Employee Relationship and Earnings Management

Abstract:

This paper examines the association between a firm's relationship with its employees and the extent of earnings management. We find that firms with friendly employee relationship (as measured by the Employee Relations Index) have more earnings management, particularly in the form of income-decreasing earnings management. Further analysis shows that cash profit sharing is the most important component in the Employee Relations Index in determining our results since managers tend to manipulate earnings downward to reduce cash payouts to employees that may be tied to earnings targets. The positive association is more evident when the firm is R&D intensive, when the firm is high-tech industries, and when the firm is in competitive industries. Our findings are robust to a variety of model specifications and endogeneity problems.

Employee Relationship and Earnings Management

I. INTRODUCTION

Understanding how financial reporting outcomes are shaped by the managerial incentives is important in accounting and finance research. Prior literature shows that managers' accounting choices are affected by a firm's nonfinancial stakeholders, such as customers, creditors, suppliers, and employees (Watts and Zimmerman, 1986; DeFond and Jiambalvo, 1994; Graham et al., 2005; Dou et al., 2015). While some papers examines how a firm's relations with nonfinancial stakeholders affect its choice in financial reporting, they almost pay no attention to a firm's relationship with rank-and-file employees (Raman and Shahrur, 2008; Dou et al., 2013). This lacking of evidence is surprising due to the fact that employees are important human capital and inside stakeholders participating in daily operations of the firm. In this paper, we attempt to fill in this gap by investigating whether and how a firm's relationship with rank-and-file employees affects the managers' choice in earnings management.

There are potentially four important arguments for why employee relationship should be related to more earnings management in the firm. First, maintaining friendly employee relationship leads to higher labor cost (Edmans, 2011; Edmans et al. 2014). Firms can lower their labor cost implicitly without breaking the harmonious relationship with employees through managing earnings downward to reduce the cash payouts that may be tied to the earning targets.

Second, modern firms reply on human capital to provide quality product, develop innovations, and maintain client relationship, and thus they have incentives to motivate employees to invest in firm-specific human capital and retain talented employees to reduce

turnover cost through establishing friendly relationship with employees (Edmans, 2011). The friendly relationship strengthens employees' ability and bargain power to extract rents from the firms. Similar to Liberty and Zimmerman (1986), managers have incentives to manipulate earnings downwards to mislead the perception of employees about the profitability of the firm so that firms can mitigate employees' ability for rent extraction.

Third, firms that attempt to establish friendly relationship with employees are more likely to be those that highly rely on human capital to create value. Hence, labor friendly firms have more incentives to motivate employees to exert more effort in work. Employees respond the friendliness of the employers with increased efforts according to Akerlof's (1982) gift exchange model. Hannan (2005) finds that employees respond the firm's kindness with higher effort when firm profit decreases than when it increases. Since labor-friendly firms are interested in inducing more effort from employees, they have incentives to influence the employees' perception of a firm's kindness by managing earnings downward to lower reported profits.

Fourth, Bae et al. (2011) argue that firms implementing labor-friendly policies are more likely to attach a high value to their reputational capital. In order to provide a credible commitment to fair employee treatment, a firm may have incentives to manipulate earnings upward to affect the employees' perception of the firm's financial health (Bowen et al., 1995; Raman and Shahrur, 2008; Dou et al., 2013).

Fifth, friendly relationship between employers and employees may also lead to less earnings management. Literature suggests that employees have a significant impact on corporate governance (Acharya et al., 2011; Atanassov and Kim, 2009; Fama, 1985; Landier et al., 2009). Employees can be treated as inside stakeholders due to their participation in daily

operation and direct observation of daily management decisions. They are able to collect information about the firm at a low cost. Friendly relationship strengthens the employee commitment and loyalty to the firm (Bridges and Harrison, 2003; Whitener, 2001), which helps foster the convergence of labor and shareholder interests to preserve the long-term value of the firm (Faleye and Trahan, 2011). Leung et al. (2009) argue that employees may suffer loss due to the wrong estimations of their future income based on the manipulated earnings. A labor-friendly firm may tend to lower its extent of earnings manipulation to cater the need of employees.

To explore the association between a firm's relationship with its employees and the managers' choices in earnings management, we exploit a firm-level measure of employee relationship, the Employee Relations Index from the KLD Database[1]. Following the literature, we adopt ratings in all the sub-categories of employee relations in the KLD to measure how the relationship between firms and their employees is. KLD rates the employee relations in the following subcategories[2]: Union Relation Strength (Weakness), Cash Profit-Sharing Strength, Employee Involvement Strength, Retirement Benefit Strength (Weakness), Health and Safety Strength (Weakness), Layoff Policy Strength (Weakness), Supply Chain Policy Strength (Weakness), and Other Strength (Weakness). The KLD assigns 0/1 in the strength and weakness

[1] Following Bae, Kang, and Wang (2011), we view the firm's relations with its employees and employee treatment as the same issue. Thus, those terms are interchangeable throughout the paper.

[2] The definition of this subcategories are as follows: Union Relations measures whether the company has taken exceptional steps to treat its unionized workforce fairly. Retirement Benefits measures whether the company has a notably strong retirement benefits program. Health and Safety measures whether the company has strong health and safety programs. Cash Profit-sharing measures whether the company has a cash profit-sharing program through which it has recently made distributions to a majority of its workforce. Employee Involvement measures whether the company encourages worker involvement and ownership through stock options available to a majority of its employees, gain sharing, stock ownership, sharing of financial information, or participation in management decision making.

of each subcategory. The Employee Relations Index is measured by using the total employee relation strength score minus the total employee relation weakness score. The total employee relation strength score is calculated as the total points a firm receives on criteria for employee strength in the KLD, while the total employee relation weakness score is obtained from the total points a firm receives on criteria for employee relation weakness in the KLD. A higher score on the Employee Relations Index indicates that the firm has a friendly relationship with employees.

To capture a firm's earnings management, we use discretionary accruals (denoted as *DA*) from a modified Jones model (Dechow et al., 1995; Jones, 1991) as our proxy for earnings management. We adopt the absolute value of discretionary accruals (*ABS_DA*) in our analyses, since earnings management includes either income-increasing or income-decreasing accruals. We examine the association between a firm's employee relationship and managers' choice in earnings management in a large sample of publicly listed firms from 1995 to 2012 with a total of 11,999 firm-year observations. Controlling for other firm characteristics, we find that firms with friendly employee relationship (as measured by the Employee Relations Index) manage their earnings more. When we re-estimate our model for the income-increasing earnings management (Positive *DA*) and income-decreasing earnings management (Negative *DA*) respectively, we find that the Employee Relations Index is more important in impacting income-decreasing earnings management (Negative *DA*). We fail to find any significant association between a firm's labor-friendliness and income-increasing earnings manipulations.

In order to explore the underlying mechanism of the positive association between employee relationship and earnings management, we further examine which component in the

Employee Relations Index plays the most important role in determining our findings. We find that among the five major components, cash profit sharing is the most important in impacting a firm's choice to manipulate earnings downward[3]. This finding suggests that managers are more likely to manipulate earnings downward to reduce cash payouts to employees that may be tied to earnings targets when the labor cost is high in a labor friendly firm.

Furthermore, we investigate whether a firm's characteristics affects our findings. Employee retention and motivation are more important in a firm emphasizing quality and innovation (Zingales, 2000). Employees are more likely to extract rents in those firms relying on human capital since they have stronger bargaining power by threating to quit the job or not to invest in firm-specific human capital. Thus, managers have more incentives to manage earnings downward to reduce labor cost in those firms. In particular, we expect that firms with more R&D activities require employees to learn more firm-specific abilities such as product development and technology innovation. Moreover, firms in competitive industries have more incentives to retain skillful employees due to employees' substantial outside job opportunities. Therefore, we partition the sample into two subsamples according to three measures: (1) R&D intensity; We classify firms with R&D intensity above sample median as R&D intensive firms and firms with R&D intensity below sample median as non-R&D intensive firms. To estimate the firm-level R&D intensity, we use R&D expenses divided by the firm's total asset. (2) High-tech industry; We define the high-tech industry according to the classification as in Loughran and Ritter (2004). (3) Herfindahl index at the two-digit SIC; We classify firms in industries with Herfindahl index below sample median as competitive industry and firms in industries

[3] The five components are Union Relations, Retirement Benefits, Health and Safety Benefits, Cash Profit-Sharing, and Employee Involvement.

with Herfindahl index above sample median as non-competitive industry; We find that the positive association is more evident when the firm is R&D intensive, when the firm is in high-tech industries, and when the firm is in competitive industries.

A major concern with our findings is the potential endogeneity of employee treatment. To address this endogeneity issue we use firm-fixed effect regression and instrumental variables regressions. We also adopt two instrumental variables to capture exogenous variations in a firm's employee relationship: (1) *NONCOMP*, a dummy variable measuring whether a state has strong noncompetition agreement enforceability, and (2) *WDL*, a dummy variable measuring whether a state has strong wrongful discharge laws. After considering the endogeneity issue, our results still remain the same.

For robustness, we first follow Kothari et al. (2005) to compute performance-matched discretionary accruals (denoted as *PMDA*) by including return on assets (*ROA*) in the prior year as a regressor in the estimation model to control for the effect of performance on measuring discretionary accruals. Second, Bae et al. (2011) adopt only the strengths in employee relations in KLD database to form the Employee Relations Index. Following Bae et al. (2011), we form a new Employee Relations Index as our alternative measure for a firm's employee relationship by using only strengths in employee relations. Third, as suggested by Bae et al. (2011), we use *Fortune*'s "100 Best Companies to Work For" (hereafter referred as BC) as an alternative measure for employee relationship. To examine whether the BC firms are more likely to manipulate earnings, we use propensity-score matching and nearest-neighbor matching approaches, as in Bae et al. (2011). We find that the alternative measures do not change our findings.

Finally, we rule out a series of alternative explanations for our findings, such as real-activity management, managerial entrenchment, labor union power, corporate ethical culture, financial constraint, and so on.

This paper contributes to the literature in several ways. First, its emphasis on the association between employee relationship and the extent of earnings management is a new addition to the literature highlighting the role of stakeholders in affecting financial reporting choices. Second, the literature has provided evidence that firms tend to manage earnings downwards due to the organized labor unions' demand in income (Liberty and Zimmerman, 1986; DeAngelo and DeAngelo, 1991; D'Souza et al., 2000). In contrast, our paper documents evidence on the general effect of rank-and-file employees.

The remainder of this paper is organized as follows: In Section II, I give a brief literature review on the topic of earnings management and employee treatment. Section III presents the hypothesis development. Section IV shows data and sample selection. In Section V, we present our regression results. In Section VI, we perform robustness analysis. Section VII concludes the paper.

II. RELATED LITERATURE

The current literature on corporate financial reporting focuses primarily on how shareholders can limit corporate misconduct based on compensation structure and corporate governance. Bergstresser and Philippon (2006) find that earnings manipulation is more pronounced at firms where the CEO's total compensation consists of more stock and option holdings. Similarly, Burns and Kedia (2006) show that the propensity to misreport is positively related to the stock-price sensitivity of the CEO's option portfolio value. Efendi et al. (2007)

find that there is a higher likelihood of financial misstatement when the CEO holds more in-the-money stock options. Johnson et al. (2009) find that the largest source of incentive for firms to commit fraud is unrestricted managerial stock holdings.

Beasley (1996) examines the relation between board compositions and financial statement fraud. He finds that lower likelihood of fraud is associated with smaller board size and higher board independence. Agrawal and Chadha (2005) study the relation between corporate governance and earnings restatement. They find that the probability of restatement is lower in companies whose boards or audit committees have an independent director with financial expertise, and is higher in companies where the CEO belongs to the founding family.

Yu (2008) investigates the role of financial analysts in affecting the firm's choice to manage earnings. He finds that firms with more analysts are less likely to manipulate earnings. Dechow et al. (2011) develop a scaled probability (F-score) that can be used as a red flag for earnings misstatements. The composite score is based on accrual quality, financial performance, nonfinancial measures such as abnormal reduction of number of employees, off-balance-sheet activities such as the use of operating leases, and stock and debt market incentives such as stock issuances. Crutchley et al. (2007) study the impact of governance, earnings quality, growth, dividend policy, and executive compensation structure on the likelihood of fraud.

Limited papers provide evidence about stakeholders and earnings management. Liberty and Zimmerman (1986) hypothesize that a firm is expected to manage earnings downwards prior to union negotiations to lower labor unions' demand in income. They contend that a signal of declining profitability helps a firm to gain concessions from the union since it misleads the perception of unions about current economic conditions. However, they fail to support their

hypothesis in their empirical study. In the subsequent studies, some of them fail to find evidence to support this hypothesis, while others provide evidence to validate it. Cullinan and Knoblett (1994) fail to find any relationship between accounting policy choices in the areas of inventory and depreciation and the extent of unionization in a firm. DeAngelo and DeAngelo (1991) documents that unionized firms in domestic steel industry manage their earnings downward prior to labor negotiation. D'Souza et al. (2000) find that unionized firms have more incentives to use immediate recognition to reduce labor renegotiation costs. All these papers are built up on the context of labor union.

Bowen et al. (1995) find that managers tend to adopt long-run income-increasing accounting methods to signal a firm's financial healthy to maintain its reputation for fulfilling implicit contracts with stakeholders. Matsumoto (2002) shows that firms wither greater reliance on implicit claims with stakeholders are more likely to manage earnings upward. Graham et al. (2005) report evidence from a survey of CFOs to support the view that firms manage their financial statements to improve their implicit contract with various stakeholders including employees. Dou et al. (2015) show that firms tend to manage long-run earnings upward to influence the perceptions of rank and file employees in employment security.

Kim et al. (2012) demonstrate that corporate social responsibility can help firms to constrain their incentives to manipulate earnings. Those socially responsible firms issue more transparent and reliable financial information to investors. Prior et al. (2008) examine whether firms adopt corporate social responsibility to hide their earnings management. They find a positive association between corporate social responsibility and earnings management in regulated industries.

Few papers study the role of a firm's employee relations in impacting corporate behaviors. Bae et al. (2011) investigate the role of employees in shaping a firm's capital structure. They find that firms with fair employee treatment maintain low debt ratios. They conclude that employee treatment plays an important role in shaping a firm's financing policy. Edmans (2011) finds that employee satisfaction is associated with higher long-run stock return, more positive earnings surprises, and announcement returns. He further argues that the stock market does not fully value intangibles, and that certain socially responsible investing (SRI) screens have a positive effect on investment returns. Jiao (2010) finds that employees represent intangible assets and better employee relations can enhance firm value substantially. Faleye and Trahan (2011) find that labor-friendly firms outperform other similar firms in both long-term stock returns and operating results. They also show that top management obtain no pecuniary benefits from taking labor-friendly practices.

III. Hypothesis Development

In modern firms, rank-and-file employees are important human capital and intangible assets of the firm since they are in charge of product development, technology innovation, maintaining relationship with customers and suppliers (Edmans, 2011). Bae et al. (2011) argue that firms can build up friendly employee relationship by offering favorable treatment including more working benefits and better working environment, which significantly increases labor cost. Maintaining friendly employee relationship leads to higher labor cost (Edmans, 2011; Edmans et al. 2014). However, Bova et al. (2015) argue that the inefficiency in labor cost can result in suboptimal production decisions and lower firm profitability since labor costs usually represent a large portion of a firm's total costs. Thus, firms need to solve a problem that is how

to lower labor cost under the current labor-friendly policy. They can manage earnings downward to reduce the cash payouts that may be tied to the earning targets when labor cost is high. The income-decreasing earnings management does not reduce employee treatment explicitly so that a firm can still maintain its friendly relationship with the employees.

Moreover, Bova et al. (2015) argue that employees have the potential to extract extra rents from the firms including more working benefits and better working environment. The friendly relationship strengthens employees' ability and bargain power to extract rents from the firms. Liberty and Zimmerman (1986) hypothesize that a firm is expected to manage earnings downwards prior to union negotiations to lower labor unions' demand in income. They contend that a signal of declining profitability helps a firm to gain concessions from the union since it misleads the perception of unions about current economic conditions. However, they fail to support their hypothesis in their empirical study. In the subsequent studies, some studies provide evidence to validate it (DeAngelo and DeAngelo, 1991; D'Souza et al., 2000; Bova et al., 2015). Therefore, managers have incentives to manipulate earnings downwards to mislead the perception of employees about the profitability of the firm so that firms can mitigate employees' ability for rent extraction.

Furthermore, Akerlof's (1982) gift exchange model shows that employees are motivated by reciprocity. They view favorable treatment as the intentions of caring them and respond with increased efforts. Hannan (2005) attempts to examine whether firm profit affects the degree of employees' reciprocity. She finds that employees provide higher effort when firm profit decreases than when it increases. The intention to be friendly with employees is much stronger when the firm is in a poor condition than when it is profitable. In respond to this kindness,

employees tend to offer higher effort. Firms that attempt to establish friendly relationship with employees are likely to be those that highly rely on human capital to create value. Thus, to induce more effort from employees, a labor-friendly firm has more incentives to influence the employees' perception of a firm's kindness by managing earnings downward.

In addition, labor-friendly firms may have more incentives to manage earnings upwards. Bae et al. (2011) argue that firms implementing labor-friendly policies are more likely to attach a high value to their reputational capital. In order to provide a credible commitment to fair employee treatment, a firm may have incentives to manipulate earnings upwards to affect the employees' perception of the firm's financial health (Bowen et al., 1995; Raman and Shahrur, 2008; Dou et al., 2013). Based on the arguments above, we have the following hypothesis:

H1A: Firms with better employee relationship are more likely to engage in earnings management.

According to the social exchange theory and the norm of reciprocity (Blau, 1964; Eisenberger et al., 1986), employees view the labor-friendly practices as the firm's commitment to them and respond with their loyalty and commitment to the firm (Bridges and Harrison, 2003; Whitener, 2001). Faleye and Trahan (2011) find that employee loyalty helps foster the convergence of labor and shareholder interests. Therefore, employees in a firm with friendly relationship have similar interest as shareholders to improve corporate governance and lower earnings management.

Moreover, Leung et al. (2009) argue that employees may suffer loss due to the wrong estimations of their future income based on the manipulated earnings. A labor-friendly firm may tend to lower its extent of earnings manipulation to cater the need of employees. Thus, we

have the competing hypothesis:

H1B: Firms with better employee relationship are less likely to engage in earnings management.

IV. DATA AND SAMPLE SELECTION

The Employee Relations Index is obtained from the KLD Database, which provides a variety of information on the firm's employee friendliness. The KLD Database is widely used in academic research to evaluate a firm's relations with its employees (Bae et al., 2011; Cronqvist et al., 2009; Ertugrul, 2011; Landier et al., 2009; Verwijmeren and Derwall, 2010; Faleye and Trahan, 2011). It is constructed from multiple data sources, such as company filings, government data, media information, and direct communication with company officers. Once KLD collects the information, its sector-specific analysts adopt a proprietary framework to rate the firms.

The main variable of interest is how a firm's employee relationship is, denoted as *ERI*. Following the literature, we adopt ratings in all the sub-categories of employee relations in the KLD to measure how a firm's employee relationship is. KLD rates the employee relations in the following subcategories:

1. Union Relation: whether or not the company has taken exceptional steps to treat its unionized workforce fairly.
2. Retirement Benefit: whether or not the company has a notably strong retirement benefits program.
3. Health and Safety: whether or not the company has strong health and safety programs.
4. Cash Profit-Sharing: whether or not the company has a cash profit-sharing program through which it has recently made distributions to a majority of its workforce.

5. Employee Involvement: whether or not the company encourages worker involvement and ownership through stock options available to a majority of its employees, gain sharing, stock ownership, sharing of financial information, or participation in management decision making.
6. Layoff Policy: whether or not the company has made significant reductions in its workforce in recent years.
7. Supply Chain Policy: whether or not the company has strong supply chain program.

The KLD assigns 0/1 in the strength and weakness of each subcategory. The Employee Relations Index is measured by using the total employee relation strength score minus the total employee relation weakness score. The total employee relation strength score is calculated as the total points a firm receives on criteria for employee strength in the KLD, while the total employee relation weakness score is obtained from the total points a firm receives on criteria for employee relation weakness in the KLD. A higher score on the Employee Relations Index indicates that the firm treats its employees fairly.

We adopt discretionary accruals as the proxy for earnings manipulation. Earnings can be divided into two parts: cash flow and accounting adjustments called accruals. The signs and sizes of accruals are subject to the managers' discretion, and thus accruals are more likely to be manipulated. However, accruals are not necessarily equal to earnings manipulation. Some accrual adjustments are made necessarily and appropriately under industry and operational conditions. Thus, accruals include two parts: nondiscretionary accruals and discretionary accruals. Discretionary accruals are widely used as the proxy for earning manipulation in the

literature[4].

We use a modified Jones model (Jones, 1991; Dechow et al., 1995) to estimate discretionary accruals (*DA*) by regressing total accruals on changes in sales and property, plant, and equipment (*PPE*) within industries cross-sectionally. A firm's discretionary accruals are computed as a percentage of lagged assets of the firm (see Appendix II for details). We use the absolute value of discretionary accruals (*ABS_DA*) as our main variable, since discretionary accruals can be either positive (income-increasing manipulation) or negative (income-decreasing manipulation) (Bergstresser and Philippon, 2006; Kim et al., 2012; Klein, 2002; Yu, 2008). Managers can overstate earnings to meet targets and hide earnings for future use during good years (i.e., "take a bath" through overstating bad assets or taking a large restructuring charge) to meet future earnings targets.

Firm financial data is obtained from CRSP/COMPUSTAT Merged Database. Executive compensation data is collected from the EXECUCOMP Database. Institutional ownership data is acquired from Thomson-Reuters Institutional Holdings (13f) Database. Analyst coverage data is obtained from I/B/E/S Database. The final sample includes 11,999 firm-year observations from 1995 to 2012.[5] All variables are winsorized at the 1% and 99% level.

Table 1 shows the summary statistics of the sample. The mean value of *ABS_DA* is 8.129% of lagged assets, which is of a similar magnitude to that of other studies (Bergstresser and

[4] See Bergstresser and Philippon, 2006; Burns and Kedia, 2006; DeAngelo, 1986; DeAngelo, 1988; DeFond and Jiambalvo, 1994; Erickson and Wang, 1999; Healy, 1985; Holthausen, Larcker and Sloan, 1995; Perry and Williams, 1994; Shivakumar, 2000; Teoh et al., 1998ab; Yu, 2008.

[5] The KLD database starts to record the data from 1991 and we download the Employee Relations Index data from 1991. However, the data quality in early years is not good due to the frequent missing firm's CUSIP identifier. After removing observations with missing CUSIP identifiers and merging with other variables, our sample starts from 1995.

Philippon, 2006; Yu, 2008). The mean level of employee treatment is -0.006.[6] A mean firm in the sample has a firm size (log value of total assets) of 7.848, a market-to-book ratio of 3.271, and a leverage of 0.176. Table 2 shows the correlation matrix among our main variables. The Employee Relations index (*ERI*) is positively related to a firm's earnings management (*ABS_DA*). The governance factors such as board size (*BOARD*) and independent directors fraction (*INDEP%*) are negatively correlated with the firm's earnings management, which is consistent with the view that corporate governance lowers the likelihood of earnings management (Beasley, 1996). External financing (*FINANCE*) and cash flow volatility (*CASH_VOL*) are positively correlated with a firm's earnings management (*ABS_DA*), implying that firms are more likely to manipulate earnings when they have financial constraint (Dechow et al., 1995; Dechow et al., 2011; Healy and Wahlen, 1999; Yu, 2008). Analyst (*ANALYST*) is positively correlated with the earnings management, consistent with the view that pressure to meet analysts' forecasts increases managerial incentives to manipulate earnings (Degeorge et al., 1999).

[Table 1 here]

[Table 2 here]

V. REGRESSION RESULTS

To capture the relation between a firm's employee relationship and earnings management, we estimate the following ordinary least squares (OLS) regression in both income-increasing firms ($DA>0$) and income-decreasing firms ($DA<0$):

[6] We use the total strength of employee treatment minus the total weakness of employee treatment to proxy for the overall employee treatment. Thus, our measure on employee treatment has negative, zero, and positive values.

$$|\mathrm{DA}_{it}| = \alpha + \beta * ERI_{it} + \gamma * Controls + Industry\ dummies + Year\ dummies + \varepsilon_{it}$$

where *t* indexes years, *i* indexes firms, and ε_{it} is an error term. ERI_{it} is the Employee Relations Index for firm i in year t. $Controls_{it}$ is a vector of firm level controls that includes firm size (*SIZE*), board size (*BOARD*), independent director fraction (*INDEP%*), market-to-book ratio (*MTB*), external financing activities (*FINANCE*), CEO's pay-for-performance sensitivity (*PPS*), leverage (*LEV*), profitability (*ROA*), institutional ownership (*INSTOWN*), analyst coverage (*ANALYST*), cash flow volatility (*CASH_VOL*), stock return (*RET*), and stock volatility (*VOL*). Two-way clustered standard errors at the firm and year level is used to compute the t-statistics.

Table 3 presents the results from the OLS regression. *ABS_DA* is the dependent variable in the regression. Column 1 reports the regression results with all firms. In column 1, the coefficient of *ERI* is positive and statistically significant, indicating that a higher level of the Employee Relations Index is associated with a higher extent of earnings management. Column 2 reports the regression results using the firms with income-increasing earnings management (Positive *DA*). We find that the coefficient of *ERI* is positive but insignificant, suggesting that a higher level of the Employee Relations Index does not lead to more income-increasing earnings manipulation. Firms with income-decreasing earnings management (negative *DA*) are used in the regression in column 3. We notice that the coefficient of *ERI* is positive and statistically significant, indicating that a higher level of the Employee Relations Index is associated with a higher extent of income-decreasing earnings management. Our findings suggest that the positive relationship between a firm's employee relationship and earnings management mainly due to the managers' incentives to manage earnings downward to lower

labor cost, to mitigate employees' ability in rent extraction, and to induce more effort.

Large firms are associated with lower extent of earnings management since larger firms face more scrutiny from layers, media and investors (Dyck et al., 2010; Yu and Yu, 2010). *MTB* is positively correlated to earnings manipulation due to the difficulties in monitoring a growth firm with information asymmetry (Crutchley et al., 2007; Wang, 2013). *FINANCE* is positively associated with earnings management, consistent with the findings in literature (Dechow et al., 1995; Dechow et al., 2011 ; Teoh, Welch, and Wong, 1998a). Higher leverage lowers a firm's incentives to engage in earnings-decreasing management, since leverage is usually proxy for closeness to debt covenant (Dechow et al., 1995; Dechow et al., 1996; Richardson et al., 2003). Both *CASH_VOL* and *VOL* are positively related to earnings manipulation, suggesting that firms are more likely to engage in earnings management when their business operation is volatile (Yu, 2008).

[Table 3 here]

We further investigate the underlying mechanisms for our findings in Table 3. We look at five subcategories of the Employee Relations Index: the Union Relations Index (*UNION*), the Employee Involvement Index (*EMP_INVOVLE*), the Health and Safety Benefits Index (*HEALTH*), the Retirement Benefits Index (*RETIREMENT*), and the Cash Profit Sharing Index (*CASH_PROFIT*)[7]. Liberty and Zimmerman (1986) hypothesize that labor union's demand for increased wages and benefits in the contract negotiations creates incentives for managers to

7 We only look at Union Relations, Health and Safety Benefits (HEALTH), Employee Involvement, Retirement Benefits, and Cash-Profit Sharing for two reasons. First, Bae, Kang, and Wang (2011) measures employee treatment by only including Union Relations, Employee Treatment, Retirement Benefits, Cash Profit-Sharing, and Health and Safety Benefits. Second, the dummy variables of Health and Safety Benefits, Layoff Policy, and Supply Chain Policy are mainly assigned zeros.

manipulate earnings downward. Mora and Sabater (2006) provide evidence that managers manipulate earnings downward prior to labor negotiations, supporting Liberty and Zimmerman (1986)'s hypothesis that wage bargaining strengthens managers' incentives to manipulate earnings for avoiding salary demands. When managers have a friendly relationship with labor union, unionized workers are in a better position to bargain for more income. Thus, managers have more incentives to manage earnings downward to shelter income from unions' demand. A higher score in the Union Relation Index may increase a firm's incentives in managing earnings downward. Similarly, the retirement benefits and cash profit sharing may closely tie to earnings target. The retirement benefits and cash profit sharing allow employees to receive monetary benefits currently or in the future, which are determined by a formula based on the reported accounting profit. In order to lower labor cost, managers have incentives to manipulate earnings downward when they consider the cost on employee retirement benefit and cash profit sharing. On the contrary, Bova et al. (2015) argue that employee ownership align the interests between employees and shareholders so that the employees have less potential to extract above-market rents from the firm. Employee ownership lowers the incentives of the firm to manage earnings downward to prevent rents extraction by the employees. The Employee Involvement Index measures whether a firm encourages worker involvement and/or ownership through stock options available to a majority of its employee. A higher score in the Employee Involvement Index should be related to a lower extent of income-decreasing earnings manipulation.

Table 4 shows the results. Only the coefficient on cash profit sharing (*CASH_SHARING*) is positive and statistically significant. The coefficients of all other indices are statistically insignificant. Cash profit sharing index measures whether company has a cash profit-sharing

program through which it has recently made distributions to a majority of its workforce. According to the KLD database definitions, this measure picks up profit sharing based on accounting profits and not just cash profits. This result is consistent with the hypothesis that managers manipulate earnings downward to reduce cash payouts to employees that may be tied to earnings targets when labor cost is high in labor-friendly firms.

[Table 4 here]

The purpose of maintaining friendly employee relationship is to recruit, motivate, and retain valuable employees. The more dependent on human capital, the higher labor is in the firm. The inefficiency in labor can result in suboptimal production decisions and lower firm profitability since labor costs usually represent a large portion of a firm's total costs (Bova et al., 2015). Thus, managers have more incentives to manage earnings downward to reduce labor cost in those firms. There are several factors affecting a firm's degree of dependence on human capital: R&D intensity, high-tech industry, and industry competition. Firms with high R&D intensity, in high-tech industry and in competitive industries have more need in employee motivation and retention. We expect that managers in R&D intensive firms, in high-tech industries, and in competitive industries have more incentives to manage earnings downward to reduce labor cost. We partition the sample into two subsamples according to three measures: (1) R&D intensity; The R&D intensity is measured by R&D expense dividend by the firm's total asset. We classify firms with R&D intensity above sample median as R&D intensive firms and firms with R&D intensity below sample median as Non-R&D intensive firms; (2) High-tech industry; We define the high-tech industry according to the classification in Loughran and Ritter (2004); (3) Herfindahl index at the two-digit SIC; We classify firms in industries with

Herfindahl index below sample median as competitive industry and firms in industries with Herfindahl index above sample median as non-competitive industry.

We re-estimate the regression in Table 3 for a subsample analysis and report the results in Table 5[8]. The results show that the positive impact of *ERI* on a firm's earnings management exists only when the firm is R&D intensive, when the firm is high-tech industries, and when the firm is in competitive industries.

[Table 5 here]

VI. ROBUSTNESS ANALYSIS

VI.1. Endogeneity of the Employee Relations Index

The problem of endogeneity is always challenging in empirical research. The omitted variables may affect both a firm's incentive to manage earnings and its employee treatment policy. In addition, it is also possible that firms engaging in earnings management are more likely to offer favorable treatment to their employees. Under such situation, the causation goes from earnings management to the employee treatment policy but not vice versa. When omitted variables or reverse causality exist, the employee relationship is not exogenous to a firm's choice to manipulate earnings. The positive coefficient estimated from the OLS regression will be biased and inconsistent. To alleviate these endogeneity concerns, I perform a battery of additional tests.

Firm-fixed effect

Firm-fixed effect removes unobservable time-invariant firm characteristics that may

[8] To save place, we do not report the results for the firms with income-decreasing earnings management. The results in the firms with income-decreasing earnings management is qualitatively the same.

generate a spurious relationship between earnings management and the Employee Relations Index, thus partially alleviating the endogeneity concern. In regressions in Table 6, we control for the firm-fixed effect and find that the coefficient estimate on the Employee Relations Index is still positive and statistically significant in all firms and in firms with income-decreasing earnings management.

[Table 6 here]

Changes-on-changes regression

Focusing on identification, we also consider using a changes-on-changes regression rather than limiting the empirics to levels of employee treatment and earnings management. Doing so offers more support that the association between employee relationship and earnings management is not driven by some omitted, underlying firm characteristics. In Table 7, we regress the changes in signed discretionary accruals between year t-1 and year t on changes in the Employee Relations Index between year t-1 and year t and changes on all other independent variables. Note that the dependent variable is the change value of signed discretionary accruals instead of the change value of absolute value of discretionary accruals. Therefore, if a firm choose to manipulate earnings downward to lower labor cost, changes in the Employee Relations Index should have a negative and significant coefficient. Consistent with our conjecture, we find that the coefficient of changes in the Employee Relations Index is negative and statistically significant in all firms and in firms with income-decreasing earnings management.

[Table 7 here]

Instrumental variables regression

To further alleviate the endogeneity concerns, we perform an instrumental variable regression. We adopt two instrument variables in the regression. First, noncompetition agreements are contracts that restrict employees from entering into or starting a similar profession or trade in competition against the firm. The noncompetition agreements are one of the most important mechanisms restricting employee mobility. Greenhouse (2014) finds that noncompetition agreements are not only written on the contracts of employees in knowledge-intensive industries and occupations but also presented on the contracts of employees in low-skilled, minimum-wage, and even volunteer positions. Starr (2015) argues that noncompetition agreements are prevalent in US given the statistics that at least 25% of the US labor Force have signed one and at least 12% are currently under one. Since employee retention is one of the most important reasons for the firm to attempt to establish harmonious relationship with employees, the noncompetition agreements significantly lower the incentives of the firm to be labor-friendly. Although we are not able to collect the data of noncompetition agreements at the firm level, we can access to the noncompetition enforceability at the state level in US. We adopt the noncompetition enforcement index at the state level from Garmaise (2009). The index considers 12 questions analyzed in Malsberger (2004) for each jurisdiction and each question for each jurisdiction worth 1 point if the jurisdiction's enforcement of that dimension of noncompetition law exceeds a given threshold. Thus, the total possible score ranges from 0 to 12. We assign a dummy variable (denoted as *NONCOMP*) measuring whether the state has strong noncompetition enforceability with the value of one if the firm's noncompetition enforcement index is greater than the sample median, zero otherwise. We expect that *NONCOMP* can serve as a valid instrument since a state's noncompetition enforcement policy

should not affect a firm's extent of earnings management beyond its correlation with employee relationship.

Our second instrumental variable is a dummy variable measuring whether the state has strong wrongful discharge laws. The employment-at-will doctrine mandated by the federal states that an employee can be dismissed by an employer for any reason with or without warning. However, a state can have three exceptions to this doctrine: implied-contract exception, public-policy exception, and good-faith exception[9]. Each of these exceptions are positively related to the job security component of positive employee treatment. We use Autor, Donohue, and Schwab's (2006) data of the passage of wrongful discharge laws. We assign a dummy variable (denoted as *WDL*) measuring whether a firm in a state with strong wrongful discharge laws, with the value of one if the firm is in a state with two or more exceptions and zero otherwise.

Table 8 presents the results[10]. In order to alleviate the weak instrument problem, we adopt the limited-information maximum likelihood (LIML) estimator in our instrumental variables regression. The first-stage regression shows that our instrumental variables perform well in predicting the score of the Employee Relations Index. As predicted, the coefficient estimates on *NONCOMP* in the first-stage regressions are negative and highly significant. The coefficient estimates on *WDL* in the first-stage regressions are positive and highly significant. In the second-stage regressions, we find that the coefficient on the predicted value of *ERI* is positive and statistically significant, consistent with our findings in OLS regression.

[9] See Dertouzos and Karoly (1992), Aalberts and Seidman (1993), Walsh and Schwarz (1996), Abraham (1998), Miles (2000), Kugler and Saint-Paul (2004), Autor, Donohue, and Schwab (2006), and MacLeod and Nakavachara (2007) for a detailed discussion.

[10] To save place, we only report the 2sls regression results for all the firms and firms with income-decreasing earnings management since *ERI* is not significant for the firms with income-increasing earnings management in the OLS regression. .

[Table 8 here]

VI.2. Alternative measure of a firm's earnings management

Performance-matched discretionary accruals

To further examine whether a higher score of the Employee Relations Index is associated with a higher extent of a firm's earnings management, we adopt performance-matched discretionary accruals as an alternative measure for earnings management. Following Kothari et al. (2005), we compute performance-matched discretionary accruals (denoted as *PMDA*) by including return on assets (*ROA*) in the prior year as a regressor in the estimation model to control for the effect of performance on measured discretionary accruals. We re-estimate the regression in Table 3 with the absolute value of performance-matched discretionary accruals (*ABS_PMDA*) as dependent variable in Table 9. We find quantitatively the same results as those in Table 3.

[Table 9 here]

VI.3. Alternative measure of a firm's employee relationship

Strengths of the Employee Relations

Bae et al. (2011) adopt only the strengths in employee relations in KLD database to form the Employee Relations Index. Following Bae et al. (2011), we form a new Employee Relations Index as our alternative measure for a firm's employee treatment by using only strengths in employee relations. The results are presented in Table 10 and our findings are not altered.

[Table 10 here]

Fortune's "100 Best Companies to Work For in America"

To further examine the association between a firm's relationship with employees and its

earnings management, we use *Fortune*'s "100 Best Companies to Work For in America" (denoted as BC) as an alternative measure for a firm's employee treatment. *Fortune* conducts an employee survey to ask various questions related to camaraderie, job satisfaction, and employees' attitudes to management credibility. In addition to the survey, the firm's response to the institute's Culture Audit is also considered by *Fortune* to make the list.[11] The BC list is widely used in the literature to proxy for the employee treatment. Faleye and Trahan (2011) adopt the BC list as the proxy for labor friendliness. They find that better employee treatment is associated with superior temporaneous accounting performance. They further find that such an association is more evident in firms dependent on human capital. Edmans (2011) also uses the BC list to proxy for employee-friendliness. He finds that employee satisfaction leads to higher long-run stock returns, and that motivated employees create substantial value to the firm. Bae et al. (2011) adopt the BC list as an alternative measure for employee treatment. They find that firms in the BC list tend to have lower leverage.

We obtain the BC list from Edmans (2011)[12]. We then merge the BC list to our sample. Because *Fortune* publishes the previous year's list at the beginning of every year, we merge the BC list for year t with our sample for year t-1. To estimate the treatment effect, we use propensity-score matching and nearest-neighbor matching approach, as in Bae et al. (2011). We choose the matching firms from all firms in Compustat within the sample period. Following Bae et al. (2011), the matching criteria include a comprehensive set of firm characteristics：market-to-book ratio, log of sales, ratio of fixed assets to total assets, return on assets, ratio of

[11] See http://money.cnn.com/magazines/fortune/rankings/ for more details.

[12] The BC list data can be download from Professor Alex Edman's personal website http://faculty.london.edu/aedmans/.

R&D expenditures to sales, ratio of SGA expenses to sales, dividend-paying dummy, ratio of sales to total assets, pension and retirement expenses per worker, firm age, board size, and independent director%. In addition to these firm characteristics, we also use industry (two-digit SIC code) and year as additional matching criteria. We present the results of propensity score matching in Table 11. In line with our previous findings using KLD rating for the employee treatment, we find that, on average, BCs are more likely to engage in earnings management activities than matching firms.

[Table 11 here]

VI.4. Alternative explanations

To rule out alternative explanations for our findings, we conduct several additional tests. First, recent studies show that firms use real activities manipulation as an alternative tool for earnings management. Firms regard real activities and accrual-based earnings management as substitutes (Badertscher, 2011; Cohen et al., 2008; Cohen and Zarowin, 2010; Roychowdhury, 2006; Zang, 2012). It is possible that the substitution effect of real activities manipulation drives the firm to adopt more accrual-based earnings management. Following Roychowdhury (2006) and Cohen et al. (2008), we adopt four measures to proxy for real activities manipulation: (1) abnormal levels of operating cash flow (*AB_CFO*), (2) abnormal production cost (*AB_PROD*), (3) abnormal discretionary expenses (*AB_EXP*), and (4) a combined measure of real activities manipulation (*COMBINED_RAM*). *COMBINED_RAM* is defined as *AB_CFO-AB_PROD+AB_EXP*. We compute abnormal values of the first three real activities' manipulation proxies as the residuals from the OLS regressions estimated by year and two digit SIC code (See Appendix III for details). To control for the substitutive nature of these two

earnings management methods, we include proxies for real activities manipulation in our regression model. Regression results are presented in Table 12.

After controlling real activities manipulation, we still find that the coefficient on the Employee Relations Index is positive and highly significant. Moreover, we find that a firm is more likely to engage in income-decreasing earnings management as *AB_CFO*, *AB_EXP*, and *COMBINED_RAM* increase. On the contrary, a firm adopts less income-decreasing earnings management as *AB_PROD* increases[13]. This finding is consistent with the literature showing that accrual-based earnings management and real activities manipulation are substitutes.

[Table 12 here]

Second, Hribar and Collins (2002) find that non-articulation events cause accruals estimation from the balance sheet and income statement to be materially misidentified about 66% of the time. Thus, our findings might be due to the materially misidentified earnings management. In order to eliminate this possibility, according to Hribar and Collins (2002), we exclude firm-year observations with three primary non-articulation events that are mergers and acquisitions, divestitures, and foreign currency translations[14]. We rerun our regression model and present the results in Table 1r. Our findings are not changed.

[Table 13 here]

A third alternative explanation to account for is the managerial entrenchment. The literature suggests that entrenched managers are more likely to expropriate shareholder wealth (Shleifer and Vishny, 1997; Bebchuk et al., 2009), which implies that managerial entrenchment

[13] Note that *AB_CFO*, *AB_EXP*, and *COMBINED_RAM* decrease, while *AB_PROD* keeps pace, as firms engage in real activities manipulation.
[14] We adopt exactly the same method to identify mergers and acquisitions, divestitures, and foreign currency translations as Hribar and Collins (2002).

increases the extent of earnings management in an attempt to gain private benefits. Prior et al. (2008) find that a manager's decision to manipulate earnings is part of his entrenchment strategy. As cited earlier, Cronqvist et al. (2008) find that entrenched CEOs tend to pay their employees more to ensure ease of wage bargaining and better social relations. To rule out the possibility that the relation between earnings management and the Employee Relations Index may be due to managerial entrenchment, we add entrenchment index (*EINDEX*), CEO tenure (*TENTURE*), and CEO pay slice (*CPS*) to our OLS regression and re-estimate the regression[15]. We report the results in Table 14. The coefficients on the Employee Relations Index are still positive and statistically significant, suggesting that our results are not due to the correlation between the Employee relations Index and managerial entrenchment.

[Table 14 here]

A fourth potential factor is labor union power. Liberty and Zimmerman (1986) hypothesize that a firm is expected to manage earnings downwards prior to union negotiations to lower labor unions' demand in income. They contend that a signal of declining profitability helps a firm to gain concessions from the union since it misleads the perception of unions about current economic conditions. However, they fail to support their hypothesis in their empirical study. In the subsequent studies, some of them fail to find evidence to support this hypothesis (Yamaji, 1986; Mautz and Richardson, 1992; Cullinan and Knoblett, 1994), while others provide evidence to validate it (DeAngelo and DeAngelo, 1991; D'Souza et al., 2000; Bova et al., 2015).

[15] The E-index is from Bebchuk, Cohen, and Ferrel (2009); a higher score in the E-index implies stronger managerial entrenchment and poorer corporate governance. CEO tenure is the number of years that the CEO has held the position. CEO pay slice is the fraction of the aggregate compensation of the top-five executive team captured by the CEO (Bebchuk, Cremers, and Peyer, 2012).

Labor union power is seen as correlated with both employee relationship and managerial decisions. To control for labor union power, we add union coverage (*UNION_MEM*) at the industry level to the regression. The industry-level data about labor union power is obtained from Hirsch and Macpherson (2003)[16]. In column 1 of Table 15, the coefficients of Employee Relations Index are still positive and statistically significant in all firms and firms with income-decreasing earnings management[17].

Our result might also be simply because of the wage effect, since the monetary related components in the Employee Relations Index drive our findings. Thus, we add the industry labor wage rate as the proxy for the wage effect in the regression[18]. We report the regression result in column 2 of Table 15. Again, we get a positive and statistically significant coefficient for the Employee Relations Index in all firms and firms with income-decreasing earnings management.

Rank-and-file employee option plans offer financial incentives to employees, giving managers an opening to manipulate earnings for private benefits through their stock and option holdings (Bergstresser and Philippon, 2006; Burns and Kedia, 2006). This manipulation also allows rank-and-file employees to receive more compensation through their option holdings, which keeps employees silent about the wrongdoing at the firm. We add an additional variable for measuring the rank-and-file employee option in the regression. The result is presented in column 3 in Table 15. We find that the Employee Relations Index still has a positive and

[16] Unfortunately, we are not able to find the labor union power at the firm level. At our best, we can use the labor union power at the industry level. *UNION_MEM* is the percentage of employees joined in labor union at the industry level.

[17] We also tried to include the collective bargaining ratio at the industry level in the regression. The results don't change. To save place, we did not report this result in the table.

[18] We use the industry level labor wage because the labor wage at the firm level is mostly missing, which significantly reduces our sample size.

statistically significant coefficient.

[Table 15 here]

It makes sense for firms that view human capital as a productive asset to invest more in employee relations. To the extent that these firms have more deferred compensation, they are likely to record more negative accruals than firms that have less deferred compensation. This could result in a mechanical relation between the Employee Relations Index and earnings management. R&D intensive firms are more likely to view human capital as a productive asset. Thus, we use R&D intensity at the firm level to proxy for the tendency of the firm to view human capital as a productive asset. The results are presented in column 1 of Table 16. Our findings remain the same.

Corporate culture channel can be another explanation for our results. A firm with ethical culture are more likely to have both better employee relationship and more timely loss recognition. The more timely loss recognition leads to more negative accruals. Thus, the association between employee relationship and earning management might simply due to the corporate ethical culture. We adopt the Forbes "The World's Most Ethical Companies" list to measure the firm's ethical culture. We assign the dummy variable as one if a firm is included in this list, zero otherwise. The results are presented in column 2 of Table 16. Our findings remain the same[19].

Likewise, firms are more likely to engage in activities that increase the Employee

[19] Although the coefficient of the Employee Relations Index becomes insignificant in the sample of all firms, it is still positive and significant in the firms with income-decreasing earnings management, which is consistent with our arguments. Moreover, the reason for the insignificant coefficient of the Employee Relations Index is probably due to the insufficient observations. Because ETHIC, the new variable included, is also insignificant. Thus, it is not because corporate ethics pick up the effect of favorable treatment.

Relations Index when they are more financially constrained. Core and Guay (2001) show that financial constraints are associated with more option grants and profit sharing. It seems plausible that more financially constrained firms may be more likely to report large negative abnormal accruals. In order to rule out this possibility, we include KZ index (measured as in Lamont et al., 2001) to control for the firm's financial constraint in the regression. The results are presented in column 3 of Table 16. Our findings remain the same.

[Table 16 here]

VII. CONCLUSION

Despite the large literature explaining how nonfinancial stakeholders affect manager's choices in financial reporting (Watts and Zimmerman, 1986; DeFond and Jiambalvo, 1994; Dichev and Skinner, 2002; Graham et al., 2005; Badertscher et al., 2012), few papers examine the association between a firm's relationship with nonfinancial stakeholders and its choice in earnings management (Raman and Shahrur, 2008; Dou et al., 2013).

In this paper, we investigate the association between a firm's employee relationship and its extent of earnings management. We find that, as measured by the Employee Relations Index, friendly employee relationship leads to a higher level of earnings manipulation. After splitting the firms with income-increasing earnings management and income-decreasing earnings management, we find that the positive relationship between friendly employee relationship and earnings management only holds in the subsample of firms with income-decreasing earnings management. Furthermore, we find that among all components in the Employee Relations Index, only cash profit sharing is significantly related to a firm's level of earnings management. All our findings suggest that managers tend to manipulate earnings downward to reduce cash

payouts to employees that may be tied to earnings targets so that firms can reduce labor cost when labor cost is high in labor-friendly firms. Moreover, we find that the positive association is more evident when the firm is R&D intensive, when the firm is in high-tech industries, and when the firm is in competitive industries.

This positive relation between employee relationship and earnings management still exists when we adopt alternative measures for either earnings management (e.g., performance-matched discretionary accruals) or employee relationship (e.g., total number of strengths in the employee relations index and whether a firm is included in the Fortune "100 Best Companies to Work For"). Finally, our findings are robust to a variety of model specifications and endogeneity issues. Overall, these findings support that a firm's relationship with employees has significantly impact on a firm's choice in financial reporting.

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Appendix I: Variable Definitions

Variables	Definition	Data Source
AB_CFO	Abnormal cash flow from operation following Roychowdhury (2006)	Manually computed
AB_EXP	Abnormal discretionary expenditure following Roychowdhury (2006)	Manually computed
AB_PROD	Abnormal production cost following Roychowdhury (2006)	Manually computed
ABS_DA	Absolute value of discretionary accruals computed from the modified Jone's model ((Dechow, Sloan, and Sweeney, 1995)	Manually computed
ABS_PMDA	Absolute value of discretionary accruals following Kothari, Leone, and Wasley (2005).	Manually computed
ANALYST	The number of analysts following the firm	I/B/E/S
BOARD	The number of board members sitting on the board	RiskMetrics
CASH_PROFIT	The total score in cash profit-sharing program subcategory	KLD
CASH_VOL	Following Yu (2008), cash flow volatility is estimated by the standard deviations of cash flows of a firm in the entire sample period, scaled by lagged assets.	Manually compute
COMBINED_RAM	AB_CFO-AB_PROD+AB_EXP	Manually computed
CPS	The fraction of the aggregate compensation of the top-five executive team captured by the CEO (Bebchuk, Cremers, and Peyer, 2011).	EXECUMOP
DA	Value of discretionary accruals computed from the modified Jone's model ((Dechow, Sloan, and Sweeney, 1995)	Manually computed
EINDEX	An index measuring the managerial entrenchment	Bebchuk, Cohen, and Ferrel (2008)
EMP_INVOLVE	The total score in employee involvement subcategory	KLD
EMP_OPTION	Value of options granted to nonexecutive employees per worker estimated by Black-Scholes option pricing model	EXECUMOP
ERI	The Employee Treatment Index is a firm's total employee relation strength score minus its total employee relation weakness score. The total employee relation strength score is formed by adding the points a firm receives on criteria for employee relation strength in the KLD database, and the total employ relation weakness score is formed by adding the points the firm receives on criteria for employee relation weakness.	KLD
ERI_STRENGTH	The total employee relation strength score is formed by adding the points a firm receives on criteria for employee relation strength in the KLD database	KLD
ETHICS	A dummy variable as one if a firm is included in this list of the Forbes "The World's Most Ethical Companies"	Forbes
FINANCE	Asset growth rate – ROA2/(1-ROA2), ROA2 = (income before extraordinary items)/Assets	COMPUSTAT

High-tech industry	A dummy defined as in Loughran and Ritter (2004).	Manually compute
INDEP%	Fraction of independent directors on the board	RiskMetrics
IND_LABOR	Labor expense divided by the number of the employees at the industry level.	COMPUSTAT
INSTOWN	The percentage of shares held by institutional investors	Thomson-Reuters Institutional Holdings (13f)
KZ_INDEX	A variable measures a firm's financial constraint.	Lamont et al. (2001)
LEV	Long-term debt/total asset	COMPUSTAT
MTB	Market value over book value of the firm	COMPUSTAT
NONCOMP	A dummy variable measuring whether a state has strong noncompetition agreement enforceability if the firm's noncompetition enforcement index is greater than the sample median.	Garmaise (2009)
PMDA	Value of discretionary accruals following Kothari, Leone, and Wasley (2005).	Manually computed
PPS (Pay-for-performance Sensitivity)	To estimate this variable, first multiply the Black-Scholes hedge ratio by the shares in options owned by the executive, then add the shares in stock owned by the executive, and finally divide the sum by total number of shares outstanding of the company.	EXECUMOP
RETIREMENT	The total score in retirement benefits subcategory	KLD
RETURN	Annual buy-and-hold stock return	CRSP
R&D intensity	A firm's R&D expenses divided by total asset	Manually compute
ROA	(Operating income after depreciation)/Assets	COMPUSTAT
SIZE	Firm size is the log value of total assets	COMPUSTAT
TENURE	The log value of number of years since CEO takes the position	EXECUMOP
UNION	The total score in union relation subcategory	KLD
UNION_MEM	The percentage of employees joined in labor union at the industry level	Hirsch and Macpherson (2003)
VOL	Standard deviation of monthly stock returns in a year	CRSP
WDL	a dummy variable measuring whether a firm in a state with strong wrongful discharge laws if the firm is in a state with two or more exceptions	

Appendix II: Estimation of discretionary accruals

We use a modified version of the Jones model (Dechow, Sloan, and Sweeney, 1995) to estimate discretionary accruals from regressions of total accruals on changes in sales and on property, plant, and equipment within industries. To obtain discretionary accruals, we first run a cross-sectional OLS regression within two-digit SIC code to estimate coefficients α_1, α_2, and α_3.

$$\frac{TA_{it}}{A_{it-1}} = \alpha_1 \frac{1}{A_{it-1}} + \alpha_2 \frac{\Delta REV_{it}}{A_{it-1}} + \alpha_3 \frac{PPE_{it}}{A_{it-1}} + \varepsilon_{it}$$

where we indexes firms, t indexes time, TA_{it} is net income minus cash flow from operations, ΔREV_{it} is the changes in sales revenues, A_{it-1} is the lagged value of firm's total assets. PPE_{it} is the gross property, plant, and equipment, ΔAR_{it} is the change in receivables. We estimate the cross-sectional models separately for each combination of calendar year and two-digit SIC code with a minimum of 15 observations. Then, we use the estimated $\hat{\alpha}_1$, $\hat{\alpha}_2$, and $\hat{\alpha}_3$ to compute nondiscretionary accruals.

$$NDA_{it} \equiv \hat{\alpha}_1 \frac{1}{A_{it-1}} + \hat{\alpha}_2 (\frac{\Delta REV_{it}}{A_{it-1}} - \frac{\Delta AR_{it}}{A_{it-1}}) + \hat{\alpha}_3 \frac{PPE_{it}}{A_{it-1}}$$

Therefore, the discretionary accruals is computed as

$$DA_{it} \equiv \varepsilon_{it} = \frac{TA_{it}}{A_{it-1}} - NDA_{it}$$

Since all the variables are scaled by total assets at the beginning of the period, the magnitude of a firm's discretionary accruals is computed as a percentage of the assets of the firm.

Following Kothari, Leone, and Wasley (2005), we augment the modified Jones model by including ROA_{t-1} to avoid potential misspecification. The residuals from the annual cross-sectional industry regression are treated as my performance-matched discretionary accruals.

We estimate the following regression:

$$\frac{TA_{it}}{A_{it-1}} = \alpha_1 \frac{1}{A_{it-1}} + \alpha_2 \left(\frac{\Delta REV_{it}}{A_{it-1}} - \frac{\Delta AR_{it}}{A_{it-1}} \right) + \alpha_3 \frac{PPE_{it}}{A_{it-1}} + \alpha_4 \frac{IBXI_{it-1}}{A_{it-1}} + \varepsilon_{it}$$

where $IBXI_{it-1}$ is income before extraordinary items at year t-1.

Appendix III: Estimation of discretionary accruals

Following existing literature (Roychowdhury, 2006 and Cohen, Dey, and Lys, 2008), sales manipulations are negatively associated with current-period operating cash flows. We use Roychowdhury (2006) model to estimate the normal value of operating cash flows:

$$\frac{CFO_t}{A_{t-1}} = \alpha_0 + \alpha_1\left(\frac{1}{A_{t-1}}\right) + \beta_1\left(\frac{S_t}{A_{t-1}}\right) + \beta_2\left(\frac{\Delta S_t}{A_{t-1}}\right) + \varepsilon_t$$

where CFO_t=cash flow from operation in year t, A=total assets, S=sales. For every firm-year, abnormal cash flow from operations (*AB_CFO*) is the residual from the regression based on year and two digit SIC industry code.

Abnormal production costs is another proxy for real activities manipulation. Following Foychowdhury (2006), we estimate the following model for normal production costs:

$$\frac{PROD_t}{A_{t-1}} = \alpha_0 + \alpha_1\left(\frac{1}{A_{t-1}}\right) + \beta_1\left(\frac{S_t}{A_{t-1}}\right) + \beta_2\left(\frac{\Delta S_t}{A_{t-1}}\right) + \beta_3\left(\frac{\Delta S_{t-1}}{A_{t-1}}\right) + \varepsilon_t$$

Abnormal production cost (*AB_PROD*) is the residual from the model.

The third proxy for real activities manipulation is the abnormal discretionary expense. Following Roychowdhury (2006), we estimate the normal level of discretionary expenses using the following equations:

$$\frac{DISEXP_t}{A_{t-1}} = \alpha_0 + \alpha_1\left(\frac{1}{A_{t-1}}\right) + \beta\left(\frac{S_t}{A_{t-1}}\right) + \varepsilon_t$$

where *DISEXP* is the discretionary expense in year t, computed as the sum of R&D, Advertising, and SG&A expenses. For every firm-year, abnormal discretionary expenditure (*AB_EXP*) is the residual from the model.

Table 1: Summary statistics

ABS_DA is absolute value of discretionary accruals computed from the modified Jone's model (Jones, 1991; Dechow, Sloan, and Sweeney, 1995). *ERI* is a firm's total employee relation strength score minus its total employee relation weakness score. The total employee relation strength score is formed by adding the points a firm receives on criteria for employee relation strength in the KLD database, and the total employ relation weakness score is formed by adding the points the firm receives on criteria for employee relation weakness. *SIZE* is the log value of total assets. *BOARD* is the number of board members sitting on the board. *INDEP%* is the fraction of independent directors on the board. *MTB* is the market value over book value of the firm. Following Wang (2013), *FINANCE* is measured by asset growth rate – ROA2/(1-ROA2), ROA2 = (income before extraordinary items)/Assets. *PPS* (Pay-for-performance Sensitivity) is measured by first multiplying the Black-Scholes hedge ratio by the shares in options owned by the executive, then adding the shares in stock owned by the executive, and finally dividing the sum by total number of shares outstanding of the company. *LEV* is measured by long-term debt/total asset. *INSTOWN* is the percentage of shares held by institutional investors. *ANALYST* is the number of analysts following the firm. *CASH_VOL* is the cash flow volatility following Yu (2008). *RETURN* is the annual buy-and-hold stock return. VOL is the standard deviation of monthly stock returns in a year.

	(1)	(2)	(3)	(4)	(5)
VARIABLES	N	mean	sd	min	max
ABS_DA	11,999	8.129	8.675	0.103	60.80
DA	11,999	-2.813	11.05	-48.51	40.77
ERI	11,999	-0.006	0.948	-2	3
BOARD	11,999	9.389	2.341	5	16
INDEP%	11,999	0.735	0.143	0.286	0.923
LEV	11,999	0.176	0.149	0	0.781
MTB	11,999	3.271	3.812	0.125	43.87
ROA	11,999	0.052	0.0910	-1.845	0.355
SIZE	11,999	7.848	1.407	2.876	10.65
FINANCE	11,999	-0.067	0.278	-0.738	2.115
CASH_VOL	11,999	0.072	0.09	0.006	1.020
PPS	11,999	18.06	42.08	0.0173	269.6
INSTOWN	11,999	0.758	0.190	0	1.147
ANALYST	11,999	6.143	7.097	0	28
RETURN	11,999	0.134	0.419	-0.765	2.171
VOL	11,999	0.103	0.0531	0.0302	0.360

Table 2: Correlation matrix

ABS_DA is Absolute value of discretionary accruals computed from the modified Jone's model (Dechow, Sloan, and Sweeney, 1995). *ABS_PMDA* is the absolute value of performance-matched discretionary accruals following Kothari, Leone, and Wasley (2005). *ERI* is a firm's total employee relation strength score minus its total employee relation weakness score. The total employee relation strength score is formed by adding the points a firm receives on criteria for employee relation strength in the KLD database, and the total employ relation weakness score is formed by adding the points the firm receives on criteria for employee relation weakness. *SIZE* is the log value of total assets. *BOARD* is the number of board members sitting on the board. *INDEP%* is the fraction of independent directors on the board. *MTB* is the market value over book value of the firm. Following Wang (2013), *FIN* is measured by asset growth rate – ROA2/(1-ROA2), ROA2 = (income before extraordinary items)/Assets. *PPS* (Pay-for-performance Sensitivity) is measured by first multiplying the Black-Scholes hedge ratio by the shares in options owned by the executive, then adding the shares in stock owned by the executive, and finally dividing the sum by total number of shares outstanding of the company. *LEV* is measured by long-term debt/total asset. *INSTOWN* is the percentage of shares held by institutional investors. *ANALYST* is the number of analysts following the firm. *CASH_VOL* is the cash flow volatility following Yu (2008). *RETURN* is the annual buy-and-hold stock return. VOL is the standard deviation of monthly stock returns in a year.

	ABS_DA	ABS_PMDA	EMP	SIZE	BOARD	INDEP%	MTB	FIN	PPS	LEV	ROA	INSTOWN	ANALYST	CASH_VOL	RETURN	VOL
ABS_DA	1.00															
ABS_PMDA	0.49	1.00														
ERI	0.001	0.03	1.00													
SIZE	-0.08	-0.11	0.16	1.00												
BOARD	-0.03	-0.15	0.07	0.50	1.00											
INDEP%	-0.03	-0.01	0.00	0.07	0.05	1.00										
MTB	0.00	0.09	0.07	0.24	0.04	-0.03	1.00									
FINANCE	0.06	0.07	0.00	0.02	-0.02	-0.05	-0.13	1.00								
PPS	0.01	0.02	-0.05	-0.21	-0.21	-0.22	-0.02	-0.03	1.00							
LEV	0.05	-0.09	-0.05	0.09	0.20	0.08	0.05	0.11	-0.14	1.00						
ROA	-0.24	-0.22	0.07	0.22	0.01	-0.03	0.25	-0.13	0.05	-0.18	1.00					
INSTOWN	0.00	0.09	-0.09	-0.15	-0.24	0.21	-0.04	0.05	-0.14	-0.01	0.01	1.00				
ANALYST	0.02	0.05	-0.05	0.31	0.06	0.09	0.01	0.01	-0.09	-0.01	0.00	0.16	1.00			
CASH_VOL	0.11	0.21	0.03	-0.04	-0.16	-0.14	0.19	0.15	0.03	-0.16	0.04	-0.03	0.01	1.00		
RETURN	0.00	0.00	0.00	0.11	-0.03	-0.03	0.14	0.06	0.00	-0.05	0.13	0.00	0.01	0.13	1.00	
VOL	0.15	0.22	-0.05	-0.33	-0.23	-0.07	-0.05	0.04	0.06	-0.03	-0.27	0.07	0.01	0.19	-0.01	1.00

Table 3: The effect of the Employee Treatment Index on earnings management in OLS regression

This table reports the results of ordinary least squares regressions examining the effect of the Employee Treatment Index on earnings management. The dependent variable is *ABS_DA*. *ABS_DA* is the absolute value of discretionary accruals computed from the modified Jone's model (Dechow, Sloan, and Sweeney, 1995). *ERI* is a firm's total employee relation strength score minus its total employee relation weakness score. The total employee relation strength score is formed by adding the points a firm receives on criteria for employee relation strength in the KLD database, and the total employ relation weakness score is formed by adding the points the firm receives on criteria for employee relation weakness. *SIZE* is the log value of total assets. *BOARD* is the number of board members sitting on the board. *INDEP%* is the fraction of independent directors on the board. *MTB* is the market value over book value of the firm. Following Wang (2013), *FINANCE* is measured by asset growth rate – ROA2/(1-ROA2), ROA2 = (income before extraordinary items)/Assets. *PPS* (Pay-for-performance Sensitivity) is measured by first multiplying the Black-Scholes hedge ratio by the shares in options owned by the executive, then adding the shares in stock owned by the executive, and finally dividing the sum by total number of shares outstanding of the company. *LEV* is measured by long-term debt/total asset. *INSTOWN* is the percentage of shares held by institutional investors. *ANALYST* is the number of analysts following the firm. *CASH_VOL* is the cash flow volatility following Yu (2008). *RETURN* is the annual buy-and-hold stock return. VOL is the standard deviation of monthly stock returns in a year. Two-way clustered standard errors at the firm and year level are used to calculate the t-statistics in parentheses, *** p<0.01, ** p<0.05, * p<0.1

	(1) All firms	(2) Firms with positive DA	(3) Firms with negative DA
ERI	0.23**	0.0004	0.34***
	(2.50)	(0.00)	(2.72)
SIZE	-0.16*	-0.33**	-0.19*
	(-1.87)	(-2.36)	(-1.73)
BOARD	-0.08*	0.14*	-0.13**
	(-1.75)	(1.75)	(-2.47)
INDEP%	-0.89	0.44	-0.98
	(-1.31)	(0.41)	(-1.56)
MTB	0.16***	-0.04	0.20***
	(4.55)	(-0.76)	(4.63)
FINANCE	1.41***	3.32***	1.30***
	(2.90)	(3.94)	(2.70)
PPS	0.00	0.00	-0.00
	(0.09)	(0.57)	(-0.04)
LEV	-2.89***	1.68	-3.20***
	(-3.60)	(1.22)	(-3.73)
ROA	-24.91***	19.33***	-30.71***
	(-5.68)	(4.83)	(-10.49)
INSTOWN	-0.03	0.37	-0.20

	(-0.06)	(0.54)	(-0.31)
ANALYST	0.04	-0.05	0.07***
	(1.32)	(-1.34)	(2.68)
CASH_VOL	8.39***	1.20	9.66***
	(4.11)	(0.48)	(4.58)
RETURN	0.50	0.36	0.54
	(1.56)	(0.80)	(1.64)
VOL	8.06**	15.88***	3.69
	(2.18)	(3.34)	(0.89)
Constant	12.76***	6.87***	12.57***
	(7.62)	(3.87)	(6.56)
Industry fixed effect	Yes	Yes	Yes
Year fixed effect	Yes	Yes	Yes
Observations	11,999	4,222	7,777
R-squared	0.21	0.21	0.30

Table 4: Subcategories of the Employee Treatment Index and income-decreasing earnings manipulation

This table reports the results of ordinary least squares regressions examining the effect of the Employee Treatment Index on income-decreasing earnings management. The dependent variable is *ABS_DA. ABS_DA* is absolute value of discretionary accruals computed from the modified Jone's model (Dechow, Sloan, and Sweeney, 1995). *UNION* is the total score in union relation subcategory. *RETIREMENT* is the total score in retirement benefits subcategory. HEALTH is the total score in health and safety subcategory. *CASH_PROFIT* is the total score in cash profit-sharing program subcategory. *EMP_INVOLVE* is the total score in employee involvement subcategory. *SIZE* is the log value of total assets. *BOARD* is the number of board members sitting on the board. *INDEP%* is the fraction of independent directors on the board. *MTB* is the market value over book value of the firm. Following Wang (2013), *FINANCE* is measured by asset growth rate – ROA2/(1-ROA2), ROA2 = (income before extraordinary items)/Assets. *PPS* (Pay-for-performance Sensitivity) is measured by first multiplying the Black-Scholes hedge ratio by the shares in options owned by the executive, then adding the shares in stock owned by the executive, and finally dividing the sum by total number of shares outstanding of the company. *LEV* is measured by long-term debt/total asset. *INSTOWN* is the percentage of shares held by institutional investors. *ANALYST* is the number of analysts following the firm. *CASH_VOL* is the cash flow volatility following Yu (2008). *RETURN* is the annual buy-and-hold stock return. VOL is the standard deviation of monthly stock returns in a year. Two-way clustered standard errors at the firm and year level are used to calculate the t-statistics in parentheses, *** p<0.01, ** p<0.05, * p<0.1

	Firms with Negative DA				
	(1)	(2)	(3)	(4)	(5)
UNION	0.30				
	(0.50)				
RETIREMENT		0.41			
		(1.48)			
HEALTH			0.18		
			(0.85)		
CASH_PROFIT				0.75**	
				(2.02)	
EMP_INVOVLE					0.56
					(1.49)
SIZE	-0.19	-0.22*	-0.13	-0.19*	-0.20*
	(-1.47)	(-1.69)	(-0.94)	(-1.72)	(-1.79)
BOARD	-0.13**	-0.14**	-0.11*	-0.13**	-0.13**
	(-2.11)	(-2.18)	(-1.81)	(-2.43)	(-2.39)
INDEP%	-0.98	-0.86	-1.17	-1.05*	-1.01
	(-1.55)	(-1.29)	(-1.51)	(-1.69)	(-1.62)
MTB	0.21***	0.22***	0.21***	0.20***	0.20***
	(4.30)	(4.38)	(4.40)	(4.92)	(4.78)
FINANCE	1.53***	1.48***	0.95*	1.30***	1.30***
	(2.95)	(2.81)	(1.69)	(2.67)	(2.66)

PPS	0.00	0.00	0.00	-0.00	-0.00
	(0.20)	(0.33)	(1.47)	(-0.06)	(-0.07)
LEV	-2.76***	-3.21***	-2.45***	-3.29***	-3.27***
	(-2.72)	(-2.96)	(-2.58)	(-3.85)	(-3.88)
ROA	-32.76***	-32.92***	-30.47***	-30.61***	-30.55***
	(-13.72)	(-13.83)	(-8.22)	(-10.38)	(-10.28)
INSTOWN	0.09	0.21	0.25	-0.20	-0.21
	(0.15)	(0.32)	(0.36)	(-0.32)	(-0.34)
ANALYST	0.08***	0.09***	0.08**	0.07***	0.07***
	(3.55)	(3.26)	(2.37)	(2.81)	(2.75)
CASH_VOL	9.79***	9.51***	8.93***	9.70***	9.56***
	(4.79)	(4.68)	(3.90)	(4.58)	(4.52)
RETURN	0.49	0.45	0.68**	0.55	0.55*
	(1.24)	(1.13)	(2.20)	(1.62)	(1.66)
VOL	2.34	2.51	3.68	3.43	3.58
	(0.53)	(0.54)	(0.75)	(0.84)	(0.87)
Constant	12.11***	15.00***	11.28***	12.53***	12.65***
	(7.44)	(9.66)	(4.95)	(6.67)	(6.78)
Industry fixed effect	Yes	Yes	Yes	Yes	Yes
Year fixed effect	Yes	Yes	Yes	Yes	Yes
Observations	6,128	5,752	6,216	7,777	7,777
R-squared	0.33	0.35	0.30	0.30	0.30

Table 5: Firm's characteristics and the Employee Treatment Index

This table reports the results of ordinary least squares regressions examining the effect of the Employee Treatment Index on earnings management. The dependent variable is *ABS_DA*. *ABS_DA* is absolute value of discretionary accruals computed from the modified Jone's model (Dechow, Sloan, and Sweeney, 1995). *ERI* is a firm's total employee relation strength score minus its total employee relation weakness score. The total employee relation strength score is formed by adding the points a firm receives on criteria for employee relation strength in the KLD database, and the total employ relation weakness score is formed by adding the points the firm receives on criteria for employee relation weakness. *SIZE* is the log value of total assets. *BOARD* is the number of board members sitting on the board. *INDEP%* is the fraction of independent directors on the board. *MTB* is the market value over book value of the firm. Following Wang (2013), *FINANCE* is measured by asset growth rate – ROA2/(1-ROA2), ROA2 = (income before extraordinary items)/Assets. *PPS* (Pay-for-performance Sensitivity) is measured by first multiplying the Black-Scholes hedge ratio by the shares in options owned by the executive, then adding the shares in stock owned by the executive, and finally dividing the sum by total number of shares outstanding of the company. *LEV* is measured by long-term debt/total asset. *INSTOWN* is the percentage of shares held by institutional investors. *ANALYST* is the number of analysts following the firm. *CASH_VOL* is the cash flow volatility following Yu (2008). *RETURN* is the annual buy-and-hold stock return. VOL is the standard deviation of monthly stock returns in a year. Two-way clustered standard errors at the firm and year level are used to calculate the t-statistics in parentheses, *** p<0.01, ** p<0.05, * p<0.1

	All firms					
	R&D intensity		High-tech industry		Industry competition	
	High	Low	Yes	No	Low	High
ERI	0.52***	-0.04	0.63***	0.12	0.16	0.25**
	(2.72)	(-0.24)	(3.24)	(1.10)	(1.05)	(2.49)
SIZE	0.27	-0.24	0.24	-0.33***	-0.40***	0.04
	(1.49)	(-1.32)	(1.19)	(-3.46)	(-2.94)	(0.38)
BOARD	-0.17	-0.04	0.04	-0.05	-0.04	-0.10*
	(-1.44)	(-0.41)	(0.28)	(-1.09)	(-0.66)	(-1.75)
INDEP%	0.44	-0.25	0.46	-0.97	-0.71	-0.24
	(0.29)	(-0.19)	(0.39)	(-1.25)	(-0.82)	(-0.28)
MTB	0.22***	0.05	0.36***	0.11***	0.16***	0.15***
	(2.59)	(1.41)	(3.49)	(3.33)	(2.95)	(3.63)
FINANCE	3.52***	0.50	3.04***	1.12*	1.33	1.49***
	(4.15)	(0.75)	(3.24)	(1.85)	(1.49)	(3.33)
PPS	0.00	0.00	-0.00	0.00	-0.00	0.00
	(0.47)	(0.71)	(-0.07)	(0.15)	(-1.02)	(1.59)
LEV	-3.88**	-3.10***	-8.07***	-1.41*	-3.67***	-2.12**
	(-2.02)	(-2.91)	(-5.78)	(-1.79)	(-3.60)	(-2.06)
ROA	-28.03***	-23.68***	-32.59***	-20.10***	-21.59***	-27.37***
	(-7.32)	(-4.46)	(-14.69)	(-3.31)	(-3.73)	(-7.29)
INSTOWN	0.15	-2.38***	1.87*	-0.22	-0.41	0.45
	(0.15)	(-3.84)	(1.75)	(-0.43)	(-0.74)	(0.67)

ANALYST	0.01	0.04	0.02	0.04	0.01	0.06**
	(0.38)	(0.77)	(0.94)	(1.00)	(0.18)	(2.34)
CASH_VOL	4.37*	8.70***	3.88	9.46***	9.02***	6.93***
	(1.93)	(2.59)	(1.38)	(4.00)	(3.29)	(2.92)
RETURN	0.54	0.72**	0.14	0.43	0.45	0.49
	(0.86)	(2.00)	(0.29)	(1.47)	(1.24)	(1.33)
VOL	12.10**	5.01	11.55***	7.45*	7.33*	12.07***
	(2.26)	(1.30)	(3.36)	(1.95)	(1.96)	(3.25)
Constant	8.27***	11.05***	10.76	13.77***	14.57***	3.60**
	(3.69)	(3.91)	(0.28)	(7.20)	(5.98)	(2.40)
Industry fixed effect	Yes	Yes	Yes	Yes	Yes	Yes
Year fixed effect	Yes	Yes	Yes	Yes	Yes	Yes
Observations	3,148	3,810	2,160	9,839	6,172	5,827
R-squared	0.30	0.20	0.40	0.19	0.20	0.24

Table 6: The effect of the Employee Treatment Index on earnings management in OLS regression controlling for firm-fixed effect

The dependent variable is *ABS_DA*. *ABS_DA* is the absolute value of discretionary accruals computed from the modified Jone's model (Dechow, Sloan, and Sweeney, 1995). *ERI* is a firm's total employee relation strength score minus its total employee relation weakness score. The total employee relation strength score is formed by adding the points a firm receives on criteria for employee relation strength in the KLD database, and the total employ relation weakness score is formed by adding the points the firm receives on criteria for employee relation weakness. *SIZE* is the log value of total assets. *BOARD* is the number of board members sitting on the board. *INDEP%* is the fraction of independent directors on the board. *MTB* is the market value over book value of the firm. Following Wang (2013), *FINANCE* is measured by asset growth rate – ROA2/(1-ROA2), ROA2 = (income before extraordinary items)/Assets. *PPS* (Pay-for-performance Sensitivity) is measured by first multiplying the Black-Scholes hedge ratio by the shares in options owned by the executive, then adding the shares in stock owned by the executive, and finally dividing the sum by total number of shares outstanding of the company. *LEV* is measured by long-term debt/total asset. *INSTOWN* is the percentage of shares held by institutional investors. *ANALYST* is the number of analysts following the firm. *CASH_VOL* is the cash flow volatility following Yu (2008). *RETURN* is the annual buy-and-hold stock return. VOL is the standard deviation of monthly stock returns in a year. Two-way clustered standard errors at the firm and year level are used to calculate the t-statistics in parentheses, *** p<0.01, ** p<0.05, * p<0.1

	(1) All firms	(2) Firms with Positive DA	(3) Firms with Negative DA
ERI	0.21*	0.004	0.35**
	(1.86)	(0.02)	(2.48)
SIZE	1.20***	0.37	1.42***
	(3.95)	(0.59)	(4.07)
BOARD	0.02	0.08	0.05
	(0.34)	(0.49)	(0.47)
INDEP%	-1.66	-3.70	0.43
	(-1.33)	(-1.54)	(0.31)
MTB	0.07	0.00	0.05
	(1.48)	(0.04)	(1.06)
FINANCE	2.67***	4.72***	2.60***
	(5.54)	(4.98)	(3.38)
PPS	0.00	0.01	-0.00
	(0.72)	(1.22)	(-0.47)
LEV	-3.34**	-3.22	-1.20
	(-2.45)	(-1.21)	(-0.77)
ROA	-34.00***	25.51***	-42.79***
	(-7.08)	(3.47)	(-17.86)
INSTOWN	-1.81	4.14	-2.96**
	(-1.58)	(1.41)	(-2.09)

ANALYST	-0.00	-0.08*	0.02
	(-0.05)	(-1.94)	(0.94)
CASH_VOL	9.03***	2.12	12.86***
	(2.82)	(0.39)	(4.52)
RETURN	0.18	0.01	0.12
	(0.60)	(0.01)	(0.38)
VOL	3.29	15.55**	-1.02
	(0.92)	(2.29)	(-0.34)
Constant	2.18	0.80	-0.13
	(0.73)	(0.13)	(-0.04)
Firm fixed effect	Yes	Yes	Yes
Year fixed effect	Yes	Yes	Yes
Observations	11,999	4,222	7,777
R-squared	0.39	0.19	0.30

Table 7: The effect of changes in the Employee Treatment Index on changes in the signed discretionary accruals

The dependent variable is change in signed discretionary accruals between year t-1 and year t. All independent variables are measured as changes between year t-1 and year t. *DA* is the discretionary accruals computed from the modified Jone's model (Dechow, Sloan, and Sweeney, 1995). *ERI* is a firm's total employee relation strength score minus its total employee relation weakness score. The total employee relation strength score is formed by adding the points a firm receives on criteria for employee relation strength in the KLD database, and the total employ relation weakness score is formed by adding the points the firm receives on criteria for employee relation weakness. *SIZE* is the log value of total assets. *BOARD* is the number of board members sitting on the board. *INDEP%* is the fraction of independent directors on the board. *MTB* is the market value over book value of the firm. Following Wang (2013), *FINANCE* is measured by asset growth rate – ROA2/(1-ROA2), ROA2 = (income before extraordinary items)/Assets. *PPS* (Pay-for-performance Sensitivity) is measured by first multiplying the Black-Scholes hedge ratio by the shares in options owned by the executive, then adding the shares in stock owned by the executive, and finally dividing the sum by total number of shares outstanding of the company. *LEV* is measured by long-term debt/total asset. *INSTOWN* is the percentage of shares held by institutional investors. *ANALYST* is the number of analysts following the firm. *CASH_VOL* is the cash flow volatility following Yu (2008). *RETURN* is the annual buy-and-hold stock return. VOL is the standard deviation of monthly stock returns in a year. Two-way clustered standard errors at the firm and year level are used to calculate the t-statistics in parentheses, *** p<0.01, ** p<0.05, * p<0.1

	All firms	Firms with Positive DA	Firms with Negative DA
ΔERI	-0.38*	-0.02	-0.47***
	(-1.81)	(-0.06)	(-2.87)
ΔSIZE	-0.49	-0.59	-1.50*
	(-0.58)	(-0.50)	(-1.93)
ΔBOARD	-0.05	0.34	-0.32*
	(-0.30)	(1.19)	(-1.76)
ΔINDEP%	-2.77	-3.44	-1.14
	(-1.61)	(-1.22)	(-0.44)
ΔMTB	0.04	0.07	0.03
	(0.36)	(0.34)	(0.40)
ΔFINANCE	0.77	3.54***	-1.34*
	(0.83)	(4.35)	(-1.65)
ΔPPS	-0.01	-0.01	-0.00
	(-0.50)	(-0.50)	(-0.33)
ΔLEV	-3.13	1.17	-5.23**
	(-1.20)	(0.33)	(-2.02)
ΔROA	52.98***	61.09***	47.33***
	(12.31)	(12.18)	(14.62)
ΔINSTOWN	2.21	3.64	4.04*
	(1.10)	(1.13)	(1.85)

ΔANALYST	-0.05	-0.06	-0.04
	(-1.06)	(-1.08)	(-1.09)
ΔCASH_VOL	-19.98***	-10.80	-20.62**
	(-2.78)	(-1.05)	(-2.36)
ΔRETURN	-0.12	0.02	0.28
	(-0.22)	(0.03)	(0.64)
ΔVOL	3.16	7.08	0.36
	(0.56)	(0.78)	(0.05)
Constant	0.74	13.76**	-12.82***
	(0.19)	(2.53)	(-4.22)
Industry fixed effect	Yes	Yes	Yes
Year fixed effect	Yes	Yes	Yes
Observations	9,911	3,457	6,454
R-squared	0.14	0.24	0.19

Table 8: The effect of the Employee Treatment Index on earnings management in 2SLS regression

This table reports the results of two-stage least squares regressions examining the effect of the Employee Treatment Index on earnings management. The dependent variable is *ABS_DA*. *ABS_DA* is the absolute value of discretionary accruals computed from the modified Jone's model (Dechow, Sloan, and Sweeney, 1995). The instrumental variable in column 1 is the dummy variable for strong noncompetition agreements at the state level, denoted as *NONCOMP*. The instrumental variable in column 2 is the dummy variable for strong wrongful discharge laws at the state level, denoted as *WDL*. *ERI* is a firm's total employee relation strength score minus its total employee relation weakness score. The total employee relation strength score is formed by adding the points a firm receives on criteria for employee relation strength in the KLD database, and the total employ relation weakness score is formed by adding the points the firm receives on criteria for employee relation weakness. *SIZE* is the log value of total assets. *BOARD* is the number of board members sitting on the board. *INDEP%* is the fraction of independent directors on the board. *MTB* is the market value over book value of the firm. Following Wang (2013), *FINANCE* is measured by asset growth rate – ROA2/(1-ROA2), ROA2 = (income before extraordinary items)/Assets. *PPS* (Pay-for-performance Sensitivity) is measured by first multiplying the Black-Scholes hedge ratio by the shares in options owned by the executive, then adding the shares in stock owned by the executive, and finally dividing the sum by total number of shares outstanding of the company. *LEV* is measured by long-term debt/total asset. *INSTOWN* is the percentage of shares held by institutional investors. *ANALYST* is the number of analysts following the firm. *CASH_VOL* is the cash flow volatility following Yu (2008). *RETURN* is the annual buy-and-hold stock return. VOL is the standard deviation of monthly stock returns in a year. Two-way clustered standard errors at the firm and year level are used to calculate the t-statistics in parentheses, *** p<0.01, ** p<0.05, * p<0.1. The p-value for Hansen's J statistic is reported when applicable

	All firms						Firms with Negative DA					
	(1)		(2)		(3)		(4)		(5)		(6)	
	First stage	Second stage	First stage	Second stage	First stage	Second stage	First stage	Second stage	First stage	Second stage	First stage	Second stage
ERI		3.98***		3.51**		3.63***		3.21***		3.57**		3.44***
		(3.86)		(2.22)		(3.01)		(3.24)		(1.97)		(2.89)
SIZE	0.06	-0.39*	0.06	-0.36**	0.06	-0.37*	0.07	-0.38**	0.07	-0.41*	0.07	-0.40**
	(1.61)	(-1.67)	(1.63)	(-1.96)	(1.65)	(-1.94)	(1.64)	(-2.14)	(1.64)	(-1.94)	(1.67)	(-2.12)
BOARD	0.00	-0.08*	0.00	-0.08*	0.00	-0.08*	0.00	-0.14***	0.01	-0.14***	0.01	-0.14***
	(0.20)	(-1.66)	(0.40)	(-1.75)	(0.36)	(-1.73)	(0.41)	(-2.81)	(0.59)	(-2.78)	(0.55)	(-2.80)
INDEP%	0.01	-0.89	-0.02	-0.89	-0.01	-0.89	-0.11	-0.64	-0.13	-0.60	-0.13	-0.62
	(0.04)	(-1.04)	(-0.12)	(-1.08)	(-0.09)	(-1.07)	(-0.73)	(-0.77)	(-0.87)	(-0.69)	(-0.83)	(-0.73)
MTB	0.01	0.14***	0.01	0.14***	0.01	0.14***	0.01	0.18***	0.00	0.18***	0.01	0.18***
	(1.19)	(4.83)	(1.14)	(4.34)	(1.15)	(4.50)	(1.00)	(5.45)	(0.90)	(5.22)	(0.93)	(5.37)
FINANCE	-0.02	1.49***	-0.02	1.48***	-0.02	1.49***	-0.05	1.45***	-0.05	1.47***	-0.06	1.47***
	(-0.59)	(3.45)	(-0.57)	(3.44)	(-0.58)	(3.45)	(-1.42)	(3.16)	(-1.39)	(3.36)	(-1.44)	(3.30)
PPS	-0.00	0.00	-0.00	0.00	-0.00	0.00	-0.00	0.00	-0.00	0.00	-0.00	0.00

	(-1.70)	(0.97)	(-1.71)	(0.91)	(-1.73)	(0.94)	(-1.56)	(0.59)	(-1.58)	(0.57)	(-1.58)	(0.59)
LEV	-0.37***	-1.47*	-0.36***	-1.65	-0.36***	-1.61*	-0.42***	-1.99*	-0.40***	-1.84	-0.40***	-1.90*
	(-3.10)	(-1.69)	(-3.04)	(-1.62)	(-3.03)	(-1.71)	(-3.05)	(-1.81)	(-2.98)	(-1.55)	(-2.96)	(-1.76)
ROA	0.40**	-26.41***	0.40**	-26.22***	0.40**	-26.26***	0.41**	-31.88***	0.41**	-32.03***	0.41**	-31.97***
	(2.23)	(-6.52)	(2.25)	(-6.52)	(2.27)	(-6.54)	(2.47)	(-11.44)	(2.45)	(-11.63)	(2.50)	(-11.69)
INSTOWN	-0.18	0.58	-0.16	0.50	-0.17	0.52	-0.16	0.24	-0.16	0.30	-0.16	0.28
	(-1.66)	(1.03)	(-1.59)	(0.77)	(-1.67)	(0.84)	(-1.52)	(0.33)	(-1.49)	(0.35)	(-1.55)	(0.35)
ANALYST	0.01	0.01	0.01	0.01	0.01	0.01	0.01	0.05*	0.01	0.05	0.01	0.05*
	(1.34)	(0.37)	(1.23)	(0.40)	(1.25)	(0.40)	(1.42)	(1.89)	(1.35)	(1.54)	(1.37)	(1.73)
CASH_VOL	0.09	8.06***	0.06	8.10***	0.07	8.09***	0.19	9.15***	0.16	9.09***	0.17	9.11***
	(0.54)	(4.31)	(0.38)	(4.34)	(0.41)	(4.34)	(0.95)	(4.69)	(0.82)	(4.61)	(0.86)	(4.66)
RETURN	-0.06*	0.71**	-0.06*	0.68**	-0.06*	0.69**	-0.06	0.71**	-0.06	0.73**	-0.06	0.73**
	(-2.03)	(2.27)	(-2.02)	(2.12)	(-2.02)	(2.18)	(-1.71)	(2.43)	(-1.65)	(2.23)	(-1.67)	(2.34)
VOL	-0.09	8.43**	-0.12	8.38**	-0.11	8.39**	-0.08	3.93	-0.10	3.96	-0.09	3.95
	(-0.30)	(2.22)	(-0.42)	(2.23)	(-0.38)	(2.23)	(-0.22)	(0.90)	(-0.27)	(0.89)	(-0.25)	(0.90)
NONCOMP	-0.53***				-0.43**		-0.62***				-0.53***	
	(-3.07)				(-2.50)		(-4.24)				(-3.55)	
WDL			0.12***		0.11***				0.11**		0.10**	
			(3.19)		(3.00)				(2.71)		(2.51)	
Industry fixed effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year fixed effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
F statistic	9.44		10.19		9.18		17.96		7.33		12.65	
Hansen J statistic (P-value)					0.7988						0.8636	
Observations	11,999	11,999	11,999	11,999	11,999	11,999	7,777	7,777	7,777	7,777	7,777	7,777
R-squared	0.03	0.07	0.03	0.03	0.03	0.04	0.02	0.08	0.04	0.05	0.04	0.06

Table 9: Performance-matched discretionary accruals and the Employee Treatment Index
This table reports the results of ordinary least squares regressions examining the effect of the Employee Treatment Index on earnings management. The dependent variable is *ABS_PMDA*. *ABS_PMDA* is the absolute value of performance-matched discretionary accruals following Kothari, Leone, and Wasley (2005). *ERI* is a firm's total employee relation strength score minus its total employee relation weakness score. The total employee relation strength score is formed by adding the points a firm receives on criteria for employee relation strength in the KLD database, and the total employ relation weakness score is formed by adding the points the firm receives on criteria for employee relation weakness. *SIZE* is the log value of total assets. *BOARD* is the number of board members sitting on the board. *INDEP%* is the fraction of independent directors on the board. *MTB* is the market value over book value of the firm. Following Wang (2013), *FINANCE* is measured by asset growth rate – ROA2/(1-ROA2), ROA2 = (income before extraordinary items)/Assets. *PPS* (Pay-for-performance Sensitivity) is measured by first multiplying the Black-Scholes hedge ratio by the shares in options owned by the executive, then adding the shares in stock owned by the executive, and finally dividing the sum by total number of shares outstanding of the company. *LEV* is measured by long-term debt/total asset. *INSTOWN* is the percentage of shares held by institutional investors. *ANALYST* is the number of analysts following the firm. *CASH_VOL* is the cash flow volatility following Yu (2008). *RETURN* is the annual buy-and-hold stock return. VOL is the standard deviation of monthly stock returns in a year. Two-way clustered standard errors at the firm and year level are used to calculate the t-statistics in parentheses, *** p<0.01, ** p<0.05, * p<0.1

	All firms	Firms with Positive DA	Firms with Negative DA
ERI	0.27***	0.04	0.32***
	(3.72)	(0.43)	(2.77)
SIZE	-0.10	-0.37***	-0.09
	(-1.22)	(-3.92)	(-0.94)
BOARD	-0.09**	0.09*	-0.12***
	(-2.11)	(1.66)	(-2.80)
INDEP%	-0.15	0.85	-0.42
	(-0.32)	(1.19)	(-0.74)
MTB	0.19***	0.01	0.26***
	(5.71)	(0.23)	(5.49)
FINANCE	0.72*	2.04***	0.64
	(1.77)	(3.23)	(1.44)
PPS	0.00	-0.00	0.00
	(0.45)	(-0.62)	(0.93)
LEV	-3.73***	0.81	-4.83***
	(-8.36)	(1.08)	(-9.68)
ROA	-15.28***	12.41***	-19.67***
	(-4.74)	(6.44)	(-8.44)
INSTOWN	0.75**	-0.34	1.33***
	(2.09)	(-0.93)	(2.59)
ANALYST	0.03*	-0.05***	0.05***

	(1.78)	(-2.65)	(2.70)
CASH_VOL	8.18***	5.26**	9.54***
	(4.49)	(2.43)	(5.43)
RETURN	0.03	0.31	-0.12
	(0.12)	(1.00)	(-0.33)
VOL	12.58***	14.52***	12.39***
	(5.78)	(5.77)	(4.38)
Constant	4.17***	0.90	4.68***
	(4.43)	(0.76)	(4.29)
Industry fixed effect	Yes	Yes	Yes
Year fixed effect	Yes	Yes	Yes
Observations	11,948	4,152	7,796
R-squared	0.19	0.17	0.26

Table 10: The effect of the Employee Treatment Index with total employee relation strength score on earnings management in OLS regression

This table reports the results of ordinary least squares regressions examining the effect of the Employee Treatment Index on earnings management. The dependent variable is *ABS_DA*. *ABS_DA* is the absolute value of discretionary accruals computed from the modified Jone's model (Dechow, Sloan, and Sweeney, 1995). *ERI_STRENGTH* is a firm's total employee relation strength score. The total employee relation strength score is formed by adding the points a firm receives on criteria for employee relation strength in the KLD database, and the total employ relation weakness score is formed by adding the points the firm receives on criteria for employee relation weakness. *SIZE* is the log value of total assets. *BOARD* is the number of board members sitting on the board. *INDEP%* is the fraction of independent directors on the board. *MTB* is the market value over book value of the firm. Following Wang (2013), *FINANCE* is measured by asset growth rate – ROA2/(1-ROA2), ROA2 = (income before extraordinary items)/Assets. *PPS* (Pay-for-performance Sensitivity) is measured by first multiplying the Black-Scholes hedge ratio by the shares in options owned by the executive, then adding the shares in stock owned by the executive, and finally dividing the sum by total number of shares outstanding of the company. *LEV* is measured by long-term debt/total asset. *INSTOWN* is the percentage of shares held by institutional investors. *ANALYST* is the number of analysts following the firm. *CASH_VOL* is the cash flow volatility following Yu (2008). *RETURN* is the annual buy-and-hold stock return. VOL is the standard deviation of monthly stock returns in a year. Two-way clustered standard errors at the firm and year level are used to calculate the t-statistics in parentheses, *** p<0.01, ** p<0.05, * p<0.1

	All firms	Firms with Positive DA	Firms with Negative DA
ERI_STRENGTH	0.19*	0.10	0.28**
	(1.72)	(0.45)	(2.14)
SIZE	-0.19**	-0.35**	-0.23**
	(-2.03)	(-2.56)	(-1.99)
BOARD	-0.08*	0.13*	-0.13**
	(-1.80)	(1.77)	(-2.51)
INDEP%	-0.95	0.40	-1.09*
	(-1.40)	(0.38)	(-1.72)
MTB	0.16***	-0.04	0.20***
	(4.51)	(-0.75)	(4.74)
FINANCE	1.43***	3.33***	1.32***
	(2.90)	(3.96)	(2.72)
PPS	0.00	0.00	-0.00
	(0.08)	(0.61)	(-0.05)
LEV	-2.94***	1.70	-3.28***
	(-3.67)	(1.22)	(-3.86)
ROA	-24.80***	19.37***	-30.56***
	(-5.61)	(4.79)	(-10.31)
INSTOWN	0.00	0.40	-0.15
	(0.00)	(0.60)	(-0.23)

ANALYST	0.04	-0.05	0.07***
	(1.32)	(-1.34)	(2.72)
CASH_VOL	8.37***	1.20	9.64***
	(4.08)	(0.48)	(4.56)
RETURN	0.51	0.37	0.56*
	(1.60)	(0.83)	(1.68)
VOL	7.91**	15.81***	3.45
	(2.13)	(3.38)	(0.83)
Constant	12.96***	6.98***	12.85***
	(7.72)	(3.88)	(6.71)
Year fixed effect	Yes	Yes	Yes
Firm-fixed effect	Yes	Yes	Yes
Observations	11,999	4,222	7,777
R-squared	0.21	0.21	0.30

Table 11: Test of the difference in earnings management between firms in *Fortune*'s "100 Best Companies to Work For" and matching firms using propensity score matching.

This table presents the test of the difference in earnings management between firms in Fortune magazine's list of "100 Best Companies to Work For" and matching firms in Compustat. The sample includes all publicly traded firms that are in Fortune's "100 Best Companies to Work For" from 1998 to 2008. The dependent variable is *ABS_DA.* We match each firm in Fortune's list with a firm that is in Compustat but not in Fortune's list using the nearest neighborhood, a Gaussian kernel, and local linear regression matching approaches. The variables we use in matching are market-to-book ratio, log of sales, ratio of fixed assets to total assets, return on assets, ratio of R&D expenditures to sales, ratio of SGA expenses to sales, dividend-paying dummy, ratio of sales to total assets, pension and retirement expenses per worker, firm age, board size, and independent director%. Robust Abadie-Imbens standard errors are used to calculate the t-values in parentheses. 95% confidence intervals are in brackets.

All firms		Firms with Positive DA		Firms with Negative DA	
Propensity-score Matching	Nearest-neighbor matching	Propensity-score Matching	Nearest-neighbor matching	Propensity-score Matching	Nearest-neighbor matching
2.65***	3.24***	6.73***	6.32**	1.70**	1.88*
(2.67)	(2.98)	(6.93)	(2.24)	(2.29)	(1.96)
[0.703, 4.605]	[1.11, 5.366]	[1.182, 10.321]	[0.790, 11.847]	[0.245, 3.153]	[-0.096, 3.847]

Table 12: The effect of the Employee Treatment Index on earnings management in OLS regression controlling for substitution effect of real activities manipulation

The dependent variable is *ABS_DA*. *ABS_DA* is the absolute value of discretionary accruals computed from the modified Jone's model (Dechow, Sloan, and Sweeney, 1995). *ERI* is a firm's total employee relation strength score minus its total employee relation weakness score. The total employee relation strength score is formed by adding the points a firm receives on criteria for employee relation strength in the KLD database, and the total employ relation weakness score is formed by adding the points the firm receives on criteria for employee relation weakness. *AB_CFO* is abnormal levels of operating cash flow. *AB_PROD* is abnormal production cost. *AB_EXP* is abnormal discretionary expenses. *COMBINED_RAM* is a combined measure of real activities manipulation. *SIZE* is the log value of total assets. *BOARD* is the number of board members sitting on the board. *INDEP%* is the fraction of independent directors on the board. *MTB* is the market value over book value of the firm. Following Wang (2013), *FINANCE* is measured by asset growth rate – ROA2/(1-ROA2), ROA2 = (income before extraordinary items)/Assets. *PPS* (Pay-for-performance Sensitivity) is measured by first multiplying the Black-Scholes hedge ratio by the shares in options owned by the executive, then adding the shares in stock owned by the executive, and finally dividing the sum by total number of shares outstanding of the company. *LEV* is measured by long-term debt/total asset. *INSTOWN* is the percentage of shares held by institutional investors. *ANALYST* is the number of analysts following the firm. *CASH_VOL* is the cash flow volatility following Yu (2008). *RETURN* is the annual buy-and-hold stock return. VOL is the standard deviation of monthly stock returns in a year. Two-way clustered standard errors at the firm and year level are used to calculate the t-statistics in parentheses, *** p<0.01, ** p<0.05, * p<0.1

	(1)			(2)			(3)			(4)		
	All firms	Firms with Positive DA	Firms with Negative DA	All firms	Firms with Positive DA	Firms with Negative DA	All firms	Firms with Positive DA	Firms with Negative DA	All firms	Firms with Positive DA	Firms with Negative DA
ERI	0.15*	0.02	0.21*	0.19**	0.07	0.28**	0.23**	0.0002	0.33***	0.17*	0.07	0.24**
	(1.69)	(0.12)	(1.86)	(2.21)	(0.45)	(2.32)	(2.50)	(0.00)	(2.69)	(1.92)	(0.41)	(1.98)
AB_CFO	0.17***	-0.09**	0.32***									
	(6.26)	(-2.53)	(16.03)									
AB_PROD				-0.03***	0.04***	-0.06***						
				(-3.65)	(3.48)	(-5.87)						
AB_EXP							0.02	-0.003	0.03**			
							(1.11)	(-0.13)	(2.08)			
COMBINED_RAM										0.04***	-0.03***	0.07***
										(6.29)	(-3.31)	(11.72)
SIZE	-0.37***	-0.21	-0.52***	-0.17**	-0.33**	-0.21**	-0.15*	-0.33**	-0.18	-0.20**	-0.31**	-0.25**
	(-4.57)	(-1.39)	(-5.19)	(-2.04)	(-2.43)	(-2.04)	(-1.77)	(-2.39)	(-1.59)	(-2.41)	(-2.23)	(-2.44)
BOARD	-0.00	0.11	0.02	-0.06	0.14*	-0.08	-0.08*	0.14*	-0.13**	-0.03	0.14*	-0.03
	(-0.02)	(1.35)	(0.46)	(-1.27)	(1.72)	(-1.54)	(-1.73)	(1.73)	(-2.39)	(-0.78)	(1.65)	(-0.61)
INDEP%	-0.48	0.34	0.08	-0.89	0.53	-0.90	-0.85	0.43	-0.95	-0.71	0.38	-0.57

	(-0.72)	(0.31)	(0.13)	(-1.26)	(0.48)	(-1.40)	(-1.26)	(0.41)	(-1.50)	(-1.02)	(0.35)	(-0.88)
MTB	0.12***	-0.04	0.12***	0.13***	-0.02	0.14***	0.15***	-0.04	0.19***	0.11***	-0.02	0.10***
	(3.80)	(-0.70)	(3.20)	(3.62)	(-0.38)	(3.90)	(4.38)	(-0.75)	(4.53)	(3.41)	(-0.43)	(2.90)
FIN	1.58***	3.36***	1.50***	1.65***	3.29***	1.61***	1.37***	3.32***	1.19**	1.62***	3.37***	1.45***
	(3.72)	(3.94)	(3.49)	(3.42)	(3.81)	(3.32)	(2.77)	(3.93)	(2.51)	(3.44)	(3.89)	(3.18)
PPS	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	-0.00	0.00	0.00	0.00
	(0.54)	(0.35)	(0.41)	(0.18)	(0.55)	(0.03)	(0.06)	(0.57)	(-0.10)	(0.20)	(0.50)	(0.01)
LEV	-2.09***	1.71	-1.51*	-2.63***	1.46	-2.60***	-2.85***	1.68	-3.11***	-2.27***	1.45	-1.89**
	(-2.71)	(1.25)	(-1.84)	(-3.15)	(1.02)	(-3.03)	(-3.48)	(1.21)	(-3.63)	(-2.73)	(1.03)	(-2.28)
ROA	-29.54***	24.99***	-39.82***	-25.67***	22.95***	-32.29***	-24.90***	19.33***	-30.67***	-26.92***	23.91***	-34.51***
	(-7.57)	(4.63)	(-22.06)	(-5.83)	(5.48)	(-11.69)	(-5.64)	(4.82)	(-10.35)	(-6.26)	(5.27)	(-14.27)
INSTOWN	-0.29	0.35	-0.68	-0.09	0.04	-0.26	-0.05	0.37	-0.21	-0.18	0.14	-0.40
	(-0.66)	(0.49)	(-1.39)	(-0.18)	(0.06)	(-0.43)	(-0.09)	(0.55)	(-0.32)	(-0.39)	(0.21)	(-0.66)
ANALYST	0.03	-0.06	0.06**	0.04	-0.05	0.07***	0.04	-0.05	0.07***	0.03	-0.05	0.06**
	(1.05)	(-1.37)	(2.23)	(1.28)	(-1.37)	(2.87)	(1.32)	(-1.35)	(2.66)	(1.16)	(-1.31)	(2.46)
CASH_VOL	7.06***	1.20	6.51***	7.72***	1.44	8.54***	8.33***	1.22	9.61***	7.15***	1.46	7.55***
	(3.92)	(0.47)	(3.80)	(3.82)	(0.53)	(4.19)	(4.08)	(0.49)	(4.50)	(3.68)	(0.54)	(3.79)
RETURN	0.47*	0.33	0.40	0.50	0.20	0.54	0.49	0.37	0.53	0.48	0.23	0.48
	(1.68)	(0.69)	(1.43)	(1.60)	(0.47)	(1.62)	(1.54)	(0.82)	(1.59)	(1.55)	(0.53)	(1.46)
VOL	7.27**	15.62***	1.55	7.96**	16.71***	3.19	8.04**	15.88***	3.61	7.65**	16.46***	2.41
	(2.03)	(3.17)	(0.41)	(2.32)	(3.62)	(0.85)	(2.17)	(3.35)	(0.89)	(2.24)	(3.54)	(0.68)
Constant	14.34***	5.85***	14.85***	13.18***	6.39***	12.74***	12.66***	6.89***	12.40***	13.41***	6.38***	12.68***
	(8.78)	(3.16)	(8.08)	(7.92)	(3.52)	(6.78)	(7.59)	(3.93)	(6.41)	(8.34)	(3.58)	(6.92)
Industry fixed effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year fixed effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	11,948	4,210	7,738	11,707	4,121	7,586	11,999	4,222	7,777	11,707	4,121	7,586
R-squared	0.23	0.21	0.38	0.21	0.21	0.31	0.21	0.21	0.30	0.22	0.21	0.33

Table 13: The effect of the Employee Treatment Index on earnings management in OLS regression excluding non-articulation events

This table reports the results of ordinary least squares regressions examining the effect of the Employee Treatment Index on earnings management. The dependent variable is *ABS_DA*. *ABS_DA* is the absolute value of discretionary accruals computed from the modified Jone's model (Dechow, Sloan, and Sweeney, 1995). *ERI* is a firm's total employee relation strength score minus its total employee relation weakness score. The total employee relation strength score is formed by adding the points a firm receives on criteria for employee relation strength in the KLD database, and the total employ relation weakness score is formed by adding the points the firm receives on criteria for employee relation weakness. *SIZE* is the log value of total assets. *BOARD* is the number of board members sitting on the board. *INDEP%* is the fraction of independent directors on the board. *MTB* is the market value over book value of the firm. Following Wang (2013), *FINANCE* is measured by asset growth rate – ROA2/(1-ROA2), ROA2 = (income before extraordinary items)/Assets. *PPS* (Pay-for-performance Sensitivity) is measured by first multiplying the Black-Scholes hedge ratio by the shares in options owned by the executive, then adding the shares in stock owned by the executive, and finally dividing the sum by total number of shares outstanding of the company. *LEV* is measured by long-term debt/total asset. *INSTOWN* is the percentage of shares held by institutional investors. *ANALYST* is the number of analysts following the firm. *CASH_VOL* is the cash flow volatility following Yu (2008). *RETURN* is the annual buy-and-hold stock return. VOL is the standard deviation of monthly stock returns in a year. Two-way clustered standard errors at the firm and year level are used to calculate the t-statistics in parentheses, *** p<0.01, ** p<0.05, * p<0.1

	Excluding M&A			Excluding divestitures			Excluding foreign currency translations		
	All firms	Firms with Positive DA	Firms with Negative DA	All firms	Firms with Positive DA	Firms with Negative DA	All firms	Firms with Positive DA	Firms with Negative DA
ERI	0.23**	-0.04	0.36***	0.23**	-0.08	0.36***	0.25***	0.02	0.36***
	(2.54)	(-0.30)	(2.88)	(2.23)	(-0.51)	(2.60)	(2.64)	(0.10)	(2.73)
SIZE	-0.16*	-0.33**	-0.19	-0.17*	-0.37**	-0.19	-0.20**	-0.45***	-0.18
	(-1.70)	(-2.17)	(-1.60)	(-1.75)	(-2.37)	(-1.60)	(-2.17)	(-2.84)	(-1.62)
BOARD	-0.08	0.12	-0.13**	-0.07	0.14	-0.12**	-0.10**	0.13	-0.16***
	(-1.62)	(1.64)	(-2.42)	(-1.39)	(1.54)	(-2.23)	(-2.31)	(1.40)	(-3.06)
INDEP%	-0.70	0.23	-0.63	-1.07	-0.00	-1.15	-1.06	0.24	-1.08

	(-1.03)	(0.22)	(-1.02)	(-1.47)	(-0.00)	(-1.58)	(-1.43)	(0.20)	(-1.35)
MTB	0.15***	-0.04	0.19***	0.16***	-0.04	0.19***	0.16***	-0.04	0.20***
	(4.34)	(-0.75)	(4.66)	(4.44)	(-0.90)	(4.40)	(4.07)	(-0.75)	(4.93)
FINANCE	1.43***	3.33***	1.34***	1.55***	3.56***	1.45***	1.42***	3.46***	1.28**
	(2.92)	(3.94)	(2.63)	(3.20)	(4.36)	(2.95)	(2.64)	(4.36)	(2.30)
PPS	0.00	0.00	-0.00	-0.00	0.00	-0.00	-0.00	0.00	-0.00
	(0.03)	(0.40)	(-0.05)	(-0.21)	(0.24)	(-0.10)	(-0.16)	(0.13)	(-0.10)
LEV	-2.93***	1.85	-3.35***	-3.13***	1.60	-3.42***	-2.92***	1.65	-3.33***
	(-3.58)	(1.25)	(-3.81)	(-3.80)	(1.15)	(-4.20)	(-3.52)	(1.25)	(-3.69)
ROA	-24.96***	19.33***	-30.79***	-24.43***	22.32***	-30.33***	-24.36***	20.21***	-30.19***
	(-5.78)	(4.81)	(-10.77)	(-5.34)	(6.08)	(-9.75)	(-5.75)	(4.95)	(-10.75)
INSTOWN	-0.11	0.39	-0.31	-0.04	0.05	-0.08	0.07	0.60	-0.19
	(-0.23)	(0.57)	(-0.48)	(-0.07)	(0.07)	(-0.11)	(0.12)	(0.81)	(-0.27)
ANALYST	0.03	-0.06	0.07**	0.03	-0.04	0.06**	0.04	-0.04	0.07***
	(1.14)	(-1.37)	(2.42)	(1.21)	(-0.90)	(2.21)	(1.50)	(-0.95)	(2.58)
CASH_VOL	8.32***	1.21	9.56***	8.22***	0.70	9.46***	8.81***	1.17	10.67***
	(4.00)	(0.48)	(4.39)	(3.89)	(0.26)	(4.34)	(3.81)	(0.44)	(4.35)
RETURN	0.54*	0.42	0.60*	0.47	0.49	0.49	0.53	0.55	0.47
	(1.69)	(0.87)	(1.78)	(1.36)	(0.90)	(1.34)	(1.52)	(1.07)	(1.33)
VOL	8.36**	15.80***	3.92	9.39**	16.82***	5.21	8.27**	15.96***	3.81
	(2.27)	(3.49)	(0.94)	(2.49)	(3.68)	(1.18)	(2.18)	(3.16)	(0.88)
Constant	10.37***	7.37***	11.56***	10.31***	5.47***	12.70***	12.83***	7.61***	12.78***
	(6.22)	(3.97)	(5.66)	(5.87)	(2.64)	(6.30)	(7.51)	(3.33)	(7.07)
Year fixed effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Firm-fixed	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

effect									
Observation	11,471	4,052	7,419	10,813	3,739	7,074	10,550	3,675	6,875
R-squared	0.20	0.21	0.29	0.21	0.21	0.29	0.20	0.21	0.30

Table 14: The relation between the Employee Treatment Index and earnings management controlling for managerial entrenchment

The dependent variables is *ABS_DA*. *ABS_DA* is the absolute value of discretionary accruals computed from the modified Jone's model (Dechow, Sloan, and Sweeney, 1995). *ERI* is a firm's total employee relation strength score minus its total employee relation weakness score. The total employee relation strength score is formed by adding the points a firm receives on criteria for employee relation strength in the KLD database, and the total employ relation weakness score is formed by adding the points the firm receives on criteria for employee relation weakness. *EINDEX* is an index measuring the managerial entrenchment obtained from Bebchuk, Cohen, and Ferrel (2008). *TENURE* is measured by the log value of number of years since CEO takes the position. CPS is measured by the fraction of the aggregate compensation of the top-five executive team captured by the CEO (Bebchuk, Cremers, and Peyer, 2011). *BOARD* is the number of board members sitting on the board. *INDEP%* is the fraction of independent directors on the board. *MTB* is the market value over book value of the firm. Following Wang (2013), *FINANCE* is measured by asset growth rate – ROA2/(1-ROA2), ROA2 = (income before extraordinary items)/Assets. *PPS* (Pay-for-performance Sensitivity) is measured by first multiplying the Black-Scholes hedge ratio by the shares in options owned by the executive, then adding the shares in stock owned by the executive, and finally dividing the sum by total number of shares outstanding of the company. *LEV* is measured by long-term debt/total asset. *INSTOWN* is the percentage of shares held by institutional investors. *ANALYST* is the number of analysts following the firm. *CASH_VOL* is the cash flow volatility following Yu (2008). *RETURN* is the annual buy-and-hold stock return. VOL is the standard deviation of monthly stock returns in a year. Two-way clustered standard errors based at the firm and year level are used to calculate the t-statistics in parentheses, *** p<0.01, ** p<0.05, * p<0.1

	(1)			(2)			(3)		
	All firms	Firms with Positive DA	Firms with Negative DA	All firms	Firms with Positive DA	Firms with Negative DA	All firms	Firms with Positive DA	Firms with Negative DA
ERI	0.28**	0.002	0.50***	0.24***	0.01	0.34**	0.22**	-0.02	0.33***
	(2.02)	(0.01)	(2.81)	(2.67)	(0.06)	(2.55)	(2.46)	(-0.11)	(2.70)
EINDEX	0.01	0.06	-0.11						
	(0.05)	(0.59)	(-0.85)						
TENURE				-0.17	-0.45**	-0.03			
				(-1.59)	(-2.04)	(-0.24)			
CPS							-0.61	-1.70	0.05
							(-0.87)	(-1.51)	(0.05)

SIZE	0.02	0.27	-0.18	-0.15*	-0.33**	-0.18	-0.17*	-0.33**	-0.20*
	(0.27)	(1.54)	(-1.09)	(-1.72)	(-2.25)	(-1.56)	(-1.89)	(-2.31)	(-1.77)
BOARD	-0.10	-0.06	-0.09	-0.09*	0.12	-0.15**	-0.08*	0.13*	-0.13**
	(-0.91)	(-0.42)	(-1.01)	(-1.94)	(1.48)	(-2.55)	(-1.69)	(1.72)	(-2.32)
INDEP%	-1.12	1.15	-1.77**	-0.71	0.56	-0.87	-0.78	0.64	-0.92
	(-0.99)	(0.61)	(-2.22)	(-1.01)	(0.50)	(-1.29)	(-1.20)	(0.59)	(-1.49)
MTB	0.14***	-0.02	0.25***	0.16***	-0.03	0.20***	0.16***	-0.04	0.20***
	(2.62)	(-0.43)	(2.97)	(4.42)	(-0.70)	(4.99)	(4.46)	(-0.80)	(4.58)
FIN	1.06*	1.32	1.50**	1.36**	3.51***	1.13**	1.40***	3.30***	1.29***
	(1.90)	(1.24)	(2.54)	(2.48)	(4.36)	(2.12)	(2.83)	(3.91)	(2.59)
PPS	-0.00	-0.00	-0.00	0.00	0.01	0.00	0.00	0.00	-0.00
	(-0.77)	(-0.08)	(-1.25)	(0.59)	(1.19)	(0.10)	(0.02)	(0.39)	(-0.03)
LEV	-1.84	3.58**	-2.83**	-2.85***	1.80	-3.27***	-2.91***	1.76	-3.28***
	(-1.28)	(2.03)	(-1.99)	(-3.73)	(1.31)	(-4.07)	(-3.52)	(1.27)	(-3.70)
ROA	-23.30***	20.43**	-33.40***	-25.09***	18.97***	-30.98***	-24.90***	19.37***	-30.75***
	(-4.03)	(2.24)	(-7.96)	(-5.83)	(4.82)	(-11.38)	(-5.66)	(4.84)	(-10.54)
INSTOWN	0.03	0.10	0.24	-0.14	0.35	-0.35	-0.04	0.42	-0.24
	(0.04)	(0.10)	(0.21)	(-0.26)	(0.48)	(-0.52)	(-0.08)	(0.63)	(-0.37)
ANALYST	0.03	-0.10**	0.08*	0.04	-0.05	0.07***	0.04	-0.05	0.07***
	(1.01)	(-2.43)	(1.91)	(1.32)	(-1.40)	(2.67)	(1.33)	(-1.39)	(2.72)
CASH_VOL	5.98***	-1.48	7.79***	8.67***	1.53	10.01***	8.39***	1.14	9.71***
	(4.34)	(-0.61)	(4.27)	(4.08)	(0.57)	(4.42)	(4.10)	(0.45)	(4.59)
RETURN	0.34	-0.66	1.16	0.54	0.42	0.59*	0.49	0.40	0.50
	(0.57)	(-0.92)	(1.54)	(1.59)	(0.89)	(1.70)	(1.54)	(0.89)	(1.54)
VOL	11.45	24.28***	6.17	8.25**	15.95***	3.90	7.83**	15.51***	3.51
	(1.63)	(2.85)	(0.98)	(2.15)	(3.21)	(0.94)	(2.10)	(3.33)	(0.85)

Constant	12.97***	5.48**	14.95***	13.38***	7.84***	12.73***	10.66***	5.09**	12.62***
	(8.37)	(2.15)	(4.36)	(7.61)	(3.78)	(6.53)	(6.22)	(2.57)	(6.21)
Industry fixed effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year fixed effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	2,910	1,118	1,792	11,627	4,076	7,551	11,970	4,215	7,755
R-squared	0.35	0.39	0.45	0.21	0.21	0.30	0.21	0.21	0.30

Table 15: The relation between the Employee Treatment Index and earnings management controlling for labor related factors

The dependent variables is *ABS_DA*. *ABS_DA* is the absolute value of discretionary accruals computed from the modified Jone's model (Dechow, Sloan, and Sweeney, 1995). *ERI* is a firm's total employee relation strength score minus its total employee relation weakness score. The total employee relation strength score is formed by adding the points a firm receives on criteria for employee relation strength in the KLD database, and the total employ relation weakness score is formed by adding the points the firm receives on criteria for employee relation weakness. *UNION_MEM* is the percentage of employees joined in labor union at the industry level. *IND_LABOR* is labor expense divided by the number of the employees at the industry level. *EMP_OPTION* is the value of options granted to nonexecutive employees per worker estimated by Black-Scholes option pricing model. *FIX/AT* is the ratio of fixed assets over total assets. *SIZE* is the log value of total assets. *BOARD* is the number of board members sitting on the board. *INDEP%* is the fraction of independent directors on the board. *MTB* is the market value over book value of the firm. Following Wang (2013), *FINANCE* is measured by asset growth rate – ROA2/(1-ROA2), ROA2 = (income before extraordinary items)/Assets. *PPS* (Pay-for-performance Sensitivity) is measured by first multiplying the Black-Scholes hedge ratio by the shares in options owned by the executive, then adding the shares in stock owned by the executive, and finally dividing the sum by total number of shares outstanding of the company. *LEV* is measured by long-term debt/total asset. *INSTOWN* is the percentage of shares held by institutional investors. *ANALYST* is the number of analysts following the firm. *CASH_VOL* is the cash flow volatility following Yu (2008). *RETURN* is the annual buy-and-hold stock return. VOL is the standard deviation of monthly stock returns in a year. Two-way clustered standard errors based at the firm and year level are used to calculate the t-statistics in parentheses, *** p<0.01, ** p<0.05, * p<0.1

	(1)			(2)			(3)		
	All firms	Firms with positive DA	Firms with Negative DA	All firms	Firms with positive DA	Firms with Negative DA	All firms	Firms with positive DA	Firms with Negative DA
ERI	0.30***	0.07	0.36***	0.23**	-0.001	0.34***	0.39***	0.30	0.54**
	(2.87)	(0.45)	(2.58)	(2.52)	(-0.01)	(2.74)	(2.86)	(0.99)	(2.22)
UNION_MEM	-0.04	-0.08	-0.04						
	(-0.80)	(-0.70)	(-0.84)						
IND_LABOR				0.002	0.01	0.00			
				(0.16)	(0.52)	(0.04)			
EMP_OPTION							6.79	-36.92***	19.63

							(0.60)	(-3.29)	(1.40)
SIZE	-0.11	-0.31*	-0.14	-0.16*	-0.33**	-0.19*	-0.02	-0.01	-0.21
	(-1.12)	(-1.76)	(-1.20)	(-1.87)	(-2.40)	(-1.76)	(-0.19)	(-0.06)	(-1.36)
BOARD	-0.07	0.19**	-0.13**	-0.08*	0.14*	-0.13**	-0.14*	-0.05	-0.13
	(-1.29)	(2.12)	(-2.21)	(-1.76)	(1.80)	(-2.48)	(-1.76)	(-0.39)	(-1.20)
INDEP%	-0.88	1.11	-1.38*	-0.89	0.41	-0.98	-0.90	1.65	-1.65*
	(-1.05)	(0.81)	(-1.83)	(-1.32)	(0.38)	(-1.52)	(-0.97)	(1.08)	(-1.71)
MTB	0.17***	-0.02	0.21***	0.16***	-0.04	0.20***	0.18***	0.06	0.19***
	(4.60)	(-0.33)	(3.91)	(4.55)	(-0.77)	(4.73)	(3.10)	(0.97)	(3.12)
FIN	1.72***	3.78***	1.65***	1.41***	3.31***	1.30***	2.47***	4.07***	2.16***
	(2.87)	(3.67)	(2.96)	(2.90)	(3.94)	(2.67)	(3.91)	(2.97)	(4.34)
PPS	0.00	0.00	0.00	0.00	0.00	-0.00	-0.00	0.00	-0.01
	(0.36)	(0.46)	(0.23)	(0.10)	(0.66)	(-0.04)	(-0.79)	(0.52)	(-1.39)
LEV	-3.67***	0.01	-3.50***	-2.89***	1.68	-3.20***	-2.92**	2.37	-3.83***
	(-4.11)	(0.01)	(-3.30)	(-3.60)	(1.22)	(-3.73)	(-2.10)	(1.02)	(-4.27)
ROA	-26.18***	20.77***	-31.82***	-24.91***	19.35***	-30.71***	-23.22***	19.63**	-30.10***
	(-6.57)	(3.95)	(-12.82)	(-5.67)	(4.82)	(-10.47)	(-5.90)	(2.54)	(-11.72)
INSTOWN	0.12	-0.19	0.19	-0.03	0.39	-0.20	-0.03	-0.04	0.28
	(0.23)	(-0.24)	(0.30)	(-0.05)	(0.57)	(-0.31)	(-0.06)	(-0.04)	(0.36)
ANALYST	0.03	-0.09**	0.07***	0.04	-0.05	0.07***	-0.00	-0.09*	0.05**
	(0.89)	(-2.08)	(2.64)	(1.31)	(-1.33)	(2.65)	(-0.16)	(-1.89)	(1.98)
CASH_VOL	6.76***	-1.66	8.87***	8.38***	1.18	9.66***	5.49***	-1.62	8.11***
	(3.62)	(-1.52)	(4.25)	(4.10)	(0.47)	(4.57)	(2.71)	(-0.82)	(3.33)
RETURN	0.33	-0.19	0.48	0.50	0.37	0.54	0.44	0.14	0.41
	(0.86)	(-0.42)	(1.23)	(1.57)	(0.83)	(1.63)	(0.89)	(0.23)	(0.73)
VOL	7.89*	19.50***	3.26	8.06**	15.91***	3.69	11.45***	23.56***	6.02

	(1.84)	(3.80)	(0.73)	(2.18)	(3.34)	(0.89)	(3.35)	(3.82)	(1.41)
Constant	11.70***	9.68**	14.66***	12.74***	6.82***	12.57***	11.80***	6.08**	13.68***
	(5.86)	(2.49)	(7.02)	(7.59)	(3.86)	(6.54)	(6.74)	(1.96)	(6.00)
Industry fixed effect	Yes	Yes	Yes	Yes	Yes	Yes		Yes	Yes
Year fixed effect	Yes	Yes	Yes	Yes	Yes	Yes		Yes	Yes
Observations	9,303	3,246	6,057	11,999	4,222	7,777	4,579	1,728	2,851
R-squared	0.22	0.21	0.34	0.21	0.21	0.30	0.23	0.29	0.36

Table 16: The relation between the Employee Treatment Index and earnings management controlling for other factors

The dependent variables is *ABS_DA*. *ABS_DA* is the absolute value of discretionary accruals computed from the modified Jone's model (Dechow, Sloan, and Sweeney, 1995). *ERI* is a firm's total employee relation strength score minus its total employee relation weakness score. The total employee relation strength score is formed by adding the points a firm receives on criteria for employee relation strength in the KLD database, and the total employ relation weakness score is formed by adding the points the firm receives on criteria for employee relation weakness. *RD_INTENSE* is the ratio of R&D expense over total assets. ETHICS is the dummy variable with the value of 1 if the firm is included in Forbes' "The World's Most Ethical Companies" list. KZ_INDEX is the kz index (Kaplan-Zingales Index) calculated as in Lamont et al. (2001). *SIZE* is the log value of total assets. *BOARD* is the number of board members sitting on the board. *INDEP%* is the fraction of independent directors on the board. *MTB* is the market value over book value of the firm. Following Wang (2013), *FINANCE* is measured by asset growth rate – ROA2/(1-ROA2), ROA2 = (income before extraordinary items)/Assets. *PPS* (Pay-for-performance Sensitivity) is measured by first multiplying the Black-Scholes hedge ratio by the shares in options owned by the executive, then adding the shares in stock owned by the executive, and finally dividing the sum by total number of shares outstanding of the company. *LEV* is measured by long-term debt/total asset. *INSTOWN* is the percentage of shares held by institutional investors. *ANALYST* is the number of analysts following the firm. *CASH_VOL* is the cash flow volatility following Yu (2008). *RETURN* is the annual buy-and-hold stock return. VOL is the standard deviation of monthly stock returns in a year. Two-way clustered standard errors based at the firm and year level are used to calculate the t-statistics in parentheses, *** p<0.01, ** p<0.05, * p<0.1

	(1)			(2)			(3)		
	All firms	Firms with Positive DA	Firms with Negative DA	All firms	Firms with Positive DA	Firms with Negative DA	All firms	Firms with Positive DA	Firms with Negative DA
ERI	0.27**	-0.13	0.41***	0.04	-0.17	0.18**	0.24**	-0.04	0.37**
	(2.12)	(-0.67)	(2.83)	(0.46)	(-0.89)	(1.98)	(2.23)	(-0.24)	(2.53)
RD_INTENSE	-1.16***	-0.66	-1.46***						
	(-2.84)	(-0.27)	(-3.74)						
ETHICS				-0.10	-0.77	-0.10			
				(-0.17)	(-0.80)	(-0.18)			
KZ_INDEX							0.001**	0.00	0.00
							(1.98)	(1.39)	(1.61)

SIZE	0.04	-0.39*	0.09	-0.20*	-0.48***	-0.24	-0.10	-0.26**	-0.15
	(0.32)	(-1.65)	(0.74)	(-1.84)	(-3.63)	(-1.34)	(-1.20)	(-2.01)	(-1.22)
BOARD	-0.11	0.23**	-0.22***	-0.09*	0.14	-0.12**	-0.08	0.14*	-0.14**
	(-1.56)	(1.98)	(-2.76)	(-1.77)	(1.62)	(-2.06)	(-1.40)	(1.76)	(-2.30)
INDEP%	-0.16	0.97	-0.52	0.04	1.78	-0.17	-0.70	0.73	-0.93
	(-0.19)	(0.70)	(-0.57)	(0.03)	(1.00)	(-0.14)	(-0.95)	(0.63)	(-1.29)
MTB	0.14***	-0.05	0.18***	0.15***	-0.10*	0.18***	0.16***	-0.04	0.20***
	(3.17)	(-0.87)	(3.27)	(3.56)	(-1.92)	(4.21)	(4.48)	(-0.69)	(4.19)
FIN	2.04***	3.68***	2.36***	0.43	3.33***	-0.03	1.44***	3.28***	1.38**
	(3.15)	(3.23)	(2.90)	(0.74)	(3.34)	(-0.04)	(2.95)	(3.62)	(2.48)
PPS	0.00	0.01	0.00	0.00	0.00	0.01	0.00	0.00	0.00
	(1.13)	(0.93)	(0.31)	(1.32)	(0.28)	(1.55)	(0.31)	(0.63)	(0.45)
LEV	-3.82***	1.93	-4.16***	-2.08*	2.19	-2.37*	-3.02***	1.44	-3.41***
	(-3.10)	(0.93)	(-3.44)	(-1.91)	(1.12)	(-1.70)	(-3.76)	(0.96)	(-3.76)
ROA	-27.29***	23.08***	-33.45***	-26.16***	23.46***	-31.38***	-24.69***	19.46***	-30.54***
	(-6.70)	(4.36)	(-13.10)	(-4.25)	(4.75)	(-7.77)	(-5.20)	(4.35)	(-9.50)
INSTOWN	-0.76	-1.12	-0.56	-0.10	0.06	-0.34	0.27	0.62	0.08
	(-1.21)	(-1.16)	(-0.70)	(-0.16)	(0.06)	(-0.52)	(0.55)	(0.85)	(0.11)
ANALYST	0.04	-0.07	0.08***	0.06	-0.05	0.10**	0.02	-0.07*	0.06**
	(1.37)	(-1.31)	(2.81)	(1.45)	(-0.88)	(2.48)	(0.79)	(-1.88)	(2.46)
CASH_VOL	6.03***	-0.28	6.77***	11.73***	7.93	7.78**	8.12***	1.48	9.03***
	(2.97)	(-0.12)	(2.90)	(3.00)	(1.45)	(2.25)	(3.64)	(0.49)	(4.01)
RETURN	0.77*	0.33	0.95*	0.65**	0.70	0.76***	0.45	0.24	0.49
	(1.66)	(0.47)	(1.86)	(2.21)	(0.84)	(3.28)	(1.27)	(0.51)	(1.43)
VOL	9.92***	19.62***	5.37	7.59	15.80**	3.19	7.86*	16.22***	3.22
	(2.87)	(3.80)	(1.46)	(1.55)	(2.42)	(0.52)	(1.90)	(2.86)	(0.77)

Constant	9.66***	8.88***	11.65***	9.85***	0.82	11.92***	9.54***	6.42***	13.23***
	(4.59)	(3.57)	(4.99)	(3.76)	(0.68)	(3.87)	(5.74)	(3.28)	(6.82)
Industry fixed effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year fixed effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	6,959	2,455	4,504	5,973	1,924	4,049	10,226	3,668	6,558
R-squared	0.22	0.20	0.34	0.26	0.35	0.34	0.22	0.21	0.32