by Badertscher et al. (2017) adjusted for donations. Standard errors are clustered at the firm level. The superscripts ***, **, and * indicate two-tailed statistical significance at the 1%, 5%, and 10% levels, respectively. All variables are as defined in appendix 1-A.

Variables	(1) <i>CONFORM_TAX</i>	(2) <i>CONFORM_TAX</i>
<i>CP</i>	0.690*** (0.107)	1.374*** (0.193)
Controls	Yes	Yes
Industry FE	Yes	No
Firm FE	No	Yes
Year FE	Yes	Yes
Observations	4,521	4,521
Adjusted R ²	0.246	0.518
Number of firms		427

Table 1-5 Association between corporate philanthropy and tax avoidance: firms with low reputation

This table reports the effect of firms' low reputation on the relation between CP and firms' tax aggressiveness or conforming tax avoidance. All dependent variable are adjusted for donations. A firm's low reputation *LOW_REPUT* is the total number of negative controversies linked to the firm published in the media in a given year. Standard errors are clustered at the firm level. Industries fixed effects are based on two-digit SIC codes. The superscripts ***, **, and * indicate two-tailed statistical significance at the 1%, 5%, and 10% levels, respectively. All variables are as defined in appendix 1-A.

Variables	(1) <i>ETR</i>	(2) <i>CETR</i>	(3) <i>BTD</i>	(4) <i>MPBT</i>	(5) <i>CONFORM_TAX</i>
<i>LOW_REPUT</i> × <i>CP</i>	0.055** (0.025)	0.095* (0.048)	0.045*** (0.016)	-0.000 (0.033)	0.004 (0.172)
<i>CP</i>	-0.016* (0.009)	-0.029** (0.013)	-0.013** (0.006)	-0.011** (0.005)	0.699*** (0.110)
<i>LOW_REPUT</i>	-0.001 (0.012)	-0.000 (0.017)	-0.008 (0.005)	-0.010 (0.007)	0.100** (0.045)
Controls	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes
Observations	3,896	3,875	4,187	4,187	4,521
Adjusted R ²	0.169	0.158	0.489	0.420	0.249

Table 1-6 Association between corporate philanthropy and tax avoidance in the wake of hurricane Katrina

This table reports the results of regressions examining the association between CP and tax aggressiveness or conforming tax avoidance following hurricane Katrina. All dependent variable are adjusted for donations. *KATRINA* is a dummy variable coded as 1 if the observation is from the period following hurricane Katrina i.e., years 2005 and 2006. Standard errors are clustered at the firm level. Industries fixed effects are based on two-digit SIC codes. The superscripts ***, **, and * indicate two-tailed statistical significance at the 1%, 5%, and 10% levels, respectively. All variables are as defined in appendix 1-A.

Variables	(1) <i>ETR</i>	(2) <i>CETR</i>	(3) <i>BTD</i>	(4) <i>MPBT</i>	(5) <i>CONFORM_TAX</i>
<i>KATRINA</i> × <i>CP</i>	0.007 (0.014)	-0.046** (0.019)	-0.020*** (0.008)	-0.013** (0.007)	0.071 (0.061)
<i>CP</i>	0.014 (0.010)	-0.017 (0.012)	-0.008 (0.005)	-0.007 (0.005)	0.675*** (0.106)
<i>KATRINA</i>	-0.000 (0.008)	-0.014 (0.012)	-0.014*** (0.003)	-0.013*** (0.004)	-0.051** (0.022)
All controls	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes
Observations	3,896	3,875	4,187	4,187	4,521
Adjusted R ²	0.169	0.158	0.489	0.420	0.260

Table 1-7 Association between corporate philanthropy, tax avoidance strategies and firm value

This table presents OLS estimation results regressions examining the impact of nonconforming and conforming tax avoidance on the association between CP and firm value. The dependent variable is the Tobin's Q in year $t+1$. The main independent variables TAX_AGG are the effective tax rate ETR , the cash effective tax rate $CETR$, the book-tax difference BTD or the Manzon-Plesko (2002) book-tax difference $MPBT$. All tax aggressiveness measures are adjusted for donations. $CONFORM_TAX$ is the measure of conforming tax avoidance developed by Badertscher et al. (2017) adjusted for donations. Standard errors are clustered by firms. Industries fixed effects are based on two-digit SIC codes. The superscripts ***, **, and * indicate two-tailed statistical significance at the 1%, 5%, and 10% levels, respectively. All variables are as defined in appendix 1-A.

Panel A Corporate philanthropy, tax aggressiveness and firm value

Variables	(1)	(2)	(3)	(4)
	$TOBIN_{t+1}$ $TAX_AGG = ETR$	$TOBIN_{t+1}$ $TAX_AGG = CETR$	$TOBIN_{t+1}$ $TAX_AGG = BTD$	$TOBIN_{t+1}$ $TAX_AGG = MPBT$
$TAX_AGG \times CP_Dummy$	-1.392*** (0.464)	-0.566* (0.298)	-1.517** (0.666)	-1.523* (0.801)
CP_Dummy	-0.532*** (0.174)	-0.248** (0.106)	0.006 (0.045)	-0.005 (0.045)
TAX_AGG	0.295 (0.465)	0.397 (0.285)	2.230*** (0.660)	2.396*** (0.704)
LEV	-0.817*** (0.268)	-0.789*** (0.271)	-0.664*** (0.209)	-0.676*** (0.211)
$MKTS$	-23.787*** (7.580)	-24.608*** (7.747)	-24.047*** (7.572)	-24.279*** (7.595)
$CAPXPPE$	1.574*** (0.457)	1.550*** (0.457)	1.452*** (0.445)	1.472*** (0.439)
$GROWTH$	0.020 (0.026)	0.018 (0.026)	0.012 (0.027)	0.013 (0.028)
FI	-0.005 (0.090)	-0.023 (0.091)	-0.050 (0.084)	-0.034 (0.083)
$MKTCAP$	0.228*** (0.036)	0.227*** (0.037)	0.234*** (0.034)	0.238*** (0.033)
ADV	2.933*** (1.045)	3.108*** (0.995)	2.412*** (0.748)	2.537*** (0.740)
RD	5.867*** (1.463)	5.812*** (1.515)	4.987*** (1.251)	5.092*** (1.274)
DIV	0.000*** (0.000)	0.000*** (0.000)	0.000*** (0.000)	0.000*** (0.000)
CG_Score	-0.001 (0.001)	-0.001 (0.001)	-0.001 (0.001)	-0.001 (0.001)
Constant	0.952*** (0.315)	1.451*** (0.421)	0.981*** (0.327)	0.942*** (0.330)
Industry FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Observations	4,234	4,163	4,523	4,522
Adjusted R ²	0.435	0.424	0.444	0.444

Table 1-7 (continued)

Panel B Corporate philanthropy, conforming tax avoidance and firm value

Variables	<i>TOBIN_{t+1}</i> <i>CONFORM TAX</i>
<i>CONFORM_TAX</i> × <i>CP_Dummy</i>	1.094** (0.429)
<i>CP_Dummy</i>	-0.032 (0.062)
<i>CONFORM_TAX</i>	-0.897** (0.394)
<i>LEV</i>	-0.654*** (0.225)
<i>MKTS</i>	-23.706*** (6.994)
<i>CAPXPPE</i>	1.574*** (0.451)
<i>GROWTH</i>	0.026 (0.026)
<i>FI</i>	-0.047 (0.078)
<i>MKTCAP</i>	0.251*** (0.031)
<i>ADV</i>	2.706*** (0.911)
<i>RD</i>	4.051*** (1.221)
<i>DIV</i>	0.000*** (0.000)
<i>CG_Score</i>	-0.001 (0.001)
Constant	-0.552* (0.330)
Industry FE	Yes
Firm FE	Yes
Observations	4,503
Adjusted R ²	0.426

Table 1-8 Association between corporate philanthropy and nonconforming tax avoidance: robustness tests

This table presents the results of several analyses to ensure the robustness of the baseline regressions between tax aggressiveness and CP. Panel A presents estimation results of the relation with alternative tax aggressiveness measures. I use the abnormal book-tax difference *ABNBTD*, the probability of sheltering *SHELTER* for a given year, the first factor extracted from a principal component analysis of the four main tax aggressiveness measures (i.e., *ETR*, *CETR*, *BTD* and *MPBT*) and the versions of the main tax aggressiveness measures adjusted for size and industry. Panel B presents estimation results of the baseline regressions using alternative measures of CP. I use a dummy variable *CP_Dummy* coded 1 if a firm makes donations in a given year and 0 otherwise, and a measure of excess corporate philanthropy *ExcessCP*. Panel C presents the results of the main regressions with additional control variables for firms' social activities, social capital and managerial ability to mitigate concerns about omitted variables. All tax aggressiveness measures in Panels A, B and C are adjusted for donations. Standard errors clustered by firms. Industries fixed effects are based on two-digit SIC codes. The superscripts ***, **, and * indicate two-tailed statistical significance at the 1%, 5%, and 10% levels, respectively. All variables are as defined in appendix 1-A.

Panel A: Alternative tax aggressiveness measures

Variables	(1) <i>ABNBTD</i>	(2) <i>SHELTER</i>	(3) <i>FACTOR TAX</i>	(4) <i>ETR adj</i>	(5) <i>CETR adj</i>	(6) <i>BTD adj</i>	(7) <i>MPBT adj</i>
<i>CP</i>	-0.013*** (0.004)	-0.141** (0.059)	-0.225** (0.091)	-0.017* (0.009)	-0.025** (0.011)	-0.005 (0.004)	-0.012** (0.005)
<i>SIZE</i>	0.002** (0.001)	-0.138*** (0.018)	0.089*** (0.030)	-0.001 (0.003)	0.010*** (0.004)	0.002 (0.001)	0.001 (0.001)
<i>LEV</i>	0.005 (0.011)	-0.065 (0.089)	0.276 (0.241)	0.022 (0.023)	0.038 (0.028)	0.014** (0.006)	0.004 (0.011)
<i>NOL_Dummy</i>	-0.001 (0.002)	0.021 (0.026)	-0.008 (0.051)	-0.003 (0.004)	-0.003 (0.006)	0.003 (0.002)	0.001 (0.002)
<i>NOL</i>	0.030*** (0.011)	-0.190 (0.132)	1.299*** (0.308)	0.096*** (0.031)	0.115*** (0.029)	0.011 (0.009)	0.032*** (0.012)
<i>FI</i>	-0.007*** (0.002)	-0.030 (0.040)	-0.167* (0.088)	0.003 (0.008)	-0.013 (0.010)	0.000 (0.002)	-0.012*** (0.003)
<i>CASH</i>	-0.028* (0.016)	-0.233** (0.096)	-0.076 (0.249)	0.013 (0.028)	0.036 (0.028)	0.006 (0.009)	-0.054*** (0.018)
<i>RD</i>	-0.138* (0.076)	-0.047 (0.242)	4.108*** (1.034)	0.355*** (0.117)	0.420*** (0.115)	-0.025 (0.040)	-0.190** (0.078)
<i>GW</i>	-0.022 (0.021)	0.285* (0.150)	0.659 (0.541)	0.024 (0.050)	0.113* (0.059)	-0.002 (0.016)	-0.006 (0.027)
<i>SALES</i>	-0.007 (0.007)	0.085 (0.074)	0.046 (0.105)	-0.028** (0.011)	0.054*** (0.016)	0.006* (0.003)	0.004 (0.007)
<i>MB</i>	0.000 (0.000)	0.001** (0.001)	0.000 (0.000)	-0.000 (0.000)	-0.000 (0.000)	0.000 (0.000)	0.000 (0.000)
<i>XSGA</i>	-0.022*** (0.008)	-0.184* (0.094)	-0.676*** (0.171)	-0.012 (0.016)	-0.064*** (0.022)	-0.026*** (0.008)	-0.044*** (0.013)
<i>ROA</i>	0.196*** (0.048)	1.451*** (0.379)	-0.931** (0.471)	0.057 (0.035)	0.065 (0.048)	0.727*** (0.021)	0.341*** (0.048)
<i>PPE</i>	-0.053 (0.034)	-0.067 (0.116)	-0.162 (0.203)	0.019 (0.018)	0.008 (0.025)	-0.017 (0.013)	-0.022 (0.015)
<i>CAPEX</i>	0.109* (0.066)	0.783* (0.459)	0.781 (0.986)	-0.115 (0.100)	0.166 (0.102)	0.043 (0.029)	0.082 (0.050)
<i>INTAN</i>	-0.014 (0.012)	-0.095 (0.121)	-0.748** (0.360)	-0.038 (0.038)	-0.148*** (0.039)	-0.010 (0.010)	-0.011 (0.016)
<i>TAXBEN</i>	-1.233*** (0.322)	-9.004*** (2.136)	-6.050 (4.544)	-1.445** (0.660)	2.489*** (0.566)	-1.127*** (0.146)	-1.695*** (0.361)
<i>EQINC</i>	-0.221 (0.151)	0.104 (1.901)	4.192 (4.216)	0.923*** (0.325)	1.390*** (0.415)	-0.018 (0.108)	-1.172*** (0.216)
<i>CG_Score</i>	-0.000** (0.000)	0.000 (0.000)	-0.002 (0.001)	-0.000 (0.000)	-0.000 (0.000)	0.000 (0.000)	-0.000 (0.000)
Constant	0.022 (0.014)	1.221*** (0.251)	-1.208 (0.888)	0.053** (0.026)	-0.128* (0.065)	-0.069*** (0.014)	0.023 (0.018)
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Observations	4,186	1,351	3,487	3,896	3,875	4,187	4,187
Adjusted R ²	0.194	0.290	0.212	0.0458	0.0824	0.851	0.371

Table 1-8 (continued)

Panel B: Alternative measures of corporate philanthropy

Variables	(1) <i>ETR</i>	(2) <i>CETR</i>	(3) <i>BTD</i>	(4) <i>MPBT</i>	(5) <i>ETR</i>	(6) <i>CETR</i>	(7) <i>BTD</i>	(8) <i>MPBT</i>
<i>CP_Dummy</i>	-0.009* (0.005)	-0.017*** (0.007)	-0.003 (0.002)	-0.004* (0.002)				
<i>Excess_CP</i>					-0.015* (0.009)	-0.027** (0.012)	-0.012** (0.006)	-0.010* (0.005)
<i>SIZE</i>	0.009*** (0.003)	0.010** (0.004)	0.004*** (0.001)	0.001 (0.001)	0.008*** (0.003)	0.009** (0.004)	0.004*** (0.001)	0.001 (0.001)
<i>LEV</i>	0.010 (0.023)	0.035 (0.030)	0.006 (0.012)	0.004 (0.012)	0.012 (0.024)	0.039 (0.030)	0.007 (0.012)	0.005 (0.012)
<i>NOL_Dummy</i>	-0.002 (0.005)	-0.005 (0.007)	0.003 (0.002)	0.001 (0.003)	-0.001 (0.005)	-0.005 (0.007)	0.003 (0.002)	0.002 (0.003)
<i>NOL</i>	0.101*** (0.035)	0.138*** (0.032)	0.043*** (0.014)	0.044*** (0.011)	0.100*** (0.035)	0.136*** (0.032)	0.042*** (0.013)	0.043*** (0.011)
<i>FI</i>	-0.002 (0.008)	-0.022** (0.010)	-0.004 (0.003)	-0.016*** (0.004)	-0.002 (0.008)	-0.022** (0.010)	-0.004 (0.003)	-0.016*** (0.004)
<i>CASH</i>	0.017 (0.029)	0.031 (0.029)	-0.018 (0.019)	-0.059*** (0.018)	0.018 (0.029)	0.032 (0.029)	-0.019 (0.019)	-0.059*** (0.018)
<i>RD</i>	0.380*** (0.119)	0.449*** (0.123)	-0.090 (0.079)	-0.193** (0.077)	0.383*** (0.121)	0.454*** (0.125)	-0.087 (0.079)	-0.191** (0.078)
<i>GW</i>	0.023 (0.055)	0.101 (0.063)	-0.046 (0.032)	-0.016 (0.028)	0.023 (0.055)	0.100 (0.063)	-0.046 (0.032)	-0.016 (0.028)
<i>SALES</i>	-0.025** (0.012)	0.058*** (0.017)	0.007 (0.008)	0.004 (0.007)	-0.026** (0.012)	0.057*** (0.016)	0.007 (0.007)	0.004 (0.007)
<i>MB</i>	-0.000 (0.000)	0.000 (0.000)	0.000 (0.000)	0.000 (0.000)	-0.000 (0.000)	0.000 (0.000)	0.000 (0.000)	0.000 (0.000)
<i>XSGA</i>	-0.040** (0.018)	-0.098*** (0.024)	-0.054*** (0.014)	-0.053*** (0.014)	-0.039** (0.018)	-0.097*** (0.023)	-0.053*** (0.014)	-0.052*** (0.014)
<i>ROA</i>	0.049 (0.038)	0.051 (0.051)	0.453*** (0.056)	0.364*** (0.052)	0.047 (0.038)	0.048 (0.050)	0.451*** (0.055)	0.363*** (0.052)
<i>PPE</i>	-0.006 (0.019)	-0.014 (0.026)	-0.041* (0.025)	-0.031** (0.016)	-0.006 (0.019)	-0.015 (0.026)	-0.042* (0.025)	-0.032** (0.016)
<i>CAPEX</i>	-0.038 (0.100)	0.267*** (0.102)	0.165*** (0.061)	0.129*** (0.048)	-0.040 (0.102)	0.263** (0.104)	0.165*** (0.061)	0.129*** (0.048)
<i>INTAN</i>	-0.032 (0.041)	-0.140*** (0.042)	-0.000 (0.018)	-0.002 (0.017)	-0.031 (0.041)	-0.138*** (0.041)	-0.000 (0.018)	-0.002 (0.017)
<i>TAXBEN</i>	-1.832*** (0.679)	2.311*** (0.581)	-2.035*** (0.375)	-1.776*** (0.384)	-1.843*** (0.680)	2.292*** (0.572)	-2.037*** (0.369)	-1.780*** (0.381)
<i>EQINC</i>	0.983*** (0.313)	1.153** (0.471)	0.012 (0.198)	-1.196*** (0.187)	0.996*** (0.309)	1.166** (0.458)	0.011 (0.196)	-1.199*** (0.187)
<i>CG_Score</i>	-0.000 (0.000)	-0.000 (0.000)	-0.000* (0.000)	-0.000 (0.000)	-0.000 (0.000)	-0.000* (0.000)	-0.000** (0.000)	-0.000* (0.000)
Constant	-0.389*** (0.029)	-0.377*** (0.063)	-0.019 (0.021)	0.005 (0.019)	-0.391*** (0.029)	-0.382*** (0.061)	-0.021 (0.021)	0.003 (0.019)
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	3,896	3,875	4,187	4,187	3,896	3,875	4,187	4,187
Adjusted R ²	0.170	0.158	0.487	0.419	0.169	0.157	0.488	0.420

Table 1-8 (continued)

Panel C: Additional control variables

Variables	(1) <i>ETR</i>	(2) <i>CETR</i>	(3) <i>BTD</i>	(4) <i>MPBT</i>
CP	-0.018** (0.009)	-0.023* (0.012)	-0.009* (0.005)	-0.009* (0.005)
<i>MA_Score</i>	0.008 (0.015)	0.002 (0.021)	0.003 (0.010)	0.001 (0.009)
<i>SOCIAL_Score</i>	0.000 (0.000)	-0.000 (0.000)	-0.000 (0.000)	0.000 (0.000)
<i>SOCIAL_CAPITAL</i>	0.000 (0.000)	0.000 (0.000)	0.000 (0.000)	0.000 (0.000)
All controls	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Observations	3,676	3,684	3,943	3,943
Adjusted R ²	0.175	0.148	0.525	0.437

Table 1-9 Association between corporate philanthropy and tax avoidance strategies: Propensity Score Matching (PSM) analysis

This table reports the results of the propensity score matching analysis. I use one-to-one nearest neighbor matching with replacement and a caliper distance of 0.03. Panel A presents the propensity score estimation results. *CP_Dummy* is a dummy variable that indicates firms that make charitable donations to nonprofits compared to those that do not make donations. Panel B reports t-tests results before and after the matching for the main firm characteristics. Panel C reports the results of the OLS regression examining the effect of CP on firms' nonconforming and conforming tax avoidance measures using the propensity-score matched sample. All tax avoidance measures are adjusted for donations. Standard errors are clustered by firms. Industries fixed effects are based on two-digit SIC codes. The superscripts ***, **, and * indicate two-tailed statistical significance at the 1%, 5%, and 10% levels, respectively. All variables are as defined in appendix 1-A.

Panel A: Propensity Score estimation

Variables	Dependent variable: <i>CP_Dummy</i>	
	Coef.	z-stat
<i>SIZE</i>	0.320	(21.83)
<i>CASH</i>	-0.130	(-1.06)
<i>RD</i>	1.542	(3.52)
<i>ROA</i>	1.148	(6.64)
2-digits SIC codes	-0.001	(-1.37)
Constant	-2.554	(-17.81)
Observations		6,106
Pseudo R ²		0.072

Panel B: Comparability of groups before and after matching

Variable	Unmatched (U)/ Matched (M)	Mean Treated	Mean Control	%bias	t-stat	p> t
<i>SIZE</i>	U	9.239	8.505	61.4	22.93	0.000
	M	9.238	9.251	-1.1	-0.46	0.646
<i>CASH</i>	U	0.122	0.121	1	0.38	0.701
	M	0.122	0.126	-2.1	-0.81	0.419
<i>RD</i>	U	0.020	0.015	12.2	4.66	0.000
	M	0.020	0.022	-4.7	-1.68	0.093
<i>ROA</i>	U	0.099	0.088	11.2	4.21	0.000
	M	0.099	0.091	7.3	3.15	0.002
2-digits SIC codes	U	42.040	43.810	-976	-3.67	0.000
	M	42.048	40.731	7.2	3.17	0.002

Table 1-9 (continued)

Panel C: OLS regression for propensity-matched sample

Variables	(1) <i>ETR</i>	(2) <i>CETR</i>	(3) <i>BTD</i>	(4) <i>MPBT</i>	(5) <i>CONFORM TAX</i>
<i>CP_Dummy</i>	-0.010* (0.005)	-0.016** (0.007)	-0.003 (0.003)	-0.005** (0.002)	0.072*** (0.011)
<i>SIZE</i>	0.010*** (0.003)	0.010** (0.004)	0.004** (0.002)	0.001 (0.001)	-0.004 (0.004)
<i>LEV</i>	0.008 (0.023)	0.036 (0.032)	-0.002 (0.013)	-0.001 (0.013)	0.042 (0.026)
<i>NOL_Dummy</i>	-0.000 (0.005)	-0.001 (0.007)	0.003 (0.002)	0.002 (0.002)	0.021 (0.015)
<i>NOL</i>	0.101*** (0.036)	0.127*** (0.033)	0.036** (0.014)	0.036*** (0.011)	-0.135* (0.082)
<i>FI</i>	0.000 (0.008)	-0.017 (0.011)	-0.002 (0.004)	-0.014*** (0.004)	-0.003 (0.007)
<i>CASH</i>	0.008 (0.027)	0.048 (0.032)	-0.019 (0.020)	-0.058*** (0.018)	0.006 (0.024)
<i>RD</i>	0.382*** (0.109)	0.418*** (0.114)	-0.098 (0.082)	-0.216*** (0.078)	0.038 (0.072)
<i>GW</i>	0.023 (0.054)	0.039 (0.071)	-0.032 (0.035)	-0.007 (0.029)	-0.026 (0.032)
<i>SALES</i>	-0.024** (0.011)	0.078*** (0.023)	0.010 (0.008)	0.007 (0.007)	-0.007 (0.013)
<i>MB</i>	-0.000 (0.000)	0.000 (0.000)	0.000 (0.000)	0.000 (0.000)	-0.000 (0.000)
<i>XSGA</i>	-0.037** (0.017)	-0.098*** (0.025)	-0.055*** (0.014)	-0.051*** (0.014)	0.044 (0.040)
<i>ROA</i>	0.038 (0.038)	0.057 (0.053)	0.445*** (0.058)	0.338*** (0.052)	0.004 (0.113)
<i>PPE</i>	-0.003 (0.020)	0.005 (0.030)	-0.013 (0.009)	-0.015* (0.009)	-0.012 (0.027)
<i>CAPEX</i>	-0.044 (0.090)	0.219** (0.109)	0.145*** (0.052)	0.138*** (0.045)	-0.068 (0.089)
<i>INTAN</i>	-0.033 (0.041)	-0.093** (0.047)	-0.008 (0.019)	-0.009 (0.017)	0.010 (0.024)
<i>TAXBEN</i>	-1.541** (0.602)	2.227*** (0.592)	-2.107*** (0.369)	-1.777*** (0.353)	1.049 (1.291)
<i>EQINC</i>	1.096*** (0.315)	1.270*** (0.462)	0.050 (0.185)	-1.161*** (0.193)	0.533 (0.509)
<i>CG_Score</i>	-0.000 (0.000)	-0.000 (0.000)	-0.000 (0.000)	-0.000 (0.000)	-0.000 (0.000)
Constant	-0.398*** (0.029)	-0.397*** (0.037)	-0.015 (0.017)	0.036** (0.017)	-0.003 (0.041)
Industry FE	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes
Observations	3,534	3,488	3,788	3,788	4,107
Adjusted R ²	0.180	0.165	0.485	0.413	0.014

Table 1-10: Association between corporate philanthropy, tax avoidance strategies and firm value: Additional robustness tests

This table presents the results of several analyses to ensure the robustness of the regressions for H2. Panel A presents estimation results of the relation with alternative tax aggressiveness measures. I use the abnormal book-tax difference *ABNBTD*, the probability of sheltering *SHELTER* for a given year, the first factor extracted from a principal component analysis of the four main tax aggressiveness measures (i.e., *ETR*, *CETR*, *BTD* and *MPBT*) and the versions of the main tax aggressiveness measures adjusted for size and industry. Panel B presents estimation results of the baseline regressions using alternative measure of firm value. I use the logarithm of firm's market-to-book ratio. All tax avoidance measures are adjusted for donations. Standard errors clustered by firms. Industries fixed effects are based on two-digit SIC codes. The superscripts ***, **, and * indicate two-tailed statistical significance at the 1%, 5%, and 10% levels, respectively. All variables are as defined in appendix 1-A.

Panel A: Alternative tax aggressiveness measures

Variables	(1) <i>TOBIN</i> _{<i>t+1</i>}	(2) <i>TOBIN</i> _{<i>t+1</i>}	(3) <i>TOBIN</i> _{<i>t+1</i>}	(4) <i>TOBIN</i> _{<i>t+1</i>}	(5) <i>TOBIN</i> _{<i>t+1</i>}	(6) <i>TOBIN</i> _{<i>t+1</i>}	(7) <i>TOBIN</i> _{<i>t+1</i>}
	<i>TAX_AGG</i> = <i>ABNBTD</i>	<i>TAX_AGG</i> = <i>SHELTER</i>	<i>TAX_AGG</i> = <i>FACTOR_TA</i> <i>X</i>	<i>TAX_AGG</i> = <i>ETR_adj</i>	<i>TAX_AGG</i> = <i>CETR_adj</i>	<i>TAX_AGG</i> = <i>BTD_adj</i>	<i>TAX_AGG</i> = <i>MPBT_adj</i>
<i>TAX_AGG</i> × <i>CP_Dummy</i>	-2.361*** (0.876)	-0.141 (0.114)	0.013 (0.042)	-1.197** (0.530)	-0.335 (0.320)	-1.305* (0.736)	-1.566* (0.872)
<i>CP_Dummy</i>	-0.059 (0.045)	0.020 (0.107)	-0.082* (0.049)	-0.092* (0.053)	-0.109** (0.054)	-0.054 (0.044)	-0.054 (0.045)
<i>TAX_AGG</i>	2.250*** (0.803)	0.299*** (0.107)	-0.010 (0.036)	0.730 (0.504)	0.336 (0.293)	2.285*** (0.689)	2.293*** (0.778)
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	4,491	4,453	3,833	4,491	4,453	4,598	4,598
Adjusted R2	0.433	0.428	0.438	0.433	0.428	0.451	0.449

Table 1-10 (continued)

Panel B Alternative measure for firm value

Variables	(1) <i>Log(MB)_{t+1}</i> <i>TAX_AGG =</i> <i>ETR</i>	(2) <i>Log(MB)_{t+1}</i> <i>TAX_AGG =</i> <i>CETR</i>	(3) <i>Log(MB)_{t+1}</i> <i>TAX_AGG =</i> <i>BTD</i>	(4) <i>Log(MB)_{t+1}</i> <i>TAX_AGG =</i> <i>MPBT</i>	(5) <i>Log(MB)_{t+1}</i> <i>TAX_AGG =</i> <i>CONFORM_T</i> <i>AX</i>
<i>TAX_AGG</i> × <i>CP_Dummy</i>	-0.504** (0.249)	-0.276 (0.191)	-1.126** (0.512)	-0.864 (0.560)	0.883*** (0.239)
<i>CP_Dummy</i>	-0.184** (0.089)	-0.105 (0.064)	0.014 (0.039)	0.002 (0.039)	0.008 (0.042)
<i>TAX_AGG</i>	-0.114 (0.202)	0.079 (0.167)	1.276*** (0.438)	1.179** (0.460)	-0.771*** (0.234)
Other controls	Yes		Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes
Observations	4,399	4,359	4,449	4,449	5,022
Adjusted R ²	0.355	0.343	0.321	0.320	0.338

Chapter 2

How do firms respond to a shift from mandatory to voluntary disclosure?

Evidence from corporate charitable donations disclosures in the UK

Abstract

This paper analyzes firms' commitment to CSR-related disclosure using a rare regulatory shift from mandatory to voluntary social disclosure in the UK, which leaves out the requirement for firms to disclose their corporate charitable donations (CCDs) on their annual reports. I examine firms' responses along a number of different dimensions including disclosure and donations levels. My analysis use hand-collected data from firms' disclosures of corporate philanthropy (CP) on their annual reports. I develop a disclosure index to measure disclosure levels on CP. Using pre-post tests on 150 UK firms, I find that following the mandatory-to-voluntary disclosure shift, firms disclose less information on their CP, decrease their CCDs and have greater agency conflicts. My results demonstrate the lack of firms' commitment in their social disclosure as long as it is not legally required. In cross-sectional test, I find that the decline in disclosure levels is less pronounced for firms practicing good corporate governance and more pronounced for firms with agency problems related to CP, measured as board members' connections to nonprofit organizations. Overall, my results suggest that the shift from mandatory disclosure to voluntary results in the existence of negative externalities.

2.1 Introduction

Economic theory suggests that a commitment to higher disclosure level can reduce information asymmetry and agency conflicts between managers and shareholders (Diamond and Verrecchia 1991). While mandatory disclosure constrain managers to disclose their internal information (Rock 2002; Stulz 2009), voluntary disclosure allows managers to choose to disclose and, thus, can be self-serving (Bushee and Leuz 2005). The purpose of this paper is to shed some light on firms' credible commitment to CSR-related activities and disclosure when mandatory disclosure becomes voluntary.

While CSR research explores the enforcement of mandatory disclosure requirements (i.e., Ioannou and Serafeim, 2016; Manchiraju and Rajgopal, 2017), this paper examines firm-specific consequences of a rare regulatory event that represents a regime shift from mandatory to voluntary disclosure that affected UK firms in 2013. The Companies Act 2006 mandates UK firms to disclose in their annual reports (Strategic and directors' reports) on the purposes and amount of money given to charities¹⁹. But in 2013, despite the worldwide trend to mandate CSR-related disclosure (i.e., China, Denmark, Malaysia, South Africa), the Companies Act Regulations (ACR) amends the former act and leaves out the disclosure requirements, making disclosure on corporate philanthropy (CP) voluntary. My paper attempts to investigate whether and to which extent the regulatory shift has an impact on corporate disclosure level and corporate charitable donations (CCDs) level.

This regulation change provides appealing features with which to study my research question. In contrast to most studies that analyze firms' disclosure after a regulatory change from voluntary to mandatory, this shift allows me to identify firms' commitment to CP disclosure when mandatory disclosure becomes voluntary. I examine the effect of an

¹⁹ For total charitable donations that exceed £2,000

exogenous shock on firms' commitment to CP and disclosure through mandatory reporting and, thereby avoiding the self-selection and omitted correlated variable issues. Moreover, while prior studies focus on disclosure levels, there is little empirical evidence on the real effects of disclosure as argued by Leuz and Wysocki (2016).

Theories of voluntary disclosure and prior research show that managers generally share their firms' positive outlook and are less forthcoming with bad news (Kothari et al. 2009). However, there is little evidence on firms' voluntary disclosure on activities that ambiguously affect firm value such as corporate philanthropy (CP) (i.e., the fact of giving a portion of corporate resources to charities). Shareholders may perceive CP either as a way of maximizing firm value (Liang and Renneboog 2016; Seifert et al. 2004) or as resources misallocation (Masulis and Reza 2015; Friedman 1970). CP is becoming a key corporate practice (Gautier and Pache 2015) and represent immediate financial costs for firms. But, while the majority of extant accounting research involves non-financial voluntary disclosures on broad corporate social responsibility activities (CSR), the issue of disclosure on CP in particular has received very limited attention in the literature (i.e., Campbell and Slack 2008; Morris and Bartkus 2015). Motivated by these considerations, my paper exploits a regulatory change about CP disclosures and examines key firms' responses to the new disclosure regulation (i.e., disclosure levels and donations levels).

First, voluntary regulation makes firms self-select into the disclosure choice based on their own firm-specific factors. Ex ante, it is not clear how a shift in the regulation from mandatory to voluntary disclosure might affect firms' reporting because they can easily change their disclosure level without the threat of penalty. On the one hand, voluntary regulation could dissuade firms to incur costs related to a reporting that is not legally required, resulting in a lower level of firms' disclosure on their CCDs. On the other hand, voluntary disclosure provides firms the opportunity to use the disclosure choice to communicate their

type. Then, a change to a voluntary regime could encourage firms to distinguish themselves from the rest of the firms by persisting their reporting effort or exerting greater efforts than in the mandatory period.

Second, the mandatory-to-voluntary disclosure regime shift may also affect firms' amount of CCDs. Under the voluntary disclosure regime, firms may feel free to make CCDs that lack a business objective or that can reveal agency issues. Having fewer reporting incentives, firms may also respond to the regulatory shift by decreasing their charitable efforts to decrease their reporting costs. Thus, the mandatory-to-voluntary shift may result in an externality imposed on society. Therefore, it is unclear what are the real effects of the regulatory change from mandatory to voluntary disclosure²⁰.

To conduct my analyses, I employ a pre-post test using a sample of 150 UK firms before and after the 2013 regulatory shock (2011-2015). To explore whether the shift from mandatory to voluntary disclosure affects firms' reporting quality on their CP, I assess the quality of the disclosure on CP by extracting scores from UK firms' annual reports using a disclosure index on CP designed along the same lines as in Plumlee, Brown, Hayes, & Marshall (2015) and Clarkson, Fang, Li, & Richardson (2013). To do so, in each report I hand-code 47 different data items that record if the data item is present in the report. I document the types of disclosures including soft and hard disclosure that firms make in their reports and seek to explain variation in corporate disclosure related to firms' charitable activities across reports and over time. My index is an overall measure of the fineness of information about CP presented in firms' reports.

²⁰ Lord Younger of Leckie, parliamentary under-secretary of state, told at the House of Lords: "While we encourage companies to engage in philanthropy, we have no evidence that this disclosure affects charitable giving while the disclosure itself has become burdensome to business."

I find that firms disclose less information on their CCDs following the mandatory-to-voluntary disclosure shift. This result is important because it suggests that firms do not credibly commit to their CSR-related disclosure, even though they were already initiated to the disclosure of their donations under the mandatory disclosure regime. In addition, I find that when mandatory disclosure on CP becomes voluntary, firms decrease their CCDs. This finding suggests that stakeholders and, in particular, the nonprofit sector could be damaged from the shift to voluntary disclosure, which deters firms to maintain their CCDs.

Motivated by prior literature which investigates the effects of corporate governance on voluntary corporate disclosure and corporate accountability (Bouwman 2011; Hermalin and Weisbach 2012), I perform a cross-sectional analysis to examine whether the quality of firms' governance moderates the relationship between the mandatory-to-voluntary disclosure shift and the disclosure levels on CP. I measure the quality of corporate governance with the corporate governance score from *ASSET4*, which includes board functions, board structure, compensation policy, shareholders' policy, and vision-and-strategy. I find that the decline in disclosure levels is less pronounced for firms practicing good corporate governance. This result supports the theory that the existence and role of governance mechanisms in a firm are a function of the level of disclosures in the firm. Moreover, I find that firms with good corporate governance mechanisms are more likely to increase their CCDs to nonprofits following the regulation than firms with poor governance. These findings indicate the positive impacts of firms' governance mechanisms on CP.

In further analysis, I find that agency conflicts arise from the decline of mandatory disclosure levels. Moreover, I find that when firms have agency problems related to CP measured as board members' connections to nonprofit organizations, firms disclose much less information on their CCDs after the regulatory shift. This suggests that when managers

strategically decrease such disclosure when they are more likely to reap private benefits from donations.

Taken together, my results suggest the lack of firms' commitment in their disclosure on CP as long as it is not legally required. These findings also suggest that the shift from mandatory disclosure to voluntary results in the existence of negative externalities.

This paper contributes to the literature in the following ways. First, I extend a literature examining the consequences of disclosure regulation, which is fairly limited according to Healy and Palepu (2001). I examine a recent disclosure regulation and show that the mandatory-to-voluntary shift results in lower disclosure and donations levels and greater agency conflicts. These externalities increase information asymmetry and deprive the nonprofit sector of corporate donations. I also contribute to the stream of research analyzing different disclosures regimes (e.g., Bischof and Daske, 2013; Dye, 1990; Li and Yang, 2016) by using a unique setting that allows me to isolate firms' commitment to disclose on their CCDs. This study particularly contributes to the existing CSR disclosure literature. Whereas prior studies looked at corporate disclosure levels on CSR (Ioannis Ioannou and Serafeim 2016) and social performance (Boodoo 2016; Bertrand 2000) following mandatory regulation, this paper is the first to analyze firms' behavior when they are no more obliged to disclose on their social responsibility. Finally, this study adds to the existing literature on CP by showing that firms' intrinsic motivations for making CCDs are related to the disclosure regime (Fich et al. 2009; Masulis and Reza 2015; Liang and Renneboog 2016).

From a public policy perspective, this paper contributes to the line of research that deals with government intervention through regulation of corporate disclosures. The shift to voluntary disclosure on CP leads to a negative charitable giving effect and a negative reporting effect. Therefore, governments and regulatory bodies need to be mindful of the externalities of disclosures regimes, especially given the recent debate about employing

mandatory disclosure policies. For example, U.S. policymakers are currently debating the appropriateness of disclosing political contributions. Recently, shareholders of some of the largest US firms request, in their proposals, more transparency and details on CP in order to better monitor these expenses. Hence, my results could be informative for policymakers in adopting a disclosure regime on social activities and especially on discretionary CCDs. However, as with any applied study, my results are specific to the regulation I examine and might not be generalizable to other settings.

The rest of the paper is organized as follows. Section 2 discusses the institutional background and related literature. Section 3 discusses the empirical predictions. Section 4 presents the sample and data. Section 5 describes the empirical results and section 6 concludes the paper.

2.2 Institutional background and literature review

2.2.1 Disclosure regulation for corporate charitable donations

The Companies Act 1985, Section 234 (3-5) upheld the requirements introduced by the Companies Act 1967 section 19 that firms should disclose contributions of over £200 to charities in the directors' report attached to their annual accounts information. Corporate cash charitable donations represent only one part of CP. Firms may also make donations through gifts in kind. But, corporate cash charitable donations provide a measure of firms' commitment to CP (Brammer and Millington 2004).

Since the inception of the Companies Act 2006, the directors' report must contain details of the names of the charities, the relevant amounts and the purpose of the donations (Accounts Regulation Sch 7 para 5). The strategic report like the directors' report must be approved by the board and signed on its behalf by a director or secretary of the firm. For

financial years commencing on or after 6 April 2008, the thresholds for disclosure of CCDs have been raised from £200 to £2,000.

In July 2013, the UK parliament approved The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013 (the "SR Regulations"), which amend the Companies Act 2006. The SR Regulations will take effect for financial years ending on or after 30 September 2013. They announce firms with a calendar year end will therefore need to include the new disclosures when they publish their 2013 annual report in spring 2014. The requirement to report on any CCD made above £2,000 and the purpose of the donations is being deleted to simplify firms' annual reports. This paper analyzes this regulatory shift from mandatory to voluntary reporting on CP. However, the requirement to show details of political donations remains.

Regulators' reasons to remove the requirement for companies to list CCDs in their annual reports are not well developed. The Department for Business, Innovation and Skills, the ministerial department of the UK Government responsible of the new SR regulations, has outlined reforms aimed at simplifying firms' annual reports. These requirements were about cutting "red tape" (i.e., excessive regulation or rigid conformity) for firms. However, these firms' requirements may not be considered as very burdensome. Some opponents of this removal, such as the Directory of Social Change²¹ believe that this new regulation is not in the public interest and the interest of charities. They assert that stakeholders need more, not less, information in the public domain about which charitable causes firms are supporting and how.

²¹ The Directory of Social Change is a nonprofit organization started by Michael Norton that campaigns to make the UK a better environment for charities to thrive in.

2.2.2 Related literature

Two theories have been offered to explain the consequences of CP on firm value. Some scholars view CP as investment that increases firm value (Wang and Qian 2011; Liang and Renneboog 2016; Patten 2008). Corporate donations may generate goodwill such as a higher employee morale, customer loyalty, and more indulgent treatment by regulators (Brown et al. 2006). Navarro (1988) argues that corporate donations increase revenues by enhancing the firm's reputation and increasing firm's sales. Lev et al. (2010) also find that corporate donations are associated with customer satisfaction and higher future revenues, specifically when firms sell products directly to the public. CP could motivate employees and inspire employees to strive for promotion (Rajan and Wulf 2006). Moreover, corporate donations can generate managerial perks for executives (e.g., charity events). Finally, firms that make donations to nonprofit organizations (which may include their own foundations) can deduct these amounts from their pre-tax income (Shapira 2012; Petrovits 2006).

Other scholars argue that CP reflects an agency problem between the manager and shareholders since managers are likely to act for their own benefits (Fama and Jensen 1983). Corporate donations may conflict with the profit-making objective of a firm and may come at the expense of shareholders. Various channels by which managers can reap private benefits from CP are identified in the literature. Corporate giving can allow managers and directors to contribute to their own pet charities (Brown et al. 2006). Furthermore, CEOs may use corporate donations to enlarge their networks, improve their own reputation, attract media attention, and advance their careers. Consequently, the high degree of discretion and the lack of accountability related to corporate donations could lead investors to place less value on the corporate cash holdings for firms that make high levels of donations (Masulis and Reza 2015). Fich et al.'s (2009) findings suggest that firms who donate more display more agency problems. Similarly, ownership by blockholders and institutional owners is negatively

associated with corporate donations (Bartkus et al. 2002). Masulis and Reza (2015) also find a positive relation between managerial entrenchment (i.e., E-index) and corporate giving (through foundations), corroborating the agency view.

Overall, the results of these prior studies suggest that there are two views on whether firm should disclose their CP. According to the value enhancement view of CP, firms will be more likely to disclose their donations to increase their value whereas the agency view suggests that firms will be less likely to widely disclose information that could deter their firm value.

Policy disclosure is of potential importance to several audiences. CP policy disclosure could, for example, help in accounting for costs and ensuring that any donation is directed so as to support shareholders' profit-making objective. For other potential audiences, such as lobby and special interest groups (Tilt 1994), such policy may serve as a basis for solicitations toward corporations. To the best of my knowledge, only two papers have looked at the disclosure issue of CP. Campbell and Slack (2008) investigated the degree of public disclosure of CP activities in annual reports of a sample of British companies. They found a relatively high rate of disclosure, but also rather erratic narratives and little consistency over the years. Morris and Bartkus (2015) findings indicate that more socially responsible firms and firms with corporate-sponsored charitable foundations are more likely to disclose their CP in outlets that can be viewed by the public. Hence, there is little evidence on firms' commitment to disclose their charitable expenses to their shareholders and to the general public.

2.3 Hypotheses development

One of the main objectives of mandatory disclosure regulations is to increase the availability of information, to increase financial reporting quality and to influence corporate practices. My

paper analyzes how firms respond to a shift from mandatory to voluntary disclosure related to CP.

The shift to a voluntary reporting could lead to the same corporate reporting quality. Signaling theory suggests that firms signal their type through disclosure (Verrecchia 2001). In particular, firms who aim to signal that they are “good corporate citizens” will maintain their disclosure level on their CP under the voluntary disclosure regime. Firms may even increase their disclosure if they want to differentiate themselves from their peers when firms are no more obliged to disclose their CP. Given the increasing prominence of corporate social responsibility (CSR), firms could maintain their reporting on donations “to signal their commitment to transparency, their willingness to be responsible and accountable, and to conform to societal norms and expectations” (Ioannou and Serafeim, 2016 p.11). Firms might continue to disclose their donations after the regulatory shift to voluntary because they might perceive benefits generated through disclosure. Prior research documents that firms with higher disclosure on their social responsibility benefit from a strong brand and a good reputation and therefore can have a better access to finance (e.g. Cheng et al., 2014; Luo and Bhattacharya, 2006). Disclosure of firms’ generosity may strengthen the firm’s relationships with investors, its customers and with the communities in which it operates and gain favor from regulators. Ioannou and Serafeim (2014) have looked at the effect of mandatory CSR disclosure on firms’ CSR reporting in four countries. They find that following CSR mandatory disclosure regulations, firms in China and South Africa increase CSR disclosure significantly relative to control firms.

Because firms have already been disclosing their CP under the mandatory regulations, such firms might simply claim that pre-existing disclosure patterns are sufficient and hence, they may not change their actual level of disclosure. Once the firm discloses its internal information it is really hard to back off and then managers are pushed to continue doing so.

Disclosure practice also entails an increase in people's expectations regarding future information, people would expect more and more internal data to be shared (Graham et al. 2005).

Moreover, when firms direct their CP toward a profit-making objective, they are more likely to disclose their CCDs to reduce shareholders skepticism about the appropriateness of firms' donations. Firms have nothing to hide if CCDs are being used for legitimate corporate purposes (Lev et al. 2010). Mandatory reporting prevents managers from using corporate giving to pursue their own objectives and even requires them to use charitable expenses based on shareholders preferences or commercial norms.

Firms have also valid reasons not to disclose information after the voluntary regulation is effective. Even though the expense of preparing a detailed report of all CCDs is minor, disclosure of donation is costly. Some costs can arise from disclosing the information itself, which represents proprietary or competitively sensitive information (Ioannis Ioannou and Serafeim 2016). For instance, disclosure of corporate charitable activities may reveal firms' strategies to develop customer relationships (Lev et al. 2010). Nevertheless, if a peer can observe the donations before the firm disclose it, the proprietary cost of donation disclosure is trivial. More importantly, there is a political cost related to CP disclosure. Some firms do not disclose their donations because disclosure may foster stakeholder curiosity regarding the recipients who receive the donations. Increasing disclosure lead stakeholders to target such firms and put pressure on them to further increase their CCDs. Special interest groups often try to influence firms' charitable programs toward their ideological causes. Moreover, CP choices may meet objections and critique from stakeholders. Donations to controversial causes can also attract criticism and negative scrutiny even if, in the end, they are beneficial to shareholders. Likewise, disclosure of donations and the recipients can reveal self-interested motives from executives (Lev et al. 2010) resulting in dissatisfied customers and

shareholders. For instance, some firms make donations to the charities related to the CEO or the board members (i.e., Occidental Petroleum example²²). In that case, corporate reputation may be damaged rather than enhanced by firms' donations (Morris and Bartkus 2015). A rich literature on disclosure incentives finds that firms respond to disclosure regulations according to their pre-existing reporting incentives and argues that these incentives *per se* rather than the disclosure regulations will impact the firm's response to a regulatory change (Leuz 2010). As a result, if firms consider disclosure to be too costly because of preparation, proprietary, or political costs, then they might choose not to disclose.

The discussion above motivates the following hypothesis (stated in null form):

H1: The shift from mandatory-to-voluntary disclosure on CP is not related to corporate disclosure level.

Existing evidence indicate that higher CSR disclosure might incentivize firms to modify their CSR practices (Konar and Cohen 1997; Doshi et al. 2013).

On the one hand, the disclosure mandatory regulation may force firms to engage in CSR initiatives. This effect may be obtained due to the regulation *per se* or because the regulation may serve as a strong signal of the commitment of the government and regulators towards social responsibility, thus increasing the importance of CSR within society. Then, firms may respond to the shift to voluntary regulation by decreasing their charitable donations because they have fewer incentives to do so without the reporting requirements or because the shift to voluntary disclosure shows a lack of governmental and regulatory commitment in terms of CP.

On the other hand, the shift to a voluntary reporting could lead to the same corporate charitable donation level. Similarly to the arguments related to firms' disclosure levels, firms

²² Armand Hammer, the head of Occidental Petroleum, donated one-third of the firm's profits in one year to build a museum to house his personal art collection (Henderson and Malani 2009).

might keep a constant level of CCDs because managers are pushed to continue their philanthropic policy. Prior CP lead to an increase in social expectations regarding future donations and firms cannot avoid claims regarding social and charitable activities (Boodoo 2016). Consumers, investors and nonprofits push pressure on firms to continue their CCDs. Moreover, voluntary disclosure allows firms to make donations that lack a business objective or that can reveal agency issues that may be perceived by other stakeholders as self-interested or controversial. Then, firms may feel free to make CCDs along this line without the reporting requirement.

Overall, I expect that disclosure levels resulting from the mandatory-to-voluntary shift on CP push firms to change their level of CCDs, leading to the following hypothesis (stated under null form):

H2: The shift from mandatory-to-voluntary disclosure on CP is not related to CCDs levels.

2.4 Sample and research design

2.4.1 Data and sample

I obtain accounting and financial data on Datastream and data on the corporate governance and the amount of CCDs from *ASSET4*, which is an ESG database from Thomson Reuters. After the regulation, firms can make CCDs but are not forced anymore to disclose them in their annual reports leading to a potential measurement error of corporate donations to test *H2*. However, *ASSET4* uses publicly available information including annual reports, but also CSR reports, firms' websites, proxy filings and non-governmental organization information. These multiple sources increase the accuracy of *ASSET4* data on corporate donations even though firms decide not to disclose their donations on their annual reports, which reduces the likelihood of a measurement error. The environmental, social and governance scores are

computed using over 750 indicators. In particular, the environmental score includes metrics covering resource reduction, emission reduction and product innovation; social score includes employment quality, health and safety, training and development, diversity, human rights, community and product responsibility; and governance includes board structure, compensation policy, board functions, shareholder rights and vision and strategy. Finally, I obtain data on CEOs' and board members' connections with charities on Boardex UK.

The initial sample of this study consists of all firms listed in the FTSE 350 Index. The FTSE 350 Index is a market capitalization weighted stock market index incorporating the largest 350 firms by capitalization that have their primary listing on the London Stock Exchange. Then, I eliminate firms in financial industries, and firms with missing data for total assets, leverage, cash, market-to-book, liabilities and corporate governance quality from 2011 to 2015. Next, I select only the first 150 largest firms of the index over the remaining 224 firms, due to constraints related to the disclosure index construction. Since the shift to voluntary disclosure came into force in 2013, and all firms must disclose CCDs before 2013, I code 2011-2012 as the pre-shift years and 2014-2015 as the post-shift years. Table 2-1 summarizes the sample selection procedure. My final sample includes a maximum number of 728 firm-year observations for both pre-event and post-event periods.

[Insert Table 2-1 here]

2.4.2 Measurement of disclosure level on CP

One of my primary dependent variable of interest is the disclosure level related to CP in annual reports. The purpose of my disclosure measure is to produce a cross-sectional ranking of disclosure levels based on the amount of disclosure on CCDs provided by firms in their annual reports. The regulation concerns the annual report, which is the main document used by every company to interact directly with stakeholders on a regular basis, providing a

comprehensive level of accounting and other company information. I develop a disclosure score, which is the number of items disclosed in the firms' annual reports and varies from 0 to 46. Larger values of the disclosure score indicate more information on CP in the annual report.

The selection of items included in the index was guided by recommendations provided in the GRI index, in GuideStar²³ and the publications from the think tank New Philanthropy Capital (NPC)²⁴. Appendix 2-B presents the items composing the disclosure score. The items included in *DON_DSCORE* reflect seven categories of CP information: generic disclosures, type of corporate giving, stakeholder engagement, causes supported by firms, recipients of corporate giving, evaluation of CP, governance of CP. The category "generic disclosures" includes mandatory items before the regulatory shift i.e., the amount and the purpose of CP.

I follow a dichotomous and quantitative approach meaning that if the information is present in qualitative and quantitative terms, a score of 2 is assigned; if the information is present only in qualitative terms, a score of 1 is assigned; and if it is absent, a score of 0. Thereby, my ad-hoc disclosure score considers soft and hard disclosure, with respective maximum scores possible of 27 and 19. However, I do not give the same importance to the items for the items included in the categories "types of corporate giving", "stakeholder engagement" and "causes of corporate giving" because I posit that it is unlikely that firms engage in all forms of CP. So, I use a weighted average method for these particular factors, meaning that if one factor includes six factors, instead of assigning 1 to one item of this category, I assign 1/6. To measure disclosure levels in my test, I employ these following scores for the different types of disclosures in order to normalize the scores to 100, making the comparison easier among the scores:

$$DON_DSCORE = (\text{value of the total disclosure score} / 46) \times 100$$

²³ <http://www.guidestar.org/Home.aspx>

²⁴ <http://www.thinknpc.org/publications/>

$$SD_DSCORE = (\text{value of the soft disclosure score} / 27) \times 100$$

$$HD_DSCORE = (\text{value of the hard disclosure score} / 19) \times 100$$

Table 2-2, Panels A and B report the summary statistics of the seven categories of factors of items. Panel B presents the mean frequencies of the factors disclosed in the annual reports. The items composing the category “generic disclosure about philanthropy” are the most frequently mentioned items, with a mean of 5.082. The “governance” is the least frequently mentioned category, with a mean of 0.420 times. Table 2-2, Panel B indicates the percentage of observations with disclosure about each of seven key philanthropy-related factors in annual reports. When disclosure on corporate charitable donation was mandatory before 2013, 99% of my sample firms have discussed at least one item in the category “generic disclosure of philanthropy” among the ten, after the regulatory shift to a voluntary regime, this percentage drops to 94%.

[Insert Table 2-2 here]

2.4.3 Assessing the validity of the disclosure score

Disclosure indices are useful research tool and prior research use them to investigate the determinants of corporate disclosure levels. However, it is not easy to measure the disclosure levels because the development and application of disclosure index require subjective assessments by the researcher applying the technique. As a result, it is important to assess the validity of the resulting measure. I use two approaches to assess the validity of *DON_DSCORE* following Botosan (1997).

First, since disclosure strategies are coordinated across various avenues, I expect the components of the disclosure index to be positively correlated with one another. Table 2-3 Panel A present correlations among the seven categories. Each of these correlation coefficients is positive and most of them are statistically significant at the 5 percent level.

Second, I calculate Cronbach's coefficient alpha (Cronbach 1951). Cronbach's coefficient alpha is a measure of internal consistency, i.e., how closely related a set of items (seven tax-related factors in this study) are as a group. Cronbach's coefficient alpha varies from zero to one. If items in the set are independent, Cronbach's alpha is zero. On the other hand, Cronbach's alpha is one when the correlation between each pair of items is one. Thus, larger values of Cronbach's alpha indicate more items in the set have shared covariance and thus likely represent the same underlying construct. Table 2-3 Panel B shows that the Cronbach's coefficient alpha for the seven components of *DON_DSCORE* is 0.809. The literature suggests a minimum Cronbach's alpha between 0.65 and 0.8 (or higher in many cases). Thus, my Cronbach's alpha meets the requirement of acceptance, suggesting that the components of *DON_DSCORE* are consistent enough to suggest that *DON_DSCORE* is reliable. In summary, the validity of *DON_DSCORE* is supported by these two set of analyses.

[Insert Table 2-3 here]

2.4.4 Research design

I test the association between the mandatory-to-voluntary shift and the levels of CCDs related disclosure by estimating the following model:

$$\begin{aligned}
 \text{Disclosure Score} = & b_0 + b_1 \text{POST}_t + b_2 \text{SIZE}_{it} + b_3 \text{D/E}_{it} + b_4 \text{ROA}_{it} + b_5 \text{MB}_{it} \\
 & + b_6 \text{DON_HIGH}_{it} + b_7 \text{RD}_{it} + b_8 \text{Ownership}_{it} + b_9 \text{CG_score}_{it} \\
 & + \text{Industry or Firm Fixed Effects}_i + \text{Year Fixed Effects}_t + \varepsilon_{i,t}
 \end{aligned} \tag{1}$$

Where *Disclosure Score* is one of the scores from the disclosure index (*DON_DSCORE*, *HD_DSCORE*, *SD_DSCORE*). Following previous studies on disclosure (Cheng et al. 2013; Ahmed and Courtis 1999; Doshi et al. 2013), I include several control variables in equation (1). I use the logarithm of total assets (*SIZE*) to control for firm size. I

control for the debt-to-equity ratio (*D/E*), the ownership structure (*OWNERSHIP*) measured by the ownership score from *ASSET4* and research and development expenditures (*RD*), and the corporate governance quality (*CG_score*) measured by the score from *ASSET4*, which includes various aspects of firms' governance mechanisms. I also control for firm value (*ROA*, *MB*), and the high level of CCDs (*DON_HIGH*) measured by a dummy variable that indicates the highest quintiles of donations. Finally, I include fixed effects for year and firm or industry using the 2-digit SIC industries. See Appendix 2-A for variable definitions. The estimated coefficient of interest is *b1*, which is expected to be significant if the shift from mandatory to voluntary disclosure have an effect on firms' disclosure levels.

I examine the association between the mandatory-to-voluntary shift and the levels of CCDs by estimating the following model:

$$\begin{aligned}
 Donations_{it} = & b_0 + b_1 POST_t + b_2 MKTCAP_{it} + b_3 LEV_{it} + b_4 CG_score_{it} \\
 & + b_5 CSR_REPORT_{it} + b_6 CAPEX_{it} + b_7 SG\&A_{it} + b_8 TOBIN_{it} + b_9 ROA_{it} \\
 & + b_{10} SALES_{it} + b_{11} ESG_perf_{it} + b_{12} CASH_{it} + b_{13} PPE_{it} \\
 & + Industry\ Fixed\ Effects_i + Year\ Fixed\ Effects_t + \varepsilon_{i,t}
 \end{aligned} \tag{2}$$

Where Donations is one of the following measures for firms' charitable donations: *DON* and *DON_dummy*. *DON* is the logarithm of one plus the amount of donations divided by total assets. *DON_dummy* is the dummy variable, which indicates whether firms make charitable donation (1 if a firm has positive donations and 0 otherwise). Following previous studies on CP (Liang and Renneboog 2016; Masulis and Reza 2015), I include several control variables in equation (2). I control for firm value (*MKTCAP*, *ROA*), financial leverage (*LEV*), sales growth (*SALES*), property, plant and equipment (*PPE*), cash (*CASH*), SG&A (*SG&A*) and capital expenditures (*CAPEX*). I also control for the quality of corporate governance (*CG_score*), firms' release of CSR reports (*CSR_REPORT*) and quality of environment, social and governance activities (*ESG_perf*). Finally, I include fixed effects for year and firm

or industry using the 2-digit SIC industries. See Appendix 2-A for variable definitions. The estimated coefficient of interest is *bl*, which is expected to be significant if the shift from mandatory to voluntary disclosure have an effect on corporate charitable donation levels.

2.5 Empirical analyses

2.5.1 Descriptive statistics

Table 2-4 presents the descriptive statistics for the dependent and control variables used in my analyses. The mean value of *DON_DSCORE* in my sample of 150 firms is 23.46 (over 100) and its standard deviation is 11.88 suggesting variations in firms' disclosure levels. The environmental, social and governance score performance based on reported data, *ESG_perf*, is higher with a mean value of 61.01 (over 100). The sample statistics for variables capturing firm characteristics are in line with those reported in other UK studies (Davies et al. 2005).

[Insert Table 2-4 here]

2.5.2 Main results

Changes in firms' disclosure levels after the regulation

Table 2-5 provides the test results for my first hypothesis *H1* on the impact of the mandatory-to-voluntary shift on firms' donations-related disclosure levels. I conduct the analyses using three measures of corporate disclosure levels and using industry in Panel A and firm fixed-effects in Panel B. In Panel A column (1), I report the results with the total disclosure score *DON_DSCORE* as the measure of firm's disclosures. The coefficient of *POST* is negative (coef. = -3.90) and significant at the 1% level (t-stat = -3.25), suggesting that after the regulatory change to a voluntary regime, firms disclose less information on their corporate charitable activities. In columns (2) and (3), when I use the soft and hard disclosure levels measures *SD_DSCORE* and *HD_DSCORE* as dependent variables, the coefficients of *POST*

are negative and significant (*SD_DSCORE* coef. = -3.25; t-stat = -2.71; *HD_DSCORE* coef. = -4.72; t-stat = -3.90). These results show that following the disclosure regulation, firms respond by decreasing mostly their quantitative information regarding their CP in their annual reports. In Panel B, I employ firm fixed-effect models in an attempt to control for differences in time-constant firm characteristics while estimating the regulation's impact on firms' disclosure levels. The coefficients of *POST* are negative across models. Overall, the coefficients on *POST* are negative and significant across all models supporting a negative reaction in firms' disclosure levels when mandatory disclosure becomes voluntary, which could indicate more information asymmetries between managers and shareholders related to CP.

[Insert Table 2-5 here]

Changes in firms' charitable donations levels after the regulation

In Table 2-6, I present the test results for *H2* on the impact of the mandatory-to-voluntary shift on firms' charitable donation amounts. I conduct the analyses using two measures of CCDs. In column (1), I report the results with the total amount of corporate charitable donations (in £) *DON*. The coefficient of *POST* is negative (coef. = -0.092) and significant at the 1% level (t-stat = -2.09), suggesting that after the regulatory change to a voluntary regime, firms give lower CCDs to nonprofits. The result is robust to a different measure of CP *DON_dummy*, which equals to 1 when firms make donations and 0 otherwise. This result is presented in columns (2) (coef. = -2.236; t-stat = -4.78). The coefficients of *POST*, in columns (3) and (4), are also significant and negative when I add firm fixed-effects. Overall, these results provide evidence of a negative reaction in firms' donation levels when mandatory disclosure becomes voluntary. This indicates a negative externality of the disclosure shift for nonprofit organizations that consequently suffer from fewer corporate funds.

[Insert Table 2-6 here]

2.5.3 The effect of corporate governance on firms' disclosure and charitable donations levels

Corporate governance mechanisms and voluntary disclosure are both means exploited to protect investors (see Garcia-Meca & Sanchez-Ballesta, 2010) and help them reduce agency conflicts (Jensen and Meckling 1976). The purpose of corporate governance is to improve voluntary corporate disclosure, corporate accountability and transparency (Goodstein et al. 1994; Hermalin and Weisbach 2012; Bouwman 2011). Adoption of corporate governance mechanisms such as outside directors, executive stock compensation and separation of the roles of chairman and CEO, enhance monitoring quality and reduce benefits from withholding information; resulting in disclosure quality improvement (Chen and Jaggi 2000; Eng and Mak 2003; Forker 1992; Bushee and Noe 2000). Hence, it is expected that voluntary disclosure level increases with the quality of corporate governance.

In Table 2-7, I perform cross-sectional analyses to examine the effect of corporate governance quality on the impact of the regulation on firms' responses (disclosure and donations). Panel A reports the results from testing how the impact of the regulatory change on firms' disclosure levels varies for firms with good corporate governance mechanisms. The variable *CG_score* measures corporate governance quality, which is the governance score provided by *ASSET4*. A larger score indicates better corporate governance mechanisms within the firm. The coefficients on the interaction term $POST \times CG_score$ are negative and significant in columns (1) and (2) when using *DON_DSCORE* (coef. = -0.152; t-stat=-1.88) and *SD_DSCORE* (coef. = -0.202; t-stat=-2.35) as disclosure levels measures, but insignificant for the measure of hard disclosure *HD_SCORE*. The negative relation between *POST* with *DON_DSCORE* and *SD_DSCORE* is then weaker for firms with good corporate

governance mechanisms. These results provide evidence that – even though firms with good corporate governance mechanisms tend to disclose less information on their CP after the regulation – they still disclose more information than firms with weak governance mechanisms.

As regards to the relation between CP and corporate governance mechanisms, prior research finds mixed results. Adams and Hardwick (1998) document that highly leveraged UK firms, which are expected to be effectively monitored by creditors, give more to charity. In contrast, Brown et al. (2006) show that the leverage ratio is negatively related to both cash giving and the establishment of a corporate foundation. Furthermore, Seifert et al., (2004) show that CP is positively related with organizational slack, measured by free cash-flow. Therefore, I expect that the quality of corporate governance mechanisms within the firm modifies the consequences of the voluntary regulation on firms' spending on CCDs.

Panel B of Table 2-7 reports the results of the cross-sectional test to analyze whether firms' donations amount after the regulatory change varies for firms with good corporate governance mechanisms. The coefficient on the interaction term $POST \times CG_score$ is positive and significant in columns (1) when using DON (coef. = 0.004; t-stat=2.21) but insignificant when using DON_dummy . The negative relation between $POST$ and DON reverse to a positive relation for firms with good corporate governance mechanisms. This result provides evidence that firms with good corporate governance mechanisms are more likely to increase their CCDs to nonprofits after the regulation than firms with poor governance. This result indicates the positive impacts of firms' governance mechanism on CP, even though firms are not more obliged to report on their donations.

[Insert Table 2-7 here]

2.5.4 The effect of board members' connections to charities on firms' disclosure levels related to CP

Executives who are members of the board or main trustees of non profit organizations (i.e., charitable foundations, educational institutions, arts related organizations) can increase their bargaining power through CP (Cai et al. 2016; Boyallian 2013). This could result in weak governance and monitoring mechanisms and lead to agency problems. These connected board members i.e., those who also serve on nonprofits' boards are likely to influence firms' CCDs in order to get personal benefits at the expense of shareholders (Masulis and Reza 2015). In order to maintain shareholders' confidence in their corporate charitable activities and convince them that corporate funds are efficiently allocated, I expect that firms with board members connected to nonprofit organizations are less likely to widely disclose on their donations. Therefore, I expect that this agency problem related to CP (board members' connections to charities) exacerbate the negative impact of the mandatory-to-voluntary shift on disclosure level.

Table 2-8 presents results from testing how the effect of the regulation on firms' disclosure levels varies for firms with agency problem related to firms' philanthropy. I measure this agency problem related to CP through board members connections to nonprofit organizations (*BOARD_CHAR*). I code the variable *BOARD_CHAR* as 1 when a firm's board member serves on the board of a nonprofit organization in a given year and 0 otherwise. I employ the three different disclosure scores *DON_DSCORE*, *SD_DSCORE* and *HD_DSCORE* previously defined to measure firms' disclosure levels. The coefficients on the interaction term $POST \times BOARD_CHAR$ are negative and significant at the 10% level in columns (1) when using *DON_DSCORE* (coef. = -5.24; t-stat=-3.85) and in column (3) when using *HD_SCORE* (coef. = -10.96; t-stat=-5.96). These coefficients indicate that firms with agency problems related to their CP are less likely to disclose after the disclosure shift.

Therefore, these results suggest a negative incremental effect of the board members connections to charities on firms' disclosure levels after the regulatory change.

[Insert Table 2-8 here]

2.5.5 Changes in firms' agency problems after the regulation

Mandatory disclosure system is an effective mechanism for solving agency problems by regulating the disclosure format and quantity, and it also offers an enforcement mechanism since it is costly not to disclose under disclosure regulation (Rock 2002). Firms can also explicitly or implicitly commit to a higher disclosure level by voluntarily following a disclosure policy (Cheng et al. 2013). However, both Stulz (2009) and Rock (2002) argue that, while managers may have incentives to commit to a high disclosure level, without disclosure regulations, voluntary disclosure enables firms to choose the content to disclose (Cheng et al. 2013), which could lead to an opportunistic behavior.

Prior literature documents that when mandatory disclosure levels decline, managers may choose to disclose strategically for their own private benefits. For example, Hope and Thomas (2008) argue that because U.S. multinational firms were no longer required to disclose earnings by geographic area after SFAS 131, multinational firms' managers decreased such disclosure to reap private benefits of control by empire building. This stream of literature suggests that agency conflicts between management and shareholders can increase when mandatory disclosure becomes voluntary. As discussed in details above, agency conflicts can also arise from CP. Prior research documents the great importance of managers' opportunistic interests in the use of CCDs to achieve their own objectives (Masulis and Reza 2015; Lev et al. 2010). The voluntary regime makes it easier for managers to hide rent-extraction activities. Therefore, I expect the shift from mandatory to voluntary disclosure of CP leads to greater agency conflicts.

There is no widely accepted measure of agency conflicts. Thus, I use the following six variables to proxy for agency conflicts existing in a firm based on evidence in prior studies (Dey 2008): firm size, organizational complexity, operating risk, free cash flow, leverage and board members connections to charities. I use a principal component analysis of these different dimensions of agency costs in order to extract the first factor of the analysis (*AGENCY*) to measure agency conflicts.

Size is measured as the natural logarithm of market capitalization. Large firms are more likely to have diffuse ownership structures that effectively separate ownership of residual claims from control of corporate decisions (Dey 2008). As a result, I expect the level of agency conflicts to be higher in larger firms.

Agency conflicts are expected to be higher in firms that are more complex. Organizational complexity is measured as the number of industries in which the firm operates (using SIC codes) since multi-industry firms mix various operations. The information aggregation issues can lead to important information asymmetries within the firm, or between firm insiders and investors (Dey 2008), resulting in inefficient capital allocation.

High growth firms have higher levels of information asymmetry and managers in these firms are likely to have more power due to a greater amount of resources under their control (Jensen 1986). Accordingly, agency conflicts are likely to be higher in firms with greater operating risk, as measured by the standard deviation of operating cash flows deflated by total assets.

Leverage is measured as the ratio of long-term debt to total assets. The agency costs related to debt are likely to be higher in firms with greater leverage. Owner-managers have an incentive to accept high-risk projects to transfer wealth from creditors to shareholders. Furthermore, firms with higher leverage ratios have greater incentives to manage earnings in

order to avoid covenant violations and/or to prevent adverse effects on their debt ratings (Watts and Zimmerman 1990). Such firms are likely to have higher agency conflicts.

Free cash flows are measured as the difference between cash flow from operations and firm's capital expenditures, scaled by the current assets. Conflicts of interests between shareholders and managers are especially severe when there are substantial free cash flows generated in the organization. Thus, I expect that firms with greater levels of free cash flows will have higher agency conflicts.

Board members connections to charities are measured by a dummy variable, which is equal to 1 if at least one of a board member has a role in a nonprofit organization. Prior literature provides evidence of the agency problems of CP in benefiting executives at the expense of shareholders (Masulis and Reza 2015). The agency costs related to CP are likely to be higher in firms with board members that have connections to charities.

I test the association between the mandatory-to-voluntary shift and the levels of agency conflicts in the firms by estimating the following model:

$$\begin{aligned}
 AGENCY_{it} = & b_0 + b_1 POST_t + b_2 SALES_{it} + b_3 RD_{it} + b_4 LIABILITIES_{it} + b_5 ANALYST_{it} \\
 & + b_6 ROA_{it} + b_7 OWNERSHIP_{it} + b_8 INDEPENDENCE \\
 & + b_9 SHARE_STRUCTURE + b_{10} BOARD_SIZE \\
 & + Industry\ Fixed\ Effects_i + Year\ Fixed\ Effects_t + \varepsilon_{i,t}
 \end{aligned} \tag{3}$$

Where *AGENCY* is the first factor of the principal component analysis of the six proxies for agency conflicts. Following previous studies on agency problems (Ang et al. 2000; Dey 2008), I include several control variables in equation (3). I control for sales growth (*SALES*), research and development expenditures (*RD*) and liabilities (*LIABILITIES*), firms' information environment (*ANALYST*). I also control for firm value (*ROA*) and corporate governance characteristics (*OWNERSHIP*, *INDEPENDENCE*, *SHARE_STRUCTURE* and

BOARD_SIZE). Finally, I include fixed effects for year and firm or industry using the 2-digit SIC industries codes. See Appendix 2-A for variable definitions.

Table 2-9 reports the test results on the impact of the mandatory-to-voluntary shift on firms' agency conflicts. In columns (1) and (2), the coefficients of *POST* are positive (coef. = 0.96; coef. = 0.432) and significant at the 1% level (t-stat = 4.012 ; t-stat = 6.942) after controlling respectively for firm and industries effects. These results suggest that after the regulatory change to a voluntary regime, there are greater agency conflicts existing in firms. This result indicates that a voluntary disclosure regime has less control on agency problems between managers and shareholders than a mandatory regime.

[Insert Table 2-9 here]

2.5.6 Additional analyses

The impact of the regulatory shift on disclosure levels: Matched difference-in-difference analysis

My main analyses hinder me from drawing causal inference. But because of the change from mandatory to voluntary reporting of CCDs in 2013, I am able to identify firms that continue to disclose after the rule. To provide stronger evidence on the impact of the regulatory shift on firms' disclosure levels, I perform a propensity-score matched difference-in-difference design. I match the 150 UK firms of my original sample to US firms using a propensity score matching design. To select the benchmark sample, I begin with all US firms comprised in the Fortune 500 ranking of 2015. To select control US firms that are reasonably comparable to the treatment UK firms, I match each treatment firm to a control firm (with replacement) based on similar observable characteristics using a PSM approach. I implement this procedure by first estimating a logit regression with an indicator variable *UKdummy* set equal to 1 for the 150 UK firms and 0 for US firms as the dependent variable. Specifically, the logit model

includes firm size (*Size*) and CCDs (*Don*), in the period preceding the voluntary disclosure rule (2011 and 2012). Then, I obtain the propensity score from the logit estimation and I match each UK firm to US firms using the two nearest neighbor matching technique (with replacement, and caliper set at 0.2). In particular, I choose for each treatment firm, the benchmark firm with the closest propensity score (based on size and firms' donations) in the same industry and year than the treatment firm (2-digit SIC code). After the matching completed, the benchmark sample includes 70 US firms. One US firm can be matched several times (i.e., max=3) to one treatment firm. Overall, my "PSM sample" includes 220 firms (880 firm-years), including 150 treatment firms (600 treatment firm years) and 70 control firms (280 control firm years).

Table 2-10 Panel A reports the means of disclosure levels for pre-treatment years (2011, 2012) and post-treatment years (2014, 2015). Disclosure levels in the pre-treatment period are significantly different between treatment and control firms, despite the matching between UK and US firms. In the post-treatment period, I find a significant difference in disclosure levels between UK firms and their matched US counterparts. For treatments, but not for control firms, I find a significantly negative change in disclosure levels before and after the regulatory shift. The change in disclosure levels between the treatment and control firms from the pre- to the post-treatment period (the difference-in-difference) is negative and statistically significant (mean = -4.311; t-stat=-2.80). This result suggests that the new voluntary reporting rule is associated with significant decreases in firms' disclosure levels.

Table 2-10 Panel B reports the multivariate results of the matched difference-in-difference analysis. The results in columns (1), (2) and (3) show that the coefficients of the interaction term Post x Treat_UK are negative (coef = -4.786; -4.091; -5.646) and significant at the 1% level (t-stat = -4.346; -3.110; -5.534) across the three measures of disclosure scores suggesting that corporate disclosure levels related to donations decrease after the disclosure

shift²⁵. These results corroborate the main results on disclosure levels and provide additional evidence of causal inference of the shift to voluntary disclosures and firms' disclosure levels. However, there are limitations regarding the implementation of my difference-in-difference analysis because US firms are not mandated to disclose on their CP on their annual reports. Therefore, any bias caused by different regulatory environments in the US and UK regarding the disclosure on CP is not implicitly controlled for. Nevertheless, I performed a parallel trend analysis (the results are not tabulated), which rules out unobserved confounding effects that may occur during the same period.

[Insert Table 2-10 here]

The impact of the regulatory shift on disclosure levels: Falsification test

In order to strengthen the interpretation of the results of *H1* and *H2* regarding the impact of the regulatory shift on corporate disclosure levels on CP and CCDs levels, I perform a placebo test by replicating my analysis around a placebo period one year earlier, using 2012 as the year of the shift, and 2011 as the year prior to the shift. Table 2-11 Panel A reports the results of this placebo test using firm-fixed effects and show insignificant coefficients for each of my disclosure scores. This indicates that my results regarding *H1* and *H2* are not attributable to unobservable factors.

[Insert Table 2-11 here]

The impact of the regulatory shift on disclosure levels: the effect of analyst following, social performance and firm transparency

I add control variables to the main model to test *H1* in order to control for the impact of firms' information environment measured by the number of analysts that follow the firm, the ESG

²⁵ Results are robust when I add firm fixed effects but the variables POST and Treat_UK are omitted by Stata because of colinearity.

performance measured by the score available on *ASSET4* and the firm's transparency measured by the *ASSET4* score, which shows firms' transparency on their CSR, health and safety and sustainability. In Table 2-11 Panel B the coefficients are negative and significant across models after controlling for the number of analysts following firms, for the ESG performance, and for the firm's transparency corroborating my previous results.

The impact of the regulatory shift on disclosure levels: Poisson regression

I test *H1* using a Poisson regression specification, since the disclosure scores are count variables. Reported in Table 2-11 Panel C, coefficients are significant and negative across models, similarly to my main results for *H1*.

The impact of the regulatory shift on disclosure levels: Alternative measure of my disclosure score

I employ an alternative measure of disclosure levels i.e., the non-normalized disclosures scores. Untabulated negative and significant results across disclosure scores, corroborating the main results regarding the negative effect of the shift on firms' disclosure levels.

Bigger sample

I perform the tests for hypotheses *H2a*, *H2b*, *H3a* and *H3b* on a bigger sample over the period 2007-2016, which consists of 1,124 firm-year observations for *H2* and 1,267 firm-year observations for *H3*. Untabulated results indicate that my main results are unchanged and then are not attributable to a small sample.

2.6 Conclusions

In summary, this paper examines how the shift from a mandatory to a voluntary disclosure regime affects firms' responses in terms of disclosure levels and donations levels. This paper shows that following the voluntary regulation, firms decrease their level of donation-related disclosure and their amount of CCDs to nonprofits. Regarding the latter, I acknowledge that

data on donations under a voluntary disclosure regime are less reliable. As a result, readers should interpret the result on donations levels with caution. Moreover, this paper provides evidence on (1) the greater agency conflicts that exist in the firms after the regulatory shift and on (2) the stronger decline of disclosure levels when managers can reap private benefits from CCDs. My results also indicate the positive impacts of firms' governance mechanisms on CP reporting and spending. In so doing, this paper adds to disclosure literature, as well as to policy discussion about the implications of the disclosure regulation of CSR expenditures and more specifically of the discretionary CCDs that are likely to involve agency issues. The literature mostly documents the impact of a change in the regulation from voluntary to mandatory CSR disclosure but there is much to know about how firms commit to social disclosures and respond to a regulation when they are not forced anymore to disclose information.

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Appendix 2-A: Variables definitions

Variable name	Definition / Calculation	Data Source
Corporate disclosure scores		
<i>Total score</i>	Total not normalized donation-related disclosure score (see Appendix 2-B for more details on the calculation of score items)	Annual reports
<i>Soft score</i>	Soft not normalized donation-related disclosure score (see Appendix 2-B for more details on the calculation of score items)	Annual reports
<i>Hard score</i>	Hard not normalized donation-related disclosure score (see Appendix 2-B for more details on the calculation of score items)	Annual reports
<i>DON_DSCORE</i>	Total normalized donation-related disclosure score measured as: $(Total\ score / \text{Maximum score possible}) * 100$ $= (\text{disclosure score reported by the firm} / 46) * 100$	Annual reports
<i>SD_DSCORE</i>	Soft normalized donation-related disclosure score measured as: $(Soft\ score / \text{Maximum score possible}) * 100$ $= (\text{soft disclosure score reported by the firm} / 27) * 100$	Annual reports
<i>HD_DSCORE</i>	Hard normalized donation-related disclosure score measured as: $(Hard\ score / \text{Maximum score possible}) * 100$ $= (\text{hard disclosure score reported by the firm} / 27) * 100$	Annual reports
Main and control variables		
<i>AGENCY</i>	First component of a principal component analysis of six proxies for agency conflicts including firm size, organizational complexity, operating risk, free cash flow, leverage and board members connections to charities.	Datastream Boardex UK
<i>ANALYST</i>	Number of analysts following a firm at the end of the year.	Datastream
<i>CAPEX</i>	Capital expenditures at the end of the year divided by total assets.	Datastream
<i>CASH</i>	Operating cash flow divided by total assets.	Datastream
<i>BOARD_CHAR</i>	Dummy variable that indicates whether a board member serves on the board of nonprofit organizations.	Boardex UK
<i>BOARD_SIZE</i>	The total number of board members at the end of the fiscal year.	ASSET4
<i>CG_score</i>	The corporate governance score from the ASSET4 ESG KPI.	ASSET4
<i>CSR_REPORT</i>	Dummy variable that indicates whether a firm releases a separate CSR report.	ASSET4
<i>D/E</i>	Ratio of total debts over equity.	Datastream
<i>DON</i>	Natural logarithm of one plus the amount of total charitable donations from ASSET4 scaled by total assets.	ASSET4
<i>DON_dummy</i>	Dummy variable, which equals 1 if a firm makes charitable donation and 0 otherwise.	ASSET4
<i>DON_HIGH</i>	Dummy variable, which equals 1 if a firm's charitable donation level is in the highest quintile and 0 otherwise.	Datastream
<i>ESG_perf</i>	The score from the ASSET4 ESG KPI to measure a firm's relative ESG performance across ten themes (emissions,	ASSET4

	environmental, product innovation, human rights, shareholders, etc.) based on firm reported data.	
INDEPENDENCE	Percentage of independent board members as reported by the company.	ASSET4
LEV	Financial leverage at the end of the year, calculated as total debt scaled by total assets.	Datastream
LIABILITIES	Total liabilities divided by total assets.	Datastream
MB	Market-to-book ratio at the end of the year, calculated as the market value of equity divided by the book value of equity.	Datastream
OWNERSHIP	Dummy variable that equals 1 if the firm is owned by a reference shareholder who has the majority of the voting right, veto power or golden share.	ASSET4
POST	Dummy variable that indicates the period after the mandatory-to-voluntary disclosure shift resulting from the Companies' Act 2006 SR regulation 2013. It equals 1 for 2013 and years after 2013 and 0 otherwise.	
POST_PLACEBO	Dummy variable that equals 1 for year 2012 and 0 for year 2011.	
PPE	Property, plant and equipment divided by total sales.	Datastream
RD	Research and development expenses at the end of the year scaled by total assets	Datastream
ROA	Return on assets measured as operating income scaled by total assets.	Datastream
SALES	The sales growth over the prior year.	Datastream
SG&A	Selling, general and administrative expenses divided by total sales.	Datastream
SHARE_STRUCTURE	Dummy variable that equals 1 if firms' outstanding equity constitute 100% of common stock.	ASSET4
SIZE	Firm size measured as the logarithm of total assets.	Datastream
Transparency	Firm's transparency score from the ASSET4 ESG KPI. This score measures firms' information related to CSR, health and safety and sustainability.	ASSET4
TOBIN	Tobin's Q measured as the ratio of firms' market value and total debts over total assets.	Datastream
UKdummy	Dummy variable that takes the value of 1 if a firm is a treatment firm i.e., a UK firm and 0 if a firm is a control firm i.e., a US firm.	

Appendix 2-B: Disclosure index on corporate charitable donations

List of items	Description of items disclosed	Soft Disclosure	Hard Disclosure	Total
item #1 (for annual reports)	Do they mention that they have a separate archived CSR/Sustainability report?	1		1
Generic disclosures on corporate philanthropy				
item #2	They report that they make donations (social, community,...)	1	1	2
item #3	They mention their corporate charitable foundation/ trust or funds	1	1	2
item #4	They describe their philanthropic role / motivations of their giving	1		1
item #5	They report their strategic direction related to their business	1	1	2
item #6	They report words or quotation of a senior executive (e.g., CEO, CFO) on their corporate philanthropy	1		1
item #7	Do they mention GRI guidelines? (Global Reporting Initiatives)	1		1
item #8	They make a categorization among their donations	1	1	2
item #9	They report their donations from countries other than UK	1	1	2
item #10	They report a pledge to donate	1	1	2
item #11	They report figures in a table or chart		1	1
Type of corporate giving	Attribute 1/6 per type			
item #12	They report cash donations	1/6	1/6	1/3
item #13	They report in-kind donations (products, software, buildings,...)	1/6	1/6	1/3
item #14	They report giving through awards	1/6	1/6	1/3
item #15	They report giving through grants	1/6	1/6	1/3
item #16	They report their fundraising programs	1/6	1/6	1/3
item #17	They report matching giving programs	1/6	1/6	1/3
Stakeholder engagement	Attribute 1/6 per type			
item #18	They report employee giving	1/6	1/6	1/3
item #19	They report employee time or employee volunteering	1/6	1/6	1/3
item #20	They report suppliers giving	1/6	1/6	1/3
item #21	They report customers giving	1/6	1/6	1/3
item #22	They report shareholders giving	1/6	1/6	1/3
item #23	They report community volunteering	1/6	1/6	1/3
Causes of corporate giving	Attribute 1/9 per cause			
item #24	Arts, culture and humanities (media, film, museums,opera, commemorative events...)	1/9	1/9	2/9
item #25	Education (schools, library, scholarships,...)	1/9	1/9	2/9
item #26	Health (e.g., hospital,	1/9	1/9	2/9
item #27	Human services (crime and legal related, employment, job related, agriculture, food nutrition, housing, shelters, public safety, disaster preparedness and relief, recreation, sports, leisure, youth development,american red cross, salvation army, volunteers of america, family services,...)	1/9	1/9	2/9
item #28	Environment and animals	1/9	1/9	2/9

item #29	Mutual/membership benefit (insurance services, pension and retirement, fraternal beneficiary societies, cemeteries...)	1/9	1/9	2/9
item #30	Public and societal benefit (civil and human rights, community improvements, economic dev, science and technology, government and public administration veterans, consumer protections and safety...)	1/9	1/9	2/9
item #31	International and foreign affairs	1/9	1/9	2/9
item #32	Religion	1/9	1/9	2/9
Recipients of corporate giving				
item #33	They specify the recipients' names	1	1	2
item #34	They specify more information on recipients (localization, policy,...)	1		1
item #35	They specify their charity partners	1	1	2
item #36	They report they support local communities in which they operate	1		1
Evaluation of their philanthropic actions				
item #37	They report their effort to measure impact of their corporate giving (they provide ways to measure the efficiency and performance of their CP)	1		
item #38	They report the impact of their past charitable activities	1	1	2
item #39	They report the expected results of the corporate giving	1	1	2
item #40	They report their past engagement - global (past philanthropy)		1	1
Governance				
item #41	They report the names of their members of the foundation board or of the direct giving program committee	1	1	2
item #42	They mention that shareholders make donations	1	1	2
item #43	They mention that CEO or other executives make donations	1	1	2
item #44	They report donations to nonprofits related to the CEO or their board members	1	1	2
item #45	They report the decision-making process of their giving	1		1
item #46	They report that grants allowance were approved by a committee	1		1
item #47	They classify matching giving programs with executives as perquisites/perks/advantage	1		1
			Total Max Score	46

Appendix 2-C: Tables

Table 2-1 Sample selection

This table presents the sample selection process and lists the data steps to construct my sample from the Datastream sample and the hand-collected sample of firms' disclosure scores. I retain the 150 largest non-financial firms and I require non-missing data to important control variables to construct the test over the period 2011-2015.

	No. of firms remaining	No. of obs. remaining
FTSE 350 firms over the period 2007-2016	350	3,500
Less: Observations from the financial sector	250	2,250
Less: Observations with missing data	224	2,224
Keep only the 150 largest firms among the 224 firms	150	1,500
Less: Observations outside the period 2011-2015	150	728

Table 2-2 Descriptive statistics and correlation of disclosure categories

This table provides summary statistics of the disclosure categories composing *DON_DSCORE*. Panel A provides, for each disclosure category, means, medians, the 25th and 75th percentiles and standard deviations. Panel B presents percentage of the firms disclosing the seven categories (at least one item in each category) in the sample firms before and after the mandatory-to-voluntary disclosure shift (excluding the year 2013). The superscripts * indicate statistical significance at the 5% level. See the Appendix 2-A for the definition of variables.

Panel A: Descriptive statistics of disclosure categories

Disclosure Categories	N	Mean	Q1	Median	Q3	Std. Dev.
<i>Generic disclosures about philanthropy</i>	600	5.082	3	5	7	2.555
<i>Type of corporate giving</i>	600	2.157	0.167	2	4	2.224
<i>Stakeholder engagement</i>	600	1.064	0	0.167	2	1.443
<i>Causes of corporate giving</i>	600	2.414	0.222	1	4	2.679
<i>Recipients of corporate giving</i>	600	2.835	1	3	4	1.968
<i>Evaluation of philanthropy</i>	600	1.038	0	1	1	1.162
<i>Governance</i>	600	0.420	0	0	0	0.865

Panel B: Percentage of firms disclosing donation-related factors in annual reports (at least one item in each category) before and after the regulatory change

Disclosure Categories	N		%	
	Pre-reg	Post-reg	Pre-reg	Post-reg
<i>Generic disclosures about philanthropy</i>	297	282	99.00%	94.00%
<i>Type of corporate giving</i>	241	216	80.33%	72.00%
<i>Stakeholder engagement</i>	189	180	63.00%	60.00%
<i>Causes of corporate giving</i>	267	250	89.00%	83.33%
<i>Recipients of corporate giving</i>	266	247	88.67%	82.33%
<i>Evaluation of philanthropy</i>	225	154	75.00%	51.33%
<i>Governance</i>	71	76	23.67%	25.33%

Table 2-3 Assessment of the disclosure score *DON_DSCORE*

This table presents the results regarding the assessment of *DON_DSCORE* as a measure of disclosure levels of corporate charitable donations in annual reports. Panel A provides Pearson's correlation coefficients between categories of *DON_DSCORE*. Panel B presents the Cronbach's alpha of the categories of *DON_DSCORE*. See the Appendix 2-B for the description of *DON_DSCORE*.

Panel A: Correlations between categories of disclosure score

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	
<i>Generic disclosures</i>	(1)	1						
<i>Type of corporate giving</i>	(2)	0.522*	1					
<i>Stakeholder engagement</i>	(3)	0.396*	0.655*	1				
<i>Causes of corporate giving</i>	(4)	0.520*	0.711*	0.522*	1			
<i>Recipients of corporate giving</i>	(5)	0.562*	0.431*	0.402*	0.454*	1		
<i>Evaluation of philanthropy</i>	(6)	0.388*	0.142*	0.037	0.242*	0.254*	1	
<i>Governance</i>	(7)	0.308*	0.347*	0.296*	0.284*	0.101*	0.183*	1

Panel B: Cronbach's alpha of the seven donation-related categories of *DON_DSCORE*

Item	N	Covariance	Alpha
<i>Generic disclosures</i>	600	1.174248	0.763
<i>Type of corporate giving</i>	600	1.202076	0.7484
<i>Stakeholder engagement</i>	600	1.540644	0.7829
<i>Causes of corporate giving</i>	600	1.109258	0.7563
<i>Recipients of corporate giving</i>	600	1.417176	0.7808
<i>Evaluation of philanthropy</i>	600	1.810955	0.8182
<i>Governance</i>	600	1.835499	0.8156
		1.441408	0.8096

Table 2-4 Descriptive statistics

This table reports the descriptive statistics for the variables used in this paper, and the results regarding the assessment of *DON_DSCORE* as a measure of disclosure levels of corporate charitable donations in annual reports. See the Appendix 2-A for the definition of variables.

Variables	N	Mean	Q1	Median	Q3	Std. Dev.
<i>CG_score</i>	728	83.05	77.67	86.31	91.59	11.63
<i>MB</i>	728	2.978	1.440	2.480	4.240	7.970
<i>DON_DSCORE</i>	600	23.46	14.79	23.85	31.34	11.88
<i>SIZE</i>	728	14.82	13.73	14.64	15.61	1.498
<i>LEV</i>	728	0.225	0.103	0.208	0.317	0.162
<i>ROA</i>	728	0.070	0.035	0.064	0.103	0.079
<i>CASH</i>	728	0.118	0.069	0.105	0.148	0.069
<i>DON</i>	728	0.566	0.027	0.176	0.713	0.855
<i>LIABILITIES</i>	728	0.565	0.416	0.571	0.705	0.209
<i>RD</i>	728	0.014	0	0	0.009	0.042
<i>CAPEX</i>	728	0.044	0.014	0.032	0.062	0.041
<i>SALES</i>	728	0.051	-0.014	0.035	0.107	0.154

Table 2-5 Impact of the regulatory shift on disclosure levels

This table reports the results of regressions examining the effect of the mandatory-to-voluntary shift on firms' disclosure levels. I run OLS regressions with three different dependent variables: the total disclosure levels *DON_DSCORE*, the soft disclosure level *SD_DSCORE*, and the hard disclosure level *HD_DSCORE*. These dependent variables are calculated on the period 2011-2015, excluding the year of the regulation (i.e., 2013). Panel A reports the results with industry fixed-effects based on two-digit SIC codes. Panel B reports the results with firm fixed-effects to control for the influence of unknown time-invariant firm-level factors. T-statistics are computed based on heteroscedasticity-robust standard errors clustered by firms. Industries fixed effects are based on two-digit SIC codes. The superscripts ***, **, and * indicate two-tailed statistical significance at the 1%, 5%, and 10% levels, respectively. All variables are as defined in appendix 2-A.

Panel A Impact of the regulatory shift on disclosure levels with industry fixed effects

Variables	(1) <i>DON_</i> <i>DSCORE</i>		(2) <i>SD_</i> <i>DSCORE</i>		(3) <i>HD_</i> <i>DSCORE</i>	
	coef	t-stat	coef	t-stat	coef	t-stat
<i>POST</i>	-3.900***	-3.637	-3.252***	-2.717	-4.722***	-3.903
<i>CG_score</i>	0.123*	1.817	0.157**	2.024	0.072	1.128
<i>SIZE</i>	-2.189***	-2.867	-2.292***	-2.844	-1.993**	-2.357
<i>D/E</i>	-0.008	-0.153	0.006	0.098	-0.026	-0.490
<i>ROA</i>	2.262	0.242	1.561	0.153	2.706	0.288
<i>MB</i>	-0.020	-0.267	0.000	0.005	-0.047	-0.635
<i>DON_</i> <i>HIGH</i>	6.188***	2.667	6.249**	2.573	6.186**	2.207
<i>Ownership</i>	0.025	0.367	0.072	0.948	-0.041	-0.611
<i>RD</i>	28.468	1.577	38.890*	1.794	14.297	0.930
Constant	34.472***	3.067	33.821***	2.882	34.640***	2.802
Year FE	YES		YES		YES	
Industry FE	YES		YES		YES	
Observations	587		587		587	
Adjusted R ²	0.265		0.247		0.273	

Table 2-5 (continued)

Panel B Impact of the regulatory shift on disclosure levels with firm fixed effects

Variables	(1) <i>DON</i> <i>DSCORE</i>		(2) <i>SD</i> <i>DSCORE</i>		(3) <i>HD</i> <i>DSCORE</i>		t-stat
	t-stat	coef	t-stat	coef	t-stat	coef	
<i>POST</i>	-3.903	-3.444***	-2.831	-2.624*	-1.970	-4.518***	-3.407
<i>CG_score</i>	1.128	0.111*	1.797	0.108	1.634	0.111	1.452
<i>SIZE</i>	-2.357	2.016	0.793	2.133	0.800	1.950	0.665
<i>D/E</i>	-0.490	0.009	0.267	-0.003	-0.083	0.029	0.534
<i>ROA</i>	0.288	11.500*	1.810	10.467	1.502	12.278*	1.771
<i>MB</i>	-0.635	0.009	0.158	-0.017	-0.246	0.046	0.627
<i>DON</i> <i>HIGH</i>	2.207	4.294*	1.905	2.258*	1.662	7.165	1.647
<i>Ownership</i>	-0.611	0.056**	2.561	0.067***	2.765	0.039	1.632
<i>RD</i>	0.930	29.815	0.792	70.530	1.543	-25.302	-0.623
Constant	2.802	-19.853	-0.526	-18.125	-0.462	-23.487	-0.534
Year FE		YES		YES		YES	
Firm FE		YES		YES		YES	
Observations		587		587		587	
Adjusted R ²		0.742		0.751		0.680	

Table 2-6 Impact of the regulatory shift on corporate charitable donations levels

This table reports the results of regressions examining the effect of the mandatory-to-voluntary shift on firms' donations levels. I run OLS regressions with two different dependent variables: *DON* the logarithm of one plus corporate charitable donations scaled by total sales, and *DON_dummy* a dummy variable which equals 1 if corporate donation is positive and 0 otherwise. T-statistics are computed based on heteroscedasticity-robust standard errors clustered by firms. Industries fixed effects are based on two-digit SIC codes. The superscripts ***, **, and * indicate two-tailed statistical significance at the 1%, 5%, and 10% levels, respectively. All variables are as defined in appendix 2-A.

Variables	(1)		(2)		(3)		(4)	
	<i>DON</i> coef	t-stat	<i>DON_dummy</i> coef	t-stat	<i>DON</i> coef	t-stat	<i>DON_dummy</i> coef	t-stat
<i>POST</i>	-0.092**	-2.093	-2.236***	-4.783	-0.073*	-1.657	-4.892***	-3.067
<i>MKTCAP</i>	0.068	1.502	0.114	0.577	-0.049	-0.968	0.729	0.520
<i>LEV</i>	-149.861***	-2.963	-358.143	-1.162	134.377**	-1.997	30.515	0.018
<i>CG_score</i>	0.003	1.044	0.004	0.159	-0.004	-1.628	0.029	0.345
<i>CSR_REPORT</i>	0.076	0.722	0.854	0.785	0.024	0.348	-	-
<i>CAPEX</i>	-0.094***	-3.385	-0.526	-0.337	0.015	0.426	11.249	1.075
<i>SG&A</i>	0.830***	2.881	-0.001	-0.001	-0.074	-0.287	-6.626	-0.981
<i>TOBIN</i>	150.837***	2.979	361.188	1.170	135.121**	2.005	-28.162	-0.016
<i>ROA</i>	-0.136	-0.245	-4.449	-1.464	-0.047	-0.239	-0.818	-0.278
<i>SALES</i>	-0.373*	-1.946	-0.979	-0.754	-0.098	-0.763	2.098	0.724
<i>ESG_perf</i>	0.002	0.695	0.011	0.607	0.004**	2.500	0.022	0.309
<i>CASH</i>	0.720*	1.756	-0.413	-0.153	0.278	0.667	-2.011	-0.237
<i>PPE</i>	-0.019	-1.426	-0.708***	-2.796	0.026	0.602	-1.458	-0.448
Constant	-0.736***	-1.993	-1.416	-0.578	0.504	1.422	-2.227	-0.164
Year FE	YES		YES		YES		YES	
Industry FE	YES		YES		NO		NO	
Firm FE	NO		NO		YES		YES	
Observations	676		579		676		220	
R ²	0.530				0.872			
Pseudo R ²			0.250				0.481	

Table 2-7 Cross-sectional analyses: The effect of corporate governance on the impact of the regulatory shift on disclosure and donation levels

Panel A reports the results of the cross-sectional test of the role of corporate governance quality *CG_score* on the impact of the mandatory-to-voluntary shift on firms' disclosure levels. Panel B reports the results of the cross-sectional test of the role of corporate governance quality on the impact of the mandatory-to-voluntary shift on firms' donation levels. T-statistics are computed based on heteroscedasticity-robust standard errors clustered by firms. Industries fixed effects are based on two-digit SIC codes. The superscripts ***, **, and * indicate two-tailed statistical significance at the 1%, 5%, and 10% levels, respectively. All variables are as defined in appendix 2-A.

Panel A: The role of corporate governance on the impact of regulatory shift on disclosure levels

Variables	(1) <i>DON_DSCORE</i>		(2) <i>SD_DSCORE</i>		(3) <i>HD_DSCORE</i>	
	coef	t-stat	coef	t-stat	coef	t-stat
<i>POST</i> × <i>CG_score</i>	-0.152*	-1.883	-0.202**	-2.352	-0.077	-0.875
<i>POST</i>	9.657	1.381	14.782*	1.973	2.101	0.281
<i>CG_score</i>	0.128**	2.084	0.132*	1.959	0.120	1.601
<i>SIZE</i>	1.934	0.783	2.024	0.786	1.909	0.657
<i>D/E</i>	0.012	0.355	0.000	0.009	0.031	0.551
<i>ROA</i>	10.813*	1.662	9.554	1.329	11.931*	1.699
<i>MB</i>	0.023	0.436	0.003	0.049	0.054	0.710
<i>DON_HIGH</i>	4.781**	2.124	2.905**	2.169	7.411*	1.712
<i>Ownership</i>	0.058***	2.655	0.071***	2.880	0.041*	1.665
<i>RD</i>	23.930	0.672	62.712	1.454	-28.275	-0.704
Constant	-18.909	-20.300	-0.554	-18.719	-0.496	-23.712
Year FE	YES		YES		YES	
Firm FE	YES		YES		YES	
Observations	587		587		587	
R ²	0.745		0.755		0.681	

Table 2-7 (continued)

Panel B: The role of corporate governance on the impact of regulatory shift on corporate charitable donation levels

Variables	(1)		(2)	
	<i>DON</i> coef	t-stat	<i>DON_dummy</i> coef	t-stat
<i>POST</i> × <i>CG_score</i>	0.004**	2.215	0.059	0.815
<i>POST</i>	-0.395***	-2.638	-9.897	-1.604
<i>MKTCAP</i>	-0.053	-1.049	0.663	0.475
<i>LEV</i>	-138.752**	-2.074	-92.795	-0.054
<i>CG_score</i>	-0.005**	-2.120	-0.008	-0.067
<i>CSR_REPORT</i>	0.064	0.865	-	-
<i>CAPEX</i>	0.019	0.547	10.672	0.997
<i>SG&A</i>	-0.136	-0.522	-6.195	-0.942
<i>TOBIN</i>	139.477**	2.081	94.919	0.055
<i>ROA</i>	-0.057	-0.292	-0.923	-0.298
<i>SALES</i>	-0.096	-0.734	2.151	0.741
<i>ESG_perf</i>	0.005**	2.559	0.028	0.382
<i>CASH</i>	0.241	0.578	-2.363	-0.268
<i>PPE</i>	0.023	0.548	-1.333	-0.407
Constant	0.623*	1.782	0.467	0.031
Year FE	YES		YES	
Firm FE	YES		YES	
Observations	676		220	
R ²	0.873			
Pseudo R ²			0.484	

Table 2-8 The role of board member connections to charities on the impact of regulatory shift on firms' disclosure levels

This table reports the results of the cross-sectional test of the role of board members' connection to charities on the impact of the mandatory-to-voluntary shift on firms' disclosure levels. T-statistics are computed based on heteroscedasticity-robust standard errors clustered by firms. Industries fixed effects are based on two-digit SIC codes. The superscripts ***, **, and * indicate two-tailed statistical significance at the 1%, 5%, and 10% levels, respectively. All variables are as defined in appendix 2-A.

Variables	(1) <i>DON_DSCORE</i>		(2) <i>SD_DSCORE</i>		(3) <i>HD_DSCORE</i>	
	coef	t-stat	coef	t-stat	coef	t-stat
<i>POST</i> × <i>BOARD_CHAR</i>	-5.245***	-3.847	-1.291	-0.940	-10.960***	-5.961
<i>POST</i>	-3.673***	-2.997	-2.900**	-2.154	-4.674***	-3.518
<i>BOARD_CHAR</i>	0.304	0.221	0.444	0.281	0.382	0.298
<i>CG_score</i>	0.123*	1.970	0.122*	1.815	0.121	1.579
<i>SIZE</i>	1.966	0.776	2.038	0.766	1.948	0.666
<i>D/E</i>	0.010	0.284	-0.003	-0.065	0.030	0.541
<i>ROA</i>	11.656*	1.827	10.582	1.513	12.516*	1.799
<i>MB</i>	0.012	0.223	-0.012	-0.187	0.048	0.653
<i>DON_HIGH</i>	4.357*	1.931	2.331*	1.712	7.210	1.654
<i>Ownership</i>	0.056**	2.552	0.068***	2.770	0.039	1.605
<i>RD</i>	28.660	0.753	68.939	1.487	-26.235	-0.642
Constant	-20.157	-0.535	-17.880	-0.456	-24.316	-0.553
Year FE	YES		YES		YES	
Firm FE	YES		YES		YES	
Observations	587		587		587	
R ²	0.743		0.749		0.687	

Table 2-9 Impact of the regulatory shift on firms' agency conflicts

This table reports the results of regressions examining the impact of the mandatory-to-voluntary shift on firms' agency conflicts. As dependent variable, I employ a principal component analysis of six proxies used in the literature for agency conflicts and take the first component as measure of *AGENCY*. T-statistics are computed based on heteroscedasticity-robust standard errors clustered by firms. Industries fixed effects are based on two-digit SIC codes. The superscripts ***, **, and * indicate two-tailed statistical significance at the 1%, 5%, and 10% levels, respectively. All variables are as defined in appendix 2-A.

Variables	(1)		(2)	
	<i>AGENCY</i> coef	t-stat	<i>AGENCY</i> coef	t-stat
<i>POST</i>	0.196***	4.012	0.432***	6.942
<i>ROA</i>	-3.892***	-2.928	0.787*	1.795
<i>RD</i>	-3.323**	-2.513	-9.401***	-3.345
<i>SALES</i>	-0.071	-0.166	-0.011	-0.040
<i>LIABILITIES</i>	3.017***	5.511	1.372***	2.612
<i>ANALYST</i>	0.051***	4.139	0.016	1.471
<i>OWNERSHIP</i>	-0.069	-0.177	-0.240	-1.231
<i>INDEPENDENCE</i>	-0.004	-0.738	-0.001	-0.461
<i>SHARES_STRUCTURE</i>	-0.315	-1.263	-0.141*	-1.957
<i>BOARD_SIZE</i>	0.067	1.381	0.018	0.857
Constant	-2.565***	-3.418	-1.051*	-1.864
Year FE	YES		YES	
Industry FE	YES		NO	
Firm FE	NO		YES	
Observations	588		588	
R ²	0.602		0.962	

Table 2-10 Impact of the regulatory shift on disclosure levels: Difference-in-difference in average disclosure levels between UK and US firms around the regulatory shift

This table reports the results of the PSM matched difference-in-difference analysis of the impact of the mandatory-to-voluntary shift on firms' disclosure levels. T-statistics are computed based on robust standard errors. PRE and POST refer respectively to the periods before and after the regulatory shift of 2013. The superscripts ***, **, and * indicate two-tailed statistical significance at the 1%, 5%, and 10% levels, respectively. All variables are as defined in appendix 2-A.

Panel A Univariate difference-in-difference analysis

	PRE (2011, 2012)	POST (2014, 2015)	Difference
Mean <i>DON_DSCORE</i> treatment group (<i>UKdummy</i> =1)	25.097	21.818	-3.278*** t=-3.413
Mean <i>DON_DSCORE</i> control group (<i>UKdummy</i> =0)	4.175	5.207	1.032 t=1.126
Difference	20.922*** t = 19.22	16.611*** 15.26	-4.311*** -2.80

Table 2-10 (continued)

Panel B Multivariate difference-in-difference analysis

Variables	(1) <i>DON_DSCORE</i>		(2) <i>SD_DSCORE</i>		(3) <i>HD_DSCORE</i>	
	coef	t-stat	coef	t-stat	coef	t-stat
<i>POST</i> × <i>TREAT_UK</i>	-4.786***	-4.346	-4.091***	-3.110	-5.646***	-5.534
<i>POST</i>	1.958**	2.343	2.350**	2.181	1.397**	2.122
<i>TREAT_UK</i>	19.233***	14.521	21.193***	12.832	16.479***	14.026
<i>SIZE</i>	-1.324**	-2.115	-1.211*	-1.712	-1.441**	-2.267
<i>LEVERAGE</i>	0.017	1.017	0.014	0.621	0.020**	2.215
<i>ROA</i>	6.159	1.031	5.887	0.858	6.289	1.086
<i>MB</i>	0.001	0.274	0.003	0.442	-0.001	-0.356
<i>DON_HIGH</i>	5.006***	2.803	4.708**	2.424	5.479***	2.691
<i>RD</i>	26.905*	1.842	34.129**	1.977	17.088	1.375
Constant	11.618	1.239	12.179	1.149	10.115	1.066
Year FE	YES		YES		YES	
Industry FE	YES		YES		YES	
Observations	868		868		868	
R ²	0.501		0.463		0.468	

Table 2-11 Impact of the regulatory shift on disclosure levels: Robustness tests

This table reports the results of robustness tests examining the impact of the mandatory-to-voluntary shift on firms' disclosure levels. Panel A reports the results of the falsification test. I perform the test on two years (2011 and 2012). *POST_PLACEBO* is a dummy variable, which equals to 1 for year 2012 (suggesting that the regulatory shift took place in 2012) and 0 for year 2011. Panel B reports the results of the tests controlling for the number of analyst following *ANALYST*, the social performance *ESG_perf* from *ASSET4*, and the *TRANSPARENCY* score from *ASSET4*, which measures whether firms' publications on CSR, health and safety or sustainability. Panel D reports the results of the tests using a Poisson regression. T-statistics are computed based on heteroscedasticity-robust standard errors clustered by firms. Industries fixed effects are based on two-digit SIC codes. The superscripts ***, **, and * indicate two-tailed statistical significance at the 1%, 5%, and 10% levels, respectively. All variables are as defined in appendix 2-A.

Panel A Falsification test

Variables	(1) <i>DON_DSCORE</i>		(2) <i>SD_DSCORE</i>		(3) <i>HD_DSCORE</i>		(4) <i>DON</i>	
	coef	t-stat	coef	t-stat	coef	t-stat	coef	t-stat
<i>POST_PLACEBO</i>	1.829	0.774	0.006	0.00	4.420	1.492	-0.001	-0.020
Controls	YES		YES		YES		YES	
Constant	2,337.536	0.443	-1,421.473	0.227	7,679.285	1.185	0.725	1.386
Year FE	YES		YES		YES		YES	
Firm FE	YES		YES		YES		YES	
Observations	293		293		293		268	
R ²	0.855		0.833		0.825		0.965	

Panel B Additional controls with firm fixed-effects

Variables	(1) <i>DSCORE</i>		(2) <i>SDscore</i>		(3) <i>HDscore</i>	
	coef	tstat	coef	tstat	coef	tstat
<i>POST</i>	-4.259***	-4.533	-3.355***	-3.086	-5.383***	-5.781
<i>ANALYST</i>	-3.067	-1.227	-2.231	-0.860	-4.083	-1.494
<i>ESG_perf</i>	0.033	0.364	0.003	0.034	0.073	0.769
<i>TRANSPARENCY</i>	0.065	1.407	0.079	1.474	0.047	1.098
Controls	YES		YES		YES	
Constant	38.920***	3.004	31.164**	2.149	49.119***	3.824
Year FE	YES		YES		YES	
Industry FE	YES		YES		YES	
Observations	560		560		560	
R ²	0.294		0.276		0.305	

Table 2-11 (continued)

Panel C Additional controls with firm fixed-effects

Variables	(1) <i>DSCORE</i>		(2) <i>SDscore</i>		(3) <i>HDscore</i>	
	coef	tstat	coef	tstat	coef	tstat
<i>POST</i>	-3.779***	-3.170	-2.882**	-2.030	-4.936***	-4.199
<i>ANALYST</i>	-0.763	-0.294	0.221	0.078	-2.012	-0.712
<i>ESG_perf</i>	0.126	1.578	0.137*	1.691	0.108	1.093
<i>TRANSPARENCY</i>	0.022	0.636	0.030	0.731	0.012	0.358
Controls	YES		YES		YES	
Constant	38.920***	3.004	31.164**	2.149	49.119***	3.824
Year FE	YES		YES		YES	
Firm FE	YES		YES		YES	
Observations	560		560		560	
R ²	0.623		0.635		0.542	

Panel D Poisson regression

Variables	(1) <i>DON_</i> <i>DSCO</i> <i>RE</i>		(2) <i>SD_</i> <i>DSCO</i> <i>RE</i>		(3) <i>HD_</i> <i>DSCO</i> <i>RE</i>		(4) <i>DON_</i> <i>DSCO</i> <i>RE</i>		(5) <i>SD_</i> <i>DSCO</i> <i>RE</i>		(6) <i>HD_</i> <i>DSCO</i> <i>RE</i>	
	coef	t-stat	coef	t-stat	coef	t-stat	coef	t-stat	coef	t-stat	coef	t-stat
<i>POST</i>	0.172* **	-3.796	0.120* **	-2.860	0.283* **	-4.010	0.183* **	-3.815	0.117* **	-2.663	0.339* **	-4.553
<i>CG_score</i>	0.005*	1.729	0.005*	1.858	0.004	1.218	0.004	1.601	0.004	1.409	0.006	1.425
<i>SIZE</i>	0.096* **	-3.283	0.087* **	-3.168	0.110* **	-2.831	0.062	0.607	0.026	0.270	0.171	1.096
<i>D/E</i>	-0.001	-0.343	-0.000	-0.071	-0.002	-0.724	0.000	0.090	-0.000	-0.173	0.001	0.212
<i>ROA</i>	0.078	0.214	0.051	0.153	0.110	0.221	0.604* *	2.098	0.460*	1.812	0.987*	1.947
<i>MB</i>	-0.000	-0.177	0.000	0.104	-0.002	-0.588	0.000	0.120	-0.000	-0.180	0.002	0.422
<i>DON_HIGH</i>	0.254* **	2.899	0.219* **	2.664	0.333* **	2.663	0.160*	1.958	0.068	1.452	0.349* *	1.964
<i>OWNERSHIP</i>	0.001	0.392	0.003	0.958	-0.002	-0.644	0.002*	1.820	0.002*	1.921	0.002	1.179
<i>RD</i>	28.468	1.577	38.890 *	1.794	14.297	0.930	29.815	0.792	70.530	1.543	25.302	-0.623
Constant	34.472 ***	3.067	33.821 ***	2.882	34.640 ***	2.802	19.853	-0.526	18.125	-0.462	23.487	-0.534
Year FE	YES		YES		YES		YES		YES		YES	
Industry FE	YES		YES		YES		NO		NO		NO	
Firm FE	NO		NO		NO		YES		YES		YES	
Observations	587		587		587		587		587		587	
R ²	0.265		0.247		0.273		0.652		0.662		0.572	

Chapter 3

Overlaps between auditors' and clients' corporate charitable donations, audit pricing and audit quality

ABSTRACT

This study analyzes the influence of charitable alignment between auditor and client i.e., the overlaps of their corporate charitable donations (CCDs) on two major audit outcomes: audit pricing and audit quality. I posit that overlaps of auditors' and clients' CCDs capture social capital at the firm-level in an audit setting. Overlaps of CCDs reveal firms' shared norms and build social networks based on a greater trust. In an exploratory analysis of the determinants of these overlaps, I find that firms with a corporate charitable foundation, a higher firm value or a bigger board size are more likely to overlap their CCDs. Moreover, I find that auditors and clients that make CCDs to the same nonprofits exhibit higher audit quality and higher audit fees. This evidence implies a better information exchange and trustworthiness among auditor and client as well as auditor's extra efforts to preserve their network. In a further analysis, I find that the effect of overlaps of CCDs between auditor and client is much stronger when auditor has a better knowledge of firms (i.e., longer auditor tenure). This study presents new evidence that the alignment of CSR activities, in particular charitable activities, between audit firms and clients, is one driver of audit outcomes and modify auditors' perceptions of firms' reporting.

3.1 Introduction

A firm's performance depends on its financial capital i.e., the funds available to a firm (i.e., debt and equity finance), but also on other various forms of capital, such as physical, intellectual and human²⁶. Recently, a literature in accounting and finance has emerged studying firms' social capital (Hilary and Hui 2009; Berglund and Kang 2013; Jha and Chen 2014), which is defined by Putnam (1995) as "features of social organizations such as *networks, norms* and *trust*" (p.67). The social capital of a firm consists broadly of the quality of the relationships that the firm has built with a variety of stakeholders (Servaes and Tamayo 2017). It includes relationships within an organization, as well as those between an organization and its external stakeholders. In this study, I focus on social capital in an audit setting in order to analyze the quality of the relationships between clients and auditors at the firm level and its relation to two audit outcomes – audit pricing and audit quality. Financial auditing offers a unique setting to investigate the role of firms' social capital given auditors' exposure to the market and their repeated interactions with clients (Pennings and Lee 1999).

As other forms of capital, social capital is a reserve of value that become an input to the firm's business model and can be modified through the activities of the firm (Adams 2015; IIRC 2013). Servaes and Tamayo (2017) propose to capture firms' social capital through their corporate social responsibility (CSR) activities, which include making corporate charitable donations (CCDs). Moreover, the existing literature suggests that firms build relationships with their stakeholders through the use of CSR activities and in particular corporate charitable donations (CCDs) (Galaskiewicz 1997; Cespa and Cestone 2007).

In this study, I propose a new way to test the role of firms' social capital on audit outcomes based on CCDs by examining the charitable alignment between audit- and client-

²⁶ The IIRC identifies the following six capitals: financial, physical, intellectual, human, social and natural.

firms. If audit-firms and client-firms make CCDs to the same nonprofit organizations, then I contend that their charitable interests are aligned. This study uses overlaps of auditors' and clients' CCDs to investigate the role of social capital among audit- and client-firms on two audit outcomes – audit pricing and audit quality.

In this paper, I first examine whether and why client-firms and audit-firms make CCDs to the same nonprofit organizations. I next investigate whether social capital between audit- and client- firms stemming from overlaps of their donations affect audit pricing and audit quality. In doing so, this study highlights the importance of firms' CSR decisions and in particular firms' discretionary CCDs on auditors' perceptions of corporate reporting.

Firms, including audit firms,²⁷ invest significantly in CCDs through direct giving or corporate foundations. However, because CCDs are rarely disclosed in corporate reports, they have been largely overlooked by accounting and auditing research until recently (e.g., Masulis and Reza 2015; Liang and Renneboog 2016). The existing literature shows that CCDs often reflect personal beliefs and values of managers (Porter and Kramer 2002), corporate norms (Genest 2005) and help firms building relationships with their stakeholders (Galaskiewicz 1997). For instance, Enron largely contributed to a hospital directed by a member of its audit committee, suggesting social interactions between the firm and an audit committee member. I argue that overlaps of auditors' and clients' CCDs indicating a charitable alignment can create the general impression of shared charitable interests, and the resulting network based on mutual trust among auditors and clients. Then, in accordance with Putnam's view of social capital (Putnam 1995) as defined earlier, overlaps of auditors' and clients' CCDs encompass the three key aspects of social capital: *norms*, *trust* and *networks*. In contrast to regional social capital (e.g., Jha and Chen 2014; Berglund and Kang 2013; Lee et al. 2014) or professional and educational networks (e.g., Guan et al. 2015; Cohen et al. 2014) examined in prior audit

²⁷ Deloitte, Ernst & Young, KPMG, and PwC spent a combined \$80 million approximately on charitable donations in 2012 (NozaSearch)

research, I argue that CCDs are firms' initiatives that allow to examine social capital between audit and client firms in a more direct way.

Two studies have investigated the impact of firms' charitable alignment in another setting. Masulis and Reza (2015) and Cai et al. (2016) look at the role of the charitable alignment between firms and their independent directors on board monitoring. However, prior research has not investigated the possible impact of a charitable alignment between external independent auditors and clients at the firm-level, which is the focal point of this study. I put forward the idea that overlaps of auditors' and clients' CCDs are likely to affect auditors' perception of firms' reporting and, therefore, audit fees and quality. A firm's audit fees are dependent on auditors' effort and their perception of litigation risk (Simunic 1980). I argue that auditors consider financial reports of clients that share the same social norms through their CCDs as more truthful. This greater trust and the resulting network reduce the perceived risk of firms' reporting and therefore will decrease audit fees. Conversely, auditors are willing to make extra efforts to provide efficient audit services and maintain their networks with clients driving up audit fees. There is not clear theoretical evidence on the implications of large audit fees on audit quality (e.g., O'sullivan 2000; Deis Jr and Giroux 1996; Hoitash et al. 2007), so I could not expect the impact of the charitable alignment on audit quality from the predictions on the audit fees. High audit fees indicate either more audit hours and work in the audit process and therefore suggest a high audit quality (O'sullivan 2000; Deis Jr and Giroux 1996) or a threat to auditors' independence given their economic dependence on clients and therefore suggest a low audit quality (Hoitash et al. 2007). Consequently, I will also consider the impact of overlaps between auditors' and clients' CCDs on audit quality, which is defined as the joint probability of auditor competence and auditor independence (DeAngelo 1981).

Firms' social capital stemmed from the charitable alignment of auditors and clients can improve audit quality by allowing a greater cooperation and coordination from the clients who transfer their information (Powell et al. 1996; Uzzi 1997; Adler and Kwon 2002). This greater information sharing results in an effective monitoring. However, the charitable alignment between auditors and clients may also lead to the development of reciprocal trust and positive regard, which could impair auditor independence. Overall, the influence of overlaps between auditors' and clients' corporate donations on audit fees and quality is an open empirical question.

I test my predictions using a sample of US firms. The sample consists of the Fortune 500 US firms and their audit firms at the national level over the 2003-2014 period. I recognize cash CCDs by hand-collecting data from the Foundation Center online database (i.e. the Foundation Directory Online) and the NozaSearch Database. The overlaps of auditors' and clients' CCDs allow to capture their level of social capital. In particular, I use a dummy variable (*OD_Dummy_6Y*) that indicates whether audit-firms and their clients have made at least one CCD to the same nonprofit organizations during a six-year window.

Before testing the predictions, I develop an exploratory determinants model of the overlaps between auditors' and clients' CCDs in order to better understand the charitable alignment between them. I identify factors from prior research on corporate philanthropy and social capital: corporate governance variables and audit and firms' financial characteristics (Gautier and Pache 2015; Brown et al. 2006; Masulis and Reza 2015). I find that firms with a corporate charitable foundation, a higher firm value or a bigger board size are more likely to overlap their CCDs and to give a higher amount of donations.

I next examine the association between audit pricing/audit quality and overlaps of CCDs between audit- and client-firms. I employ two widely used measures to capture audit quality: financial restatements (*RST*) and discretionary accruals (*DAC_DD*). I find that when

clients and their audit firms make CCDs to the same nonprofits, audit fees are higher, suggesting a fee premium. This suggests that auditors exert more efforts and exercise their professional care in the performance of the audit with clients who share the same charitable values in order to protect their networks. My results differ from Berglund and Kang (2013) and Jha and Chen (2014) who examine the influence of social capital on audit fees and find that firms headquartered in counties with high social capital pay lower audit fees. The analysis of social capital at the firm level (both audit and client firm) and the specific analysis of firms' charitable alignment may explain this difference in results.

I find that firms that support the same nonprofits than their audit firms have higher audit quality as demonstrated by their lower likelihood of restatements and lower discretionary accruals. This evidence suggests that the charitable alignment between audit- and client-firms imply an effective communication, critical to the audit quality. I also find that the effect of overlaps of donations between audit- and client-firms is much stronger for clients with longer auditor tenure when the auditors can benefit of a better knowledge of the firms' operations and accounts. This reinforces the argument that more effective communication and transfer information when firms' charitable interests are aligned with auditors' interests. The results are robust to alternative measures of audit quality and audit pricing (i.e., going concern opinion, auditor tenure, and the proportion of non-audit fees on total fees).

I attempt to control for some of the endogeneity and mitigate the effects of omitted variables. First, I employ a firm fixed-effect model in attempt to control for differences in time-constant firm characteristics. Second, I also add an instrumental variable analysis while estimating the impact of overlaps of CCDs on audit quality. I use a dummy variable that indicates whether a firm has a corporate charitable foundation. Consistently, I find a positive association between overlaps of auditors' and clients' CCDs and audit quality.

This paper makes several important contributions. First, I contribute to a recent body of research showing that social capital and social relations affects corporate decisions (Hasan et al. 2016; Jha and Cox 2015; Lennox 2005; Hwang and Kim 2009). Two related papers - Berglund and Kang (2013) and Jha and Chen (2014) - examine the influence of social capital in an audit setting but at the regional level rather than among firms. However, social capital at the regional level is exogenous to individual firms' influence and decision-making that develop their own norms (Berglund and Kang 2013). Therefore, regional social capital does not predict accurately individual firms' norms, networks and trust. In this paper, I respond to calls to study social capital at the firm level (Servaes and Tamayo 2017) by using overlaps of CCDs among firms. Berglund and Kang (2013) and Jha and Chen (2014) focus on the effect of social capital on audit pricing and neglect audit quality, which is important to understand factors that affect firms' financial reporting quality. Past studies on social relations focus on school and professional relations between individuals. These studies disregard charitable activities that allow firms to build strong and long-lasting social relations (Porter and Kramer 2002). The use of the CCDs between audit-firms and their clients contributes to the understanding of how social capital emerged within firms.

Second, this study contributes to the auditing literature by presenting new evidence that congruence of CSR activities, in particular charitable activities, of audit firms and clients, is one driver of audit outcomes. My evidence entails that the discretionary CCDs are not anecdotal and have influence on firms' networks, norms and trustworthiness that, in turn, modify auditors' perceptions of firms' reporting.

Third, this paper also contributes to the stream of research on corporate philanthropy (Lev et al. 2010; Navarro 1988; Porter and Kramer 2002). In particular, it adds to the burgeoning stream of research that explores the relational dimension of CCDs and its effects on firms' monitoring (Masulis and Reza 2015; Cai et al. 2016). To the best of my knowledge,

my study is the first that provides evidence of it in an audit context, wherein the monitoring effectiveness is critical.

The remainder of the paper is organized as follows. Section 3.2 discusses literature and hypotheses development. Section 3.3 describes the research design and data. Section 3.4 presents the results. Finally, section 3.5 concludes.

3.2 Background and hypotheses development

This section discusses some of the research that underlies the notion of social capital and its relation to CCDs. Then, I formulate two hypotheses with different predictions on the influence of the charitable alignment between auditors and clients on audit outcomes – audit fees and audit quality.

3.2.1 Social capital and charitable donations

The concept of social capital has been a subject of extensive research in sociology (Coleman 1988), political science (Putnam 1993), and economics (Fukuyama 1995; Adler and Kwon 2002) and recently in accounting (Hasan et al. 2017; Jha and Cox 2015). Social capital is defined as features of social life - networks, norms and trust – that enable participants to act together more effectively to pursue shared objectives (Putnam 1995). While social capital can occur at different levels (e.g., at the individual level, at the regional level), this paper examines social capital at the firm level. At the firm level, social capital is broadly defined as the quality of the relationships that the firm has built with a variety of stakeholders (Servaes and Tamayo 2017).

My approach to analyze social capital at the firm-level is based on the firms' charitable alignment measured as the overlaps of their CCDs. Social capital at the firm-level is built on the firm's history and reputation and prevails independently of the people involved, even though individuals may improve the social capital of their organization (Schneider 2009).

According to Inkpen and Tsang (2005 p. 151), firms' social capital is a public good because the "members of an organization can tap into the resources derived from the organization's network of relationships without necessarily having participated in the development of those relationships". Therefore, in this study, I argue that CCDs matter for its employees and other internal stakeholders.

Overlaps of auditors' and clients' CCDs encompass the three key aspects of social capital highlighted in Putnam's (1995) definition: norms, networks and trust. The concept of social capital has been related to charitable activities when Putnam (1995) asserted that social capital and civic commitment were declining in the United States as participations in nonprofits organizations declined (Schneider 2009). CCDs help firms build values and civic norms²⁸, which lead to a greater trust (Genest 2005) and is a crucial source of *networks*. I posit that when charitable interests are aligned, they behave in ways that their network considers trustworthy. Moreover, firms' charitable activities create long-lasting bonds, and open new social circles to firms by participating notably in activities such as charity events and galas (Shapira 2012; Galaskiewicz 1997). Social networks built via CCDs are more than simple connections, they are reciprocal and durable ties that people and organizations use over time (Schneider 2009). Taking together, I argue that firms that make donations to the same charities share the same social interests and norms, which reinforce common views, a greater trust and result in social networks.

Despite the role of firms' charitable activities in building social capital (Putnam 1995), studies on firms' social capital focus on the presence of nonprofit organizations in the firms'

²⁸ As evidenced in prior literature, firms may use CCDs in order to support their communities and do good for society (i.e., altruistic motives) or in order to get benefits for the firm or managers (i.e., opportunistic motives) (Shapira 2012). Social capital still arises from firms' charitable donations when their motives are opportunistic because donations still create values, norms and networks, irrespective of firms' initial intentions.

region rather than on CCDs. Most accounting studies measure social capital at the regional level where a firm is headquartered (Jha and Chen 2014; Berglund and Kang 2013; Hasan et al. 2017). The most commonly used social capital measure is a variable developed by Rupasingha et al. (2006) based on the voter turnout in presidential elections, response rates in US census surveys, the total number of non-profit organizations and social organizations in each US county. Although this measure may reflect the general trust in the society, it cannot fully account for the trust and social norms in the firm. By using this social capital measure in an audit setting, Jha and Chen (2014) and Berglund and Kang (2013) relate social norms at the community level to audit pricing on the assumption that more regional social norms are associated with more trust among clients and auditors. However, social capital at the regional level is not a direct measure of firms' and auditors' own social capital. In contrast, even though CCDs do not capture all the aspects of the Rupasingha et al. (2006) measure, these donations represent firms' initiatives and reflect firms' trust, norms and networks, essential for my research question. In addition, regions with social capital among a wider array of residents involve slow development of trusting relationships across groups and over time, compared to relationships based on trust and corporate norms (Putnam et al. 2003).

3.2.2 Related literature

This paper builds on an emerging field of accounting research that examine the effects of social capital on economic and financial decisions (e.g., Pevzner et al. 2015; Hilary and Huang 2015; Hasan et al. 2016; Jha and Cox 2015) and more particularly on audit outcomes (e.g., Jha and Chen 2014; Berglund and Kang 2013). Berglund and Kang (2013) and Jha and Chen (2014) find that social capital surrounding firms is associated to lower audit fees. The rationale is that auditors are aware that managers in high social capital areas are more likely to be honest in their financial reporting and consequently charge lower audit fees for these clients. That said, this evidence does not answer the question of the influence of the social

capital that emerged directly from both audit- and client-firm (and not from their local environment) on audit outcomes.

My paper builds also on the literature on the influence of social network on financial decisions, given that it is one important aspect of social capital (Putnam 1995). There is considerable evidence that personal and friendly relations influence the formation of social networks and affect firms' decision-making processes and economic outcomes (Cohen et al. 2014; Fracassi and Tate 2012; Hwang and Kim 2009; Cohen et al. 2010; Engelberg et al. 2012; Bruynseels and Cardinaels 2013; Lennox 2005). Several studies investigate the social networks between external auditors and clients' managers and their consequences on audit outcomes (e.g., Lennox 2005). Lennox (2005), Menon and Williams (2004), and Baber et al. (2014) show that firm executives' relations with audit firms stemming from their working experience impair audit quality and earnings quality. However, other papers document that such professional networks do not decrease auditor independence and may improve audit quality (Geiger et al. 2008; Naiker and Sharma 2009; Naiker et al. 2012). Kwon and Yi (2012) and Guan et al. (2015) focus on social networks between auditors and firm's management formed through educational backgrounds and find mixed evidence on audit quality. While some papers acknowledge that strong social relations may stem from charitable activities (e.g., Ishii and Xuan 2014; Bruynseels and Cardinaels 2013; Dey and Liu 2010; Fracassi and Tate 2012), they do not directly test the role of CCDs on external auditors' perceptions of firms' financial reporting and the resulting audit outcomes.

Finally, few prior studies have investigated the impact of firms' charitable alignment with other stakeholders. Masulis and Reza (2015) examine whether corporate supported charitable causes overlap with independent director charitable interests measured by their charitable affiliations (i.e., when the director has a role in a nonprofit organization) and show that this charitable alignment is associated with greater CEO compensation. Similarly, Cai et

al. (2016) show that overlaps of CCDs and independent directors' charitable affiliations are associated with less effective monitoring. Further, they find poor reporting quality only at firms that make CCDs to charities affiliated with audit committee members. While these studies account for the reciprocal aspects of CCDs, they do not investigate the impact of a charitable alignment between external independent auditors and clients at the firm-level.

3.2.3 The influence of the charitable alignment between auditors and clients on audit fees and audit quality

This paper offers several explanations of why firms and their auditors would make donations to the same nonprofits based on past studies and anecdotal evidence. First, firms make CCDs based on managers' personal preferences or based on corporate culture and norms (Breeze 2010). For instance, in the 1970s, every partner at Arthur Andersen had to make CCDs in the "matching giving program" of the audit firm and has been told where to donate²⁹ (Toffler and Reingold 2004). The dimensions and urgency of the problem for which funding is sought is also likely to play a role in a firm's decision to donate to charities. Nonprofit organizations can request corporate donations from their nearby area, including local corporations and audit firms. Second, both auditor and client firm have their own incentives to strategically donate to the same charities. On the one hand, by imitating their audit firms, client-firms may expect to "opinion shop" for their auditors or to gain reputation towards auditors by serving their charitable interests. On the other hand, audit firms may make donations to the same charities than their clients in order to please client management and retain their business.³⁰ I develop a determinants model as an exploratory test (Section 4) in order to identify the factors that affect the charitable alignment between auditors and clients measured by the overlaps of their CCDs.

²⁹ "I was being told what I was to support, and with how much, so the firm could be recognized for a magnanimous donation. I bit my tongue, wrote the check" (Toffler and Reingold 2004).

³⁰ A former auditor in a Big 4 in the US agrees that this idea is descriptive of actual practice and confirmed me that they were looking at their client's donations in order to choose where to make their own CCDs.

In a seminal paper, Simunic (1980) shows that a firm's audit fees are dependent on the audit effort and the litigation risk. Prior research shows that during the audit process, auditors' judgments and decisions are sensitive to the clients' trustworthiness (Ponemon 1993; Kerler and Killough 2009), which therefore can affect their audit effort and their perceived audit risk of the clients. There is a reciprocal trust between members of high social-capital organizations (Fukuyama 1995), characterized in this study by their overlaps of CCDs. Auditors trust their clients more, and have better communication with them when they share the same corporate norms and charitable values, which lead them to reduce their effort and reduce their perceived audit risk, both control and detection risk of financial reporting. Therefore, I can expect that when audit firms and client firms make donations to the same charities and share a high social capital, auditors will charge lower audit fees.

In accordance with the potential view that audit firms make CCDs to the same charities than their clients in order to please client management and retain their business, they are also more concerned about reputation damage and litigation risk (Lev 1995; Keune and Johnstone 2012). Given their relationships and networks with clients based on shared charitable interests, I argue that auditors want to avoid potential reputation damage or litigation risk and therefore would provide more efficient audit services. Prior evidence suggests that in order to offer an effective investigation and ensure that the financial statements are free from material misstatements, more audit effort is required, which will lead to higher audit fees (O'sullivan 2000). From a client's perspective, these increased audit efforts lead clients to be more satisfied. Behn et al. (1999) show that client satisfaction positively affect audit fees, because satisfied clients are less likely to bargain and are more willing to accept high audit fees to be charged. Therefore, this view predicts a fee premium when audit firms and clients overlap their CCDs. Based on the above discussion, I propose the following hypothesis stated in null form:

H1: Overlaps of CCDs between audit firms and their clients do not affect audit fees.

I will not be able to interpret the results on audit fees in terms of audit quality, because there is not clear theoretical evidence on the implications of large audit fees on audit quality (e.g., O'sullivan 2000; Deis Jr and Giroux 1996; Hoitash et al. 2007). High audit fees indicate more audit hours and work in the audit process (O'sullivan 2000; Deis Jr and Giroux 1996) or can suggest threat to auditors' independence given their economic dependence on clients (Hoitash et al. 2007). Consequently, I also consider the impact of overlaps between auditors' and clients' CCDs on audit quality.

Audit firms produce essentially services that are subject to the client, who actively participate to the audit work. Thus, to enhance the quality of the provided audit service, clients need to convey and share firm's information with the auditors about firm's operations, transactions and accounts, business model, as well as internal control functions. Auditing requires a mutual understanding between auditors and clients and also timely and productive information sharing between them. As evidenced in past studies, this might be helped and improved by social capital (e.g., Powell and Smith-Doerr 1994; Nebus 1998). Sharing social norms and values such as charitable values through the overlaps of donations improves information sharing and communication effectiveness (L Cohen et al. 2010; Cohen et al. 2014; Engelberg et al. 2012). Firms are also more likely to have frequent interactions when they share high social capital (Jha and Chen 2014) and notably when their charitable interests are aligned. Therefore, auditors with a better access to their clients' information could better monitor them (Wu 2008; Chami and Fullenkamp 2002). Such information transfer between auditors and clients decreases the detection risk and result in a higher audit quality. Finally, as mentioned earlier, when auditors and clients participate to a same charitable network through their donations, auditors are more likely to exercise their professional care in the performance of the audit, leading to greater audit efforts. Consequently, social capital stemmed from

overlaps between audit- and client-firms' CCDs improves audit quality by increasing audit efforts.

However, in accordance with the view that clients expect to “opinion shop” for their auditors or to gain reputation towards auditors by serving their charitable interests, several arguments suggest that a negative association between audit quality and overlaps of CCDs is possible. Social norms affect individuals' decisions and influence managerial behavior and corporate decisions (e.g., Hilary and Hui 2009; Hasan et al. 2016). Auditors trust more their clients if they share mutual social norms and values (e.g., Hilary and Huang 2015; Ang et al. 2015) through their CCDs. As a result, auditors can rely more on internal controls and achieve less substantive auditing procedures, which consequently lead to lower audit efforts and a lower audit quality. Moreover, client firms cannot verify audit quality and they might rely on their networks to choose or to maintain their auditors. Accordingly, audit firm's social capital and especially their networks help the development and retention of clients (Pennings and Lee 1999). As a result, while making CCDs to the same nonprofits is motivated by the civic norms and social values, it is also encouraged, to a certain extent, by the benefits that may arise from the resulting social network. A recent auditing research shows that social networks at individual level stemming from auditors' working or educational experience can impair auditor independence and audit quality (Lennox 2005; Menon and Williams 2004; Bruynseels and Cardinaels 2013). A strong network in high social capital organizations promotes greater trust over time among its members and facilitates cooperation and collusive behaviors (Jha and Chen 2014). The collusive behaviors include more favorable judgments (Uzzi 1996; McPherson et al. 2001) and a weaker critical scrutiny. Additionally, a strong social network encourages more positive interpretations of others' decisions (Uzzi 1996), reducing auditors' professional skepticism and underestimating the risk of material misstatement in clients' financial reporting (Nelson 2009). Therefore, I expect that the social relations between

auditors and clients built through overlaps of their CCDs promote a greater trust and positive regard (Silver 1990) leading auditors and clients to feel compelled and reduce their efforts. As a result, overlaps of CCDs between audit firms and clients can reduce audit quality by reducing audit competence and independence. The above discussion lead to the following hypothesis, stated in null form:

H2: Overlaps of CCDs between audit firms and their clients do not affect audit quality.

3.3 Research Design and data

3.3.1 Overlaps of charitable donations between auditors and clients as a firm-level measure of social capital

To measure overlaps of CCDs, I use a dummy variable that equals 1 if a firm from the Fortune 700 and its auditor gave at least once cash amounts of CCDs to the same nonprofit organization in a six-year window, and 0 otherwise. The maximum auditor tenure of my sample being 12 years, I choose the first half of this maximum i.e., a six-year period to avoid the excessive-familiarity period of the auditor-client relationship that could bias the potential impact of firms' social capital.

I match Fortune 700 firms' CCDs with their audit firms' corporate donations by charity names by performing a fuzzy matching of textual data in Excel³¹. I use a matching score greater than 0.80.

3.3.2 Measures of audit quality and audit pricing

In order to explore the association between overlaps of auditors' and clients' donations and audit fees, I use the natural logarithm of audit fees (*AUD_FEES*) and the natural logarithm of

³¹ With the Fuzzy Lookup Add-In for Excel

annual total fees of the firm in the current year (*TOT_FEE*). If the coefficients of *AUD_FEES* and *TOT_FEE* are significantly positive, then audit fees are likely to be high. Since there is not clear theoretical evidence on the implications of large audit fees on audit quality, I also explore the association between overlaps of auditors' and clients' donations and audit quality.

Empirical measures for audit quality can be noisy and there is little consensus on the most appropriate proxy (DeFond and Zhang 2014). Thus, I conduct the tests using two proxies of audit quality that are used in prior literature: restatements (*RST*) and signed discretionary accruals (*DAC_DD*) (Dechow and Dichev 2002).

Accounting restatements correct misstatements in previously issued financial statements. Restatements are required when material misrepresentation in financial statements is discovered, and are usually strong evidence of poor audit quality. Compared to the other proxies, restatements are a relatively direct measure of audit quality because they show the auditor signed off on materially misstated financial statements (Francis 2013). I use Audit Analytics database to identify restatements announced during the 2003-2014 period. The restatements variable *RST* is initially coded 1 for each firm-year observation for financial statements that were later restated, 0 otherwise. If the coefficient of *OD_Dummy_6Y* is significantly positive, earnings are more likely to be overstated and then audit quality is likely to be low.

The second proxy for audit quality is earnings quality. Researchers in audit primarily use earnings quality measures to detect opportunistic earnings management (Choi et al. 2010). This is motivated by the belief that high quality audit constrains opportunistic earnings management. I use the modified Dechow and Dichev (2002) model suggested by McNichols (2002) to estimate abnormal working capital accruals. The model specifies working capital accruals as the following:

$$WC_GROWTH_{it} = a_0 + a_1.CFO_{it-1} + a_2.CFO_{it} + a_3.CFO_{it+1} + a_4.\Delta SALES_{it} + a_5.PPE_{it} + e_{it}$$

(1)

Where WC_GROWTH_{it} is working capital accruals in year t for firm i computed as $WC_GROWTH_{it} = \Delta CA_{it} - \Delta CL_{i,t} - \Delta Cash_{i,t} + \Delta STDEBT_{i,t}$ with ΔCA_{it} = firm i's change in current assets between year t-1 and year t, $\Delta CL_{i,t}$ = firm i's change in current liabilities between year t-1 and year t, $\Delta Cash_{i,t}$ = firm i's change in cash between year t-1 and year t, $\Delta STDEBT_{i,t}$ = firm i's change in debt in current liabilities between year t-1 and year t. CFO is operating cash flows divided by total assets for the current year. $\Delta SALES_{it}$ is firm i's change in sales between year t-1 and year t. PPE_{it} is firm i's gross value of PPE in year t. All variables are scaled by total assets.

The model is estimated cross-sectionally in each industry (two-digit SIC) – year and I require at least 10 observations in an industry-year combination. The signed residuals of the Dechow and Dichev (2002) model are determined as discretionary accruals DAC .

3.3.3 Data and sample selection

My initial sample consists of the Fortune 700 US firm for the years 2003 through 2014. These are the 700 largest firms in terms of total revenues comprised in the Fortune ranking of 2015. Firms included in the sample are those comprised in the Fortune 700 rankings of 2013, 2014 and 2015, leading to an initial sample of 654 firms.

I identify cash corporate charitable donations by hand-collecting data from two sources: the Foundation Center online (i.e. the Foundation Directory Online, FDO)³² and NOZAs³³. The Foundation Center collected the data from a combination of surveys and public records including IRS information returns (Forms 990 and 990-PF), grant-makers' websites, annual reports, philanthropic press and other sources. Generally, all grants of over

³² For more information, see: www.foundationcenter.org/fdo

³³ For more information, see: www.nozasearch.com

\$10,000 are included for all foundations. Moreover, the FDO only includes corporate donations that are verified by firms themselves or compiled from reliable public records (the database relies on more than 35 diverse information sources).

In order to ensure accuracy of my compiled database and alleviate the potential self-selection of direct donations, I crosscheck and complete the data with a second source of donations data, i.e., NOZAsearch that provides amounts of corporate donations mostly from nonprofits sources (i.e., nonprofits' websites). This search engine is the world's largest searchable database for charitable donation records. It is comprised of detailed charitable donations that have been collected from publicly available Internet locations such as nonprofits' websites. When FDO does not display the donation amount for a firm-year observation, I use the amount displayed in NOZAsearch, if available³⁴. NOZAsearch provides a donation range for each donation. I adopt a conservative approach by taking the lower bound for each donation record because sometimes the upper bound is specified as "And up" (i.e., higher unknown amount). I exclude donation amounts recorded as "Not specified". Moreover, CCDs of audit firms are not available on FDO, therefore I collect it on NozaSearch Database. I include only donations of over \$10,000 to leave out corporate matching programs of employee donations. I also remove them manually in case some matching giving donations remain in my sample. I also exclude CCDs given to United Way, which is a large US nonprofit organization that supports a wide range of other charities that are not identifiable.

I require that all necessary accounting and financial data be available in Compustat and audit data in Audit Analytics. I extract corporate governance data in Boardex and county-level social capital data on the website of the Northeast Regional Center for Rural Development (NRCRD) at the Pennsylvania State University. Social capital data reported in NRCRD are available for the years 2005, 2009, and 2014. It is the first principal component

³⁴ When the firm-year donation is missing in NOZAsearch, I assumed a zero donation.

from a factors analysis based on the percentage of voters in presidential elections, response rates in US census surveys, the total numbers of non-profit organizations, and the total numbers of ten types of social organizations (religious organizations, civic and social associations, business associations, political organizations, professional organizations, labor organizations, bowling centers, physical fitness facilities, public golf courses and sport clubs).

I exclude financial institutions (SIC codes 6000-6999) due to the different nature of the specificities of this industry. My sample includes 6,339 firm-year observations that represent 549 firms and 52 industries (2-digit SIC code). Among these firm-year observations, 547 out of 6,339 firm-year observations in my dataset have overlaps of CCDs among audit firms and their clients in a six-year window (i.e., 8.6% of the sample). The unavailability of firm-level controls further reduces the observations in the sample. I winsorize all of the continuous variables in the model at the 1st and the 99th percentiles in order to mitigate the possible effects from outliers. I report the sample composition in Table 3-1.

[Insert Table 3-1 here]

I present in Table 3-2 some characteristics regarding the overlaps of CCDs between Fortune 700 US firms and their respective audit firms. As Panel A shows, Fortune 700 firms and their audit firms make mutual donations most often to charities that support education (47.74%) such as universities. Panel B presents the scope of corporate donations and shows that, in most cases, audit firms' and their clients make common donations to national (50.7%) and local (47.3%) charities, rather than to international ones (2%). Finally, Panel C shows that the most common type of overlaps of CCDs to the same charities between audit firms and clients are annual gift (82.5%).

[Insert Table 3-2 here]

Table 3-3 present descriptive statistics and correlations of the data. As Panel A shows, the average amount of total corporate donations is \$2.4 millions and the average amount of

mutual CCDs made by client-firms (resp. audit firms) is \$48,000 (resp. \$15,000). The sample statistics for variables capturing firm characteristics are in the range of those in the extant literature. For instance, the mean (median) firm size measured as logarithm of total assets is 8.96 (8.88).

[Insert Table 3-3 here]

3.3.4 Determinants of overlaps of auditors' and clients' corporate charitable donations

Before testing the hypotheses, I first conduct an exploratory analysis to identify some factors explaining why auditors and their clients make CCDs to the same nonprofits. I employ a regression specification similar to that in (Masulis and Reza 2015).

In my model, I include variables related to the market of corporate philanthropy such as the number of nonprofit organizations in firms' counties (*NCCS*), a dummy variable that indicates whether a firm has a corporate foundation (*FOUND*), firms' and audit firms' CCDs (*DON*). I also add a factor linked to firms' networks that could drive the overlaps of firms' donations. I employ the total number of connections a person on a firm's board possesses, then I sum all these relations to measure the firm's board network size (*NETWORK*). I also include firms' quality of corporate governance by taking into account the firm's board size (*BOARD_SIZE*), board composition (*BOARD_COMP*), board tenure (*BOARD_TEN*). I add in the determinants model some audit firm characteristics that can drive the overlaps of donations. I employ an indicator variable for the big four audit firms (*BIG*), a variable that indicates whether an audit firm and its client are in the same city (*NLOCAL*), audit firms' specialization i.e., when an audit firm has the highest market share of an industry (*AUDSPEC*) and auditor tenure (*TENURE*), logarithm of total fees paid to the audit firm (*TOTFEES*), a variable that indicates whether the audit firm has changed the prior year (*AUDCHANGE*). Finally, I include firms' financial characteristics such as the firm's size (*SIZE*), firm's inherent risk (*RISK*), firm's operating cash flow (*CFO*), firm's sales growth

over the prior year (*SALES*), firm's stock return the number of firms' business segments (*SEGMENTS*) to account for client firms' complexity, firms' performance (Tobin's Q *TOBIN*, and market-to-book *MB*), firm's stock performance during the fiscal year (*RET*) and firm's debt ratio. In addition, I include industry-fixed effects in the model to parse out differences in donations across industries and year-fixed effects to control for general time trends in donations.

Therefore, I run the following determinants model:

$$\begin{aligned}
 OVER_DON_{it} = & \text{Corporate philanthropy variables} + \text{Firms' network variable} \\
 & + \text{Corporate governance variables} + \text{Audit firms variables} \\
 & + \text{Firm financial characteristics} + \text{Industry and Year fixed effects}
 \end{aligned} \tag{2}$$

Where $OVER_DON_{it}$ is one of the two proxies OD_Dummy_6Y and OD_Amount_6Y that measure overlaps of donations between audit firms and their client firms. OD_Dummy_6Y is the indicator variable that takes the value 1 if an audit firm and its client firm makes CCDs to the same nonprofit organizations in a six-year window, and 0 otherwise. OD_Amount_6Y is the sum of the cash amounts of CCDs given by audit firms and their clients to the same nonprofit organizations in a six-year window. I employ a logistic regression when I use OD_Dummy_6Y as a dependent variable and a Tobit regression when I use OD_Amount_6Y as a dependent variable.

Table 3-4 reports the regression results. I find that firms that have a corporate foundation that give larger CCDs are more likely to make and make larger corporate donations to the same nonprofits than their audit firms. In contrast, donations of firms located in counties where the number of nonprofits is larger are less likely to overlap with their auditors' donations. When the number of local nonprofits is high, firms are often asked to be generous toward them and therefore corporate giving may be pervasive leading to fewer overlaps of donations with other firms.

The corporate governance is another determinant of overlaps of audit firms' and clients' donations. Firms that have larger board, shorter tenure and have more non-executive directors are more likely to make corporate donations to the same nonprofits than their audit firms.

Some audit variables explain the overlaps of audit firms' and clients' donations such as the auditor industry specialization and the auditor tenure. I also notice that non-big four audit firms are more likely to make and make larger corporate donations to the same nonprofits than their clients.

Among client-firm characteristics, firms with greater sales growth, a higher Tobin's Q and more business segments are more likely to make and make larger donations to the same nonprofits. Finally, the size of firms' social network is another determinant of overlaps of audit firms' and clients' donations.

[Insert Table 3-4 here]

3.3.5 The baseline model

In order to test the effect of the overlaps of donations on audit fees, I develop the following model based on previous related research (Lisic et al. 2014).

$$\begin{aligned}
 FEE_{it} = & a_0 + a_1 OD_dummy_{it} + a_2 SIZE_{it} + a_3 LEV_{it} + a_4 LOSS_{it} + a_5 CFO_{it} + a_6 AGE \\
 & + a_7 RET_{it} + a_8 CURRENT_{it} + a_9 QUICK_{it} + a_{10} INT_WEAK \\
 & + a_{11} AUD_CHANGE_{it} + a_{12} NLOCAL_{it} + a_{13} AUD_SPEC_{it} + a_{14} TENURE \\
 & + a_{15} BIG_{it} + a_{16} GC_OPINION_{it} + a_{17} RISK_{it} + a_{18} DEBT_{it} + a_{19} NON_AUD_FEE_{it} \\
 & + a_{20} FINANCIAL_END_{it} + Firm\ Fixed\ Effects_i + Year\ Fixed\ Effects_t + \varepsilon_{i,t} \quad (3)
 \end{aligned}$$

where:

FEE = one of the two proxies for audit pricing AUD_FEE and TOT_FEE . AUD_FEE is the natural logarithm of annual audit fees of the firm in the current year. TOT_FEE is the natural logarithm of annual total fees of the firm in the current year.

OD_dummy = 1 if in a six-year window period a firm and its audit firm make corporate charitable donations to the same nonprofit organization and 0 otherwise;

SIZE = firm size measured as the logarithm of total assets;

LEV = firm's leverage measured as firm's total liabilities scaled by total assets;

LOSS = 1 if a firm reports a negative ROA for the current year and 0 otherwise;

SALES = firm's sales growth over the prior year;

CFO = firm's operating cash flow less extraordinary items scaled by total assets;

AGE = firm's age measured as the number of years elapsed since the firm first appeared in Compustat;

RET = firm's stock performance during the fiscal year measured as the growth of the firm's adjusted stock price (annual close price scaled by the cumulative adjustment factor);

CURRENT = firm's current ratio computed as total current assets scaled by total current liabilities;

QUICK = firm's quick ratio measured as the current assets less inventories scaled by current liabilities;

AUD_CHANGE = 1 if the auditor is not the same than in the previous record and 0 otherwise;

NLOCAL = 1 if an audit firm is in the same city than its client firm and 0 otherwise;

INT_WEAK = number of firm's material weaknesses identified by the audit firm;

AUDSPEC = 1 if an audit firm is a specialist i.e., when an audit firm has the highest market share of an industry (2-digit SIC code) and 0 otherwise;

TENURE = tenure of the last auditor

BIG = 1 if an audit firm is a big 4 firm i.e., PWC, Deloitte, EY, KPMG and 0 otherwise;

GC_OPINION = 1 if a going concern opinion has been issued in year *t* and 0 otherwise;

RISK = firm's inherent risk measured as the sum of total inventories and receivables scaled by total assets;

DEBT = firm's debt ratio measured as firm's long-term debt over total assets;

NON_AUD_FEE = the natural logarithm of non-audit fees

FINANCIAL_END = 1 if a firm has a December fiscal year end in the current year and 0 otherwise.

To investigate whether audit quality (*RST*, *DAC*) would be enhanced or diminished by the overlaps of donations between audit firms and client firms, I estimate the following baseline regression models:

$$\begin{aligned}
 RST_{it} = & a_0 + a_1 OD_dummy_{it} + a_2 SIZE_{it} + a_3 LEV_{it} + a_4 LOSS_{it} + a_5 SALES_{it} + a_6 CFO_{it} \\
 & + a_7 AGE + a_8 ROA_{it} + a_9 CURRENT_{it} + a_{10} ASSET_TURN_{it} + a_{11} AR_{it} \\
 & + a_{12} INVENTORY_{it} + a_{13} SEGMENT_{it} + a_{14} INV_{it} + a_{15} TOBIN_{it} + a_{16} RISK_{it} \\
 & + a_{17} RET_{it} + a_{18} NLOCAL_{it} + a_{19} TENURE_{it} + a_{20} BIG_{it} + a_{21} AUDSPEC_{it} \\
 & + a_{22} AUD_FEE_{it} + Firm\ Fixed\ Effects_i + Year\ Fixed\ Effects_t + \varepsilon_{i,t}
 \end{aligned} \tag{4}$$

where:

RST = 1 if there is a restatement and 0 otherwise;

ROA = firm's pretax income scaled by total assets;

ASSET_TURN = firm's asset turnover ratio computed as sales scales by total assets;

AR = firm's accounts receivables scaled by total assets;

INVENTORY = firm's inventory scaled by total assets;

SEGMENTS = firm's number of business segments;

INV = firm's investment securities measured as cash and short term investments scaled by total assets;

TOBIN = firm's Tobin's Q measured as the sum of total assets and market value of equity less cash and short term investments divided by total assets;

AUD_FEE = the natural logarithm of annual audit fees of the firm in the current year.

To be consistent with prior work summarized in Rajgopal et al. (2015), I modify the control variables in the regression where the dependent variable is the signed discretionary accruals (DAC) (Dechow et al. 1995) as below:

$$\begin{aligned}
 DAC_{it} = & a_0 + a_1 OD_dummy_{it} + a_2 SIZE_{it} + a_3 LEV_{it} + a_4 LOSS_{it} + a_5 SALES_{it} \\
 & + a_6 CFO_{it} + a_7 AGE + a_8 ROA_{it} + a_9 TACC_{it} + a_{10} ISSUE_EQUITY_{it} \\
 & + a_{11} ISSUE_DEBT_{it} + a_{12} RET_{it} + a_{13} ASSET_TURN_{it} \\
 & + Firm\ Fixed\ Effects_i + Year\ Fixed\ Effects_t + \varepsilon_{i,t}
 \end{aligned} \tag{5}$$

where:

DAC = Dechow and Dichev (2002) signed discretionary accruals;

$TACC_{it}$ = firms' total accruals measured as operating income less operation cash flows adjusted by extraordinary items;

$ISSUE_EQUITY_{it} = 1$ if a firm issues new equity (i.e., if sale of firm's common and preferred stock is larger than 50% of the market value of equity) and 0 otherwise;

$ISSUE_DEBT_{it} = 1$ if a firm issues new debt and 0 otherwise.

Other control variables are as defined above.

3.4 Results

3.4.1 The association between audit pricing and overlaps of auditors' and clients' corporate charitable donations

Table 3-5 presents the regression results of the association between audit pricing and overlaps of CCDs between audit firms and their clients. I conduct the analyses using two proxies for audit pricing. The coefficients on OD_Dummy_6Y indicate that when audit firms and client firms make donations to the same nonprofits, the audit fees are higher. In column (1), when I

employ *AUD_FEE* as the dependent variable, the coefficient of *OD_Dummy_6Y* is 0.029, significant at the 5% level. Similarly, in column (2) when I use *TOT_FEE*, the coefficient of *OD_Dummy_6Y* is 0.019, significant at the 10% level. This result documents a fee premium when audit- and clients-firms share social capital through overlaps of their donations. It suggests that auditors make extra-efforts to protect their networks and provide more efficient audit services. My result is different than in Jha and Chen (2014) and Berglund and Kang (2013) who find that auditors charge lower fees to firms headquartered in areas with higher social capital. This difference could be due to the different levels of analysis in studying social capital. This study looks directly at the influence of client-and audit-firms' initiatives related to social capital on audit fees as opposed to these recent studies that explore the impact of firms' regional initiatives on audit pricing.

[Insert Table 3-5 here]

3.4.2 The association between audit quality and overlaps of auditors' and clients' corporate charitable donations

Table 3-6 presents the regression results of the association between audit quality and overlaps of CCDs between audit firms and their clients. I conduct the analyses using two proxies for audit quality. The coefficients on *OD_Dummy_6Y* indicate that when audit firms and client firms make CCDs to the same nonprofits, the audit quality is enhanced as demonstrated by their lower restatements (*RST*) and lower discretionary accruals (*DAC*). When I use *RST* in column (1), the coefficient of *OD_Dummy_6Y* is -0.652, significant at the 5% level (t-stat=-2.145). When I use *DAC* in column (2), the coefficient of *OD_Dummy_6Y* is negative and significant (coef. = -0.003; t-stat=-1.704). Overall, these results evidenced that overlaps of CCDs between audit firms and their clients are significantly and positively associated with audit quality. These findings suggest that the level of social capital shared by audit- and clients-firms built through their donations facilitates information sharing between auditors and

clients and improves auditors' professional care, leading to higher audit efforts which result in a higher audit quality.

[Insert Table 3-6 here]

3.4.3 The association between audit quality and overlaps of auditors' and clients' corporate charitable donations for longer auditor tenure

The key argument that explains the result is that the social capital shared by auditors and their clients built through overlaps of their donations are such that auditors and their clients can communicate and transfer information more effectively leading to a better audit quality. Then, I should expect that the association between overlaps of donations and audit quality is stronger when auditor tenure is longer. A long relationship between an auditor and its client allows auditors to be more familiar and have a better knowledge of the firm's business operations and accounts. In contrast, auditors with short tenure may lack client-specific knowledge (Stice 1991).

I split the sample of firms by the level of auditor tenure. I choose a turning point of 9 years for long auditor tenure following prior studies (i.e., Brooks 2011). Results are reported in Table 3-7. I find that the effect of overlaps of corporate donations between audit- and client-firms is much stronger for clients with long auditor tenure. In columns (1) and (3), when the sample only includes firms with auditor tenure longer than 8 years, the coefficients of *OD_Dummy_6Y* is -0.627 when using *RST* as proxy for audit quality and -0.003 and significant at 10% when using *DAC* as proxy for audit quality. In contrast, in columns (2) and (4) when the sample is limited to only those with shorter auditor tenure (less than 9 years), the coefficients of *OD_Dummy_6Y* are not significant.

[Insert Table 3-7 here]

3.4.3 Additional and robustness tests

Instrumental variable approach

I use an instrumental variable approach to further validate the interpretation of the results regarding the relation between overlapped donations and audit quality. To do so, I run a 2SLS that uses instruments for the endogenous variable, *OD_Dummy_6Y*. As instruments, I use a dummy variable *FOUND* that indicates whether a firm has a corporate charitable foundation. It is reasonable to expect that overlaps of CCDs between audit firms and their clients are more likely to occur when firms have a corporate charitable foundation and therefore engage in corporate philanthropy. Therefore, I expect that the instrument *FOUND* highly correlates with *OD_Dummy_6Y* and does not correlate with audit quality.

The results of the instrumental variable approach are reported in Table 3-8. Column 1 reports the coefficients of the first-stage regression. The instrument *FOUND* is both strongly and statistically significant (coef=1.111; t-stat=4.457). Column (2) shows the results of the second stage regressions for *RST* as the proxy for audit quality. The coefficient of the predicted value *OD_Dummy_6Y* is -0.623 and is significant at the 1% level (t-stat=-2.901). This result supports my main findings that social capital among audit firms and clients built through overlaps of their donations affects positively audit quality.

[Insert Table 3-8 here]

Alternative measures of audit quality and audit pricing

I conduct a sensitivity test using two alternative measures for audit quality: the issuance of going concern opinion and the auditor tenure.

Going concern opinions are direct measures of the auditor's opinion about the financial statements and auditor independence. If the auditor finds a going-concern problem during the auditing process, an independent auditor would report it. But these are issued only

in exceptional cases. I found in Audit Analytics 32 going concern opinions on my sample during the 2003-2014 period. The variable *GC_opinion* is initially coded 1 for each firm-year observation for firms that receive a going concern opinion and 0 otherwise. Panel A of Table 3-9 reports the regression results using the issuance of going concern opinion as the dependent variable. The coefficient on *OD_Dummy_6Y* indicate that when audit firms and client firms make CCDs to the same charities, the audit quality is enhanced as demonstrated by a higher likelihood of receiving going concern opinions. The coefficient of *OD_Dummy_6Y* is positive and significant at the 1% level (coef. = 8.386; t-stat=2.945).

[Insert Table 3-9 here]

Panel A of Table 3-9 reports the regression results using the auditor tenure as an alternative measure for audit quality (column 2). While regulators have shown concern that long auditor tenure could threaten auditor independence, several prior studies find convincing evidence that audit quality increases with longer auditor tenure (i.e., Carcello and Nagy 2004; Knechel and Vanstraelen 2007). Long tenure improves auditors' competencies in providing high audit quality. The auditor's knowledge of the client's business and financial reporting practices is likely to increase over time, thereby increasing the auditor's ability to assure that the financial statements reflect the client's underlying performance (DeFond and Zhang 2014).

The coefficient of *OD_Dummy_6Y* is significant and positive corroborating the previous findings. This suggests that firms, with CCDs that overlap their auditors' CCDs, are more likely to have a longer tenure and therefore lead to a lower audit risk that can result in a higher audit quality.

I conduct another sensitivity test using the ratio of non-audit fees to total fees (*Prop_NAF*) as an alternative empirical proxy for audit quality and audit pricing. Prior studies show that the proportion of non-audit fees to total fees is positively associated with lack of

auditor independence (Frankel et al. 2002; Ashbaugh et al. 2003). As can be seen in Table 3-9, Panel B, the coefficient of *OD_Dummy_6Y* is negative and significant at 5% (coef=-0.010; t-stat=-2.216) suggesting that auditors with donations that overlap their clients' donations are more likely to receive a lower proportion of non-audit fees to total fees. This result documents that auditors and clients' charitable alignment does not impair auditor independence and therefore is positively associated with audit quality.

Alternative measures of overlaps of corporate charitable donations

I perform a sensitivity test using an alternative measure of overlaps of CCDs. I follow a less conservative approach in defining overlaps of CCDs by using a dummy variable (*OD_dummy*) that takes the value of 1 if audit firms and their clients make at least one CCD to the same nonprofits in any given year over the entire period 2003-2014.

In Table 3-9, Panel A reports the regression results using this alternative measure of overlaps of CCDs. The coefficients of *OD_dummy* are significant and negative for the dependent variables *RST* (coef=-0.688; t-stat=-2.335) and *DAC* (coef=-0.003; t-stat=-1.73). Overall, my results corroborate the previous findings that a charitable alignment between firms and their audit firms is associated with a higher audit quality.

Additional controls

Further, I add a control variable that captures firms' regional social capital. Prior studies find that firms' social capital at the county level affect audit processes (Berglund and Kang 2013; Jha and Chen 2014). Following Rupasingha et al. (2006), I capture the levels of social capital in US counties by strength of civic norms and density of social networks in the counties where corporate headquarters are located. I use the county-level social capital measure based on the data provided by the Northeast Regional Center for Rural Development (NRCRD) at the Pennsylvania State University. The social capital measure includes voter turnouts in

presidential elections, response rates in US census surveys, the total numbers of non-profit organizations, and the total numbers of ten types of social organizations for all US counties in the years of 2005, 2009 and 2014. I use a linear interpolation to estimate the social capital measure for the other years of the sample period (2003-2014). As can be seen in Table 3-9, Panel D, the results continue to hold.

3.5 Conclusions

In this study, I investigate the influence of auditors' and clients' charitable alignment on audit pricing and audit quality using the overlaps of their CCDs. Overlaps of CCDs can serve as a measure of social capital at the firm level by revealing firms' norms and allowing social interactions based on a greater trust. These results indicate that the charitable alignment between audit firms and clients is positively related to higher audit quality and audit fees. This evidence suggests that overlaps of audit firms' and clients' CCDs represent social capital which imply a better information exchange and trustworthiness among them as well as greater auditors' efforts to maintain their trust-based network.

The use of the charitable alignment between audit-firms and their clients contributes to our understanding of how social capital emerged within firms. This study presents also new evidence that congruence of CSR activities, in particular charitable activities, of audit firms and clients, is one driver of audit outcomes. This evidence entails that the discretionary CCDs are not anecdotal and have influence on firms' networks, norms and trustworthiness that, in turn, modify auditors' perceptions of firms' reporting.

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Appendix 3-A: Variables definitions

<i>AGE</i>	firm's age measured as the number of years elapsed since the firm first appeared in Compustat;
<i>AR</i>	Accounts receivable intensity, computed as ending balances of accounts receivables (Compustat #302) divided by total assets (Compustat #6);
<i>ASSET_TURN</i>	Current assets (Compustat #4) to total assets (Compustat #6);
<i>AUD_CHANGE</i>	1 if the auditor is not the same than in the previous record and 0 otherwise
<i>AUD_FEE</i>	The natural logarithm of annual audit fees (AuditAnalytics);
<i>AUDSPEC</i>	1 if an audit firm is a specialist i.e., when an audit firm has the highest market share of an industry (2-digit SIC code) and 0 otherwise;
<i>BIG</i>	1 if an audit firm is a big 4 firm i.e., PWC, Deloitte, EY, KPMG and 0 otherwise;
<i>BOARD_COMP</i>	Board composition
<i>BOARD_SIZE</i>	Board size
<i>BOARD_TEN</i>	Board tenure
<i>CFO</i>	Operating cash flows (Compustat #308) divided by total assets for the current year (Compustat #6);
<i>CP_FIRM</i>	
<i>CURRENT</i>	Current ratio computed as current assets (Compustat #4) divided by current liabilities (Compustat #5) at the end of the year;
<i>DAC</i>	Discretionary accruals from the modified Dechow and Dichev (2002) model (McNichols 2002);
<i>DEBT</i>	The average level of the ratio of total debt (Compustat #42) to total assets (Compustat #6).
<i>FINANCIALEND</i>	1 if a firm has a December fiscal year end in t but not in t-1, and 0 otherwise;
<i>FOUND</i>	1 if a firm has a corporate charitable foundation and 0 otherwise
<i>GC_OPINION</i>	1 if a going concern opinion has been issued in year t and 0 otherwise
<i>INT_WEAK</i>	number of firm's material weaknesses identified by the audit firm;
<i>INV</i>	firm's investment securities measured as cash and short term investments scaled by total assets
<i>INVENTORY</i>	Ratio of inventory (Compustat #59) to total assets (Compustat #6);
<i>ISSUE</i>	issuance of new equity, coded 1 if firm issued new equity during the year (amount of Compustat #108 exceeding 5 percent of the firm's market value of equity), else 0;
<i>LEV</i>	firm's leverage calculated as liabilities (Compustat #181) scaled by total assets (Compustat #6);
<i>LOSS</i>	Indicator variable coded 1 if a firm reports a negative ROA, and 0 otherwise;
<i>MB</i>	Market-to-book ratio at the end of the year, calculated as the market value of equity (Compustat #199 x #25) divided by the book value of equity (Compustat #60);
<i>NCCS</i>	Number of nonprofits in firms' counties
<i>NETWORK</i>	Network size of firms' board members
<i>NLOCAL</i>	1 if an audit firm is in the same city than its client firm and 0 otherwise;

<i>NON_AUD_FEE</i>	Natural log of fees paid for non audit services.
<i>OD_DUMMY_6Y</i>	1 if in a six-year window period a firm and it audit firm make corporate charitable donations to the same nonprofit organization and 0 otherwise;
<i>OD_DUMMY</i>	1 if in a firm and it audit firm make corporate charitable donations to the same nonprofit organization over the period 2003-2014 and 0 otherwise
<i>Prop_NAF</i>	$(1 + \text{non-audit fees}) / \text{total fees}$
<i>QUICK</i>	Ratio of current assets (Compustat #4) less inventory (Compustats #59) to current liabilities (Compustat #5);
<i>RET</i>	firm's stock performance during the fiscal year measured as the growth of the firm's adjusted stock price (annual close price scaled by the cumulative adjustment factor);
<i>RISK</i>	firm's inherent risk measured as the sum of total inventories and receivables scaled by total assets;
<i>ROA</i>	firm's pretax income scaled by total assets;
<i>RST</i>	Restatement variable initially coded 1 for each firm-year observation for financial statements that were later restated, 0 otherwise (AuditAnalytics);
<i>SALES</i>	The sales growth over the prior year;
<i>SEGMENT</i>	firm's number of business segments;
<i>SIZE</i>	firm size measured as the logarithm of total assets;
<i>TA</i>	firms' total accruals measured as operating income less operation cash flows adjusted by extraordinary items;
<i>TENURE</i>	tenure of the last auditor
<i>TOBIN</i>	Year-end Tobin's q adjusted by the market median, where Tobin's q is computed as $(\text{book value of total debts} + \text{market value of shareholder equity}) / \text{book value of total assets}$;
<i>TOT_FEES</i>	natural logarithm of annual total fees of the firm in the current year;
<i>Debt_issue</i>	issuance of new debt, coded 1 if firm issued new debt during the year (nonzero Compustat #111), else 0;

Appendix 3-B: Tables

Table 3-1 Sample composition

This table presents the sample selection process. Panel A lists the data steps to construct my sample from the Compustat sample and my hand-collected sample of charitable donations from FDO (Foundation Directory Online) and NOZAssearch. I retain non-financial firms and I require non-missing data to construct the control variables used in the baseline regressions. Panel B lists the number of observations in 2003-2014 available in the different datasets that I employ to construct the variables used in the analyses.

Panel A: Sample selection

	No. of obs. dropped	No. of obs. remaining
Fortune 700 firms in Compustat, 2003-2014		7,365
Less: Observations from the financial sector	(1,026)	6,339
<i>Do firms and their audit firms overlap their CCDs in a six-year period?</i>		
Yes		547
No		5,792
<i>Do firms and their audit firms overlap their CCDs in any given year?</i>		
Yes		690
No		5,649

Table 3-2 Characteristics of overlaps of corporate charitable donations between Fortune 700 firms and their audit firms

This table presents some characteristics regarding the common donations made by audit firms and their clients to the same charities during a six-year window. Panel A shows the frequency in percent of the categories of charities where clients and their audit firms make common donations. Panel B shows the frequency in percent of the scope of these donations and Panel C presents the frequency in percent of the type of CP OF audit firms and clients.

Panel A: Categories of charities

Categories	Percent
Education	47.74%
Human services	17.35%
Health	11.85%
Arts, Culture, Humanities	7.77%
Community Development	5.07%
Research and public policy	2.48%
Animals	2.13%
Community Development	2.04%
Religion	1.75%
Environment	1.01%
International	0.44%
Human and Civil Rights	0.37%
Total	100%

Panel B: Scope of overlaps of corporate charitable donations

Scope	Percent
National	50.7%
Local	47.3%
International	2.0%
Total	100%

Table 3-2 (continued)

Panel C: Type of corporate philanthropy

Type	Percent
Annual Gift	82.5%
Cumulative Giving	7.3%
Capital Gift/Campaign Gift	2.5%
Program Gift	2.1%
Event Attendee or Sponsorship	1.6%
In-Kind Goods or Services	1.3%
Yearly Gifts	0.9%
Planned Gift Legacy Gift	0.8%
Named Funds Named Endowments	0.7%
Scholarship Gift	0.3%
Endowment Gift	0.1%
Founding Donor	0.0%
Total	100%

Table 3-3 Descriptive statistics

This table provides descriptive statistics and correlations between the variables used in my regressions. Panel A provides summary statistics for each variable. Panel B compares firm characteristics and the audit quality measures between the firms that make charitable donations to the same nonprofits than their audit firms and the other firms. Panel C presents the number of observations per audit firms. Panel D provides Pearson's correlation coefficients between variables. All continuous variables are winsorized at the 1% and 99% level. The superscripts ***, **, and * indicate two-tailed statistical significance at the 1%, 5%, and 10% levels, respectively. See the Appendix 3-A for the definition of variables.

Panel A: Summary statistics

Variables	N	Mean	SD	Min	25 th Pctl	50 th Pctl	75 th Pctl	Max
<u>CCD variables</u>								
<i>Total donations (millions)</i>	6,339	2.416	6.775	0.000	0.000	0.079	1.100	43.894
<i>OD_Dummy_6Y</i>	6,339	0.084	0.277	0.000	0.000	0.000	0.000	1.000
<i>Audit firms' common donations (millions)</i>	6,339	0.015	0.210	0.000	0.000	0.000	0.000	6.260
<i>Client firms' common donations</i>	6,339	0.048	0.780	0.000	0.000	0.000	0.000	36.000
<i>Number of nonprofits per county</i>	5,240	8608	8169	58	2677	6204	12000	41,000
<u>Audit variables</u>								
<i>RESTATEMENTS</i>	6,003	0.105	0.307	0.000	0.000	0.000	0.000	1.000
<i>GC_OPINION</i>	6,028	0.005	0.073	0.000	0.000	0.000	0.000	1.000
<i>DAC_DD</i>	3,817	0.000	0.024	-0.113	-0.012	0.000	0.012	0.132
<i>TENURE</i>	6,339	10.327	3.121	1	10	12	12	12
<i>LOG_AUDFEES</i>	6,003	15.167	0.947	12.812	14.527	15.202	15.775	17.296
<i>AUD_SPEC</i>	6,339	0.563	0.496	0.000	0.000	1.000	1.000	1.000
<i>LOG_NON_AUDFEES</i>	5,803	13.453	1.553	7.086	12.553	13.592	14.496	16.699
<i>AUD_CHANGE</i>	6,339	0.104	0.306	0.000	0.000	0.000	0.000	1.000
<i>NLOCAL</i>	6,339	0.379	0.485	0.000	0.000	0.000	1.000	1.000
<i>BIG_FOUR</i>	6,339	0.933	0.250	0.000	1.000	1.000	1.000	1.000
<u>Firm variables</u>								
<i>SIZE</i>	6,223	8.962	1.254	5.974	8.092	8.881	9.831	12.173
<i>LEV</i>	6,213	0.621	0.221	0.078	0.491	0.610	0.729	2.792
<i>CFO</i>	6,218	0.104	0.068	-0.282	0.062	0.097	0.139	0.574
<i>RET</i>	5,451	0.194	0.698	-0.991	-0.046	0.138	0.344	23.424
<i>MB</i>	5,997	11.451	580.274	-688.456	1.531	2.360	3.867	45000
<i>DEBT</i>	6,210	0.242	0.190	0.000	0.118	0.216	0.327	2.318
<i>TOBIN</i>	5,998	2.085	0.965	0.957	1.451	1.792	2.398	6.297
<i>LOSS</i>	6,339	0.088	0.283	0.000	0.000	0.000	0.000	1.000
<i>ROA</i>	5,669	0.096	0.102	-0.825	0.042	0.084	0.142	1.138
<i>SALES</i>	5,664	-0.115	0.403	-11.332	-0.164	-0.060	-0.001	5.641
<i>INV</i>	6,220	0.105	0.112	0.000	0.026	0.069	0.149	0.843
<i>ASSET_TURN</i>	6,219	1.268	1.136	0.071	0.590	0.975	1.543	19.804
<i>CURRENT</i>	6,044	1.720	0.943	0.201	1.144	1.505	2.040	12.076
<i>AR</i>	5,846	-0.007	0.028	-0.325	-0.014	-0.004	0.002	0.503
<i>INVENTORY</i>	6,180	0.119	0.128	0.000	0.020	0.081	0.169	0.854
<i>FINANCIAL_END</i>	6,339	0.001	0.033	0.000	0.000	0.000	0.001	1.000
<i>TA</i>	6,218	0.002	-858.186	1944.365	-908	-300.150	-85.515	14,000
<i>ISSUE</i>	6,339	0.088	0.283	0.000	0.000	0.000	0.000	1.000
<i>DEBT_ISSUE</i>	6,339	0.759	0.428	0.000	1.000	1.000	1.000	1.000
<i>RISK</i>	5,808	0.108	0.125	-0.227	0.015	0.075	0.164	0.854
<i>LITIGATION</i>	6,339	0.456	0.498	0.000	0.000	0.000	1.000	1.000
<i>AGE</i>	6,327	41.431	20.194	7	23	36	67	68

<i>SEGMENTS</i>	4,374	3.256	3.506	1	1	2	4	41
<i>INT_WEAKNESSES</i>	5,271	0.066	0.067	0	0	0	0	20
<i>NETWORK_SIZE</i>	3,628	4,358.86 0	3,613.89 2	29	1,595	3,576	6,172.50 0	23,000
<i>BOARD_SIZE</i>	5,782	10.335	2.214	5	9	10	12	16
<i>BOARD_COMP</i>	5,782	0.931	0.298	0.444	0.818	0.889	0.917	4.600
<i>BOARD_TEN</i>	5,782	5.546	3.328	0.000	3.300	5.100	7.200	17.200

Table 3-3 (continued)

Panel B: Descriptive statistics of firms' characteristics and audit quality measures

Firms and audit firms make donations to the same nonprofits:	Yes		No		Difference in means (no – yes) t-statistic
	N	Mean	N	Mean	
Variables					
<u>Audit variables</u>					
<i>RESTATEMENTS</i>	531	0.107	5,472	0.087	1.467
<i>GC_OPINION</i>	531	0.005	5,497	0.006	-0.113
<i>DAC_DD</i>	335	0.000	3,482	-0.001	0.426
<i>TENURE</i>	531	10.270	5,497	10.951	-4.819
<i>LOG_AUDFEES</i>	531	15.455	5,472	15.139	-7.386
<i>AUD_SPEC</i>	531	0.483	5,808	0.555	-4.121
<i>AUD_CHANGE</i>	531	0.098	5,808	0.105	0.499
<i>NLOCAL</i>	531	0.403	5,808	0.377	-1.171
<i>BIG_FOUR</i>	531	0.962	5,808	0.930	-2.841
<u>Firm financials</u>					
<i>SIZE</i>	531	9.448	5,692	8.917	-9.404
<i>RET</i>	487	0.144	4,964	0.199	1.648
<i>DEBT</i>	527	0.207	5,683	0.245	4.407
<i>LOSS</i>	531	0.090	5,808	0.111	1.471
<i>ROA</i>	494	0.111	5,175	0.095	-3.447
<u>Corporate governance</u>					
<i>BOARD_SIZE</i>	519	11.037	5,263	10.266	-7.601
<i>BOARD_COMP</i>	519	0.935	5,263	0.931	-0.316
<i>BOARD_TEN</i>	519	5.960	5,263	5.505	-2.97

Panel C: Audit firms' distribution

Firms and audit firms make donations to the same nonprofits:	Yes		No		Total	
	Frequency	%	Frequency	%	Frequency	%
Deloitte & Touche	38	7.16	1,363	38	1,401	23.34
Ernst & Young	229	43.13	1,584	229	1,813	30.20
KPMG	130	24.48	1,057	130	1,187	19.77
PwC	114	21.47	1,398	114	1,512	25.19
Grant Thornton	5	0.94	37	5	42	0.70
BDO USA	7	1.32	11	7	18	0.30
BDO Seidman	8	1.51	18	8	26	0.43
Ciulla Smith & Dale	-	-	3	-	3	0.05
McGladrey	-	-	1	-	1	0.02
Total	531	100%	5,472	531	6,003	100%

Table 3-3 (continued)

Panel D: Pearson correlation matrix

The superscript * indicates two-tailed statistical significance at the 5% level.

	<i>OD_Dummy_6Y</i>	<i>RESTATEMENTS</i>	<i>GC_OPINION</i>	<i>DAC_DD</i>	<i>TENURE</i>	<i>LOG_AUDFEES</i>	<i>AUD_SPEC</i>	<i>AUD_CHANGE</i>	<i>NLOCAL</i>	<i>BIG_FOUR</i>	<i>SIZE</i>	<i>RET</i>	<i>DEBT</i>	<i>LOSS</i>	<i>ROA</i>	<i>BOARD_SIZE</i>	<i>BOARD_COMP</i>	<i>BOARD_TENURE</i>	
<i>OD_Dummy_6Y</i>	1																		
<i>RESTATEMENTS</i>	-0.018	1																	
<i>GC_OPINION</i>	0.001	0.019	1																
<i>DAC_DD</i>	-0.006	-0.002	-0.025	1															
<i>TENURE</i>	0.060*	-0.004	-0.040*	0.033*	1														
<i>LOG_AUDFEES</i>	0.094*	-0.022	0.007	-0.030	0.120*	1													
<i>AUD_SPEC</i>	0.051*	-0.013	0.016	0.016	0.131*	0.227*	1												
<i>AUD_CHANGE</i>	-0.003	0.020	0.019	-0.003	-0.107*	-0.235*	-0.003	1											
<i>NLOCAL</i>	0.014	-0.01	0.02	0.010	0.091*	0.041*	0.027*	-0.007	1										
<i>BIG_FOUR</i>	0.035*	-0.003	0.011	0.007	0.477*	0.084*	0.168*	0.050*	0.108*	1									
<i>SIZE</i>	0.118*	-0.028*	0.005	-0.022	0.137*	0.739*	0.139*	-0.124*	0.135*	0.111*	1								
<i>RET</i>	-0.022	0.000	-0.056*	-0.034*	-0.050*	-0.029*	-0.022	0.006	-0.008	-0.003	-0.045*	1							
<i>DEBT</i>	-0.055*	-0.009	0.013	-0.023	-0.137*	0.035*	0.015	0.016	0.049*	-0.063*	0.070*	-0.010	1						
<i>LOSS</i>	-0.018	0.007	0.180*	-0.1251*	-0.088*	0.020	-0.010	0.042*	-0.032*	-0.016	-0.028*	-0.081*	0.224*	1					
<i>ROA</i>	0.045*	-0.022	-0.165*	0.143*	0.111*	-0.116*	-0.025	-0.056*	-0.013	0.018	-0.091*	0.152*	-0.293*	-0.514*	1				
<i>BOARD_SIZE</i>	0.099*	0.007	-0.018	0.012	0.117*	0.393*	0.138*	-0.024	0.047*	0.034*	0.478*	-0.042*	0.061*	-0.029*	-0.034*	1			
<i>BOARD_COMP</i>	0.004	0.018	0.025	-0.000	-0.009	0.107*	0.023	-0.062*	-0.008	0.035*	0.081*	-0.037*	0.051*	0.045*	-0.101*	-0.013	1		
<i>BOARD_TEN</i>	0.039*	-0.004	-0.027*	0.051*	0.130*	-0.103*	0.024	-0.010	-0.060*	-0.061*	-0.053*	-0.064*	-0.145*	-0.049*	0.088*	0.093*	-0.077*	1	

Table 3-4 Determinants of overlaps of auditors' and clients' corporate charitable donations

This table presents results of the determinants analysis of overlaps of auditors' and clients' corporate charitable donations. *OD_dummy_6Y* takes the value of 1 in a six-year window for firms with overlapped donations with their audit firms. *OD_dummy_6Y* is the amount of overlapped donations given by audit firms and their clients. All continuous variables are winsorized at the 1% and 99% level. For each variable, t-statistics are reported and are calculated based on standard errors clustered by firms. The superscripts ***, **, and * indicate two-tailed statistical significance at the 1%, 5%, and 10% levels, respectively. All variables are as defined in appendix 3-A.

Variables	(1)		(2)	
	<i>OD_dummy_6Y</i> coef	tstat	<i>OD_Amount_6Y</i> coef	tstat
<i>NCCS</i>	-0.000**	-2.036	-0.000***	-5.052
<i>FOUND</i>	1.188***	2.916	0.472***	11.891
<i>CP_FIRM</i>	0.446	1.183	0.160**	2.570
<i>BOARD_SIZE</i>	0.163**	2.494	0.086***	20.520
<i>BOARD_COMP</i>	0.102	0.180	0.084*	1.948
<i>BOARD_TEN</i>	-0.051	-1.464	-0.010**	-2.144
<i>SIZE</i>	0.093	0.406	-0.010**	-2.002
<i>RISK</i>	0.929	0.509	0.079	0.516
<i>CFO</i>	-2.862	-1.282	-0.856***	-2.841
<i>SALES</i>	0.365*	1.741	0.100***	3.468
<i>RET</i>	-0.871**	-2.123	-0.339***	-9.454
<i>MB</i>	-0.000	-0.322	-0.000***	-2.636
<i>DEBT</i>	-0.302	-0.332	-0.156	-1.175
<i>SEGMENTS</i>	0.108**	2.490	0.042***	9.046
<i>BIG</i>	-2.984***	-3.583	-1.565***	-34.265
<i>NLOCAL</i>	0.278	0.901	0.016	0.448
<i>AUDSPEC</i>	0.258	0.824	0.073**	1.975
<i>TENURE</i>	0.063	0.831	0.027***	7.047
<i>TOBIN</i>	0.302*	1.901	0.105***	7.149
<i>TOT_FEES</i>	-0.537	-1.546	-0.199***	-66.279
<i>AUD_CHANGE</i>	-0.176	-0.241	-0.120***	-3.887
<i>NETWORK</i>	0.000	0.355	0.000***	3.854
Constant	4.106	1.082	-3.020***	-65.823
Industry FE	YES		YES	
Year FE	YES		YES	
Observations	1,554		1,903	
Pseudo R ²	0.179		0.201	

Table 3-5 Impact of overlaps of auditors' and clients' corporate charitable donations on audit pricing

This table presents results of firm fixed-effects OLS regressions examining the association between overlaps of audit- and client-firms' corporate charitable donations and audit pricing. I use two types of audit pricing: audit fees (*AUD_FEE*) and total fees (*TOT_FEE*). All continuous variables are winsorized at the 1% and 99% level. For each variable, t-statistics are reported and are calculated based on standard errors clustered by firms. The superscripts ***, **, and * indicate two-tailed statistical significance at the 1%, 5%, and 10% levels, respectively. All variables are as defined in appendix 3-A.

Variables	(1)	t-stat	(2)	t-stat
	<i>AUD_FEE</i> coef		<i>TOT_FEE</i> coef	
<i>OD_DUMMY_6Y</i>	0.029**	2.281	0.019*	1.668
<i>SIZE</i>	0.386***	12.771	0.376***	13.776
<i>RET</i>	0.016***	3.572	0.013***	3.525
<i>LEV</i>	0.121	1.268	0.129	1.489
<i>LOSSI</i>	0.055**	2.549	0.034*	1.781
<i>CURRENT</i>	0.020	0.472	0.009	0.235
<i>QUICK</i>	-0.022	-0.475	-0.007	-0.166
<i>FINANCIALEND</i>	-0.325*	-1.809	-0.255	-1.476
<i>TENURE</i>	-0.036***	-3.426	-0.012	-1.505
<i>GC_OPINION</i>	0.006	0.066	0.055	0.618
<i>DEBT</i>	0.022	0.193	0.007	0.064
<i>CFO</i>	0.063	0.402	0.023	0.163
<i>NON_AUD_FEE</i>	0.000***	3.789	0.000***	12.888
<i>AGE</i>	-0.006*	-1.912	0.001	0.507
<i>RISK</i>	0.350*	1.757	0.285*	1.703
<i>INT_WEAK</i>	0.028	1.574	0.027*	1.685
<i>AUDCHANGE</i>	-0.105**	-2.368	-0.095**	-2.447
<i>NLOCAL</i>	-0.010	-0.132	-0.002	-0.025
<i>AUDSPEC</i>	0.135***	5.201	0.125***	5.071
<i>BIG</i>	0.232	1.233	0.247	1.522
Constant	10.808***	34.757	10.745***	38.586
Firm FE	YES		YES	
Year FE	YES		YES	
Observations	4,743		4,743	
Adjusted R ²	0.944		0.953	

Table 3-6 Impact of overlaps of auditors' and clients' corporate charitable donations on audit quality

This table presents results of firm fixed-effects OLS regressions examining the association between overlaps of audit- and client-firms' corporate charitable donations and audit quality. I use two proxies for audit quality: restatements (RST) and discretionary accruals from Dechow and Dichev model (DAC). All continuous variables are winsorized at the 1% and 99% level. For each variable, t-statistics are reported and are calculated based on standard errors clustered by firms. The superscripts ***, **, and * indicate two-tailed statistical significance at the 1%, 5%, and 10% levels, respectively. All variables are as defined in appendix 3-A.

Variables	(1)	t-stat	(2)	t-stat
	RST coef		DAC coef	
<i>OD_DUMMY_6Y</i>	-0.652**	-2.145	-0.003*	-1.704
<i>SIZE</i>	0.203	0.484	-0.000	-0.159
<i>LEV</i>	-0.033	-0.032	-0.010*	-1.812
<i>LOSS</i>	-0.308	-0.995	-0.007***	-2.756
<i>ROA</i>	0.110	0.047	0.054***	3.824
<i>SALES</i>	0.664*	1.916	0.002	0.966
<i>ASSET_TURN</i>	0.000	0.000	0.001	0.439
<i>AGE</i>	3.204***	3.824	-0.000***	-3.991
<i>CFO</i>	-1.172	-0.432	-0.046**	-2.286
<i>RET</i>	-0.123	-0.553	-0.003***	-3.511
<i>SEGMENT</i>	-0.102*	-1.872		
<i>CURRENT</i>	-0.328	-1.325		
<i>AR</i>	19.942	1.098		
<i>INVENTORY</i>	14.857	0.809		
<i>TOBIN</i>	0.279	1.324		
<i>RISK</i>	-19.753	-1.132		
<i>NLOCAL</i>	0.508	0.830		
<i>TENURE</i>	-1.082***	-4.313		
<i>BIG</i>	-1.611***	-3.469		
<i>AUD_FEE</i>	0.787**	2.003		
<i>AUDSPEC</i>	0.444	1.324		
<i>INV</i>	3.027	1.559		
<i>TA</i>			0.000	0.209
<i>ISSUE</i>			0.000	0.083
<i>DEBTISSUE</i>			0.002	1.325
Constant	-45.635***	-3.486	0.027*	1.732
Firm FE	YES		YES	
Year FE	YES		YES	
Observations	1,648		3,645	
Pseudo R ²	0.189			
Adjusted R ²			0.078	

Table 3-7 Impact of overlaps of auditors' and clients' corporate charitable donations on audit quality for longer auditor tenure

This table presents results of firm fixed-effects OLS regressions examining the association between overlaps of audit- and client-firms' corporate charitable donations and audit quality when I split the sample based on the length of auditor tenure (less or more than 8 years). All continuous variables are winsorized at the 1% and 99% level. For each variable, t-statistics are reported and are calculated based on standard errors clustered by firms. The superscripts ***, **, and * indicate two-tailed statistical significance at the 1%, 5%, and 10% levels, respectively. All variables are as defined in appendix 3-A.

Variables	(1) Auditor tenure > 8		(2) Auditor tenure < 8		(3) Auditor tenure > 8		(4) Auditor tenure < 8	
	<i>RST</i> coef	tstat	<i>RST</i> coef	tstat	<i>DAC</i> coef	tstat	<i>DAC</i> coef	tstat
<i>OD_DUMMY</i>	-0.627*	-1.908	-1.042	-0.979	-0.003*	-1.715	-0.002	-0.346
<i>6Y</i>								
<i>SIZE</i>	0.027	0.056	1.272*	1.685	0.000	0.108	-0.003	-0.887
<i>LEV</i>	-0.186	-0.162	0.302	0.131	-0.013	-1.648	-0.004	-0.805
<i>LOSSI</i>	-0.413	-1.089	-0.918	-1.324	-0.007**	-2.226	-0.007	-1.545
<i>ROA</i>	2.756	1.161	-8.338	-1.312	0.058***	3.784	0.049	1.637
<i>SALES</i>	0.633	1.520	0.874	0.660	0.002	0.936	0.000	0.104
<i>ASSET_TURN</i>	0.177	0.402	-0.471	-0.335	0.002	0.680	-0.003	-0.694
<i>AGE</i>	0.833**	2.071	-1.602	-0.215	-0.000***	-3.265	-0.000	-0.135
<i>CFO</i>	-4.106	-1.600	5.260	1.205	-0.058**	-2.477	-0.009	-0.273
<i>RET</i>	-0.140	-0.436	0.025	0.148	-0.002	-1.412	-0.003***	-4.206
<i>SEGMENTS</i>	-0.131**	-1.978	-0.016	-0.177				
<i>CURRENT</i>	-0.391	-1.541	-0.499	-0.538				
<i>AR</i>	12.912	0.727	0.936	0.004				
<i>INVENTORY</i>	5.211	0.292	5.809	0.028				
<i>TOBIN</i>	0.268	1.215	0.265	0.244				
<i>RISK</i>	-13.587	-0.800	2.418	0.012				
<i>NLOCAL</i>	0.401	0.594	-0.140	-0.110				
<i>TENURE</i>	0.754	1.011	1.866	0.538				
<i>BIG</i>	-1.989***	-3.449	-65.041	-0.227				
<i>AUD_FEE</i>	0.753*	1.669	1.476*	1.758				
<i>AUDSPEC</i>	0.476	1.130	0.444	0.695				
<i>INV</i>	2.204	1.063	8.075	1.177				
<i>TA</i>					0.000	0.157	-0.000	-0.608
<i>ISSUE</i>					-0.000	-0.156	0.003	0.640
<i>DEBTISSUE</i>					0.002*	1.744	-0.001	-0.189
Constant	30.961***	-3.303	44.449	0.122	0.024	1.293	0.038	1.009
Firm FE	YES		YES		YES		YES	
Year FE	YES		YES		YES		YES	
Observations	1,391		259		3,071		574	
Pseudo R ²	0.200		0.224					
Adjusted R ²					0.0818		0.0682	

Table 3-8 Impact of overlaps of auditors' and clients' corporate charitable donations on audit quality: Instrumental variable analysis

This table presents results of a 2SLS analysis examining the association between overlaps of audit- and client-firms' corporate charitable donations and audit quality (*RST*). All continuous variables are winsorized at the 1% and 99% level. For each variable, t-statistics are reported and are calculated based on standard errors clustered by firms. The superscripts ***, **, and * indicate two-tailed statistical significance at the 1%, 5%, and 10% levels, respectively. All variables are as defined in appendix 3-A.

Variables	(1)		(2)	
	First stage <i>OD_DUMMY_6Y</i> coef	t-stat	Second stage <i>RST</i> coef	t-stat
<i>OD_dummy_6Y_{predicted}</i>			-0.623***	-2.901
<i>SIZE</i>	0.224	1.564	-0.149	-0.846
<i>LEV</i>	-0.322	-0.586	-1.658***	-2.828
<i>LOSSI</i>	-0.128	-0.340	-0.165	-0.573
<i>ROA</i>	0.218	0.139	1.154	1.002
<i>SALES</i>	-0.061	-0.219	0.335	1.347
<i>INV</i>	-0.433	-0.426	0.037	0.037
<i>ASSET_TURN</i>	-0.192	-1.343	-0.274	-1.587
<i>AGE</i>	0.019***	3.375	0.023***	2.659
<i>SEGMENTS</i>	0.025	0.910	-0.029	-1.102
<i>CURRENT</i>	-0.070	-0.631	-0.264*	-1.777
<i>AR</i>	-0.676	-0.126	2.405	0.491
<i>INVENTORY</i>	1.726	0.451	2.087	0.492
<i>CFO</i>	-0.107	-0.075	-3.352**	-2.079
<i>TOBIN</i>	0.123	0.975	0.099	0.882
<i>RET</i>	-0.367*	-1.708	-0.468**	-2.258
<i>RISK</i>	-1.306	-0.358	-0.851	-0.210
<i>NLOCAL</i>	-0.156	-0.730	-0.422*	-1.935
<i>TENURE</i>	-0.027	-0.739	-0.029	-0.826
<i>BIG</i>	-2.769***	-6.140	-1.204	-1.503
<i>AUD_FEE</i>	-0.003	-0.013	0.236	1.256
<i>AUDSPEC</i>	0.109	0.548	0.009	0.049
<i>FOUND</i>	1.111***	4.457		
Constant	-2.542	-0.987	-1.876	-0.729
Industry FE	YES		YES	
Year FE	YES		YES	
Observations	3,318		3,232	
Pseudo R ²	0.141		0.0754	

Table 3-9 Impact of overlaps of auditors' and clients' corporate charitable donations on audit quality: Robustness tests

Panel A Alternative measure for audit quality

Variables	(1)	t-stat	(2)	t-stat
	<i>TENURE</i> coef		<i>GC_OPINION</i> coef	
<i>OD_DUMMY_6Y</i>	0.000***	8.275	8.386***	2.945
<i>SIZE</i>	0.000***	10.318	-8.727*	-1.791
<i>LEV</i>	0.000***	7.092	8.965	0.722
<i>LOSSI</i>	0.000***	10.529	2.407*	1.844
<i>ROA</i>	0.000***	5.323	-4.982	-0.341
<i>SALES</i>	0.000***	3.925	11.062*	1.880
<i>INV</i>	0.000***	7.773	142.714***	3.568
<i>ASSET_TURN</i>	0.000***	5.346	-24.250***	-3.436
<i>AGE</i>	-0.212***	-2.173e+12	-1.220**	-2.529
<i>MB</i>	0.000***	3.995	-0.244	-0.813
<i>AUDSPEC</i>	-0.000***	-3.636	1.986	0.802
<i>NLOCAL</i>	0.000	1.054	7.017*	1.673
<i>CFO</i>	0.000	1.432	-13.800	-0.988
<i>RISK</i>	-0.000***	-6.261	-3.172	-0.117
<i>RET</i>	0.000***	3.409	-4.366***	-2.828
<i>AUD_FEE</i>	0.000**	2.051	4.840**	2.046
<i>TENURE</i>			-3.916**	-2.513
Constant	15.385***	3.457e+12	91.880	1.254
Firm FE	YES		YES	
Year FE	YES		YES	
Observations	4,994		167	
R ²	1.000			
Adjusted R ²	1			
Pseudo R ²			0.753	

Table 3-9 (continued)

Panel B Alternative measure for audit quality/fees

Variables	<i>Prop_NAF</i> coef	t-stat
<i>OD_DUMMY_6Y</i>	-0.010**	-2.216
<i>SIZE</i>	0.027***	3.130
<i>RET</i>	-0.003	-1.644
<i>LEV</i>	0.010	0.304
<i>LOSSI</i>	-0.018***	-2.655
<i>CURRENT</i>	-0.009	-0.558
<i>QUICK</i>	0.009	0.486
<i>FINANCIALEND</i>	0.036	0.939
<i>TENURE</i>	0.016***	5.795
<i>GC_OPINION</i>	0.043*	1.886
<i>DEBT</i>	-0.011	-0.294
<i>CFO</i>	-0.049	-1.115
<i>AGE</i>	0.004***	5.103
<i>RISK</i>	-0.069	-1.347
<i>INT_WEAK</i>	-0.001	-0.236
<i>AUDCHANGE</i>	0.004	0.260
<i>NLOCAL</i>	-0.016	-0.821
<i>AUDSPEC</i>	0.009	1.039
<i>BIG</i>	0.014	0.316
Constant	-0.237***	-2.788
Firm fixed effects	YES	
Year fixed effects	YES	
Observations	4,743	
Adjusted R ²	0.567	

Panel C Alternative measure of overlaps of corporate charitable donations

Variables	(1) <i>RST</i> coef	t-stat	(2) <i>DAC</i> coef	t-stat
<i>OD_dummy</i>	-0.688**	-2.335	-0.003*	-1.737
Other Controls	YES		YES	
Firm fixed effects	YES		YES	
Year fixed effects	YES		YES	
Observations	1,645		3,645	
Pseudo R ²	0.193			
Adjusted R ²			0.079	

Table 3-9 (continued)**Panel D Controlling for regional social capital**

Variables	(1) RST coef	t-stat	(2) DAC coef	t-stat
<i>OD_DUMMY_6Y</i>	-0.792**	-2.325	-0.003*	-1.683
<i>SOCIAL_CAPITAL</i>	-0.346	-0.687	0.002	0.727
Other controls	YES		YES	
Firm fixed effects	YES		YES	
Year fixed effects	YES		YES	
Observations	1,400		2,955	
Pseudo R ²	0.192			
Adjusted R ²			0.0868	

General conclusion

1. Main findings and contributions

This dissertation concludes with the following main findings. Chapter 1 investigates if firms' choices of prosocial activities reflect apparent *consistency*, by examining (1) whether decisions about corporate philanthropy (CP) are consistent with two forms of corporate tax avoidance strategies and (2) whether investors reward this consistency. This study shows that (1) firms that engaged in CP are consistent across their prosocial activities and therefore are less likely to engage in nonconforming tax avoidance and conforming tax avoidance, and (2) investors view firms' inconsistency between tax strategies and CP as a costly strategy that ultimately reduces firm value.

Chapter 2 examines firm responses to a regulatory shift from mandatory to voluntary disclosure on CP that affected UK firms in 2013. This study finds that following the mandatory-to-voluntary disclosure shift on CP's information, firms disclose less information on their CP and decrease the level of their CCDs. Firms do not credibly commit to their CSR-related disclosure, even though they were already initiated to the disclosure of their donations under the mandatory disclosure regime. Moreover, this paper provides evidence on the greater agency conflicts that exist in the firms after the regulatory shift and on the stronger decline of disclosure levels when managers can reap private benefits from CCDs.

Chapter 3 investigates whether social capital between audit- and client- firms stemming from overlaps of their donations affect audit pricing and audit quality. It appears that the likelihood for audit firms and their clients to make CCDs to the same nonprofits and the size of their mutual donations are both higher for firms with a corporate charitable foundation, with a higher firm value or with a bigger board size. The main findings of this chapter document that when clients and their audit firms make CCDs to the same nonprofits, (1) audit fees are higher and (2) audit quality is higher as demonstrated by their lower

likelihood of restatements and lower discretionary accruals. These findings propose that (1) auditors exert more efforts and exercise their professional care in the performance of the audit with clients who share the same charitable values in order to protect their networks and (2) the charitable alignment between audit- and client-firms imply an effective communication, critical to the audit quality. I further find that the effect of overlaps of donations between audit- and client-firms is much stronger for clients with longer auditor tenure when the auditors can benefit of a better knowledge of the firms' operations and accounts.

Noteworthy contributions of this dissertation to the current body of reporting research are that it (1) provides initial evidence on the use of different forms of tax avoidance strategies with different levels of transparency in relation to CP, (2) documents firms' lack of commitment to their reporting on CP, and (3) proposes a new way to measure social capital among firms through their overlaps in CP and show its influences auditors' perceptions of financial reporting quality and the resulting audit quality and fees.

2. Concluding thoughts on the three essays

Several points are worth noting about the linkages between the results of this dissertation. First, "doing good" is increasingly part of society expectations. But a prosocial behavior is no longer sufficient for a firm to be regarded as a "good corporate citizen". Firms need to show a coherent prosocial policy in order to receive the reputational benefits and the resulting financial impact (e.g., Brammer & Millington, 2005; Lev, Petrovits, & Radhakrishnan, 2010). Consequently, to ensure a consistency among their prosocial practices, firms modify their tax strategies accordingly given the image concerns of tax avoidance. In particular, the findings of the first chapter suggest that firms that engaged in CP prefer not to engage in aggressive tax planning but also in less noticeable conforming tax avoidance.

Second, although, CP provides firms with a potential good reputation and therefore should be a good news to report, firms rarely voluntarily disclose their CP practices on their reports (e.g., annual or CSR reports). In general, firms will only notify their broad social engagement without giving any specific names of nonprofit organization supported. Firms do not engage in the disclosure of CP under a voluntary regime, as documented in the second chapter of this dissertation.

From these two studies, I can conclude that while firms want to be perceived as socially responsible and to appear consistent, it can be surprising that firms prefer not to report details on their CP. These details on their philanthropic policy could potentially put them in the spotlight and increase the risk of being criticized for their philanthropic choices, which could reap the reputational benefits of CP. In particular, when details are disclosed about CP policies undertaken by firms, it is easily for the public to detect the inconsistencies of firms' prosocial behavior. Without information disclosed about CP, a firm's philanthropic choices don't have to be justified and modified to appear consistent with their prosocial policy. Overall, it appears that firms would benefit from reporting their broad engagement in CP but without giving more details that could be used against them.

Third, CP does not only increase firm's reputation, it also modifies the perception of firms' financial reporting quality and in particular the perception of auditors whose charitable interests are aligned. In this study, the focal point is not the consistency among firms' prosocial actions but the consistency between firms' actions and one stakeholder's actions i.e., the audit-firm's CP.

Overall, image concerns of CP are important and can dictate firms' reporting choices and modify the perception of firms' reporting.

3. Limitations and future research

At many stages of this dissertation, I was obliged to tackle empirical and theoretical challenges. While several challenges have been addressed, others remain unresolved leading this dissertation to be subject to some limitations. I also point

First, the empirical analyses rely on data on CCDs that are subject to limitations. There is a self-selection bias that typically arises in voluntary disclosure settings (Leuz and Wysocki 2016). For chapters 1 and 3, I hand-collected the US data on CP from two databases, FDO and NOZAssearch, specialized on collecting information on CP. In the US, disclosure of corporate donations through firms' foundations is mandatory, but the disclosure of direct charitable donations is voluntary which creates a potential self-selection issue for this type of donation. When a firm-year has no information on one of the two sources, I assumed this firm-year's donation as a null amount. This introduces a bias given that the lack of information on donations may be due to firms' willingness to withhold the information about their direct donations and not because they do not make CCDs. Nevertheless, to somehow address this concern, I employed two different databases that collect corporate donations from different sources, leading my data to be as complete as possible. I also perform these tests on a sample of giving firms only (i.e., corporate CCDs higher than zero) and check whether results hold. For chapter 2, I obtain the amount of CCDs from *ASSET4*, which is widely used in literature on CSR. The shift from a mandatory to a voluntary disclosure regime in the UK suggest that following the regulation firms can make CCDs but are not forced anymore to disclose them in their annual reports leading to a potential measurement error of corporate donations after the shift. However, *ASSET4* uses publicly available information including annual reports, but also CSR reports, firms' websites, proxy filings and non-governmental organization information. These multiple sources increase the accuracy of *ASSET4* data on corporate donations even though firms decide not to disclose their donations on their annual reports, which reduces the likelihood of a measurement error. Nonetheless, readers should

interpret the result that firms reduce their donations levels following the regulatory shift with caution given the less reliability of the data on donations under a voluntary disclosure regime. My research can also suffers from some limitations induced by data availability on the categories of corporate philanthropy expenses. I focus on cash donations but other categories may be relevant to study for future research such as in-kind donations and in particular firms' shares donations and donations of products in stocks. It would be interesting to analyze the impact of these particular categories of donations on firms' reporting.

Second, the results of this dissertation are limited to a sample focused on of larger firms in the UK (FTSE 350) and the US (Fortune 700). Further research should examine why different firms may be driven by different motivations by comparatively exploring smaller firms or firms in countries with different institutional characteristics, in emerging markets and in countries where a lower perceived quality of financial reporting.

Third, in chapter 2, I built a disclosure index to detect the level of the disclosure based on a direct analysis of original documents of annual reports where the information is made available before the mandatory-to-voluntary regime shift. My analysis focuses on annual reports because the UK regulation imposed before 2013 the disclosure requirements on firms' annual reports. However, the reduction of firms' disclosure following the regulatory shift may be due to a change in firms' reporting behavior with regard to the reporting medium. I leave to future research the additional analysis of CSR reports as well to verify whether firms do not reduce their disclosure but change it by providing the information on another medium like CSR reports. Regarding the measurement of the disclosure index it is based on content analysis consisting of the evaluation of the narrative of annual reporting using scores for each observation unit. Although I have demonstrated the internal and external validity of this measure, measurement error may still exist. The index can capture the variability of textual reporting, but it might be affected to the subjectivity of the researcher. However, research

assistants help me reading annual reports during this coding phase, reducing my subjectivity in interpreting the narratives and partly validating the data. This methodology requires more resources in terms of time taken in the research employed. This, therefore, represents a limitation in the use of this approach as it requires an increased use of resources and the process of collecting data is more difficult. This inevitably leads to an analysis in chapter 2 of a smaller sample, as shown in previous studies (Jo & Kim, 2007; Beattie & Thomson, 2007).

Fourth, my evidence does not enable me to tell whether it is the CCDs that are driving the documented associations in the three chapters. Although the dissertation uses several remedies for mitigating endogeneity traditionally used in accounting research, such as firm-fixed effects, propensity score matching, DiD, the possibility that my findings are not partially driven by unobservable elements cannot be ruled out. The data on donations does not allow to identify the exact announcement date of firms' donations, which would be useful to perform an event study. Future research should aim to address these empirical challenges.

Fifth, for some of the findings, while I suggest coherent explanations based on prior literature, anecdotal evidence or intuition, I do not empirically test them. For instance, in chapter 3, I do not provide empirical evidence on whether auditors and clients give to the same charities intentionally or unintentionally and what are their motivations behind their giving behavior. Moreover, I have not tackled the empirical challenge to include in the model the 'first move' i.e. who is the first to make donation to a charity. In chapter 2, I provide evidence on firms' disclosure level but not on their motivations and suggest explanations to understand why firms do not voluntarily disclose good news such as CP but I did not test them. For future research, an interview-based approach may be useful to understand motivations that lead firms to reduce their voluntary disclosure on their CP.

Fifth, while I have focused a fair amount in this dissertation on corporate image concerns, other behavioral aspects should also be added to the picture in order to augment the

understanding of charitable activities. It would be interesting to focus on the association between corporate decisions and managers' personal charitable activities (e.g., what are the impacts of the family foundation of the CEO or the CEO's share gifts on corporate decision?).

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