Friends in High Places: An Examination of Politically Connected Governments*

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Abstract

We use variation in the power of U.S. local governments' representation in Congress to provide evidence about the link between political connections and local governments' stewardship over public resources. We find that local governments located in the constituencies of powerful politicians maintain weaker internal controls and issue less reliable and less timely public financial disclosures than other local governments. Moreover, following the plausibly exogenous termination of a powerful political connection, local governments receive less federal funding and improve their stewardship. The effects are attenuated in states with historically low levels of corruption and in the presence of monitoring by voters. Our evidence suggests that powerful political representation weakens local governmental incentives to act in the public interest.

Keywords: Political economy, Stewardship, Financial reports, Senate, House of Representatives, City, County

JEL Codes: G18, G38, H1, H7, H83, M4

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1 Introduction

Cities and counties ("local governments" hereafter) play a central role in the U.S. government system because they are responsible for basic services such as primary education, roads, water, and emergency response. Commensurate with this significant role, local governments have allocation responsibilities for substantial government resources; over $1.5 trillion in 2015.[1] To put this amount into perspective, consider that in the same year, U.S. federal government revenues were approximately $3.4 trillion and the aggregate net income of the Fortune 500 was $945 billion.

Although many local governments receive funds from the federal government, local governments with connections to powerful congressional committee members have better access to federal resources than those that do not (Cohen et al., 2011). However, little is known about whether greater access to resources affects local governments' efforts to oversee and effectively deploy their funds. We investigate whether powerful political connections influence local governments' stewardship over public funds.

Ex ante, the effect of powerful political connections on local governments' stewardship is unclear. Connections could associate with weaker stewardship over public funds for several reasons. First, greater allocations could increase the consumption of private benefits because local governments can continue to provide the same quality of services to constituents without drawing attention to the expropriation. Anecdotal evidence supports this argument. For instance, a recent news report about the development of new train platforms in New York City suggests previously undisclosed government funds were diverted to allow politically

[1] Source: Brookings Institute Tax Policy Center.

connected labor unions, construction companies, and consulting firms to amass large profits.[2]

Second, bond investors may reduce their demand for stewardship from connected local governments. This can occur either because connected governments rely less on bond markets for financing (for parallel arguments in a corporate setting, see Leuz and Oberholzer-Gee (2006)) or because bondholders view the political connection as insurance against negative outcomes (Gore et al., 2004; Houston et al., 2014).

Alternatively, connections could associate with stronger stewardship over public funds for several reasons. First, the distributions of federal resources are subject to extensive controls and monitoring. For example, direct federal fund allocations above certain thresholds are subject to mandatory audits (Petrovits et al., 2011). Local governments that do not demonstrate stewardship over their funds are at risk for reduced federal allocations. Second, powerful politicians and their connected entities likely face more attention and scrutiny from the media and the public (e.g. Ramanna and Roychowdhury 2010). In an effort to avoid negative attention, connected local governments have incentives to maintain stewardship over their funds.

Third, local government officials can use stewardship to signal to voters that they are not exploiting their positions to extract rents (Brender, 2003; Brender and Drazen, 2008). This increases local government officials' chances of winning their elections because voters prefer politicians that act in the best interest of the public (Ferejohn, 1999) and because political challengers cannot as readily use corruption and expropriation arguments against incumbents. In sum, the argument that connected local governments have incentives to ensure public funds are used properly is consistent with empirical findings and with widely

[2]"The Most Expensive Mile of Subway Track on Earth", New York Times, December 28, 2017.

held views in political science (Van Lent, 2012).

Multivariate tests for a sample of 7,166 unique local governments between 1999 and 2016 show that powerful congressional representation is linked to weaker local government stewardship over funds. These results are robust and economically significant; a one standard deviation increase in the strength of political representation on a top congressional committee is associated with a 13 to 20 percent decline in stewardship.

We measure stewardship as the first principal component of multiple audit outcomes, including: an unmodified audit opinion, no material weakness, no significant deficiency, no non-compliance with laws and regulations, and financial reporting timeliness. A one standard deviation increase in connectedness reduces the likelihood of: an unmodified audit opinion by 1.8 percent, no material weakness by 2.3 percent, no significant deficiency by 2.4 percent, no material non-compliance by 1.8 percent, and report timeliness by 2.6 percent. We also find that political connectedness reduces the likelihood that a local government is classified by their auditor as a low-risk client by 4 percent and reduces stewardship over directly allocated federal funds by 10 percent.

The power of local governments' political connections via representation in Congress varies both in the cross-section and over time. Thus, we include local government fixed effects and year fixed effects in our analyses, allowing us to focus on the relation between changes in political connectedness and subsequent changes in stewardship.

However, it is possible that our results are affected by correlated omitted variables. For example, time-variant factors such as economic conditions can affect both the power of political connections and local government stewardship over expenditures. To address this issue, we use powerful politicians' plausibly exogenous departures from Congress (due to either

unanticipated death or Cabinet appointment) to identify variation in the link between local governments and powerful political connections. The findings from difference-in-difference tests indicate that following the loss of a powerful congressional representative, local governments *improve* stewardship over their funds. These findings corroborate the idea that political connections reduce the incentives for local governments to maintain proper controls over public funds.

Thus far, we assume that the mechanism that links political connections to local government stewardship is the disproportionate allocation of government funds to constituencies of powerful U.S. Senators and Representatives. This assumed mechanism is based on theoretical and empirical evidence that powerful politicians attempt to maximize their chances of re-election by channeling government allocations to their constituents (Shepsle and Weingast, 1994; Levitt and Poterba, 1999; Cohen et al., 2011). We validate this mechanism by examining the time-series of local governments' response to plausibly exogenous Congressional departures.

If preferential access to federal distributions drives our results, we expect federal allocations to decline before stewardship improves. Indeed, we find that local governments affected by a Congressional departure first experience a decline in federal allocations and then improve their stewardship over public funds. Our time-series evidence supports the idea that that the negative relation between political connections and stewardship is driven by governmental fund allocations.

Next, we evaluate which of the two explanations for the negative link between political connections and local government stewardship discussed above explain our findings (expropriation or reduced bondholder demand). First, we use a state-level measure of public official

corruption to identify cross-sectional variation in local governments' propensity to engage in expropriation. Consistent with a supply-side explanation for our results, we find that local governments in states with a limited history of corruption do not reduce stewardship in the presence of powerful political representation.

Second, we find limited evidence of a statistical association between the power of a local government's political connections and the propensity to issue new debt. We also find limited evidence that those governments that are bond market participants respond differently to political connections than other governments. These findings suggest that it is unlikely that bondholders reduce their demand for stewardship. Together, these results support the idea that connected local governments supply weak stewardship to consume private benefits.

Finally, we consider whether bondholders, voters, and auditors have a disciplining effect on connected local governments' stewardship over public funds. Bond investors and underwriters provide heightened scrutiny around new bond issues and increase demand for local government stewardship. Voter monitoring of politicians prevents them from engaging in self-serving behavior (Besley and Smart, 2007; Alt and Lowry, 2010). High quality auditors are more likely to detect misbehavior and therefore serve a stronger monitoring role than low quality auditors (Austin and Robbins, 1986).

We find that the negative relation between political connections and local government stewardship is fully offset in the presence of political competition. Thus, monitoring by voters plays an important role in local governments' stewardship over public funds. By contrast, monitoring by bondholders and auditors plays a limited role in deterring local governments' bad behavior.

This is the first study to provide evidence about the effects of powerful political connec-

tions in the U.S. public sector, and specifically, local governments. Although recent reports suggest the U.S. is in the bottom 10 percent of corrupt countries,[3] our results highlight room for improvement in local governments' control and expenditure decisions.

Further, our paper is relevant to two streams of literature. The first stream investigates determinants of state and local government governance characteristics such as financial reporting quality (e.g. Zimmerman 1977; Gore 2004; Beck 2017). Our study particularly complements recent papers that focus on political determinants of financial reporting-related governance characteristics.[4] Our findings contribute to this literature by documenting a distinct channel – representation by powerful politicians in Congress – that adversely affects local government stewardship over public funds.

Second, our paper is related to a stream of literature at the intersection of accounting and political economy, which documents the consequences of political connections for corporations.[5] Our paper complements these studies by documenting that political connections also have implications for other types of organizations. Local governments have different reporting requirements and incentives and governmental stakeholders have different monitoring incentives than those of public corporations.

The paper proceeds as follows. Section 2 provides some background relevant to our setting and describes the data we use. Section 3 describes our empirical methodology, presents

[3]Source: Transparency International Corruption Perceptions Index 2017.

[4]For example, Kido et al. (2012) find that election-related incentives are positively associated with state governments' accounting manipulation. Gore (2015) finds that governments obscure the amount of resources available in the presence of strong labor unions. Cuny (2016) shows that politically competitive county governments are more likely to withhold negative news than those that are not politically competitive.

[5]Studies document that corporate political connections are associated with higher profitability (Amore and Bennedsen, 2013), reduced likelihood of facing IRS tax audits and SEC investigations for financial misconduct (Hunter and Nelson, 1995; Correia, 2014), higher analyst earnings forecast accuracy (Christensen et al., 2017), more favorable accounting standard setting outcomes (Ramanna, 2008), a greater propensity to hire a Big N auditor (Guedhami et al. (2014)), better merger antitrust review outcomes (Mehta et al., 2018), and lower quality financial reports (Leuz and Oberholzer-Gee 2006; Chaney et al. 2011).

results, and provides identification. Section 4 considers the channel through which political connectedness can lead to weak stewardship over public funds. Section 5 demonstrates the strength of monitors and Section 6 concludes.

2 Background and Data

2.1 Local Governments and Single Audits

States delegate administrative authority to political subdivisions, including 3,142 counties and 19,492 municipalities. The power afforded to these local governments varies by state, but generally includes control over utilities, roads, airports, libraries, parks, schools, court systems, law enforcement, fire safety, prisons, property taxes, and social programs. Despite the importance of local governments to Americans' everyday lives, publicly available and timely financial information about these governments is limited. This lack of information limits the ability of investors and voters to oversee local governments.

One avenue through which stakeholders can monitor local governments' stewardship efforts is the outcomes from single audits. Single audits are mandatory audits for all entities receiving over $750,000 of federal funds. Audited entities are required to provide financial statements and the results of the audits to the Federal Audit Clearinghouse within nine months of the fiscal year end.[6] Furthermore, audited entities are required to report the results of two types of audits: a financial statement audit and a compliance audit. The financial statement audit is analogous to that of an audit for a publicly listed corporation

[6]Although the audit results are required to be made public, there is no similar requirement for the underlying financial statements during our sample period. Therefore, only the audit outcomes are easily observable for a large set of local governments.

and includes an examination of the financial statements, accompanying notes, and internal control systems. The compliance audit focuses on the local government's use of federal fund allocations. The audit specifically evaluates whether the usage of the funds is consistent with the conditions underlying the allocations and compliant with applicable laws and regulations.

Before executing the single audit, the auditor must evaluate the local government and identify it as a high risk or low risk auditee. For high-risk (low-risk) local governments, the auditor is required to audit at least 40 percent (20 percent) of all the federal assistance received during the year. Upon completion of the audit, the auditor provides the local government with opinions on both types of audits and a summary of findings.

A sample schedule of findings and questioned costs is included in Appendix B. The auditors issued unmodified financial statement and compliance audit opinions for the county of Johnson, Iowa in 2016. However, the auditors identified a material weakness in internal controls over financial reporting. They go on to explain the nature, the cause, and the effect of the weakness and provide recommendations for remediation.

To provide a sense for the type of information contained in the audit reports, Appendix C provides examples of detailed findings from audit reports filed in 2016.[7] The city of Petersburg, Virginia's expenditures exceeded appropriations. The city also commingled a "multitude" of federal funds and funds from other sources. The city of Elizabeth, New Jersey did not report several large sub-awards to the Department of Housing and Urban Development.

[7]The full audit report is available for fiscal year start dates on or after December 26, 2014.

2.1.1 Single Audit Data

The Federal Audit Clearinghouse maintains a Single Audit database, in which the results of Single Audits are available to the public. The database includes the following relevant information for entities receiving over $750,000 in federal funds: the fiscal year end, the date of the audit report, the entity's direct federal expenditures, the identity of the auditor, the outcome of the auditor's risk assessment of the auditee, the audit opinion for the financial statement and compliance audits, and whether a material weakness and/or significant deficiency was identified for each audit. We use these measures to evaluate stewardship over funds because of the breadth of coverage, the long time-series, and the availability of the data.

We identify all U.S. cities and counties ("local governments") in the Single Audit database for all years between 1999 and 2016. Data availability limitations constrain our start date to 1999. Next, for each local government we identify ZIP codes from the Single Audit database and use US Census data to match each observation to a congressional district and state.[8] Our sample consists of 56,042 local government-year observations across 7,166 unique local governments.[9]

We collect all five financial audit outcome variables from the Single Audit database. First, we create an indicator equal to one if the local government's auditor issues an unmodified audit opinion pertaining to year t (i.e., no adverse, qualified, or disclaimed opinion) and

[8]The ZIP code to congressional district match dataset is from https://www.census.gov/geo/maps-data/.

[9]The sample of 7,166 unique local governments represents approximately one third of the cities and counties in the United States. The remaining local governments do not receive enough direct federal funding to participate in the Single Audit database. In untabulated analyses, we remove all local governments that report ZIP codes that cross congressional district boundaries. Our results are economically and statistically similar for tests using this subsample of governments.

zero otherwise (no_mao). Panel A of Table 1 shows that 88 percent of government-years are characterized by an unmodified audit opinion.

Second, we create an indicator equal to one for the 76 percent of government-years in which the auditor does not identify a material weakness in internal controls over financial reporting (no_mw). Third, an indicator equal to one in the 63 percent of government-years in which the auditor does not identify a significant deficiency in internal controls over financial reporting (no_sd).[10] Fourth, an indicator equal to one in the 91 percent of government-years in which the auditor does not identify material noncompliance with laws or regulations (no_mnc).[11] Fifth, the time lag between period-end and the audit report date divided by 365 and multiplied by negative one, so that higher values represent higher quality (*timely*). The average audit is completed 259 days after year-end.

To create a summary measure of local government stewardship, $Stewardship_{g,t}$, we take the first principal component of these five measures. Panel B of Table 1 illustrates that these variables are strongly correlated with one another. Material weaknesses and significant deficiencies are the strongest determinants of $Stewardship_{g,t}$. However, the correlations between the components of $Stewardship_{g,t}$ are imperfect, suggesting these constructs capture distinct elements of local governments' stewardship. In untabulated analyses, we find that our tabulated results below are qualitatively similar when we remove each one of the five

[10] A material weakness is a deficiency, or a combination of deficiencies, in internal controls, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency in internal controls is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We treat these internal control outcomes as separable because 18 percent of our government-year observations are characterized by both a significant deficiency and a material weakness. Nonetheless, our results are robust to measuring the internal control outcomes (material weaknesses and significant deficiencies) as a single ordinal variable.

[11] Material noncompliance is less severe than a significant deficiency, but could still have a direct and material effect on the determination of financial statement amounts.

underlying audit outcome variables and recalculate $Stewardship_{g,t}$, and when we use a count of the five audit outcome variables.

2.2 Political Connections

The political economy literature shows that Congress' expenditure allocations are influenced by the power of recipients' political representation. For instance, Levitt and Poterba (1999) argue that senior committee members can determine a committee's actions and have the greatest ability to allocate federal government resources to their constituencies. They find that federal expenditures are positively related to political seniority. In subsequent work, Aghion et al. (2009) and Cohen et al. (2011) show that not all congressional committees are equal. Senior representation on *powerful* congressional committees positively affects federal expenditure allocations to governmental entities and states.

2.2.1 Political Connection Data

Following prior work, we measure the strength of a local government's representation in Congress based on the seniority of related Congresspersons and Senators that serve on the ten most powerful committees. We determine the top ten committees based on the methodology from Edwards and Stewart III (2006). They track politician demand for transfers to each congressional committee to determine committee power rankings. For instance, a politician switching from committee A to committee B implies that the politician values the latter more highly than the former. The demand for a given committee is the proxy for that committee's power.[12] Furthermore, within each committee, we determine seniority based on a politician's

[12]The ten most powerful Senate committees using this methodology are Finance, Veterans Affairs, Appropriations, Rules, Armed Services, Foreign Relations, Intelligence, Judiciary, Budget, and Commerce. Sim-

length of tenure in Congress.

We use congressional data from MIT Professor Charles Stewart III to link each local government-year observation to Congresspersons and Senators. The sample period covers the 105th Congress to the 114th Congress. We also collect data on the congressional committee assignments for each politician, committee membership appointment, and departure dates. We use the politicians' appointment dates to calculate each politician's relative seniority.

For each local government year, we calculate the aggregate political representation on the top ten committees by summing politicians' years of service in the House and Senate. We also calculate similar measures for local government representation on the top 5, top 3, and top 1 committee. Thus, X in the variable $PolRepX_{g,t}$ is set to the number of top committees used to determine a local government's political representation on those $TopX$ committees (1, 3, 5, or 10). For a given X, the value assigned to $PolRepX_{g,t}$ for government g in year t captures the aggregate years of representation in Congress. This can be compared across local governments for the same X.

This local government-year measure is best illustrated using an example: The county of Shelby is located in Alabama's 6th congressional district. In 2004, the House representative for Alabama's 6th district (Congressman Spencer Bachus) served on three committees (Judiciary, Transportation and Infrastructure, and Financial Services), of which only the first two are in the list of the ten most powerful committees. As of 2004, Congressman Bachus served in the House for 12 years. Similarly, Alabama's Senators, Jeffrey Sessions (Richard C. Shelby), serve on 3 (1) of the top ten most powerful Senate committees and served in the

ilarly, the most powerful House committees are Ways and Means, Appropriations, Energy and Commerce, Rules, International Relations, Armed Services, Intelligence, Judiciary, Homeland Security, and Transportation and Infrastructure.

Senate for 7 (17) years respectively. The value of *PolRep10* for Shelby county in 2004 represents the aggregate years of service on the most powerful congressional committees (12*2 + 7*3 + 17*1 = 62). We divide these values by 100 for ease of interpretation in relation to the dependent variables.[13]

To alleviate concerns that our empirical results are sensitive to this measure, we use an alternative proxy to measure the power of local governments' political connections. This alternate measure is an indicator equal to one if the local government has a political representative in the top seniority quartile of a *TopX* committee, and zero otherwise. Seniority is separately determined for the Senate and House because of systematic differences in the average tenure of politicians in the two chambers. Untabulated empirical results using this measure of political connectedness are qualitatively similar to the results for $PolRepX_{g,t}$ documented below.

Panel A of Table 1 shows that $PolRepX_{g,t}$ for local governments in our sample represents 63 aggregate years of service on *Top10* committees, 33 years on *Top5* committees, 21 years on *Top3* committees, and 6 years on *Top1* committees, on average. Panel B of Table 1 shows that representation on these committees is significantly negatively correlated with all of our measures of stewardship.

[13]To further illustrate, we calculate *PolRep3* for Shelby County. Of the three committees that Congressman Spencer Bachus served on, none are in the list of the three most powerful committees. Senator Jeffrey Sessions (Richard C. Shelby) serves on none (one) of the top 3 most powerful Senate committees. The value of *PolRep3* for Shelby county in 2004 represents the aggregate years of service on the most powerful congressional committees (12*0 + 7*0 + 17*1) = 17.

2.3 Empirical Methodology

To examine whether local government stewardship over funds is linked to political representation on powerful congressional committees, we estimate the following OLS specification:

$$Stewardship_{g,t} = \alpha + \beta_1 PolRepX_{g,t-1} + \beta_2 Bond_{g,t} + \beta_g + \beta_t + \varepsilon_{g,t} \quad (1)$$

where $Stewardship_{g,t}$ measures local government g's stewardship in year t. $PolRepX_{g,t-1}$ measures the power of congressional representation in year *t-1*, and is equal to one of: *PolRep1*, *PolRep3*, *PolRep5*, or *PolRep10*. Because the federal budget (and therefore fund distributions) is set in advance, we measure political connections in year *t-1* and stewardship in year t. $Bond_{g,t}$ is an indicator equal to one if local government g issues a bond in year t. Because the treatment (political connectedness) varies at the district level, standard errors are clustered by congressional district. We include local government fixed effects and year fixed effects in all specifications so we do not need to otherwise control for time-invariant local government characteristics that could affect stewardship.

3 Results

3.1 Primary Results

Panel A of Table 2 presents results from multivariate tests examining the link between stewardship and connections to powerful politicians. The coefficient on *PolRep1* in Column (1) is negative and statistically significant. This finding is consistent with the notion that local government stewardship over funds is weaker in the presence of senior congressional

representation on powerful congressional committees. The evidence in Columns (2) through (4) supports this finding across representation on *Top3*, *Top5*, and *Top10* congressional committees. The coefficients on $PolRepX_{g,t-1}$ are negative and statistically significant in all specifications.

The results are also economically significant; a one standard deviation increase in the strength of political representation by *Top1* (*Top3*) congressional committee members is associated with a 13 (20) percent decline in local government stewardship.[14] We also find that bond issuances are associated with better stewardship, however the relation is statistically insignificant. In untabulated tests, the coefficient on bond issuance is positive and significant at conventional levels if we remove the local government fixed effect.[15]

To ease interpretation, Panel B of Table 2 presents results in which the dependent variable is equal to each of the five constructs used in computing $Stewardship_{g,t}$. In the interest of brevity, we present results for two of the primary independent variables: *PolRep3* and *PolRep10*. Results are consistent across the remaining independent variables of interest (*PolRep1* and *PolRep5*). We find that a one standard deviation increase in connectedness

[14]The 0.09 standard deviation of *PolRep1* multiplied by the coefficient of -0.674, divided by the median value of *Stewardship*. We evaluate economic significance at the median because the mean value in a first principal component analysis is, by construction, zero.

[15]We undertake three additional untabulated analyses. First, we check whether our results are driven explicitly by the Appropriations committees in the Senate and the House. Note that both the House and Senate Appropriations committees rank in the top 3 in terms of importance. We find that our results for the top 3, top 5, and top 10 congressional committees are qualitatively similar after we exclude political connections to Appropriations committee members. Second, we examine whether the benefit of political connections varies based on whether the connection is relatively stronger to the party of a sitting president. We create an indicator variable set to one for local governments in the constituencies of at least two politicians from the same party as the sitting president, and set to zero otherwise. We interact this variable with $PolRepX_{g,t-1}$. The results indicate that both the standalone term and the interaction term are statistically linked to weaker stewardship. However, an F-test indicates that the economic effect between the groups is significantly different. Third, we examine whether House or Senate representation drive our results by recalculating $PolRepX_{g,t-1}$ based on the total representation on Senate and House powerful committees separately. After reestimating our primary specification, we find that the link between a local government's political connectedness and stewardship are not statistically different across powerful House and Senate representation.

to a top 3 committee member reduces the likelihood of: an unmodified audit opinion by 1.8 percent, no material weakness by 2.3 percent, no significant deficiency by 2.4 percent, no material non-compliance by 1.8 percent, and report timeliness by 2.6 percent.

In sum, the results from Table 2 provide evidence that local governments in the constituencies of politicians serving on powerful congressional committees maintain relatively weak stewardship over funds.[16]

3.2 Tests Using Alternate Measures of Governance

Our primary measure of governance focuses broadly on a local government's stewardship over public funds. To provide further insights about the consequences of powerful political representation, we also examine two alternative proxies for governance using data from the Single Audit database. First, we examine auditor risk assessments of the auditee, as determined during the planning phase of the audit. We obtain this data from the Single Audit database because local government auditors are required to publicly disclose their ex ante risk assessments for local government clients. We create an indicator, $LowRisk_{g,t}$, equal to one if the auditee is identified as low-risk, and zero otherwise. Forty-nine percent of governments in our sample are considered "low risk." Second, we create a summary measure of the governance over federal funds allocated to the local government based on the three compliance outcomes disclosed in the Single Audit database ($Compliance_{g,t}$).

[16]We recognize that our outcome variables are jointly determined by the auditor and the auditee. As such, a possible alternative explanation for our results is increased auditor effort. To address this possibility, we re-estimate equation (1) interacting $PolRepX_{g,t\text{-}1}$ with an indicator equal to one if the auditor identifies the auditee as low risk in the planning phase of the audit. We find that the coefficient on the interaction is statistically and economically insignificant in three out of four specifications. Thus, connected local governments that are low risk auditees are generally no less likely to experience negative audit outcomes than those that are high risk. Auditor effort is unlikely to explain our results.

To create the summary $Compliance_{g,t}$ measure, we first create an indicator equal to one for the 93 percent of our sample that receives an unmodified compliance audit opinion, and zero otherwise (no_mao_comp). Second, we create an indicator equal to one for the 91 percent of the sample for which the auditor does not identify a material weakness in internal controls over federal fund usage (no_mw_comp), and zero otherwise. Third, we create an indicator equal to one for the 82 percent of the sample for which the auditor does not identify a significant deficiency in internal controls over federal fund usage (no_sd_comp), and zero otherwise. $Compliance_{g,t}$ is the first principal component of these three measures.

Table 3 presents regression results from tests of Equation (1) in which we replace $Stewardship_{g,t}$ with one of these two alternate governance measures: $LowRisk_{g,t}$ (in Columns (1) through (4)) or $Compliance_{g,t}$ (in Columns (5) through (8)). The findings corroborate our main results. We find robust evidence of a negative relation between a local government's powerful representation in Congress and the likelihood that: 1) auditors view the local government as a low risk auditee; and 2) auditors identify and report problems in the audits of federal fund receipts. In particular, the coefficients on $PolRepX_{g,t-1}$ are statistically significant in all specifications. In economic terms, a one standard deviation increase in connectedness to *Top3* congressional committee members reduces the chances of being a low-risk auditee by 4.1 percent and reduces compliance with regulations surrounding federal expenditures by 10.1 percent.

These findings provide a number of insights. First, auditors ex ante expect that powerfully connected local governments are more likely to demonstrate weak stewardship over public funds. Second, weak stewardship is not restricted to the financial reporting system but also to systems used to control the receipt and usage of direct federal appropriations.

3.3 Identification and Mechanism

3.3.1 Identification

The evidence provided thus far is cross-sectional in nature. It is possible that changes in representation on powerful committees and changes in local government's stewardship over funds are jointly determined by omitted variables such as local economic conditions. To tighten the link between powerful political representation and local government stewardship, we use a source of variation in local governments' political connections that is unlikely to be systematically linked to an omitted variable.

We exploit changes to local governments' representation on powerful congressional committees via plausibly exogenous politician departures from Congress. To ensure that we can attribute changes in stewardship to political connections, our politician departures need to occur for reasons that are unlikely to be directly correlated with factors that affect local government stewardship over funds.

Recent studies impose varying criteria to determine appropriate politician departure cases. Bertrand et al. (2018) use departures of House members that occur because of death, resignation, or primary defeat to identify a source of variation in corporations' charitable donations to charities within politicians' districts. However, in our setting, it is possible that poor underlying state or district economic conditions affect both politician reelection prospects and local government incentives to ensure funds are properly used and controlled. Mehta et al. (2018) use politician transfers from Judiciary committees to more powerful committees to identify variation in the ability of corporations to obtain political influence over antitrust regulators. Because committee transfers do not affect a politician's link to his

or her constituency, such an approach is not feasible in our setting.

To identify changes in local governments' representation on powerful congressional committees via politician departures from Congress, we identify politicians that: (1) unexpectedly die while in office; or (2) are appointed to presidential cabinet positions and resign from Congress. These departures are unlikely to be directly correlated with local governments' stewardship over funds.

We highlight that although all politician departures result in a new politician being appointed or elected for the open seat, we focus solely on politician departures. This is because the seniority system in Congress results in newly tenured politicians having the lowest seniority ranking on congressional committees and thus the weakest ability to influence allocations to their constituencies. Consistent with this fact, Levitt and Poterba (1999) find that states that were represented by very senior Democratic congressmen grew more quickly during the 1953-1990 period than states that were represented by more junior congressional delegations.

We use Senate and House records and our congressional membership dataset to identify all cases of politicians that depart Congress. We then use Factiva and LexisNexis to manually identify the cause and date of death. We define death as unexpected if a politician dies within six months of announcing an illness. After imposing this restriction, we have 23 unexpected death events and two cabinet appointments during our sample period.[17] These 25 cases are summarized in Appendix D. In total, at the time of departure, the politicians represent 588 unique sample local governments. The empirical results for the departure tests discussed

[17]Note that our cabinet appointment cases do not include Hillary Clinton (D-NY) because of uncertainty around her departure. In particular, her appointment as Secretary of State occurred within six months of her loss in the Democrat primary election. Nonetheless, our empirical results are robust to including Hillary Clinton's cabinet appointment as an unexpected departure from Congress.

below hold for all specifications if we use only unexpected death cases.

We create an indicator, $DepartX_{g,t\text{-}1}$, equal to one for local governments in the constituencies of a politician serving on a powerful congressional committee who experienced a plausibly exogenous drop in their political connectedness in the prior four years (i.e. from t-1 to t-4), and zero otherwise. We use a four-year window because this is the average of the length of Senate terms (6 years) and House terms (2 years).[18] The value of X again represents whether the departure represents a politician serving in the top 1, 3, 5, or 10 most powerful congressional committees. Approximately 1.0 percent of our government-years are characterized by the departure of a *Top1* committee member and 3.0 percent are characterized by a *Top10* committee member's departure.

Table 4 presents the regression results. The independent variable of interest is equal to one of: *Depart1, Depart3, Depart5*, or *Depart10*. A positive coefficient on these variables indicates that local governments exhibit stronger stewardship after they experience a plausibly exogenous loss of influential congressional representation on a powerful congressional committee.

The coefficients on $DepartX_{g,t\text{-}1}$ are all positive and statistically significant. This is consistent with the idea that the power of a local government's congressional representation affects local government stewardship. In economic terms, the loss of a political connection on the top ranking congressional committee (i.e. *Depart1*) is associated with a 42 percent improvement in stewardship, relative to the median level of $Stewardship_{g,t}$. The loss of a political connection to a top 10 committee member is associated with a 30 percent improvement

[18] Our results are robust to using a two-year window or a six-year window.

in stewardship.[19]

3.3.2 Mechanism

We also use these plausibly exogenous departures from Congress to consider the likely mechanism that drives our results: governmental fund allocations. Nonpartisan distributive politics models suggest that politicians attempt to maximize their chances of re-election by maximizing the policy benefits and allocations that are channeled to their constituents (see Shepsle and Weingast, 1994). Consistent with these models, empirical studies document that powerful political connections are associated with more government allocations (Levitt and Poterba, 1999; Cohen et al., 2011).

We examine the time-series of changes in local governments' direct federal expenditures and stewardship after the plausibly exogenous loss of influential congressional representation. If governmental fund allocations drive our results, we expect improved stewardship to follow reduced federal allocations.

Columns (1) through (4) of Table 5 present regressions of $FederalExp_{g,t}$ on $PostY\_TopXDeparture_{g,t}$, where Y is the number of years that pass since the powerful Congressman's departure on a $TopX$ committee. Columns (5) through (8) present regressions of $Stewardship_{g,t}$ on $PostY\_TopXDeparture_{g,t}$. We find statistically and economically significant evidence that local governments expend fewer federal dollars after the departure of

[19]We note that a possible concern with the exogeneity of Congressional departures due to cabinet appointments is that politicians who accept cabinet positions do so because they anticipate poor future economic conditions in their constituencies. Poor future economic conditions could conceivably increase local government stewardship over public funds. Findings from two analyses suggest this concern is unlikely to explain our empirical findings. First, we note that the replacement Senator from each of the cabinet appointee's states (Michael Bennet (D-CO) replaced Kenneth Salazar (D-CO) and Ed Markey (D-MA) replaced John Kerry (D-MA)) win their subsequent reelection campaigns. Incumbents are more likely to lose elections during poor economic conditions. Second, the empirical results for our departure tests hold for all specifications after removing both cabinet appointment cases.

a powerful political representative.

In particular, federal expenditures begin to significantly decline in the first year following the departure and continue to decline until three years after the departure. Stewardship begins to significantly improve in the second year following the departure and continues to improve in the third year. This time-series evidence collectively suggests that connected local governments improve their stewardship *after* the decline in federal allocations occurs. We conclude that the negative relation between political connections and stewardship is driven, at least in part, by governmental fund allocations.

4 Channels

We next explore possible channels that could explain the negative link between political representation and local government stewardship over funds.

4.1 Expropriation

Connected local governments could supply weaker stewardship to enable their consumption of private benefits. If the results we document thus far are attributable to connected local governments' bad behavior, these results should attenuate in states that historically demonstrate low levels of corruption. We create an indicator, $LowCorrupt_s$, equal to one for the ten states that Liu and Mikesell (2014) identify as the least corrupt. This ranking of state-level corruption uses the U.S. Department of Justice *Reports to Congress on the Activities and Operations of the Public Integrity Section* from 1976–2008 to identify the number of federal, state, and local public officials convicted of a corruption-related crime across in each state,

weighted by the state's population.[20] Local governments within the ten least corrupt states account for approximately 16 percent of our sample.

Panel A of Table 6 shows that strong anti-corruption practices at the state-level fully offset local governments' propensity to reduce their stewardship in the presence of a powerful politician. In all four specifications, the sum of the coefficients on $PolRepX_{g,t-1}$ and $PolRepX_{g,t-1}$ *$LowCorrupt_s$ are not statistically or economically different from zero. These results broadly support our attribution of the link between stewardship and powerful political representation to local governments' poor behavior.

4.2 Reduced Demand from Bondholders

If our primary results thus far are attributable to reduced reliance on the bond market, and thus reduced investor demand for stewardship, then political connections should associate with a lower likelihood of issuing new bonds. We collect data on local government bond issuances that occur during our sample period from the Thomson-Reuters SDC Platinum database to identify all bond issues with principal amounts over $1 million. Next, we match these data with our local government observations. We create an indicator, $Bond_{g,t}$, equal to one if local government g issues bonds in year t. Twenty-five percent of our government-years are characterized by a bond issuance.

We replace our dependent variable with $Bond_{g,t}$ and examine whether $PolRepX_{g,t-1}$ lowers the likelihood of issuing new bonds. In three of four specifications in Panel B of Table 6, the relation is statistically and economically insignificant. Thus, while reduced demand

[20] Using this metric, the ten least corrupt states are: Oregon, Washington, Minnesota, Nebraska, Iowa, Vermont, Utah, New Hampshire, Colorado, and Kansas.

from bondholders may play a limited role in the relation between political connections and stewardship, it is not a key determinant.

If our results are attributable to bond investors viewing political connections as insurance, reducing their demand for stewardship, only local governments that are bond market participants should reduce stewardship in response to powerful political representation. We create an indicator, $Issuer_g$, equal to one for the 60 percent of local governments that issue bonds during our sample period. This allows us to identify governments that have accessed the bond market.

Panel C of Table 6 shows that the interaction between $PolRepX_{g,t-1}$ *$Issuer_g$ is insignificant in three of four specifications. Moreover, the un-interacted coefficients on $PolRepX_{g,t-1}$ are statistically and economically negative in all four specifications, illustrating that local governments that are not bond issuers significantly reduce stewardship in the presence of political connections. Thus, our results are not attributable to reduced demand from bondholders.

5 Monitoring

5.1 Bondholders

Prior research documents that the quality of local government financial reports is positively related to the access to debt capital (Austin and Robbins, 1986). Therefore, we examine whether the negative link between powerful political representation in Congress and stewardship over funds is attenuated around municipal bond issuances. Our empirical tests focus

on bond issuances rather than the effect of existing bonds because at the time of issuance, government entities have the greatest incentives to signal they maintain strong stewardship over funds.

The interaction between $PolRepX_{g,t-1}$ and $Bond_{g,t}$, captures whether the effect of powerful political connections on stewardship differs for local governments that issue bonds. A positive coefficient on this interaction term is consistent with bondholders moderating the negative effect of powerful political connections.

In Panel A of Table 7, we find that the interaction between $PolRepX_{g,t-1}$ and $Bond_{g,t}$ is only statistically significant in Column (2). Overall, this finding suggests that bondholders and underwriters are a limited source of discipline over stewardship. Even in the presence of monitoring by bondholders and underwriters, connections are associated with weak stewardship.

5.2 Voters

Next, we consider the role of voters as monitors over local governments' stewardship. We assume that local government elected officials and their competitors require voter support to be re-elected. This results in incentives to implement and promote policies to be transparent and maintain proper controls over funds (Baber, 1990). Baber et al. (2013) suggest governments are most likely to be concerned about governance practices when there is greater competition between political parties. One explanation for this finding is that incumbent politicians are worried about opposition candidate efforts to draw voter attention to weak governance practices as a signal of the incumbent politician quality.

We use the Ranney Index (Ranney, 1976) to identify political competition at the county level. If voters consider local governments' stewardship over funds when evaluating connected officials, then we expect to observe better stewardship in counties that are more politically competitive. The index ranges from 0.5 to 1.0, with 0.5 representing no competition between the two major parties (i.e., 100 percent registered democrats, 0 percent registered republicans) and 1.0 signifying perfect competition (i.e., 50 percent registered democrats and 50 percent registered republicans). After limiting the sample to states for which voter registration details are available from David Liep, we have a sample of 27,705 local government-year observations from 28 states.[21]

We create an indicator, $PolComp_g$, equal to one for local governments whose Ranney Index is in the top quartile of all local governments in our sample (above 0.96). The interaction between $PolRepX_{g,t-1}$ and $PolComp_g$ measures the differential effect of powerful political connections on stewardship for local governments in politically competitive constituencies. A positive coefficient on this interaction term is consistent with voters moderating the negative effect of powerful political connections. Note that because the Ranney Index is time-invariant, local government fixed effects absorb it and thus our specification does not include $PolComp_g$ as a standalone variable.

We present empirical results in Panel B of Table 7. We find that the coefficients on the interaction term bear positive signs in all four columns, and are statistically significant in Columns (2), (3), and (4). This finding suggests that local political competition is a

[21]There are 22 states that do not publicly disclose voter registration details. These states are Alabama, Arkansas, Georgia, Hawaii, Idaho, Illinois, Indiana, Michigan, Minnesota, Mississippi, Missouri, Montana, North Dakota, Ohio, South Carolina, Tennessee, Texas, Utah, Vermont, Virginia, Washington, and Wisconsin.

powerful disciplining mechanism over stewardship.[22] Moreover, the sum of $PolRepX_{g,t-1}$ and the interaction term $PolRepX_{g,t-1}$ and $PolComp_g$ is not significantly different from zero in any specification, suggesting that voters' monitoring can fully offset the bad behavior of connected local governments.

5.3 Auditor Quality

Finally, we examine whether the link between stewardship over funds and powerful political representation is affected by the quality of the auditor evaluating the financial reports. We note that our analysis is a joint test of whether auditors identify weaknesses and choose to report these weaknesses.

Because only two percent of our sample governments use Big N auditors, we use independent (as opposed to state) auditors as a proxy for higher quality audit providers. An independent auditor audits 88 percent of local governments in our sample.We create an indicator, $IndepAudit_{g,t}$, equal to one for local governments whose year t audit report is from an independent auditor.

The interaction between $PolRepX_{g,t-1}$ and $IndepAudit_{g,t}$ captures whether the effect of powerful political connections on stewardship differs for local governments with high quality auditors. A positive coefficient on this interaction term is consistent with the notion that local governments with powerful political representation in Congress are less likely to maintain weak stewardship over funds in the presence of higher quality auditors.

[22] Our results may be affected by the fact that the Ranney Index is time-invariant. In particular, it is possible that if local government-level political competition varies over time, the values for $PolComp_g$ are more likely to be measured with error for sample years that are more distant from 2010. In untabulated analyses we limit the sample to five years prior to and post 2010 (i.e. the 10 years from 2005 to 2015). The results are qualitatively similar to the tabulated findings.

The results in Panel C of Table 7 show that the interaction between $PolRepX_{g,t-1}$ and $IndepAudit_{g,t}$ is positive and significant in two of four specifications. Moreover, F-tests indicate that even in the presence of independent auditors, connected local governments reduce their stewardship over funds. Thus, independent auditors marginally attenuate the likelihood that connected governments weaken their stewardship over funds.

6 Conclusion

We investigate the effects of links to powerful politicians on local government stewardship over public funds. Focusing specifically on local governments in the U.S., we document a negative relation between powerful political representation in Congress and stewardship. Additional tests using variation in political connectedness via politician departures from Congress that are unlikely to be correlated with future performance indicate that stewardship improves following these departures.

We document that federal allocation of funds is a plausible mechanism that links Congressional representation to local governments' stewardship. We also explore a variety of explanations for the negative link between political connections and stewardship; our findings are consistent with the idea that local governments' powerful connections enable wealth expropriation.

Further, we examine the role of bondholders, voters, and auditors as monitors over local governments' stewardship over public funds. We find that the negative relation between Congressional representation and stewardship is fully attenuated in the presence of political competition, but not in the presence of bondholders or high-quality auditors.

This paper makes two primary contributions. First, given increased worldwide interest in the financial health of local governments, our paper is a timely addition to the literature examining factors that influence the local government efforts to properly and effectively use public funds. Although other studies have focused on accounting choices by local governments (Evans and Patton, 1983; Baber, 1983; Baber et al., 1987; Kido et al., 2012), we are the first to provide evidence about the effect of Congressional representation on the extent to which local governments maintain stewardship over their funds.

Second, our paper is an important addition to the literature examining the consequences of links to powerful politicians. Prior studies largely focus on the effects of these links in the context of corporations. Our study is the first to show that these links can have consequences for local governments.

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Appendix A: Definitions of Variables

Variable	Definition
Bond	An indicator for local governments that issue municipal bonds in year t, and zero otherwise.
Compliance	An aggregate measure of compliance with regulations surrounding federal fund usage, where higher values suggest stronger compliance. Measured as the first principal component of the following variables found in the compliance audit report pertaining to year t: (1) unmodified audit opinion, (2) no material weakness, and (3) no significant deficiency.
DepartX	An indicator variable having the value of one if in the prior four years, the local government loses a connection to a politician serving on a TopX committee because the politician unexpectedly dies or is appointed to a cabinet position, and zero otherwise.
FederalExp	The natural logarithm of total federal expenditures.
Income	The natural logarithm of median per capita income, measured at the county-year level, from the Bureau of Economic Analysis.
Indep Audit	An indicator equal to one if an independent auditor performs the single audit, and zero if a state auditor performs the audit.
Issuer	An indicator equal to one if the local government issues bonds during our sample period.
Low Corrupt	An indicator equal to one for the ten states that Liu and Mikesell, 2014 identify as the least corrupt. This ranking of state-level corruption uses the U.S. Department of Justice *Reports to Congress on the Activities and Operations of the Public Integrity Section* from 1976–2008 to identify the number of federal, state, and local public officials convicted of a corruption-related crime across in each state, weighted by the state's population.
Low Risk	An indicator equal to one if the auditor identifies the auditee as low risk during the planning phase of the Single Audit.
no_mao	An indicator variable equal to one if the auditor provides an unmodified audit opinion (i.e., no adverse opinion, disclaimer of opinion, or qualified opinion) on the financial statements, and zero otherwise.

Appendix A, continued

Variable	Definition
no_mao_comp	An indicator equal to one if the auditor provides an unmodified audit opinion (i.e., no adverse opinion, disclaimer of opinion, or qualified opinion) on compliance with regulations over a major federal funds program, and zero otherwise.
no_mnc	An indicator variable equal to one if the auditor does not identify material noncompliance with laws or regulations, and zero otherwise.
no_mw	An indicator variable equal to one if the auditor does not identify a material weakness in the internal controls over the financial statements, and zero otherwise.
no_mw_comp	An indicator variable equal to one if the auditor does not identify a material weakness in internal controls over a federal award program, and zero otherwise.
no_sd	An indicator variable equal to one if the auditor does not identify a significant deficiency in internal controls over the financial statements, and zero otherwise.
no_sd_comp	An indicator equal to one if the auditor does not identify a significant deficiency in internal controls over a major federal fund program, and zero otherwise.
PolComp	An indicator equal to one if the county's Ranney index (Ranney, 1976) is in the most competitive quartile of the sample.
PolRepX	The sum of tenure (in years) of an entity's total political representation on the X committees, divided by 100. X is set to one of the 1, 3, 5, or 10 most powerful committees.
Population	The natural logarithm of population, measured at the county-year level, from the Bureau of Economic Analysis.
PostY_TopXDeparture	An indicator equal to one in the Y^{th} year after a connected politician serving on a *TopX* congressional committee unexpectedly dies or is appointed to a cabinet position.

Appendix A, continued

Variable	Definition
Stewardship	An aggregate measure of stewardship over funds, where higher values suggest higher stewardship. Measured as the first principal component of the following variables found in the financial statement audit report pertaining to year t: (1) unmodified audit opinion, (2) no material weakness, (3) no significant deficiency, (4) no material noncompliance, (5) the lag between period end and the audit report date, multiplied by negative one.
timely	The number of days between the date the CPA signed the audit report minus the fiscal year ending date, divided by 365 and multiplied by negative one so that higher numbers represent higher reporting quality.

Appendix B: Sample Schedule of Findings and Questioned Costs

JOHNSON COUNTY, IOWA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED JUNE 30, 2016

Part I: Summary of the Independent Auditor's Results

a. Unmodified opinions were issued on the financial statements.

b. A material weakness in internal control over financial reporting was disclosed by the audit of the financial statements.

c. The audit did not disclose any non-compliance which is material to the financial statements.

d. No material weaknesses in internal control over major programs were disclosed by the audit of the financial statements.

e. An unmodified opinion was issued on compliance with requirements applicable to each major program.

f. The audit disclosed no audit findings which are required to be reported in accordance with the Uniform Guidance, Section 200.515.

g. The major programs were CFDA Numbers:

10.557 Special Supplemental Nutrition Program for Woman, Infants and Children
93.074 Hospital Preparedness Program (HPP) and Public Health Emergency Preparedness (PHEP) Aligned Cooperative Agreements

h. The dollar threshold used to distinguish between Type A and Type B programs was $750,000.

i. Johnson County, Iowa did not qualify as a low-risk auditee.

Part II: Findings Related to the Financial Statements

INTERNAL CONTROL DEFICIENCIES:

16-II-A Financial Reporting – During the year ended June 30, 2016, it was determined that certain capital asset's transactions from prior to July 1, 2015 were mistakenly omitted from the capital assets listing. The effects of these omissions are shown in Note 17 of the current year financial statements.

Recommendation – The County should maintain an updated listing of capital assets that reconciles to the audited financial statements.

Response – The County will review its process for capital assets and ensure in the future that it maintains an updated capital asset listing and that it reconciles to the audited financial statements.

Conclusion – Response accepted.

CITY OF PETERSBURG, VIRGINIA

Schedule of Findings and Questioned Costs
Year Ended June 30, 2016 (Continued)

SECTION II - FINANCIAL STATEMENT FINDINGS: (CONTINUED)

2016-017 Compliance Finding - Expenditures in Excess of Appropriations

Criteria: Per the Code of Virginia, an expenditure should not be incurred until first an appropriation is made authorizing the expenditures.

Condition: The City had expenditures in excess of appropriations for the following functions in the general fund:

Function	Expenditures in Excess of Appropriations
General Government Admin	$ 59,453
Public Safety	$ 303,053
Health and Welfare	$ 449,464
Debt Service	$ 1,307,841

Cause: The City did not have procedures in place to monitor appropriations and expenditures.

Effect: The City incurred expenditures without a corresponding appropriation authorizing the expenditure.

CITY OF PETERSBURG, VIRGINIA

Schedule of Findings and Questioned Costs
Year Ended June 30, 2016 (Continued)

SECTION II - FINANCIAL STATEMENT FINDINGS: (CONTINUED)

2016-011 Material Weakness - Material Reclassifications Proposed to Federal Revenues

Criteria: Federal Revenues should be appropriately recorded in the financial statements.

Condition: The Auditor proposed material adjustments to the City's recording of revenues received from federal sources – direct and pass-through federal revenues. The City had commingled and misclassified a multitude of federal revenues with state and/or local revenues within the accounting system.

Cause: The City does not have adequate staff or resources to monitor the City's posting of federal grant revenues or prevent the City's Schedule of Expenditures of Federal Awards, which is presented in the City's CAFR, from being materially misstated.

Effect: The City's Schedule of Expenditures of Federal Awards could be materially misstated.

Recommendation:

We recommend the City implement procedures to ensure the City's federal revenues are appropriately accounted for and reported. This includes maintaining a list of all federal grants received, the CFDA number for each federal grant, the amount expended for each federal grant, the amount received for each federal grant, and a review process ensuring that all federal revenues are accurately recorded in the general ledger.

City of Elizabeth

Schedule of Federal and State Award Findings and Questioned Costs

June 30, 2016

F 2016-004
Reporting (L)
Federal Program:
Department of Housing and Urban Development
Emergency Solutions Grant (14.231)

Criteria:	As an additional condition to form HUD 7082, the grantee is required to comply with 2 CFR part 170 Reporting Subaward Information.
Condition:	The grantee did not report eight subawards that were $25,000 or greater.
Context:	The grantee did not report any subawards that were $25,000 or greater.
Effect:	The condition to comply with 2 CFR part 170 was not satisfied.
Cause:	The grantee has not assigned a responsible individual to report subawards.
Questioned Costs:	None
Recommendation:	The grantee should assign an individual to report subawards.
Client Response:	Included in the client prepared corrective action plan.

Appendix D: Plausibly Exogenous Politician Departure Cases

Name	Chamber	Constituency	Local Govt's Affected	Year of Departure	Reason for Departure
Chafee, John H.	Senate	RI	9	1999	Heart failure
Brown, George E., Jr.	House	CA 42nd	2	1999	Infection
Coverdell, Paul	Senate	GA	137	2000	Cerebral hemorrhage
Dixon, Julian C.	House	CA 32nd	12	2000	Heart failure
Spence, Floyd D.	House	SC 2nd	14	2001	Surgical complications
Wellstone, Paul David	Senate	MN	207	2002	Plane crash
Mink, Patsy T.	House	HI 2nd	4	2002	Pneumonia
Moakley, John Joseph	House	MA 9th	5	2002	Myelodysplastic syndrome
Matsui, Robert T.	House	CA 5th	5	2005	Pneumonia
Thomas, Craig	Senate	WY	38	2007	Leukemia
Gillmor, Paul E.	House	OH 5th	23	2007	Fall
Davis, Jo Ann	House	VA 1st	20	2007	Cancer
Millender-McDonald, Juanita	House	CA 37th	5	2007	Cancer
Carson, Julia M.	House	IN 7th	3	2007	Cancer
Lantos, Tom	House	CA 1st	24	2008	Cancer
Jones, Stephanie Tubbs	House	OH 11th	6	2008	Cerebral hemorrhage
Salazar, Kenneth Lee	Senate	CO	107	2009	Appointed Sec. of the Interior
Byrd, Robert C.	Senate	WV	82	2010	Natural causes
Murtha, John P., Jr.	House	PA 12th	10	2010	Infection
Payne, Donald M.	House	NJ 10th	4	2012	Cancer
Lautenberg, Frank R.	Senate	NJ	74	2013	Viral pneumonia
Kerry, John F.	Senate	MA	60	2013	Appointed Sec. of State
Young, C.W. Bill	House	FL 13th	9	2013	Cancer

Table 1: Descriptive Statistics

Panel A presents summary statistics that describe the variables used in the study. Panel B presents Pearson product correlations among the main variables used in the study. All variables are defined in Appendix A.

Panel A: Descriptive Statistics

Variable	N	Mean	Std Dev	25th Pctl	50th Pctl	75th Pctl
Stewardship	56,042	0.00	1.36	-0.63	0.47	1.07
no_mao	56,042	0.88	0.32	1.00	1.00	1.00
no_mw	56,042	0.76	0.43	1.00	1.00	1.00
no_sd	56,042	0.63	0.48	0.00	1.00	1.00
no_mnc	56,042	0.91	0.29	1.00	1.00	1.00
timely	56,042	-0.71	0.40	-0.75	-0.64	-0.51
Low Risk	56,042	0.49	0.50	0.00	0.00	1.00
Compliance	56,042	0.00	1.38	0.61	0.61	0.61
no_mao_comp	56,042	0.93	0.26	1.00	1.00	1.00
no_mw_comp	56,042	0.91	0.29	1.00	1.00	1.00
no_sd_comp	56,042	0.82	0.39	1.00	1.00	1.00
PolRep1	56,042	0.06	0.09	0.00	0.00	0.11
PolRep3	56,042	0.21	0.17	0.09	0.17	0.30
PolRep5	56,042	0.33	0.24	0.16	0.28	0.44
PolRep10	56,042	0.63	0.40	0.34	0.56	0.83
Depart1	56,042	0.01	0.11	0.00	0.00	0.00
Depart3	56,042	0.02	0.15	0.00	0.00	0.00
Depart5	56,042	0.03	0.16	0.00	0.00	0.00
Depart10	56,042	0.03	0.16	0.00	0.00	0.00
Federal Exp	56,042	15.04	1.43	13.94	14.80	15.84
Population	52,122	9.59	1.07	9.02	9.82	10.38
Income	51,897	10.72	0.35	10.53	10.71	10.90
Bond	56,042	0.25	0.43	0.00	0.00	1.00
Ranney	27,705	0.91	0.06	0.88	0.91	0.96
IndepAudit	56,042	0.88	0.33	1.00	1.00	1.00
LowCorrupt	56,042	0.16	0.37	0.00	0.00	0.00
Issuer	56,042	0.60	0.49	0.00	1.00	1.00

Table 1, continued

Panel B: Correlation Matrix

		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
(1)	Stewardship	1											
(2)	no_mao	0.55***	1										
(3)	no_mw	0.77***	0.22***	1									
(4)	no_sd	0.68***	0.16***	0.44***	1								
(5)	no_mnc	0.59***	0.23***	0.27***	0.18***	1							
(6)	timely	0.37***	0.12***	0.15***	0.11***	0.09***	1						
(7)	Low Risk	0.42***	0.24***	0.39***	0.27***	0.19***	0.14***	1					
(8)	Compliance	0.33***	0.11***	0.29***	0.23***	0.18***	0.17***	0.25***	1				
(9)	PolRep1	-0.03***	-0.02***	-0.04***	0.00	0.03***	-0.09***	-0.03***	-0.04***	1			
(10)	PolRep3	-0.07***	-0.03***	-0.06***	-0.03***	-0.02***	-0.10***	-0.07***	-0.04***	0.84***	1		
(11)	PolRep5	-0.09***	-0.03***	-0.08***	-0.04***	-0.03***	-0.10***	-0.07***	-0.06***	0.71***	0.84***	1	
(12)	PolRep10	-0.05***	-0.01*	-0.06***	-0.04***	-0.01**	-0.02***	-0.03***	-0.01*	0.30***	0.39***	0.50***	1

Table 2: Relationship Between Political Connections and Stewardship over funds

This table presents regression results examining the relation between stewardship and political connectedness, as follows:

$$Stewardship_{g,t} = \alpha + \beta_1 PolRepX_{g,t-1} + \beta_2 Bond_{g,t} + \beta_g + \beta_t + \varepsilon_{g,t}$$

$Stewardship_{g,t}$ measures local government g's stewardship over funds in year t. In Panel A, $Stewardship_{g,t}$ is the first principal component of five financial audit outcomes. In Panel B, $Stewardship_{g,t}$ is equal to the five individual financial audit outcomes, as follows: no_mao in Columns (1) and (2), no_mw in Columns (3) and (4), no_sd in Columns (5) and (6), no_mnc in Columns (7) and (8), and *timely* in Columns (9) and (10). $PolRepX_{g,t}$ is a measure of the power of congressional representation, and is equal to one of: *PolRep1*, *PolRep3*, *PolRep5*, or *PolRep10*. *Bond* is an indicator equal to one if local government g issues a new bond in year t. We include local government fixed effects and year fixed effects in all specifications. Standard errors are clustered by congressional district. All variables are defined in Appendix A.

Panel A: Main Result				
	(1)	(2)	(3)	(4)
	Stewardship			
PolRep1	-0.674***			
	(0.227)			
PolRep3		-0.557***		
		(0.114)		
PolRep5			-0.249***	
			(0.065)	
PolRep10				-0.205***
				(0.040)
Bond	0.002	0.003	0.002	0.000
	(0.014)	(0.015)	(0.015)	(0.015)
Gov't FE	YES	YES	YES	YES
Year FE	YES	YES	YES	YES
Observations	56,042	56,042	56,042	56,042
R-squared	0.567	0.568	0.567	0.568

Table 2, continued

Panel B: Components of Stewardship										
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
	no_mao		no_mw		no_sd		no_mnc		timely	
PolRep3	-0.091***		-0.102***		-0.090***		-0.094***		-0.108***	
	(0.030)		(0.034)		(0.031)		(0.026)		(0.024)	
PolRep10		-0.033***		-0.034***		-0.067***		-0.018**		-0.032***
		(0.011)		(0.013)		(0.013)		(0.008)		(0.010)
Bond	0.008**	0.007**	-0.010*	-0.010**	0.003	0.002	0.005	0.005	-0.008	-0.008
	(0.004)	(0.004)	(0.005)	(0.005)	(0.006)	(0.006)	(0.003)	(0.003)	(0.005)	(0.005)
Gov't FE	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
Year FE	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
Obs	56,042	56,042	56,042	56,042	56,042	56,042	56,042	56,042	56,042	56,042
R^2	0.560	0.560	0.473	0.472	0.489	0.490	0.448	0.447	0.424	0.424

Table 3: Alternate Measures of Governance

This table presents regression results examining the relation between alternate measures of governance and political connectedness, as follows:

$$Governance_{g,t} = \alpha + \beta_1 PolRepX_{g,t-1} + \beta_2 Bond_{g,t} + \beta_g + \beta_t + \varepsilon_{g,t}$$

In Columns (1) through (4), $Governance_{g,t}$ is an indicator equal to one if the auditor identifies the local government as a low-risk auditee in the planning stage of the audit (*Low Risk*). In Columns (5) through (8), $Governance_{g,t}$ is the first principal component of three compliance audit outcomes, defined in Appendix A (*Compliance*). $PolRepX_{g,t}$ is a measure of the power of congressional representation, and is equal to one of: *PolRep1*, *PolRep3*, *PolRep5*, or *PolRep10*, each defined in Appendix A. *Bond* is an indicator equal to one if local government g issues a new bond in year t. We include local government fixed effects and year fixed effects in all specifications. Standard errors are clustered by congressional district.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Low Risk				Compliance			
PolRep1	-0.158**				-0.432***			
	(0.069)				(0.158)			
PolRep3		-0.119***				-0.361***		
		(0.034)				(0.090)		
PolRep5			-0.085***				-0.162***	
			(0.027)				(0.056)	
PolRep10				-0.046***				-0.089***
				(0.016)				(0.034)
Bond	0.001	0.001	0.001	0.001	0.016	0.017	0.016	0.016
	(0.006)	(0.006)	(0.006)	(0.006)	(0.019)	(0.019)	(0.019)	(0.019)
Gov't FE	YES	YES	YES	YES	YES	YES	YES	YES
Year FE	YES	YES	YES	YES	YES	YES	YES	YES
Observations	56,042	56,042	56,042	56,042	56,042	56,042	56,042	56,042
R-squared	0.458	0.458	0.459	0.458	0.409	0.409	0.409	0.409

Table 4: Plausibly Exogenous Variation in Political Connectedness

This table presents regression results examining the relation between stewardship and plausibly exogenous variation in political connectedness, as follows:

$$Stewardship_{g,t} = \alpha + \beta_1 DepartX_{g,t-1} + \beta_2 Bond_{g,t} + \beta_g + \beta_t + \varepsilon_{g,t}$$

$Stewardship_{g,t}$ measures local government g's stewardship over funds in year t. It is the first principal component of five financial audit outcomes, defined in Appendix A. The independent variable of interest, $DepartX_{g,t-1}$, is an indicator equal to one if a connected politician serving on a *TopX* congressional committee unexpectedly dies or is appointed to a cabinet position between years *t-1* and *t-4*. It is equal to one of: *Depart1, Depart3, Depart*5, or *Depart*10, each defined in Appendix A. *Bond* is an indicator equal to one if local government g issues a new bond in year t. We include local government fixed effects and year fixed effects in all specifications. Standard errors are clustered by congressional district.

	(1)	(2)	(3)	(4)
	Stewardship			
Depart1	0.199***			
	(0.060)			
Depart3		0.131***		
		(0.037)		
Depart5			0.137***	
			(0.035)	
Depart10				0.139***
				(0.034)
Bond	0.003	0.003	0.003	0.003
	(0.015)	(0.015)	(0.015)	(0.015)
Gov't FE	YES	YES	YES	YES
Year FE	YES	YES	YES	YES
Observations	56,042	56,042	56,042	56,042
R-squared	0.567	0.567	0.567	0.567

Table 5: Time-Series Response to Plausibly Exogenous Variation in Political Connectedness

This table presents regression results examining the relation between federal expenditures, stewardship, and political connectedness in the years following a plausibly exogenous departure, as follows:

$$FederalExp\ (Stewardship)_{g,t} = \alpha + \beta_1 PostY\_TopXDeparture_{g,t} + \beta_2 Bond_{g,t} + \beta_g + \beta_t + \varepsilon_{g,t}$$

$FederalExp_{g,t}$ is the natural logarithm of direct federal expenditures in year t. $Stewardship_{g,t}$ measures local government g's stewardship over funds in year t. It is the first principal component of five financial audit outcomes, defined in Appendix A. The independent variables of interest, $PostY\_TopXDeparture_{g,t}$, are indicators equal to one in the Y^{th} year after a connected politician serving on a *TopX* congressional committee unexpectedly dies or is appointed to a cabinet position. *Bond* is an indicator equal to one if local government g issues a new bond in year t. We include local government fixed effects and year fixed effects in all specifications. Standard errors are clustered by congressional district.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	FederalExp				Stewardship			
	X=1	X=3	X=5	X=10	X=1	X=3	X=5	X=10
Post0_TopXDeparture	0.036	0.019	0.008	0.001	0.144	0.107	0.116	0.102
	(0.038)	(0.034)	(0.033)	(0.032)	(0.135)	(0.075)	(0.071)	(0.069)
Post1_TopXDeparture	-0.109**	-0.080**	-0.093**	-0.098***	0.076	0.075	0.085	0.067
	(0.051)	(0.039)	(0.038)	(0.037)	(0.106)	(0.074)	(0.069)	(0.069)
Post2_TopXDeparture	-0.142**	-0.097*	-0.102**	-0.104**	0.245**	0.113	0.131*	0.126*
	(0.063)	(0.052)	(0.049)	(0.048)	(0.109)	(0.078)	(0.072)	(0.071)
Post3_TopXDeparture	-0.150***	-0.133**	-0.136***	-0.135***	0.269***	0.231***	0.243***	0.227***
	(0.052)	(0.052)	(0.048)	(0.046)	(0.103)	(0.070)	(0.066)	(0.064)
Post4_TopXDeparture	-0.148*	-0.092	-0.099*	-0.103*	0.136	0.038	0.045	0.026
	(0.085)	(0.063)	(0.058)	(0.056)	(0.098)	(0.086)	(0.079)	(0.077)
Post5+_TopXDeparture	-0.051	0.073	0.051	0.036	0.015	-0.037	-0.030	-0.058
	(0.065)	(0.052)	(0.050)	(0.050)	(0.087)	(0.075)	(0.071)	(0.070)
Bond	0.014*	0.014*	0.014*	0.014*	0.003	0.002	0.002	0.002
	(0.008)	(0.008)	(0.008)	(0.008)	(0.015)	(0.015)	(0.015)	(0.015)
Gov't FE	YES	YES	YES	YES	YES	YES	YES	YES
Year FE	YES	YES	YES	YES	YES	YES	YES	YES
Observations	56,042	56,042	56,042	56,042	56,042	56,042	56,042	56,042
R-squared	0.890	0.891	0.891	0.891	0.567	0.567	0.567	0.567

Table 6: Possible Channels: Supply of Stewardship or Demand for Stewardship

This table presents regression results examining whether our results are driven by local governments' supply of stewardship or investors' demand for stewardship. Panel A considers whether low corruption at the state level moderates the relation between stewardship and political connectedness, as follows:

$$Stewardship_{g,t} = \alpha + \beta_1 PolRepX_{g,t-1} + \beta_2 PolRepX_{g,t-1} * LowCorrupt_s + \beta_3 Bond_{g,t} + \beta_g + \beta_t + \varepsilon_{g,t}$$

Panel B considers whether bond issuances vary with political connectedness, as follows:

$$Bond_{g,t} = \alpha + \beta_1 PolRepX_{g,t-1} + \beta_g + \beta_t + \varepsilon_{g,t}$$

Panel C considers whether a history of bond issuances exacerbates the relation between stewardship and political connectedness, as follows:

$$Stewardship_{g,t} = \alpha + \beta_1 PolRepX_{g,t-1} + \beta_2 PolRepX_{g,t-1} * Issuer_g + \beta_3 Bond_{g,t} + \beta_g + \beta_t + \varepsilon_{g,t}$$

$Bond_{g,t}$is an indicator equal to one if local government g issues a new bond in year t. $Stewardship_{g,t}$ measures local government g's stewardship over funds in year t. It is the first principal component of five financial audit outcomes, defined in Appendix A. $LowCorrupt_s$ is an indicator equal to one if local government g is in a low corruption state, s. $Issuer_g$ is an indicator equal to one if the local government g issues bonds during our sample period. $PolRepX_{g,t-1}$ is a measure of the power of congressional representation in year t-1, and is equal to one of: *PolRep1*, *PolRep3*, *PolRep*5, or *PolRep10*, each defined in Appendix A. We include local government fixed effects and year fixed effects in all specifications. Standard errors are clustered by congressional district.

Table 6, continued

Panel A: Corruption				
	(1)	(2)	(3)	(4)
	Stewardship			
PolRep1	-0.755***			
	(0.243)			
PolRep3		-0.637***		
		(0.129)		
PolRep5			-0.294***	
			(0.073)	
PolRep10				-0.223***
				(0.043)
PolRep1*LowCorrupt	0.638			
	(0.388)			
PolRep3*LowCorrupt		0.657***		
		(0.199)		
PolRep5*LowCorrupt			0.463***	
			(0.169)	
PolRep10*LowCorrupt				0.238**
				(0.100)
Bond	0.002	0.003	0.001	0.000
	(0.014)	(0.015)	(0.015)	(0.015)
*PolRepX+PolRepX*LowCorrupt*	*-0.117*	*0.020*	*0.169*	*0.015*
*P-value: PolRepX+PolRepX*LowCorrupt=0*	*0.736*	*0.887*	*0.247*	*0.866*
Gov't FE	YES	YES	YES	YES
Year FE	YES	YES	YES	YES
Observations	56,042	56,042	56,042	56,042
R-squared	0.567	0.569	0.568	0.568

Table 6, continued

Panel B: Raising debt				
	(1)	(2)	(3)	(4)
	Bond			
PolRep1	-0.043			
	(0.038)			
PolRep3		0.004		
		(0.018)		
PolRep5			-0.014	
			(0.013)	
PolRep10				-0.016**
				(0.008)
Gov't FE	YES	YES	YES	YES
Year FE	YES	YES	YES	YES
Observations	56,042	56,042	56,042	56,042
R-squared	0.499	0.499	0.499	0.499

Table 6, continued

Panel C: Bond Issuers				
	(1)	(2)	(3)	(4)
	Stewardship			
PolRep1	-0.823***			
	(0.243)			
PolRep3		-0.559***		
		(0.147)		
PolRep5			-0.206**	
			(0.091)	
PolRep10				-0.137**
				(0.053)
PolRep1*Issuer	0.235			
	(0.274)			
PolRep3*Issuer		0.002		
		(0.137)		
PolRep5*Issuer			-0.074	
			(0.102)	
PolRep10*Issuer				-0.115**
				(0.054)
Bond	0.002	0.003	0.001	-0.000
	(0.014)	(0.015)	(0.015)	(0.015)
*PolRepX+PolRepX*Issuer*	*-0.588*	*-0.557*	*-0.280*	*-0.247*
*P-value: PolRepX+PolRepX*Issuer=0*	*0.031*	*0.000*	*0.000*	*0.000*
Gov't FE	YES	YES	YES	YES
Year FE	YES	YES	YES	YES
Observations	56,042	56,042	56,042	56,042
R-squared	0.567	0.568	0.567	0.568

Table 7: Investors, Voters, and Auditors as Monitors

This table presents regression results examining whether bondholders, political competition, and strong auditors moderate the relation between stewardship over funds and political connectedness, as follows:

$$Stewardship_{g,t} = \alpha + \beta_1 PolRepX_{g,t-1} + \beta_2 PolRepX_{g,t-1} * Monitor_{g,t} + \beta_3 Monitor_{g,t} + \beta_4 Bond_{g,t} + \beta_g + \beta_t + \varepsilon_{g,t}$$

$Stewardship_{g,t}$ measures local government g's stewardship over funds in year t. It is the first principal component of five financial audit outcomes, defined in Appendix A. Panel A considers bondholders as monitors. $Bond_{g,t}$ is an indicator equal to one if local government g issues a new bond in year t. Panel B considers voters as monitors. *PolComp* is a time-invariant indicator equal to one if local government g is in the top quartile of political competitiveness, based on their 2010 Ranney Index. Panel C considers auditors as monitors. $IndepAudit_{g,t}$ is an indicator equal to one if an independent (rather than state) auditor audits local government g in year t. $PolRepX_{g,t-1}$ is a measure of the power of congressional representation in year *t-1*, and is equal to one of: *PolRep1, PolRep3, PolRep5*, or *PolRep10*, each defined in Appendix A. We include local government fixed effects and year fixed effects in all specifications. Standard errors are clustered by congressional district.

Panel A: Investors as Monitors				
	(1)	(2)	(3)	(4)
	Stewardship			
PolRep1	-0.737***			
	(0.235)			
PolRep3		-0.597***		
		(0.122)		
PolRep5			-0.266***	
			(0.069)	
PolRep10				-0.209***
				(0.042)
PolRep1*Bond	0.235			
	(0.169)			
PolRep3*Bond		0.161*		
		(0.088)		
PolRep5*Bond			0.074	
			(0.066)	
PolRep10*Bond				0.014
				(0.041)
Bond	-0.013	-0.031	-0.022	-0.008
	(0.019)	(0.024)	(0.026)	(0.030)
*PolRepX+PolRepX*Bond*	*-0.502*	*-0.436*	*-0.192*	*-0.195*
*P-Value: PolRepX+PolRepX*Bond=0*	*0.042*	*0.000*	*0.015*	*0.000*
Gov't FE	YES	YES	YES	YES
Year FE	YES	YES	YES	YES
Observations	56,042	56,042	56,042	56,042
R-squared	0.567	0.568	0.567	0.568

Table 7, continued

Panel B: Voters as Monitors				
	(1)	(2)	(3)	(4)
	Stewardship			
PolRep1	-0.321			
	(0.259)			
PolRep3		-0.526***		
		(0.105)		
PolRep5			-0.348***	
			(0.083)	
PolRep10				-0.261***
				(0.051)
PolRep1*PolComp	0.388			
	(0.382)			
PolRep3*PolComp		0.784***		
		(0.192)		
PolRep5*PolComp			0.522***	
			(0.193)	
PolRep10*PolComp				0.423***
				(0.158)
Bond	-0.011	-0.012	-0.014	-0.015
	(0.021)	(0.021)	(0.021)	(0.021)
PolRep*X*+PolRep*X*PolComp*	*0.067*	*0.258*	*0.174*	*0.162*
P-Value: PolRep*X*+PolRep*X*PolComp=0*	*0.812*	*0.120*	*0.325*	*0.284*
Gov't FE	YES	YES	YES	YES
Year FE	YES	YES	YES	YES
Observations	27,705	27,705	27,705	27,705
R-squared	0.560	0.562	0.562	0.563

Table 7, continued

Panel C: Auditors as Monitors				
	(1)	(2)	(3)	(4)
	Stewardship			
PolRep1	-0.490			
	(0.742)			
PolRep3		-1.733***		
		(0.506)		
PolRep5			-0.444***	
			(0.171)	
PolRep10				-0.422***
				(0.139)
PolRep1*IndepAudit	-0.188			
	(0.750)			
PolRep3*IndepAudit		1.317***		
		(0.492)		
PolRep5*IndepAudit			0.227	
			(0.179)	
PolRep10*IndepAudit				0.241*
				(0.140)
IndepAudit	0.200**	-0.096	0.121	0.065
	(0.087)	(0.132)	(0.096)	(0.107)
Bond	0.002	0.002	0.002	0.000
	(0.014)	(0.014)	(0.015)	(0.015)
*PolRepX+PolRepX*IndepAudit*	*-0.678*	*-0.416*	*-0.217*	*-0.181*
*P-Value: PolRepX+PolRepX*IndepAudit=0*	*0.003*	*0.000*	*0.002*	*0.000*
Gov't FE	YES	YES	YES	YES
Year FE	YES	YES	YES	YES
Observations	56,042	56,042	56,042	56,042
R-squared	0.568	0.570	0.568	0.569