Political uncertainty and earnings management: Evidence from Latin American countries

Incerteza política e gerenciamento de resultados: Evidências de países da América Latina

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Abstract

Purpose: This article aims to examine whether political uncertainty affects the accounting choices of firms' managers in the sense of practicing earnings management through discretionary accruals.

Originality/value: The research is original for providing evidence on the direction of earnings management practice following periods of political uncertainty and considering emerging countries in Latin America. The study helps signal to capital market agents in those countries the impact of political uncertainty on the quality of accounting aggregates.

Design/methodology/approach: The final sample comprised 352 firms (3,005 observations-year), considering the period 1998-2018. Political uncertainty was a proxy for the countries' presidential election years. At the same time, earnings management was captured by discretionary accruals estimated according to the Jones' model (1991) modified by Dechow et al. (2012). Multiple linear regression with estimation by System Generalized Method of Moments (Sys-GMM) guided the tests.

Findings: It was found that presidential election periods are associated with managers' decisions to increase earnings by positive discretionary accruals, allowing us to infer that political uncertainty impacts managers' accounting choices regarding earnings management. The results proved to be robust to different test alternatives. The findings have practical implications for agents who use accounting information as an informational signal in their decisions, whether from the perspective of investors (current shareholders or potential shareholders) or the perspective of other stakeholders associated with the firm (employees, suppliers etc.).

Keywords: political uncertainty, earnings management, discretionary accruals, presidential elections, quality of accounting information

Resumo

Objetivo: Este artigo tem como objetivo examinar se a incerteza política afeta as escolhas contábeis de gestores de firmas no sentido de praticarem o gerenciamento de resultados por meio de accruals discricionários.

Originalidade/valor: A pesquisa é original por fornecer evidências sobre a direção da prática de gerenciamento de resultados seguindo períodos de incerteza política e considerando países emergentes da América Latina. O estudo é útil por sinalizar aos agentes dos mercados de capitais daqueles países o impacto da incerteza política na qualidade dos agregados contábeis.

Design/metodologia/abordagem: A amostra final ficou constituída por 352 firmas (3.005 observações-ano), considerando-se o período de 1998 a 2018. Incerteza política teve como proxy os anos de eleições presidenciais dos países, ao passo que o gerenciamento de resultados foi captado pelos accruals discricionários estimados segundo o modelo de Jones (1991) modificado por Dechow et al. (2012). A regressão linear múltipla com estimação por System Generalized Method of Moments (Sys-GMM) balizou os testes.

Resultados: Constatou-se que períodos de eleições presidenciais estão associados à decisão de gestores em incrementar lucros via accruals discricionários positivos, permitindo-se inferir que a incerteza política impacta as escolhas contábeis de gestores quanto à prática do gerenciamento de resultados. Os resultados se mostraram robustos a diferentes alternativas de testes. Os achados têm implicações práticas para agentes que utilizam a informação contábil como sinal informacional em suas decisões, quer seja na perspectiva de investidores (acionistas atuais ou potenciais acionistas), quer seja na perspectiva de outros *stakeholders* associados à firma (colaboradores, fornecedores etc.).

Palavras-chave: incerteza política, gerenciamento de resultados, accruals discricionários, eleições presidenciais, qualidade da informação contábil

INTRODUCTION

Political uncertainty can be broadly defined as the uncertainty surrounding the future actions of governments (Pástor & Veronesi, 2013). Such an event is characterized by being associated with incentives and uncertainties with implications for the behavior of firm managers (Julio & Yook, 2012).

Among the possible effects of political uncertainty, research has signaled the influence of this event on the accounting choices of managers, taking the definition of accounting choice as any decision whose main purpose is to influence (either in form or substance) the result of the accounting system of a particular way (Fields et al., 2001); evidence points to a reduction in investment by firms (Julio & Yook, 2012), a reduction in the quantity and quality of information provided to investors (Chen, Chen et al., 2018) and greater conditional conservatism (Dai & Ngo, 2020).

Another possible accounting choice of managers that would also be influenced in periods of political uncertainty refers to the practice of earnings management. Stein and Wang (2016) argue that the increase in uncertainty in capital markets can create incentives for the practice of earnings management by firm managers. It turns out that political uncertainty is also associated with increased uncertainty about the future performance of the firm (Boutchkova et al., 2012; Brogaard & Detzel, 2015; Dai & Ngo, 2020) and, as a result, such an event would also be associated with earnings management.

Pieces of evidence in this direction, on the other hand, have not been uniform, so many findings can be pointed toward greater earnings management in periods of political uncertainty (Bermpei et al., 2022; Cui et al., 2020; Yung & Root, 2019) and towards less earnings management in periods of political uncertainty (Jain et al., 2021; Kim & Yasuda, 2021; Roma et al., 2021). Such studies, however, did not point out the direction of earnings management practiced by firm managers, that is, whether increasing or reducing earnings.

From this perspective, Stein and Wang (2016) state that, when firm results are more uncertain, managers are more likely to opt for accounting choices by reducing their earnings due to the fact that the market can attribute bad performances to luck or expect such performances to be transitory. On the other hand, Bu et al. (2019) argue that certain political incentives can influence managers to adopt accounting choices that increase their reported earnings.

However, no studies with such a specific direction were found in a non-exhaustive collection. Moreover, no studies that examined this issue in the

context of emerging countries in Latin America were found, which offer a better setting for studying the economic impacts of political events because, compared to developed markets, they usually have fewer legal and financial institutions, stable and more intrusive political systems, as Chen, Chen et al. (2018).

It should be noted that although Yung and Root (2019) considered two emerging countries in Latin America (Brazil and Chile), their findings of greater earnings management in periods of political uncertainty do not allow inferring the meaning of earnings management applied by equity firm managers in those countries.

It is also worth noting that Passos and Cavalcante (2021) examined the impact of political uncertainty on the quality of accounting information in Latin American countries. However, only considering as a measure of quality the ability of the components of reported earnings to predict future cash flows without presenting any evidence in the direction of the practice of earnings management. Finally, it is also highlighted that Roma et al. (2021) examined whether political uncertainty affects the earnings management of firms only in Brazil, but only considering the Economic Policy Uncertainty (EPU) measure by Baker et al. (2016) as a proxy for political uncertainty and without considering the effects of this measure on earnings management.

In this sense, the direction of earnings management practiced by managers during periods of political uncertainty, in the context of Latin American countries, seems to constitute an unanswered research gap. Due to this context, we seek to collect evidence to answer the following question:

• Do firm managers, in the context of Latin American countries, opt for accounting choices by increasing or reducing their reported earnings during periods of political uncertainty?

Political uncertainty was measured considering periods of presidential elections in the studied countries, while the practice of earnings management was measured by discretionary accruals estimated by the Jones' model (1991) modified by Dechow et al. (2012). The findings signaled that national election periods are associated with managers' decision to increase earnings by positive discretionary accruals, which implies that political uncertainty impacts managers' accounting choices in the sense of practicing earnings management to increase reported earnings.

It argues about the relevance of the research in the sense of providing evidence on the effects of periods of political uncertainty on the accounting choices of firm managers in the context of emerging countries in Latin America. In this context, Passos and Cavalcante (2021) argue that the insti-

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tutional environment of Latin American countries can provide incentives for greater discretion of managers in reporting earnings in periods of political uncertainty since those countries are characterized by having weak enforcement mechanisms and of investor protection (Brown et al., 2014; La Porta et al., 1998; Moura et al., 2020).

The investigation is also relevant for capturing an effect that has not been explored in the international context, that is, the influence of political uncertainty on the practice of earnings management in the context of emerging markets, thus filling a relevant research gap.

The research, therefore, innovates by considering the research object in specific countries in Latin America, thus differentiating itself from the research by Yung and Root (2019). In addition, the research also differs from Passos and Cavalcante (2021) by considering the adverse effects of political uncertainty in a measure that also reflects the quality of accounting aggregates not considered in that study, that is, the practice of earnings management. Finally, the study also differs from Roma et al. (2021) for considering other Latin American countries, in addition to Brazil, as well as for directing tests around the different measures for political uncertainty (presidential elections and EPU) and their effects on the direction of earnings management practiced by managers.

Furthermore, the investigation contributes to the increase of the theory of accounting choices, providing evidence of the impact of an exogenous event on firms in the decision of managers to opt for accounting choices that distance reported earnings from the underlying economic performance of firms. It also contributes to the literature related to the hypothesis of political uncertainty, as already reported in other investigations (Brogaard & Detzel, 2015; Dai & Ngo, 2020). Finally, the research also contributes to the literature related to the quality of accounting information, specifically by presenting evidence that complements Chen, Chen et al. (2018), Yung and Root (2019), and Passos and Cavalcante (2021) on the negative impact of an event exogenous to firms on the quality of accounting information disclosed by managers.

THEORETICAL FRAMEWORK

Political uncertainty and decisions of firms' managers

The interaction between politics and economic outcomes has been widely debated in the literature, and one of the ways that has been suggested as

capable of influencing accurate decisions is through the channel of uncertainty and instability (Julio & Yook, 2012). In this regard, Dai and Zhang (2019) point to uncertainty as a key channel through which political factors affect financial markets.

The term uncertainty, in the context of political science, has several meanings, the most predominant being that related to incomplete information in the context of theoretical models of strategic interaction games (Lupu & Riedl, 2013). Lupu and Riedl (2013), on the other hand, define uncertainty in terms of the imprecision with which actors can predict future interactions, noting that elections, a typical event of democratic regimes, introduce uncertainty into the environment so that the actors know what is possible and likely, but do not know what will occur; according to the authors, elections introduce the possibility of unforeseen political outcomes.

From this perspective, researchers have interpreted political uncertainty regarding future government actions. Along these lines, Pástor and Veronesi (2013) model uncertainty about political costs as a source of political uncertainty; according to the authors, political costs are uncertain, as investors cannot fully anticipate which government policies will be chosen. Considering this argument, Pástor and Veronesi (2013) broadly interpret political uncertainty as the uncertainty surrounding governments' future actions.

It is noteworthy that there is no consensus in the literature on a direct and efficient proxy for the political uncertainty attribute. On the other hand, Julio and Yook (2012) point to presidential elections as an attribute that provides an interesting configuration for researchers, even aligning themselves with the argument of Lupu and Riedl (2013) around the increase in uncertainty associated with elections. According to Julio and Yook (2012), national elections (or presidential elections, in the case of a presidential government system) are relevant for corporate decisions because they have implications for industry regulation, monetary and marketing policies, taxation, and, in more extremes, possible expropriation or nationalization of private firms. Furthermore, presidential election periods provide a relevant setting for research since they are defined exogenously by any individual firm and are fixed by the constitutional rules of said nation (Julio & Yook, 2012).

Political uncertainty has been associated with incentives and uncertainties with implications for both political agents and firm managers (Julio & Yook, 2012). In this regard, Julio and Yook (2012) point to Rodrik (1991) as one of the outstanding examples in the literature; the author developed a model in which private investments are a function of political uncertainty, taking political uncertainty as the probability of political reform. The author

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concludes that even moderate amounts of political uncertainty can act as a heavy tax on investment, signaling that firm managers could opt for lower investment levels.

Also, in the context of investment decisions, Julio and Yook (2012) examined whether political uncertainty, with presidential elections as a proxy, affects the level of investment in a sample of firms from 48 countries from 1980 to 2005. During periods of political uncertainty, managers reduce their firms' investments, in line with the argument that the temporary increase around presidential elections creates incentives that should induce an immediate decline in investments (Julio & Yook, 2012).

It is emphasized that the evidence pointed towards the reduction of investments following greater political uncertainty may signal the impact of political uncertainty on the accounting choices of managers, considering accounting choice as any decision whose main purpose is to influence (either in form or in substance) the outcome of the accounting system in a particular way (Fields et al., 2001).

Chen, Chen et al. (2018), examining firms in the Chinese capital market in the period 2000-2014, provide direct evidence of the impact of political uncertainty on managers' accounting choices; the authors point out that firm managers react to political uncertainty – captured by changes in the local government of cities – by reducing the quantity and quality of information provided to investors. It should be noted that, in the context of China, researchers have sought to capture the political uncertainty surrounding the turnover of local governments, considering that only one party (the Chinese Communist Party) governs that country and has perpetual and monopolistic control of power (Chen, Chen et al., 2018).

Dai and Ngo (2020) also provide evidence of the interaction between political uncertainty and managers' accounting choices. The authors, investigating firms in the US capital market from 1963 to 2016, provide evidence that conditional conservatism increases in periods of political uncertainty captured by periods of government elections in the United States of America.

Taken together, the evidence suggests that managers' accounting choices are also affected by periods of political uncertainty. Specifically, the increase in uncertainty in the capital market, caused by political uncertainty, also seems to guide managers' accounting choices.

Political uncertainty and earnings management

Managers practice earnings management through accounting policy choices or real actions, affecting accounting reporting, in order to achieve

some specific goal of reported earnings (Scott, 2012). This practice is a consequence of managers' discretion to manipulate accounting information on firm performance (Healy & Wahlen, 1999).

In the context of such a practice, firm managers can manipulate earnings through real economic activities (management based on real activities) or discretionary accruals (accruals-based management), the latter being the measure most commonly used by researchers to capture distortions induced by earnings management (Dechow et al., 2012).

Considering that the practice of earnings management constitutes an accounting choice and that political uncertainty is relevant in affecting accounting choices, it can be expected that political uncertainty also impacts that practice. Evidence of this relationship does not point in a uniform direction. It is conditioned to the measures employed for political uncertainty (EPU index by Baker et al. (2016) or periods of national elections) for earnings management (earnings management based on accruals or in actual activities) or even conditioned to the investigated countries.

In this regard, findings can be pointed towards the positive impact of political uncertainty on earnings management for the North American (Bermpei et al., 2022) and Chinese (Cui et al., 2020) capital markets, taking EPU measurement and accruals-based management. On the other hand, evidence can also be pointed out indicating a reduction in earnings management following greater political uncertainty in the US capital market (Jain et al., 2021), considering the year of presidential elections and activity-based earnings management real; this finding was also found for the Japanese capital market (Kim & Yasuda, 2021), however considering the EPU measure and the practice of earnings management based on accruals. It is noteworthy that Roma et al. (2021) also signaled the negative impact of political uncertainty on earnings management in a sample of firms in the US market, using the EPU measure and earnings management based on accruals as a proxy; the tests also involved a sample of firms from the Brazilian market. However, the findings were not significant.

Doesn't this evidence, on the other hand, point out any signal to the direction of the effect of political uncertainty on the earnings reported by firms, that is, do managers practice earnings management by increasing or reducing their earnings in the face of the increase in uncertainty associated with political uncertainty?

In the context of greater uncertainty in capital markets arising from political uncertainty and accounting choices according to such an event, managers may have incentives to opt for accounting practices to manage

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earnings by reducing earnings during periods of national elections. It should be noted that the practice of earnings management increasing (reducing) earnings is captured when observing discretionary accruals with a positive (negative) sign (Chen, Lin et al., 2008).

Stein and Wang (2016) provide evidence that supports such an argument. The authors argue that managers are more likely to manage earnings by reducing them in periods of greater uncertainty, specifically when firm results are more uncertain since the market can attribute bad performances to luck or expect such performances to be transitory.

The authors, examining firms from the Compustat database in the period from 1996 to 2013, presented evidence that managers report more negative discretionary accruals (reducing earnings) in periods of greater economic uncertainty about firms' future performance. The findings, therefore, point to managers opportunistically managing earnings around market agents' uncertainty about firm value.

It turns out that political uncertainty increases the uncertainty associated with the firm's future performance, according to Dai and Ngo (2020). Evidence provided by Boutchkova et al. (2012) and Brogaard and Detzel (2015) confirm this argument, signaling greater volatility of future cash flows in periods of political uncertainty.

In this sense, the increase in uncertainty in the capital market, caused by periods of presidential elections, can create incentives for firm managers to direct their accounting choices towards managing reported earnings by reducing earnings. Scott (2012), in this scenario, argues that policy-related issues can also contribute to firm managers reducing reported earnings.

Gonçalves et al. (2022) provide evidence supporting this argument. The authors, examining a sample of firms from 15 European countries in the period from 2011 to 2018, pointed out that earnings management increases in environments of political uncertainty, using years of national elections as a proxy, and that this practice is carried out to reduce earnings (except small and medium-sized firms, which tend to increase their earnings by earnings management). The practice of earnings management was captured according to the Jones' model (1991), modified by Dechow et al. (1995).

On the other hand, it is also likely that firm managers take advantage of the increase in uncertainty associated with political events and opt for aggressive accounting choices to increase reported earnings.

Bu et al. (2019) presented evidence in line with such an argument. The authors, examining the effects of political uncertainty on the practice of conditional conservatism for a sample of Chinese firms, pointed to a reduction in

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conditional conservatism during periods of political uncertainty, suggesting more aggressive earnings reporting. They attribute these findings to the probable involvement of firms from that country with political agents from that place.

Yung and Root (2019), while not pointing to the expected direction of earnings management practiced during periods of political uncertainty, provide evidence of such practice around the event in a sample of 18 countries from 2001 to 2014. The practice of earnings management was captured according to the models of Jones (1991), Jones (1991) modified by Dechow et al. (1995), and Dechow and Dichev (2002) modified by Francis et al. (2005); political uncertainty was measured by the political uncertainty index of Baker et al. (2016). The findings point to greater (minor) earnings management in periods of greater (minor) political uncertainty.

Despite including two emerging Latin American countries in their sample (Brazil and Chile), Yung and Root (2019) only presented tests with an aggregated sample of countries without directing specific tests or controls to that block of countries. Examining the issue becomes relevant in the context of emerging capital markets because these markets have attributes (weak enforcement and investor protection mechanisms, for example) that make them more susceptible to being affected by political events, according to Chen, Chen et al. (2018).

For all the above, it can be expected that political uncertainty will impact the accounting choices of managers in terms of managing earnings, both increasing and reducing earnings, according to the arguments and evidence raised above.

METHODOLOGICAL PROCEDURES

The study's sample included companies listed in Argentina, Brazil, Chile, and Mexico (Buenos Aires Stock Exchange; Brazil Stock Exchange, OTC (B3); Santiago Stock Exchange; and the Mexican Stock Exchange, respectively). The choice of these countries considered their economic relevance, emphasizing that they were the most relevant economies in the context of emerging markets in Latin America in 2019, according to data from the World Bank (2021). Although Colombia and Peru could also meet that criterion of economic relevance, both the low quality of data from firms in these countries and the low representation of these markets concerning the other countries in the sample were found, following the criteria of Paulo

et al. (2014) and Passos and Cavalcante (2021), which is why firms from those countries were not considered.

Furthermore, for the composition of the final sample, some items were also excluded for lack of data and for belonging to the financial sector due to the fact that their disclosure practices differ from the usual practice of firms in other sectors (Pincus et al., 2007). The final sample consisted of 352 firms (3,005 observations per year), as shown in Table 1.

Table 1

Formation of the sample by countries

	Argentina	Brazil	Chile	Mexico	Full sample
Firms	40	189	40	83	352
Observations-year	364	1,422	628	591	3,005

The investigation included events observed in the 1998-2018 period. This choice considered capturing the possible effects of different electoral periods on firms in the sampled countries, as also applied by Passos and Cavalcante (2021).

The data necessary for processing the study were collected from the Thomson Reuters database, which is used to collect accounting information, and from the World Bank Database of Political Institutions (The World Bank), such database used for collection related to presidential election periods. Winsorizing of continuous variables was processed, considering the 1 and 99 percentiles, following Lima et al. (2018), to mitigate outlier effects. It should be noted that the results and inferences are not sensitive to the winsorizing procedure since they remain at a significance level of 10%, even when considering variables without any winsorizing process.

Political uncertainty was measured during periods of presidential elections, following Chen, Hope et al. (2018), Julio and Yook (2012), and Passos and Cavalcante (2021). For that, a binary variable was used to designate the presence of periods of presidential elections; the election period was considered the year of the presidential elections, following Julio and Yook (2012) and Passos and Cavalcante (2021).

Discretionary accruals were estimated by country and firm according to the Jones' model (1991) modified by Dechow et al. (2012), according to Equation 1:

$$ACC_t = \alpha_1 + \alpha_2 \left(\frac{1}{A_{t-1}}\right) + \alpha_3 \left(\Delta R_t - \Delta AR_t\right) + \alpha_4 \left(PPE_t\right) + \alpha_5 \left(ACC_{t-1}\right) + \varepsilon_t \quad (1)$$

wherein:

ACC_t = accruals in period t, scaled by total assets in period t-1;

A_{t-1} = total assets at the end of the period t-1;

ΔR_t = variation in net revenue between periods t-1 e t, scaled by total assets for the period t-1;

ΔCR_t = variation in trade accounts receivable between periods t-1 and t, scaled by total assets for the period t-1;

PPE_t = balance of fixed assets accounts in the period t, scaled by total assets for the period t-1;

ACC_{t-1} = accruals in period t-1, scaled by total assets for the period t-2;

ε_t = regression error term.

Accruals for the period were measured using the variation in working capital needs (WCN) as a proxy, according to Dechow et al. (2012), as expressed in Equation 2:

$$ACC_t = \left[\left(\Delta AC_t - \Delta AF_t\right) - \left(\Delta PC_t - \Delta PF_t\right)\right] / AT_{t-1} \quad (2)$$

wherein:

ACC_t = accruals in the period scaled by total assets of t-1;

$(\Delta AC - \Delta AF)$ = increase in operating current assets in the period;

$(\Delta PC - \Delta PF)$ = increase in operating current liabilities in the period;

AT_{t-1} = total assets in the period t-1.

After estimating Equation 1, discretionary accruals are obtained by the difference between accruals for period t (ACC_t) and accruals estimated by Equation 1 for period t ($\widehat{ACC_t}$), according to Equation 3:

$$AD_t = ACC_t - \left[\alpha_1 + \alpha_2 \left(\frac{1}{A_{t-1}}\right) + \alpha_3 \left(\Delta R_t - \Delta CR_t\right) + \alpha_4 \left(PPE_t\right) + \alpha_5 \left(TA_{t-1}\right)\right] \quad (3)$$

wherein:

AD_t = discretionary accruals for the period t;

ACC_t, A_{t-1}, ΔR_t, ΔCR_t, PPE_t e ACC_{t-1} defined as previously.

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The discretionary accruals were therefore measured using the error term in Equation 1 (ε_t). Values closer to 0 for ε_t indicate lower levels of earnings management, while values higher than 0 point higher levels of earnings management (Martins et al., 2016). Furthermore, higher values of ε_t in the negative direction indicate managers managing earnings in the sense of reporting lower values for this attribute. In comparison, higher values of that term in the positive direction indicate managers managing earnings to report higher values for this aggregate.

To examine whether firm managers, in the context of Latin American countries, opt for accounting choices by increasing or reducing their reported earnings during periods of political uncertainty, the model expressed in Equation 4 was outlined:

$$AD_{i,t,k} = \beta_0 + \beta_1 ELE_{t,k} + \beta_2 CRESC_{i,t,k} + \beta_3 TAM_{i,t,k} + \beta_4 ENDIV_{i,t,k}$$
$$+ \beta_5 ROA_{i,t,k} + \beta_6 IFRS_k + \sum_{c=7}^{9}\beta_c D\_PAISES \qquad (4)$$
$$+ \sum_{y=10}^{29}\beta_y D\_ANO + \sum_{s=30}^{37}\beta_s D\_SETOR + v_{i,t,k}$$

wherein:

$AD_{i,t,k}$ = discretionary accruals of firm i, in period t and country k;

$ELE_{t,k}$ = dummy for periods of presidential elections in period t and country k, assuming 1 when election year and 0 otherwise;

$CRESC_{i,t,k}$ = variation in operating revenues of firm i, in period t and country k, scaled by total assets of $t-1$;

$TAM_{i,t,k}$ = log of book value (BV) of firm i, in period t and country k;

$ENDIV_{i,t,k}$ = ratio between the debts and the total assets of firm i, in period t and country k;

$ROA_{i,t,k}$ = ratio between operating earnings in period t and total assets in period $t-1$;

$IFRS_k$ = dummy variable representing the period of adoption of the IFRS standard in the country k;

$D\_PAÍSES$ = dummy variables for countries;

D_ANO = dummy variables for years;

D_SETOR = dummy variables for sectors;

$v_{i,t,k}$ = model error term.

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The variables growth in operating revenues (CRESC), firm size (TAM), debt (ENDIV), and return on assets (ROA) represent control for the extension of discretionary accruals because they are characteristics of firms that are valuable predictors of asset management results (Kung et al., 2019). A positive and significant association is expected for the TAM and CRESC variables (Chen, Lin et al., 2008), as well as for the ROA variable (Ali & Zhang, 2015); as for the variable ENDIV, a negative association with discretionary accruals is expected (Ali & Zhang, 2015).

Dummy variables representing the years, sample countries, and sectors (Thomson Reuters – TRBC classification) were also included in the model (4) to control possible temporal effects arising from the different countries and sectors surveyed.

A binary variable representing the period after convergence to the IFRS standard was also included in Equation 4, considering the different convergence periods of each country in the sample to control possible effects of the change in accounting standards in the sample countries, as applied by other studies in the context of Latin American countries (Passos & Cavalcante, 2021; Pelucio-Grecco et al., 2014). The following convergence periods were considered, with support in Passos and Cavalcante (2021): beginning in 2009 for Chile; beginning in 2010 for Brazil; and starting in 2012 for Argentina and Mexico. Thus, the dummy for IFRS assumes 1 for the complete post-IFRS period (all years) in each sample country and 0 otherwise.

The β_1 coefficient is expected to be significant, indicating that, in periods of presidential elections, firms tend to practice earnings management either by negative discretionary accruals (earnings management reducing earnings) or by positive discretionary accruals (earnings management increasing earnings).

Models were processed using multiple linear regression with estimation by the System Generalized Method of Moments (Sys-GMM). The regressions were processed with variance correction for finite samples in order to correct possible heteroscedasticity of the residuals, according to Windmeijer (2005).

The existence of multicollinearity between the independent variables was examined through correlation analysis and problems of autocorrelation of the residuals through Arellano and Bond's tests (1991); said problems were absent, according to tests performed (not reported). The Hansen Test was performed, which did not prove to be significant, indicating that the instruments used in estimating the models are exogenous, confirming the consistency of estimation by Sys-GMM.

Finally, the residuals were not normally distributed. This condition, however, is not critical and possible to be relaxed due to the sample size and

is supported by the Central Limit Theorem (Greene, 2012), as the property of estimators with asymptotic normal distribution as the sample size increases (Passos & Cavalcante, 2021).

Additionally, the samples segregated according to the different sample periods are described, considering the existence or not of periods of political uncertainty.

RESULTS

Descriptive measures of the variables considered in the study for the total sample are presented in Table 2, according to Panel A, as well as descriptive measures are indicated for the variable discretionary accruals (AD) according to different countries and according to the event political uncertainty caused by the periods of presidential elections, as shown in Panel B. In Panel A, the high dispersion of the variables AD, CRESC, and ROA is verified, as one can observe their high coefficients of variation (94.000; 4.578; 1.011, respectively), with TAM and ENDIV showing greater homogeneity since they have lower coefficients of variation (0.107 and 0.565, respectively).

By Panel B, considering the total sample of countries, a positive average of discretionary accruals is observed in periods of presidential elections, which provides evidence that managers opt for accounting choices to increase earnings by positive discretionary accruals. On the other hand, in non-election periods, managers seem to opt for discretionary accruals, reducing reported earnings. Mean equality tests proved to be significant, thus confirming the different behavior for discretionary accruals around the national elections event for the entire sample.

It is also noted that this different behavior seems to be driven by the sample of firms in Brazil since the mean equality tests were significant only for this country, although Panel B in Table 2 indicates that firms in Argentina and Mexico could manage earnings by reducing earnings, considering negative AD means in these countries. However, the non-significance of the tests does not provide robustness to this inference.

Table 2

Description of samples and variables

Panel A – Full sample descriptive statistics					
Variable	Mean	Median	Standard deviation	Minimum	Maximum
AD	0.001	0.005	0.094	-0.322	0.320
ELE	0.256	0.000	0.436	0.000	1.000
CRESC	0.045	0.023	0.206	-0.623	0.918
TAM	20.603	20.448	2.204	15.231	25.522
ENDIV	0.278	0.265	0.157	0.002	0.894
ROA	0.090	0.078	0.091	-0.152	0.425

Panel B – Descriptive statistics on discretionary accruals (AD) by country and national election period						
	National elections	N	Mean	Median	Standard deviation	Stat. t	Stat. z
Full sample	Yes	768	0.008	0.010	0.095	-2.177**	-2.755***
	No	2,237	-0.001	0.003	0.002		
Argentina	Yes	76	-0.001	0.005	0.015	-0.298	-0.483
	No	288	-0.007	-0.007	0.009		
Brazil	Yes	413	0.013	0.014	0.005	-2.054**	-2.532**
	No	1,009	0.001	0.007	0.003		
Chile	Yes	156	0.006	0.007	0.006	-1.455	-1.085
	No	472	-0.003	0.004	0.003		
Mexico	Yes	123	-0.001	0.006	0.008	0.086	-0.153
	No	468	0.000	-0.000	0.004		

Note. Definition of variables: AD = discretionary accruals, estimated by Jones' model modified by Dechow et al. (2012); CRESC = change in operating revenues; TAM = firm size, estimated by the log of book value; ENDIV = ratio between debts and total assets; ROA = ratio between operating earnings and total assets. N Panel A: 3,005 observations-year. Stat. t refers to the statistic for the t-test for two independent samples (results for tests with equality and inequality of variances between samples are similar), whereas Stat. z refers to statistics for the Mann-Whitney test for two independent samples.

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Considering the difference found in the treatment of discretionary accruals in Brazil, parametric (Anova) and non-parametric (Kruskal-Wallis) tests were estimated in order to test whether there are significant differences between countries in the treatment of discretionary accruals in periods of Presidential elections. None of those mentioned above tests (unreported) showed any significant difference between the countries sampled during the presidential election period.

Next, Table 3 presents correlation coefficients between the study variables, considering parametric and non-parametric coefficients. The tests point to a positive and significant association between discretionary accruals and presidential election periods, signaling managers' use of positive discretionary accruals in those periods, confirming the relationship already reported in the previous analysis.

Table 3

Correlation coefficients between variables

	AD	ELE	CRESC	TAM	ENDIV	ROA
AD	1	0.05***	-0.08***	0.30***	0.09***	0.12***
ELE	0.04**	1	-0.02	-0.00	0.01	0.02
CRESC	-0.04**	-0.02	1	0.09***	-0.07***	0.32***
TAM	0.26***	-0.01	0.06***	1	-0.09***	0.35***
ENDIV	0.09***	0.01	-0.07***	-0.13***	1	-0.30***
ROA	0.11***	0.00	0.35***	0.26***	-0.16***	1

Note. The lower triangle refers to Pearson coefficients, while the upper triangle refers to Spearman coefficients. Definition of variables: AD = discretionary accruals, estimated by the Jones' model modified by Dechow et al. (2012); CRESC = change in operating revenues; TAM = firm size, estimated by the log of book value; ENDIV = ratio between debts and total assets; ROA = ratio between operating earnings and total assets. * Significance at the 10% level. ** Significance at the 5% level. *** Significance at the 1% level.

The other variables, namely revenue growth, firm size, debt ratio, and ROA, were associated with discretionary accruals, which seems to confirm their usefulness as predictors of those attributes, as indicated by Kung et al. (2019). It should be noted that no high correlation coefficients were found between the model's explanatory variables under test, indicating the absence of possible multicollinearity problems between the variables.

The findings, so far, point to managers managing earnings through positive discretionary accruals in periods of presidential elections, in line with

the evidence already reported by Bu et al. (2019) and Yung and Root (2019), in the sense of more aggressive earnings reporting in periods of greater political uncertainty.

Based on what is shown in Table 4, the investigation is deepened, and the results are presented to test the influence of presidential election periods on managers' choices regarding the use of discretionary accruals. In estimating the regression, the variables operating revenue growth (CRESC), firm size (TAM), debt ratio (ENDIV), and ROA were treated as endogenous, using, then, lags 2 and longer for the differences equation and lags 1 and longer for the levels equation. The representative variables of the presidential election periods (ELE) and the dummy variables for IFRS adoption (IFRS), years (D_ANO), countries (D_PAÍSES), and sectors (D_SETOR) were treated as exogenous.

Table 4

Political uncertainty and discretionary accruals

Variables	Dependent variables: AD		
	Coefficients	Standard error	p-value
AD_{t-1}	-0.081	0.041	0.049
ELE	0.008	0.004	0.065
CRESC	-0.050	0.031	0.108
TAM	0.016	0.007	0.017
ENDIV	0.111	0.042	0.009
ROA	0.137	0.064	0.031
IFRS	-0.000	0.013	0.982
Intercept	-0.386	0.143	0.007
Dummy for countries	Yes		
Dummy for years	Yes		
Dummy for sectors	Yes		
Observations-year	2,586		
Number of firms	329		
Number of instruments	297		

(continues)

Table 4 (conclusion)

Political uncertainty and discretionary accruals

Variables	Dependent variables: AD		
	Coefficients	Standard error	p-value
Wald statistics		54.88***	
AR(1)		-6.07***	
AR(2)		0.07	
Hansen test		235.75	

Note. Model:

$$AD_{i,t,k} = \beta_0 + \beta_1 ELE_{t,k} + \beta_2 CRESC_{i,t,k} + \beta_3 TAM_{i,t,k} + \beta_4 ENDIV_{i,t,k}$$

$$+ \beta_5 ROA_{i,t,k} + \beta_6 IFRS_k + \sum_{n=7}^{N} \beta_n D\_PA\acute{I}SES$$

$$+ \sum_{k=N+1}^{K} \beta_k D\_ANO + \sum_{j=K+1}^{J} \beta_j D\_SETOR + v_{i,t,k}$$

Definition of variables: $AD_{i,t,k}$ = discretionary accruals of firm i in period t and country k; ELEk = dummy for presidential election periods in country k, assuming 1 when election year and 0 otherwise; CRESC$_{i,t,k}$ = change in operating revenues of firm i in period t and country k, scaled by total assets in $t-1$; TAM$_{i,t,k}$ = log of book value (BV) of firm i in period t and country k; ENDIV$_{i,t,k}$ = ratio between debts and total assets of firm i in period t and country k; ROA$_{i,t,k}$ = ratio between operating earnings in period t and total assets in period $t-1$; IFRS = dummy representing the period of adoption of the IFRS standard; D_PAÍSES = dummy for each country; D_ANO = dummy for each year; D_SETOR = dummy for each sector. They are processed by the Sys-GMM. AR(1) and AR(2) refer to tests for first and second-order autocorrelation, respectively, in which statistical significance is expected only for AR(1). Hansen test refers to the test for the joint validity of the instruments, in which the non-significance of the referred test indicates the validity of the instruments used. The CRESC, TAM, ENDIV, and ROA variables were treated as endogenous variables, using lags 2 and longer for the differences equation and lags 1 and longer for the levels equation. In contrast, the ELE, IFRS, D_ANO, D_PAÍSES, and D_SETOR variables were treated as exogenous. *** Significance at the 1% level.

There is a positive and significant influence (at the 10% level) of presidential election periods on firm managers' recognition of discretionary accruals, as already reported in tables 2 and 3. This finding suggests that, in presidential elections periods, managers tend to increase earnings by positive discretionary accruals, confirming the findings of Bu et al. (2019) on more aggressive accounting practices during periods of political uncertainty. The findings also confirm the evidence reported by Yung and Root (2019), Cui et al. (2020), and Bermpei et al. (2022) regarding management practice following periods of political uncertainty.

It should be noted that the variables TAM, ENDIV, and ROA were significant in positively affecting discretionary accruals. The expected relation-

ship between the TAM and ROA variables was already highlighted by Chen, Lin et al. (2008) and Ali and Zhang (2015). However, it was expected that the debt ratio of firms would negatively impact discretionary accruals (Ali & Zhang, 2015). A possible explanation for this finding would lie in earnings management, increasing earnings to avoid contractual violations (Elayan et al., 2008) or to obtain advantageous contractual terms (Charitou et al., 2007). It should be noted that the CRESC and IFRS variables did not significantly impact discretionary accruals.

In order to capture additional evidence regarding the use of positive discretionary accruals in periods of political uncertainty, the model expressed in Equation 4 was estimated using logistic regression with clustered errors per firm, replacing the AD variable with a dummy representative of firms with both positive discretionary accruals (PAD_POS) and negative discretionary accruals (PAD_NEG), to capture the impact of political uncertainty on the probability of earnings management in both possible directions. The results (unreported) signaled that political uncertainty increases (reduces) the probability of using positive (negative) discretionary accruals by about 7.39% (7.39%), which supports the evidence already reported in Table 4.

It was also verified whether the results in Table 4 are directed by any of the countries in the sample, according to evidence reported in Table 2 for the influence of the sample of firms in Brazil. For this purpose, Equation 4 was estimated by segregating the tests in a sample of firms only in Brazil and in other countries. The (unreported) results did not point to any effect of political uncertainty on discretionary accruals in the segregated tests, which seems to signal that the evidence reported in Table 4 does not originate from a single country but from a group of countries.

Furthermore, it was also examined whether the results in Table 4 are sensitive to the proxy used for political uncertainty. For this purpose, Equation 4 was estimated with settings similar to those reported in Table 4, replacing the ELE variable with a representative measure of EPU for each country in the sample (except for Argentina, which does not have data for this measure), such a measure developed by Baker et al. (2016) and available in Economic Policy Uncertainty (2020). Again, the results are qualitatively similar to those already reported in Table 4 and point to the significance (at the 10% level) of EPU in positively affecting discretionary accruals, suggesting that the findings are not sensitive to the measure used for political uncertainty. It is noteworthy that, although this evidence is relevant, the availability of the EPU measure for only three countries in the sample limits direct comparison with the results in Table 4.

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Based on the findings, the expectation is confirmed that political uncertainty is associated with the decision of managers to manage earnings by increasing earnings by positive discretionary accruals, allowing us to infer, therefore, that managers of firms in Latin American countries make accounting choices increasing their reported earnings during periods of political uncertainty.

The evidence, therefore, confirmed the argument that the increase in uncertainty, caused by periods of presidential elections in emerging markets, creates incentives for managers to report higher earnings through positive discretionary accruals, thus confirming Bu et al.'s argument (2019) on more aggressive accounting practices following periods of political uncertainty. In this regard, it is likely that the argument of Bu et al. (2019) in the direction of probable involvement of firms with political agents is also reflected in an explanation for the findings of this research, due to such a relationship is expected to some extent also in Latin American countries. It should also be noted that the evidence also confirms the findings of Yung and Root (2019) regarding the practice of earnings management in periods of political uncertainty.

Concerning the fact that the indicated evidence is not in line with the study by Gonçalves et al. (2022), which pointed to a reduction in earnings by earnings management in periods of political uncertainty, it is worth mentioning that the authors considered European countries in their sample and period 2011-2018 for the events examined, which represents a different configuration in the tests applied in this research. Despite this fact, Equation 4 was estimated with configurations similar to those reported in Table 4, considering the period examined by Gonçalves et al. (2022), noting that the coefficient for variable ELE remains positive and significant at the level of 10%, which indicates that the findings are robust to different periods of analysis, in addition to the entire period examined, as well as providing evidence that the differences are driven by the different characteristics of the countries considered in the research.

Finally, it is worth noting that both the alignment with Bu et al. (2019) and non-alignment with the study by Gonçalves et al. (2022) provide incentives for future research agendas. Regarding the first, it is likely that the relationship between firms and political agents plays a relevant role when considering the relationship between political uncertainty and earnings management in the context of emerging Latin American countries, thus constituting a research gap for future studies. As for the second, it is likely that the differences in the institutional arrangements of the countries,

including when considering political attributes, also affect, to some extent, the relationship between political uncertainty and earnings management in the context of those countries, which also constitutes an agenda for future research.

CONCLUSIONS

We examined the extent to which firm managers, in the context of Latin American countries and during periods of political uncertainty, opt for accounting choices by increasing or reducing their reported earnings. Such choices would be made either according to the argument that political uncertainty can increase the uncertainty associated with the performance of firms and, therefore, would create incentives for the decision of managers to report lower earnings by discretionary accruals or according to the argument that in periods of political uncertainty, managers would opt for accounting choices increasing earnings in view of the increase in uncertainty associated with the political event.

The period of presidential elections was used as a proxy for political uncertainty. At the same time, the practice of increasing/decreasing earnings management was captured through discretionary accruals estimated according to the Jones' model (1991) modified by Dechow et al. (2012).

The evidence suggests that periods of presidential elections are differentiating attributes of the practice of earnings management by managers, confirming the expectation that those agents opt for accounting choices that increase earnings by positive discretionary accruals in periods of political uncertainty when considering emerging countries from Latin America. These findings allow us to conclude that political uncertainty influences managers' accounting choices, corroborating international studies.

We advance in the international literature by presenting evidence that increases the hypothesis of political uncertainty and the theory of accounting choices, specifically by providing insights into the interaction of the aforementioned theoretical models. In this direction, the research complements the findings about the negative impact of political uncertainty on the quality of disclosed accounting information already reported in Chen, Chen et al. (2018), Bu et al. (2019), Yung and Root (2019), Cui et al. (2020) and Bermpei et al., 2022.

It is noteworthy that, in this regard, the evidence was more in line with studies developed with a sample of emerging countries, the case of China,

for example, as evidenced by Bu et al. (2019), while research carried out with a sample predominantly from developed countries, as is the case of the study by Gonçalves et al. (2022), provide evidence that differs from the findings of this research. Supported by Bu et al. (2019), in addition to the recognized characteristics (weak enforcement and investor protection mechanisms) of emerging markets that do not provide incentives for managers to report high-quality earnings, possible relationships between firms and political agents likely offer an explanation to some extent for the findings when considering Latin American countries. Such findings can direct future research agendas by examining possible differences in the institutional arrangements of the countries, including those related to political attributes, which could provide more explanations for the relationship between political uncertainty and earnings management.

Furthermore, the investigation sheds light on the effects of political events on the availability of valuable and relevant information in the context of emerging countries, which offer a more susceptible configuration to the impact of those events. In this context, the investigation complements the findings of Passos and Cavalcante (2021), aligning itself with the argument that political uncertainty adversely affects the quality of accounting information in Latin American countries.

It should be noted that the evidence provides practical implications for agents in capital markets in Latin America, specifically about the adverse impact of political uncertainty on the quality of earnings; in this regard, the research indicates the need to consider election years as a relevant attribute in directing managers' accounting choices to increase earnings by positive discretionary accruals.

The research is limited by considering only four emerging countries in Latin America due to the availability of data and the relevance of these countries in the context of that continent, which is why it is suggested that future research deepen the investigation into other relevant emerging capital markets, which can provide further insight into the relationship between political uncertainty and the practice of earnings management.

The investigation was also limited by capturing the political uncertainty effect only considering periods of presidential elections and, to a limited extent, considering the EPU. In contrast, other measures, such as political risk indices and crises, can be used as alternative proxies to capture that effect, which is suggested for future research. It is also suggested for future research around the above limitation to examine possible effects of events surrounding the effective change of government or other attributes related to elections on the quality of accounting information.

In addition, it is also suggested that future investigations examine the effects of political uncertainty on earnings management by actual activities since this practice represents another way to manipulate earnings and could be associated with the political uncertainty event.

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