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DETERMINANTS AND IMPLICATIONS OF AUDIT REPORTING
LAGS IN CHINA

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MPHIL

LINGNAN UNIVERSITY

2012

DETERMINANTS AND IMPLICATIONS OF AUDIT REPORTING
LAGS IN CHINA

by
LUO WEI

A thesis
Submitted in partial fulfillment
Of the requirements for the Degree of
Master of Philosophy in Business

Lingnan University

2012

ABSTRACT

Determinants and Implications of Audit Reporting Lags in China

by

LUO Wei

Master of Philosophy in Accounting

Timeliness is an essential attribute of corporate financial reporting as it affects the usefulness of information made available to external investors. The recognition that the length of audit is the single most important determinant influencing the timeliness of earnings announcements has motivated investigations on audit reporting lags in different countries. Nevertheless, there is a lack of research on this issue in China where the institutional environment for accounting and auditing practices is different from that of other countries. The growing interest in the Chinese stock market from domestic and international investors further increases the importance of this research. In this study, I first explore the determinants of audit reporting lags in China based on the characteristics of the Chinese audit market and business environment. I then examine the implications of long audit reporting lags. The findings of this paper indicate that audit risk, audit complexity, and auditor expertise are all associated with the length of audit reporting lags in China. Firms with long audit reporting lags are more likely to have adverse consequences such as non-standard opinions and financial statement restatements in subsequent periods.

DECLARATION

I declare that this is an original work based primarily on my own research, and I warrant that all citations of previous research, published or unpublished, have been duly acknowledged.

(Luo Wei)
May 3, 2012

CERTIFICATE OF APPROVAL OF THESIS

DETERMINANTS AND IMPLICATIONS OF AUDIT REPORTING
LAGS IN CHINA

by
LUO Wei

Master of Philosophy

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DETERMINANTS AND IMPLICATIONS OF AUDIT REPORTING

LAGS IN CHINA

Chapter 1 Introduction

Timeliness as one of the most important qualitative characteristics of accounting information requires that reliable information be made available to financial statement users when they need it. A lack of timeliness can lead to a loss of relevance and usefulness of financial information (FASB, 1980). This issue has received increasing attention from regulatory authorities and accounting researchers. Considering that a lengthy delay in the release of audited financial statements makes the information less valuable to investors, the US Securities and Exchange Commission (SEC) announced phased reductions in reporting time limits from 90 days after the financial year end to 60 days (SEC, 2002b). In China, listed companies are required to issue their audited annual reports to the China Securities Regulatory Commission (CSRC) and the related stock exchanges within 4 months after the financial year-end. The importance of timeliness has been recognized by many studies. For example, timeliness could have an impact on market value. Focusing on the US market, Beaver (1968) indicates that investors postpone their purchases and sales of the security until the earnings report is released. Interestingly, timeliness of the release of audit report can also have an impact on the accuracy of accounting information.

Bronson et al. (2011) suggest that lengthy audit lag reduces the reliability of preliminary earnings releases: a 20 day delay in the audit report date increases the probability of a PEA (preliminary earnings announcement) revision that indicates a decrease in earnings reliability by one percentage point. However, the requirement that annual financial statements be subjected to external audit can conflict with timely reporting because the timeliness of financial reporting depends on the length of the audit. It is thus important to explore the determinants of audit reporting lag and its implications. Most previous studies were conducted in the settings of developed countries or jurisdictions, such as the U.S. (Bronson et al., 2011; Kinney and McDaniel, 1993; Krishnan and Yang, 2009), Australia (Davis and Whittred, 1980), and Hong Kong (Ng and Tai, 1994). A related study by Haw et al. (2003) examines the effect of audit opinion and earnings surprise on the timeliness of earnings announcements in China from 1995 to 1999. However, they did not investigate the consequences of late announcements. I examine a broader set of determinants on audit reporting lag as well as the consequences of long audit report lag in subsequent periods, based on a more recent data set with an improved audit environment in China.

There are several reasons for conducting this study in the context of China. First, the institutional environment of accounting and auditing practices in China is different from that of developed countries. For example, most listed firms are audited by Big 4 auditors in the developed markets. In recent years, the market

share of Big 4 has been well over 90% across the world's G8 economies (Grant Thornton, 2007). In the domestic Chinese markets, however, Big 4 auditors audit a much smaller portion of listed firms (around 40% of the market in terms of revenue and 7% in terms of number of listed clients) (CICPA, 2010). Therefore, in contrast to prior studies which focus on Big 4 auditors, this study focuses on small and medium size audit firms whose audit lag could be affected by factors different from those of large audit firms. Furthermore, my sample data indicate that the standard deviation of audit reporting lags for firms that are audited by Big 4 and non-Big 4 auditors are 19 days and 25 days, respectively. The larger variation in audit lags for non-Big 4 auditors suggests more importance in studying the determinants and implication of long audit reporting lag. Second, there is a unique advantage of conducting this research in the context of China. The fact that all Chinese companies have the same financial year end (December 31) helps eliminate the confounding factor of having different year-ends for different companies in the study of audit report lag. For example, companies with year-end during the busy season for auditing may experience longer audit delay because of human resource constraints and scheduling problems in audit firms. Previous studies have documented both positive (Davis and Whittred, 1980) and negative (Ashton, et al., 1987) relationships between audit delay and whether the company's year-end date is in the audit busy season. In addition, when the audit is conducted at about the same time as the tax reporting, the audit lag may be affected by tax works. These confounding factors of having different

year-end and tax reporting season on audit reporting lag are eliminated in the context of China because of the uniform year-end for financial and tax reportings for Chinese listed companies.

Third, most prior studies focus on examining the impact of company characteristics such as company size, industry classification, and corporate governance characteristics on audit report lag. This study, however, examines a comprehensive set of audit related characteristics. The improvements of the institutional environment in China lead the auditors to attach more importance to enhance audit quality (Chen et al., 2010). It is then interesting to see, after an overall improvement in audit quality, whether specific audit characteristics including audit risk, audit complexity, and auditor expertise play significant roles in influencing audit reporting lag. Furthermore, as far as can be determined, no published research has examined the adverse consequences of long audit report lag on accounting and audit reportings in subsequent years.

Lastly, the still rapid growth of the Chinese economy means that a growing body of domestic and international investors is interested in receiving timely and reliable financial information. China is now the second largest economy in terms of nominal GDP (Washington, 2010). The findings of this study should assist investors and regulatory authorities in obtaining a clearer understanding of factors that influence the timeliness of financial information in China.

During the audit process, the auditor and the client are continuously involved in negotiations on the treatment of various accounting issues. Extremely long audit lags often imply prolonged negotiations to settle significant disagreements between the two parties. According to the client-auditor negotiation literature, negotiations often result in less conservative reporting as auditors make compromises (Antle and Nalebuff, 1991; Gibbins et al., 2001). As a consequence, the problems in the accounts may not be eliminated after negotiation. Adverse future consequences are likely to appear when the existing problems are re-discovered in later years. In this study, I examine two future outcomes related to accounting and audit reportings for firms with long audit lags. The first is the receipt of non-standard audit opinion. When the problems in financial statements resurface in the future, auditors may have to issue non-standard opinions. Another future consequence is financial statement restatements. As suggested by Palmrose and Scholz (2004), restatement of financial statements is one of the most visible indicators of improper accounting. I examine if these future adverse events are associated with long audit reporting lag.

Specifically, I first develop an audit reporting model which examines the association between audit characteristics and audit reporting lags for listed companies in China. Then, I develop two models to assess the consequences of prolonged audit lags. I find that longer audit reporting lags are significantly

associated with a higher level of audit risk, audit complexity and a lower level of auditor expertise. I also find that prolonged audit lags are significantly associated with more non-standard audit opinions and restatements of financial reports.

The findings about the determinants of audit lags help auditors understand the determinants of audit delay so as to assess how the auditing process could be improved. The implications of prolonged audit lag help management and investors better understand and prepare for the adverse consequences. Regulatory bodies may also find the study results helpful in assessing auditing regulation governing the release of financial statements.

Chapter 2 Institutional Background

2.1 The Financial Reporting Environment in China

2.1.1 Audit reporting regulation

In China, there are several reporting regulations relevant to the audit report date. The 1995 Specific Independent Audit Guidelines (No.7, article 19) defines audit date as “the date when the CPA completes the fieldwork for the audit. The date of the audit report should not generally be earlier than the date when the entity’s management confirms and signs the financial statements” (CICPA, 1995). In the 2003 Specific Independent Auditing Standard No. 7 (revised),

article 15 states that the audit date is “the date when the CPA completes audit work. The date of the audit report should not be earlier than the date when the audited entity’s management signs the accounting reports” (CICPA, 2003). In the Auditing Standards for the Chinese Institute of Certified Public Accountants issued in 2007, regulation No. 1501 specifies that “The audit report should indicate the date of the report. This date should not be earlier than the date when the Certified Public Accountant obtains sufficient and appropriate audit evidence (including management’s acknowledgement of its responsibility for the financial statements and the evidence of its approval of the financial statements) and determines the audit opinion on the financial statements based on such evidence” (CICPA, 2007). In practice, CPAs usually hand in the draft audit report and the draft audited financial statements to management before signing the audit report formally. If management approves and signs the audited financial statements, the auditor will then sign the audit report.

As to the length of the audit reporting lag, Article 66 of the Securities Law of the People's Republic of China (2005 Revision) specifies that “A listed company whose shares or bonds have been listed for trading shall, within four months as of the end of each accounting year, submit to the securities regulatory authority under the State Council and the stock exchange an annual report” (Standing Committee of the National People's Congress, 2005). The annual reports must be audited. Depending on the company and auditor situation, the audit lag could be a few weeks, but some large companies with complex

problems may need more time to obtain relevant information and submit the annual report in late April. However, if companies cannot submit annual reports before the deadline, they will face a variety of negative consequences. First, they will need to make relevant disclosures about the reasons for the delay and pay penalties. According to Rules Governing the Listing of Stocks on the Shanghai and Shenzhen Exchanges, “any listed company unable to disclose its periodic reports within the specified time limit shall, in a timely manner, report to the Exchange and make public the reasons thereof, its solution plan and the deadline for a delayed disclosure” (Shanghai Stock Exchange, 2008; Shenzhen Stock Exchange, 2008). According to Article 193 of the Securities Law of the People's Republic of China, “Where an issuer, a listed company or any other obligor of information disclosure fails to disclose information according to the relevant provisions (including late submission of annual reports) or where there is any false record, misleading or major omission in the information it has disclosed, it shall be ordered to correct, given a warning and imposed a fine up to 600,000 yuan. The person in charge and any other person as held to be directly responsible shall be given a warning and be imposed a fine up to 300,000 yuan” (Standing Committee of the National People's Congress, 2005). Second, the shares of the company can be suspended for trading by relevant stock exchange until the annual report is released. Finally, given the importance of earnings announcements to investors and companies, a late filing of annual report can cause adverse market effects. According to Bartov et al. (2011), capital markets

react negatively when a company files a late annual report. Chinese investors also use the timing pattern of annual report releases to predict future earnings as it has been demonstrated that firm performance is associated with the timing of annual report releases in China: good news firms release their annual reports earlier than bad news firms, and loss firms release their annual reports the latest (Haw et al. 2000).

2.1.2 Financial Statement Restatement and Audit Opinion

The restatement regulations in China have become more stringent over the years. The first restatement standard is the 1999 Standard of Changes in Accounting Policies and Estimates, and Corrections of Material Accounting Errors. Section 3 of the standard gives a description of the restatement methods and requires the disclosure of restatement amount and reasons in the footnotes of the financial statements (Ministry of Finance, 1999). In 2003, the China Securities Regulatory Commission issued Rules on Information Disclosure for Listed Companies No.19 - The Correction of Financial Information and its Disclosure. This regulation requires that listed companies use Provisional Announcement of Significant Matters to report restated financial information (CSRC, 2003). In 2006, Accounting Standards of Business Enterprises, Changes in Accounting Policies and Estimates, and Corrections of Accounting Errors requires that a restatement revises all the affected line items in the financial statements for all relevant periods (Ministry of Finance, 2006). According to Wong and Wu (2011), the reasons for Chinese firms to issue restatements can be

classified into 8 categories: mistakes from subsidiaries, tax miscalculation, misstatement of costs and expenses, misstatement of depreciation and provisions, revenue recognition problems, subsidiaries revenue and book-tax conforming adjustments, and other mistakes and misclassifications. There could be many potential negative consequences of financial statement restatements such as damage to corporate image, reduced confidence by investors on published financial statements, and a drop in credit rating. Wei et al. (2009) find that market reactions to restatement announcements are negative in China. The types of announcement that generate significant negative market reactions include announcements that are caused by serious accounting problems or are related to core accounting indicators, and announcements that significantly reduce earnings or show important bad news¹.

There are 5 categories of audit opinion in China: standard unqualified opinion, unqualified opinion with explanatory notes, qualified opinion, adverse opinion, and disclaimer of opinion. In this study, non-standard audit opinions include all audit opinions except for unqualified opinions. If a listed company receives a non-standard opinion, the company could suffer negative regulatory and economic consequences. First, according to Compilation Rules for Information Disclosures by Companies That Offer Securities to the Public No.14, Audit Opinions That Are Not Standard and Unqualified and the Handling of

¹ Announcements that are caused by serious accounting problems refer to the supplements or corrections for issues relevant to major accounting policies and changes in accounting estimates that could affect audit opinion.

Relevant Matters, “where the company has obviously violated the accounting standards, rules or relevant information disclosure requirements and such violation would, if not rectified, cause the registered accountant to issue an audit opinion that is not standard and unqualified, the registered accountant shall point that out and request the company to make necessary adjustments (Article 6). If the company refuses to do so or if the adjustment is not adequate and the accountant consequently issues an audit opinion that is not standard and unqualified, the stock exchange may suspend trading of the shares of the company (Article 7). During the suspension, the relevant matters will be investigated and dealt with by the China Securities Regulatory Commission (Article 8)” (CSRC, 2001). Furthermore, it has been found that investors do value audit opinions (Fargher and Wilkins, 1998; Soltani, 2000). According to Chen et al. (2000), the stock market reacts negatively to non-standard opinions in China.

2.2 The Audit Environment in China

2.2.1 The Development of Auditing Standards in China

In the 1990s, there were some voluntary auditing standards issued by the Chinese Institute of Certified Public Accountants (CICPA) and the Chinese Association of Certified Public Auditors (CACPA). However, a series of financial frauds necessitated the need to monitor auditors more closely and to better achieve international harmonization. Therefore, the China Independent Auditing Standards Commission (CIASC) was formed in 1994. In 1995, the first

batch of China's Independent Auditing Standards (CIASs) was issued to improve the quality and credibility of auditing in China. According to Lin and Chan (2000), Chinese auditing standards are similar to international standards and guidelines in many respects because the emerging Chinese accounting profession adopted the well-established international standards and guidelines with little change. The CIASs are legally binding on all certified public accountants who conduct audit to give an opinion on the financial statements prepared by management (Cooper et al. 2002).

2.2.2 The Chinese Audit Market

China's audit firms were affiliated with the government before 1998. This affiliation often resulted in a lack of independence and regional protectionism. Realizing the importance of establishing an independent audit profession, the Ministry of Finance and the China Securities Regulatory Commission issued regulations to disaffiliate audit firms from government agencies by 1998. After this disaffiliation reform, while there are improvements, the personnel of audit firms still have close relationship with local governments. Audit quality and independence continue to be influenced by government. (Chan et al., 2006) In addition, the intense competition of China's audit market gives clients more bargaining power while imposing more business pressure on auditors. According to Chen et al. (2010), at the end of 2006 73 audit firms in China were eligible to audit about 1400 listed companies. In other words, one qualified firm had less

than 20 listed customers to audit. A series of scandals involving earnings manipulation and fraudulent financial reporting were exposed around 2001. This led to a series of regulatory improvements to protect investors. As a result, litigation and sanction risks faced by Chinese auditors have risen significantly. According to Chen et al. (2010), auditors were less likely to compromise quality for economic benefits from important clients in the post-2001 period as the institutional environment became more protective for investors.

Lastly, the Chinese audit market is different from audit markets in the developed countries as it is not dominated by the Big 4 auditors. According to the ranking of accounting firms disclosed by the CICPA (2010), the market share of Big 4 auditors in China is only 44.3% when measured by total revenue and 43.9% when measured by audit income in 2009.

Chapter 3 Literature Review and Hypothesis Development

3.1 Audit Characteristics and Audit Reporting Lag

Facing higher audit risks, auditors might increase the number of audit procedures and devote more time in discussions and negotiations with their clients. As a result, the length of the audit reporting lag will be increased. Chan et al. (2012) found that the adopters of clawback (or compensation recovery) provisions, which lead to lower audit risk, experience shorter audit lags. Low

profitability or losses are signals of problems in the operation of a company, and they could increase the likelihood of financial failure or management fraud. As a consequence, audit risk is increased. Courtis (1976) found that profitability significantly explains the difference between slow and fast reporters. Ashton et al. (1989) found longer delays for companies reporting net losses. Bamber et al. (1993) found that companies in financial distress tend to have longer audit reporting lags. In this paper, leverage is also viewed as an indicator of a firm's financial stability and could be positively related to audit risks. A high total debt to total asset ratio could increase the risk of financial failure of a company and auditors tend to spend more time evaluating the operation of such a company. However, it could also be argued that high leverage attracts more attention and monitoring from creditors and should be associated with less audit risk. Altman's Z score, a measure of bankruptcy risk, is also included as an indicator of audit risk. Finally, whether the audited company has pending litigation can have an impact on the risk of the audit. I consider the existence of contingent liabilities an indicator of such risk. The above discussion leads to the first hypothesis:

H1: Companies with a higher level of audit risk have longer audit lags than companies with a lower level of audit risk.

Audit complexity can be another determinant of the length of audit lags. If the business of the audited entity is very complex, it can take the auditors more

time to collect and process information. Leventis et al. (2005) found that audit reporting lag is positively associated with the existence of extraordinary items which increases audit complexity. Ng and Tai (1994) used the number of principal subsidiary companies held by a company to represent complexity and diversification of business operation, and they found that complexity is positively related to audit reporting lag. In this study, it is expected that a higher audit fee is associated with a more complex audit because audit fee is an indicator of the time and effort devoted to the audit, and it should be positively related to a company's level of business complexity (Hanlon et al., 2012). The issuance of a non-standard opinion also increases audit complexity. According to Whittred (1980), auditors might try to avoid issuing a non-standard opinion by increasing the number of audit procedures to reduce any uncertainty or disagreement. Management might also try to avoid a non-standard opinion by discussing and negotiating with the auditors more frequently or in greater depth. Either way, audit complexity is increased. The above discussion leads to the second hypothesis:

H2: Companies with a higher level of audit complexity have longer audit delays than companies with a lower level of audit complexity.

As for the association between auditor expertise and audit reporting lag, large auditors such as the Big 4 auditors are expected to have more efficient

audit planning, better human resources and more experience in auditing and thus represent higher audit expertise. According to Ashton et al. (1989), large auditors finish the audit quicker because of their expertise. In addition, auditor expertise can be related to the auditor's experience with a company. A change in auditor could imply lower auditor expertise as a new auditor has less experience in auditing the company and is less knowledgeable about the company's operation and accounting procedures. According to Tanyi et al. (2010), audit report lags change after either voluntary or involuntary auditor switches. According to Ng and Tai (1994), the length of audit lag is positively associated with a change in auditor probably because the newly appointed audit firm needs time to familiarize itself with the company and to evaluate the strengths and weaknesses of the internal control system. The above discussion leads to the third hypothesis:

H3: Auditors with more expertise have shorter audit lags than auditors with less expertise.

3.2 Audit Reporting Lag and Adverse Outcomes

Long audit reporting lags imply intense negotiation between the managers and the auditors to resolve their disagreements. According to Antle and Nalebuff (1991), an auditor's initial offer in the negotiation can be conservative. However, if management feel that they know better about the state of the company's

financial condition, they may protest or try to change the adjustments made by the auditor that result in understatements of income, while remaining silent on adjustments that cause overstatements of income. As a consequence, only income increasing adjustments are left unopposed. Utilizing an analytical model, Antle and Nalebuff (1991) demonstrate that as auditing contracts are designed to maximize joint auditor-client surplus, the expected ex post bias is always upward. In other words, after negotiation, the auditors tend to be less conservative and the result is more aggressive financial reporting. According to Gibbins et al. (2001), management views the negotiation as a win-lose situation and intend to persuade the auditors. Auditor's acquiescence or compromise is often expected. As problems in the financial statements often continue to exist after the negotiation, there will likely be adverse consequences when these problems resurface in the future. Non-standard audit opinions and financial statement restatements are used as indicators of adverse future consequences in this study. The above discussion leads to the fourth and fifth hypotheses:

H4: Companies with long audit reporting lags are more likely to receive non-standard audit opinions in subsequent years than companies with short audit reporting lags.

H5: Companies with long audit reporting lags are more likely to have financial statement restatements in subsequent years than companies with short audit

reporting lags.

Chapter 4 Research Methodology

Three regression models are developed. The first model examines the determinants of audit reporting lags. The second and third models examine the relationship between long audit reporting lags and two future adverse consequences. The first model is specified as follows:

$$\begin{aligned} \text{Auditlag}_t = & \alpha_0 + \alpha_1 \text{Audit_risk}_t + \alpha_2 \text{Audit_complexity}_t + \alpha_3 \text{Audit_expertise}_t + \\ & \sum \alpha_j \text{Control variables}_t + \varepsilon \end{aligned} \quad (1)$$

where *Audit_risk* is measured by (1) *Assetreturn*: the ratio of earnings before interest and taxes to total assets; (2) *Loss*: an indicator variable if net income is less than zero; (3) *Leverage*: the ratio of total debt to total assets; and (4) *Zscore*: Altman's Z-score: a measure of bankruptcy risk²; (5) *Contingent_liability*: an indicator variable if a company has contingent liability. *Auditor_complexity* is measured by (1) *Audit_fee*: the natural logarithm of total audit fee; and (2) *Opinion*: an indicator variable if the company does not receive a standard opinion. *Audit_expertise* is measured by (1) *Auditor*: an indicator variable if the

² Z-score = $1.2X_1 + 1.4X_2 + 3.3X_3 + 0.6X_4 + 0.999X_5$, where X_1 is working capital (current assets less current liabilities) to total assets, X_2 is retained earnings divided by total assets, X_3 is earnings before interest and taxes divided by total assets, X_4 is market value of equity divided by total liabilities, and X_5 is total operating revenue divided by total assets

auditor of a company is not a Big 4 auditor; and (2) *Change*: An indicator variable when there is a switch of the company's external auditor.

Following previous research, six categories of control variables known to influence audit reporting lag are included:

(1) Corporate Governance

Several studies explored the relationship between audit delay and corporate governance characteristics. For example, Mohamad, et al. (2010) examined whether characteristics of the board of directors and the audit committee are related to the timeliness of audit reporting, and find that audit committee size and the number of audit committee meetings are negatively associated with audit reporting lag, while the proportion of independent directors on the board has a positive relationship with audit lag.

In the context of China, the importance of board independence has been emphasized. In August 2001, the China Securities Regulatory Commission (CSRC) released the Guidelines for Introducing Independent Directors to the Board of Directors of Listed Companies (CSRC, 2001). According to the Guideline, by June 30th, 2002, at least two members of the board of directors shall be independent directors. At least one third of board shall be independent directors by June 30th, 2003. In this study, the percentage of independent directors on the board, the number of board meetings, and the ownership

concentration are included to control for the impact of corporate governance on audit lag. It is expected that a more independent board that has more frequent board meetings will oversee the financial reporting process more closely and ensure a more timely submission of financial statements.

As to ownership concentration, Chinese companies are characterized by a highly concentrated ownership structure which could have two effects on audit reporting lags. On one hand, when the ownership entrenchment effect is dominant, the controlling shareholders may have self serving behavior at the expense of outside shareholders (Fan and Wong, 2002) and tend to cover up such behavior by withholding unfavorable information or deferring the release of financial reports. As a result, under the entrenchment perspective, the audit reporting lag should be longer for firms with a high level of ownership concentration. On the other hand, if the incentive alignment effect is dominant, controlling shareholders might be encouraged to facilitate the release of financial information to benefit minority shareholders. For example, Gomes (2000) indicates that high concentration may lead to the controlling shareholders' commitment toward a reputation of not expropriating minority shareholders. Therefore, under the incentive alignment perspective, the audit reporting lag should be shorter for firms with a high level of ownership concentration.

(2) Earnings Surprise

Previous studies have shown that the timing of a company's earnings

announcements is related to whether the earnings convey good news or bad news (Givoly and Palmon, 1982). Generally, a company tends to be more willing to disclose earnings announcement early when the earnings convey good news and contain large positive earnings surprise. In this study, I include *Goodnews* (an indicator variable if net income is not smaller than forecast net income) and *Surprise* (the difference between actual earnings per share and forecast earnings per share) to control for the impact of earnings surprise on audit reporting lag.

(3) Information Demands

It is anticipated that larger companies attract more attention from the public and have more pressure to issue financial reports in a timely fashion so that they can meet the information demands of investors, trade unions and regulatory agencies. The negative relationship between corporate size and audit reporting lag has been documented by previous studies (Carslaw and Kaplan, 1991; Ng and Tai, 1994). Therefore, company size is included as a control variable in the model. Furthermore, if a firm is concurrently listed on more than one stock exchange, its financial information will be followed by more investors and this may pressure the firms and the auditors into issuing financial statements earlier. On the other hand, as the financial information is used by more investors, the auditor may want to be more cautious because of increased litigation risks. It is, therefore, an empirical issue as to how the listings on more than one stock exchange could influence audit lag. I include an indicator variable if the shares

of a firm are traded simultaneously on more than one stock exchange to capture this effect.

(4) Earnings Quality

Companies with low earnings quality are expected to be less willing to disclose their financial information on time. Krishnan and Yang (2009) found evidence that companies with high audit lags had slightly higher levels of absolute discretionary accruals which suggests lower earnings quality. In this study, an indicator variable is included for companies issuing restatements to control for the influence of earnings quality, as restatements are usually associated with misreporting of financial statements (Rezaee, 2002). In this study, I also consider the influence of regulatory pressure on earnings quality. In China, companies in the finance and public utilities industries are subject to more regulatory pressure. For example, the financial industry is monitored by the China Insurance Regulatory Commission, China Securities Regulatory Commission, China Banking Regulatory Commission, and the People's Bank of China. The public utilities industry is regulated by institutions such as State Electricity Regulatory Commission. Since these industries are more closely and strictly supervised by authorities, their earnings quality could be higher. Their management may want to have their audit reports issued sooner. On the other hand, as the regulatory bodies have more specific regulations and requirements regarding the audit and financial reporting of companies in such industries, it

may take the auditors more time to complete the audit in accordance with the regulations. More regulations could also cause more earnings manipulations when regulations are based on accounting numbers and thus result in longer reporting lags. An indicator variable is used if a company belongs to highly regulated sectors to account for the impact of regulatory pressure on audit reporting lag.

(5) Chinese Characteristics

Apart from variables that are found to be associated with audit delay in previous studies, specific Chinese characteristics that may affect audit reporting lags are included: A. Tradable Shares. One feature of listed companies in China is that they have two types of shares: tradable shares and non-tradable shares. A higher percentage of tradable shares indicate a greater number of investors who rely on financial reports to make decisions. The auditor will face higher litigation risk as the number of investors increase. This could result in more workload and longer audit reporting lag. However, it could also be argued that a larger number of external investors will increase the pressure on management to shorten the audit reporting lag so that financial statements can be released more timely. B. State Ownership. It is widely known that many Chinese firms are state-owned or only partially privatized despite a series of economic reforms. This characteristic could have an influence on audit reporting lag. On one hand, the government as the largest owner could impose a high level of pressure on the

firm to submit financial reports in a timely fashion. On the other hand, state ownership may imply inefficiency in management as state-owned firms are often used by government institutions for political purposes such as a means of channeling benefits to supporters. An inefficient management team might be less willing to disclose their problematic financial information to the public. I use an indicator variable if the largest shareholder is the government to control for the influence of state ownership on audit delay.

(6) Year and Industry Dummies

These variables are used to control for year and industry effects. I have six year dummies and six industry dummies included in the regression models.

The other two hypotheses will be tested by the following models:

$$Opinion_t = \gamma_0 + \gamma_1 Long_audit_lag_{t-1} + \sum \gamma_j Control\ variables + \varepsilon \quad (2)$$

$$Restatement_t = \beta_0 + \beta_1 Long_audit_lag_{t-1} + \sum \beta_j Control\ variables + \varepsilon \quad (3)$$

In the second model, *Opinion_t* is an indicator variable which equals one if the company receives a non-standard opinion in year *t*, and zero otherwise. *Long_Audit_lag_{t-1}* is an indicator variable defined by: A. firms with the top 5% longest audit lag (the number of days between the year-end and the date on which an audit report is signed). B. firms with the top 10% longest audit lag. C.

firms with the top 15% longest audit lag. The control variables are chosen following previous studies on determinants of non-standard opinion: current year audit opinion, profitability (measured by the ratio of earnings before interest and taxes to total assets), loss, revenue (measured by total operating revenue), leverage, bankruptcy risk, company size, auditor (whether the auditor is a Big 4 auditor), cash flow (whether there is any negative operating cash flow), and equity (whether there is any negative book value of equity) (Mutchler et al. 1997; Reynolds and Francis, 2000).

In the third model, *Restatement_t* is an indicator variable which equals 1 if a company restates its financial statements in year t, and zero otherwise. The independent variable is *Long_Audit_lag_{t-1}*. Several important determinants of restatement (in year t) are included in the model as control variables. First, I control for current year restatements in year (t-1). I also control for operational risk using the ratio of inventory to total assets. According to Kinney and McDaniel (1989) and Defond and Jambalvo (1991), the probability of restatement is associated with profitability, earnings growth (measured by growth rate of return on equity), loss, leverage, bankruptcy risk (measured by Altman's Z score), company size, opinion, and auditor. I also choose control variables based on studies conducted in the Chinese context. According to Wei et al. (2010), the location of the stock exchange and whether a Chinese company is classified as ST (Special Treatment) firms are associated with restatements. ST firms are companies receiving special treatment on the stock exchange because

of financial difficulties. A list of variable definitions is given in Table 1.

[Insert Table 1 about here]

Chapter 5 Data Collection

The sample data consist of companies that issue A and B shares on the Shanghai and Shenzhen Stock Exchanges. I extract accounting data from the China Stock Market and Accounting Research (CSMAR) database. The sample period covers a recent six-year period, 2004-2009. Audit reports were issued in 2010 on the 2009 financial statements. I started from 2004 because the CICPA published the Guidance on the Practice Criteria for Certified Public Accountants of China No.5 – Audit Report in 2003. This document gives detailed guidance about audit dates. When a CPA decides the audit date, he or she should consider the following factors: the audit procedures should have been completed; issues that should be adjusted or published by the audited entity have been proposed and the audited entity has agreed or refused to make the adjustments or publications; the management of the audited entity has formally signed the accounting statements (CICPA, 2003). This detailed guidance facilitates the auditors' determination the appropriate audit report date. In addition, among the 9153 firm year observations, around 4000 of them are dropped from the sample due to the lack of analysts' forecast data in measuring the earnings news variables.

Chapter 6 Empirical Results

6.1 Descriptive Statistics

Table 2 Panel A shows the descriptive statistics of the dependent variable: audit reporting lag. The mean audit lag for all firm year observations is 87.06 days. This level of audit delay is longer than those reported in previous studies for other countries. According to Ettredge et al. (2006), the mean audit delay for the U.S. companies is 50 days in 2003 and 70 days in 2004. According to Ashton et al. (1989), Canadian companies have a mean audit delay of 55 days. The longer audit reporting lag in China may be explained by the relatively liberal requirement of submitting annual reports within 120 days after the financial year end while the USA and Canada have a stricter 90-day requirement.

[Insert Table 2 about here]

As can be observed from the histogram in Figure 1, the mean audit lag for year 2004 was the shortest: 84.82 days. It then rose to about 87 days in the following two years. In 2007, the audit lag slightly decreased to 86.6 days. Year 2008 (audit report issued in 2009) experienced the longest audit lag: 89.52 days. The 2008 financial crisis might account for this unprecedented audit delay. As many companies suffered huge losses or had financial difficulties because of the crisis, auditors had to devote more time investigating financial statements for potential problems or the companies may want to postpone the release of bad

news. In 2009 (audit report issued in 2010), the mean audit lag was reduced to 85.68 days.

[Insert Figure 1 about here]

Table 2 panel B presents the descriptive statistics for all the independent variables. 14% companies experienced losses which might lead to longer audit delay. The average leverage level for Chinese companies is 55% which is higher than that of other countries: US firms have a leverage of 20% for family firms and 24% for non-family firms (Chen et al., 2010); French firms have a leverage of 23% (Aubert, F., 2009); Malaysian firms have a leverage of 44% (Yaacob, N.M., 2012); New Zealand firms have a leverage of 46% (Carslaw and Kaplan, 1991). This is perhaps because of government control of Chinese companies. About eighteen percent of companies had contingent liabilities that may increase audit risk. Nine percent of listed companies received non-standard audit opinion. Companies have about ten subsidiaries on average. Only 7% of listed companies employed Big 4 auditors and this reveals a highly competitive audit market in China. Also, 9% of companies switched their auditors during the sampling period. The average percentage of tradable shares for Chinese companies is 53%. In over 50% of the firms, the largest shareholder is state related. This reveals that the Chinese government plays a significant role in controlling listed companies. The average holding percentage of the largest shareholder is 38%. This reveals a highly concentrated ownership structure in China. The average percentage of independent directors is 36% which satisfies the 1/3 independent board members

requirement. The board of directors has about 8 meetings per year and, on average, about 45% companies have good news or receive higher earnings than expected. These companies may be more willing to accelerate the release of annual reports. On average, companies receive 8% lower earnings per share (EPS) than forecast EPS. Finally, 11% of listed companies had restatements which could result in long audit reporting lags.

Table 3 presents the correlation matrix for all variables. First, audit lag is significantly correlated with many of the experimental variables. For example, audit lag is significantly negatively correlated with asset return and Zscore, while significantly positively correlated with the existence of losses, leverage level, the existence of contingent liabilities, the receipt of non-standard opinion and audit fee. Audit lag is also significantly positively related to an auditor change. It is interesting to observe that the audit lag is significantly negatively related to a non-Big 4 auditor. This is not consistent with the expectation that a non-Big 4 auditor with a lower level of audit expertise should have a longer audit lag. However, as non-Big 4 auditors suffer less from reputation losses, they may cut short their auditing process to save costs. In addition, the dependent variable, audit lag, is significantly correlated to many control variables. For example, audit lag is found to be significantly positively related to the percentage of tradable shares. This result supports the proposition that there is a higher litigation risk faced by the auditors of companies that have a larger

number of tradable shares which in turn results in more workload and longer audit reporting lag. State ownership is significantly negatively correlated with audit lag. This result suggests that government as a controlling shareholder could probably impose higher pressure on companies and ensure a timely submission of financial reports. Audit lag is significantly negatively correlated with ownership concentration suggesting that the alignment effect dominates the entrenchment effect and large shareholders can impose more pressure on companies to submit financial statements timely. Audit lag is significantly negatively correlated with the number of board meetings, suggesting that better corporate governance could promote timely reporting. It is found that audit lag is significantly negatively related to good news and earnings surprise. This is consistent with the expectation that companies tend to accelerate the auditing process when there is positive information contained in the earnings announcements. Finally, companies with concurrent listings on more than one stock exchange are found to have significantly longer audit lag. The auditors may increase the audit time for such companies because of higher litigation risk.

[Insert Table 3 about here]

6.2 Determinants of Audit Reporting Lag

Table 4 presents the multivariate regression result for the determinants of audit reporting lag. The industry and year dummies are included in the model but not tabulated. The result shows that asset return is significantly negatively related to audit reporting lag. That is, a higher profitability which indicates a

lower level of audit risk results in shorter audit delay. As expected, the existence of contingent liabilities suggesting the possible existence of pending litigations is significantly positively related to audit lag as such problems increase the audit risk. Thus, the result supports the first hypothesis that companies with a higher level of audit risk have longer audit lags than companies with a lower level of audit risk. I also observe that the receipt of a non-standard opinion, audit fee and number of subsidiaries which imply more audit complexity are all significantly positively associated with audit lag. This result supports the second hypothesis that companies with a higher level of audit complexity have longer audit delays than companies with a lower level of audit complexity. Finally, auditor change which indicates a lower level of audit expertise is significantly associated with the length of audit lag with the expected positive sign, supporting the third hypothesis.

[Insert Table 4 about here]

Regarding the control variables, one of the corporate governance characteristics – the number of board meetings - is found to be significantly negatively related to audit lag. This is consistent with the expectation that stricter corporate governance tends to ensure a more timely submission of financial statements. It is also found that *good_news* is significantly negatively related to the length of audit lag. This is consistent with the expectation that companies tend to accelerate the release of good news. Firms with high regulatory pressures have significantly shorter audit delay probably because the regulatory bodies

supervise the financial reporting of such companies more strictly.

6.3 Consequences of Long Audit Reporting Lag

As mentioned earlier, two adverse consequences of long audit reporting lag are examined in this study. Table 5 Panel A presents the findings for the association between the receipt of non-standard opinion and long audit lag. In all three models, I found that long audit lag is significantly positively related to the receipt of non-standard audit opinion in the following year. In addition, most control variables are also significantly related to the dependent variable with the expected signs. For example, firms receiving non-standard opinions in the previous year are more likely to receive non-standard opinions in the current year. Firms with lower profitability, more losses, lower revenue, higher leverage, and negative equity and cash flows are more likely to be issued a non-standard opinion.

[Insert Table 5 about here]

Table 5 Panel B presents the findings for the association between financial statement restatement and long audit lag. It is found that restatement in the subsequent year is significantly positively associated with long audit reporting lag in the 5% definition option. However, in the 10% and 15% cases, the associations are not significant possibly because some of the audit lags are not abnormally long in these two cases. Interestingly, I found that companies listed on the Shanghai Stock Exchange are more likely to make restatements. This is probably because companies listed on this exchange are larger companies that

are subject to more scrutiny from auditors and the public.

To summarize, the empirical results support hypotheses four and five. Companies should be alerted that a prolonged audit lag could be associated with adverse consequences including the receipt of non-standard opinion and financial statement restatement in the subsequent year.

Chapter 7 Sensitivity Tests

7.1 Exclude “ST” Firms

In March, 1998, China's Securities Regulatory Commission (CSRC) started a policy to give “special treatment” to firms with abnormal financial problems.³ These firms are then called “ST” firms. This policy reminds the investors that they need to pay special attention to default risk. Because of “ST” firms’ abnormal financial condition, some studies exclude such firms to reduce their irregular influence on regression results. In this study, I re-examine the determinants of audit lags in China after excluding “ST” firms.

As can be observed from Table 6 (Panel A) the regression results are not

³ ST firms are subject to the following “treatments”:

1. The company’s share and its derivatives will be designated as “ST”, and its trading quotation is to be published in another board.
2. The daily quotation fluctuation for the company’s share is limited to 5%.
3. During the period of “special treatment”, the company’s middle-term report must be audited (Bai, et al., 2002).

significantly different from those in Table 4. Asset return and contingent liability are significantly related to audit lag with expected signs suggesting that higher audit risks are associated with longer audit lags. The receipt of non-standard opinion, audit fee, and number of subsidiaries are significantly positively related to audit lags. This result supports that audit complexity is positively associated with audit lags. It is also found a change in auditor is significantly positively associated with audit lag at the 10% significance level. Therefore, all three hypotheses are supported by the sensitivity test result.

[Insert Table 6 about here]

7.2 Drop of Earnings Surprise Variables

The lack of analysts' forecast data reduces the sample size by about 4000 observations. Therefore, in the second sensitivity test, I drop the two earnings surprise variables and re-examine the first model. The results shown in Table 6 (Panel B) are not significantly different from those in Table 4. Asset return is significantly negatively related to audit lag while the existence of loss is significantly positively related to audit lag. The first hypothesis is supported. The receipt of non-standard audit opinion, audit fee, and number of subsidiaries are all significantly positively related to audit lag. This result indicates that higher audit complexity is associated with longer audit lag. A change in auditor is significantly positively related to audit lag, and the third hypothesis is supported.

7.3 Auditor Change (Alternative Definition)

In the third sensitivity test, I re-examine the determinants of audit lags in China after adjusting the auditor change variable. Specifically, because switches from a non-Big 4 auditor to a Big 4 auditor may not indicate a decrease of audit expertise, I exclude such cases from my analysis. The result shown in Table 6 (Panel C) is not significantly different from that of the original model in Table 4. Asset return and the existence of contingent liabilities are significantly related to audit lag with the expected signs, and the first hypothesis is supported. The receipt of non-standard audit opinion, audit fee, and number of subsidiaries are all significantly positively related to audit lag as expected. Finally, the significantly positive association between auditor change and audit lag supports the third hypothesis.

7.4 Audit Opinion (Alternative Definition)

In a sensitivity test for Model 2, I classified the “unqualified opinion with emphasis of matter paragraph” opinion as standard opinion instead of non-standard opinion as in Table 5, (Panel A). As can be observed in Table 6 (Panel D), there is no change in the relationship between the experimental variables and the dependent variable when the first definition option for long audit lag is adopted. That is, firms with the top 5% longest audit lag are more likely to receive non-standard opinions in the subsequent year even with this re-classification of audit opinion.

7.5 Non-standard Audit Opinion and Long_Audit_Lag (t-2)

In a sensitivity test for both models 2 and 3, I changed the test variable from long_audit_lag (t-1) to long_audit_lag (t-2) to examine whether abnormally long audit reporting lag would still result in the receipt of non-standard opinion or financial statement restatement after two years. As can be observed from the Table 6 (Panels E and F), the relationships between long_audit_lag (t-2) and the receipt of non-standard opinion are significant in all three definitions of long_audit_lag. However, I do not find significant relationships between long_audit_lag (t-2) and restatement.

7.6 Restatements (Exclusion of trivial restatements)

In China, restatements could be triggered by trivial issues not affecting accounting numbers in the financial statements. For example, disclosures of clerical errors, supplementary information, explanatory information, and change of accounting policy are all included in restatements. I re-define the restatement variable in Model 3 by excluding less relevant restatements: in Table 6 (Panel G), restatements about clerical errors are excluded, and the result shows that long audit lag is significantly positively associated with restatements in the first definition option, i.e. top 5% of audit lag. In Table 6 (Panel H), restatements that correct for clerical errors, disclose explanatory, supplementary, and change of accounting policy information are excluded. The result shows that long audit lag

is also significantly positively related to restatement in the first definition option, i.e. top 5% of audit lag.

Chapter 8 Conclusion and Implications

This paper examines the determinants of audit reporting lags in China and the consequences of long audit reporting lags. Audit reporting lags are found to be significantly associated with audit risk, audit complexity, and audit expertise. Specifically, a higher level of audit risk and audit complexity and a lower level of audit expertise are associated with longer audit delay. Since all Chinese listed firms have the same financial year end, I am able to assess the determinants of audit reporting lag without the confounding effects of differing balance sheet dates. I also found that the more frequent issuance of non-standard opinion and accounting restatements after a firm has a prolonged audit lag. Prolonged audit delay implies intensive negotiations between auditors and the management. Even though agreements may finally be reached between the auditor and the management, potential problems in the financial statements are often detected in subsequent years and can have adverse consequences.

There are two additional implications from this research. For management, they should be more careful in examining the causes of prolonged audit delay in an attempt to reduce or avoid adverse consequences. To the regulators, as 54%

of the listed companies in China actually take not more than 3 months to complete their financial statement audit, the 120-day requirement may be too generous. Also, the 120-day requirement may unnecessarily reduce the timeliness of the release of accounting information in China. For example, companies may strategically delay the release of bad news for as long as possible. Therefore, regulatory authorities may consider shortening the 120-day requirement to be more compatible with international practice and to insure that the published financial statements are timely and useful for investors.

I acknowledge several limitations in this study. First, there are many different measures of audit risk, audit complexity, and audit expertise. While the measures used in this study represent the more direct measures and they are supported by prior literature, I do not include all possible measures. Some measures used can be classified under either audit risk or complexity. Some control variables also can affect audit risk and complexity. Nevertheless, even if I re-classify some measures from audit risk to audit complexity (or vice versa) or from control variables to experimental variables, my test results indicate that the conclusions on the hypotheses will not change. Second, I did not examine the capital market effect of long audit delay because this specific consequence was studied in prior literature and I want to focus on the accounting and audit reporting consequences that have not been examined in prior studies.

Finally, while litigation is an important factor driving audit reporting lag in the US, litigations for Chinese companies are not as widespread. Some Chinese companies are reluctant to disclose such contingencies. I have included a contingent liability variable to account for this effect. Limited disclosure by Chinese companies on litigation precludes a more elaborated analysis on this issue.

Table 1
Variable Definitions

Variable	Definition
Asset_return	The ratio of earnings before interest and taxes to total assets
Audit_fee	The natural logarithm of total audit fee
Auditor	An indicator variable if the auditor is a non-Big 4 auditor
Cash_flow	An indicator variable if the operating cash flow is negative
Change	An indicator variable if the company's external auditor is switched
Concentration	Holding percentage of the largest shareholder
Contingent_liability	An indicator variable if the company has any contingent liability
Equity	An indicator variable if the book value of equity is negative
Exchange	An indicator variable if the shares of a firm are traded simultaneously on more than one stock exchange
Good_news	An indicator variable if net income is not smaller than forecast net income
Growth_rate	Growth rate of return on equity
Ln_audit_lag	Natural logarithm of the number of days between client's fiscal year-end and the audit report date
Independent	The percentage of independent directors on the board
Inventory	The ratio of inventory to total assets
Leverage	The ratio of total debt to total assets
Location	An indicator variable if a firm is listed on the Shanghai Stock Exchange
Long_audit_lag	An indicator variable for firms with the top 5%, 10%, and 15% longest audit lag
Loss	An indicator variable if net income is less than zero
Nmeeting	Number of board meetings
Nsubsidiaries	Number of subsidiaries
Opinion	An indicator variable if the company does not receive a standard opinion
Regulatory_Pressure	An indicator variable if the company belongs to highly regulated sectors
Restatement	An indicator variable for companies announcing financial statements restatements
Revenue	Natural logarithm of total operating revenue
STfirm	An indicator variable if a firm is classified as "ST" firm
Surprise	The difference between actual earnings per share and forecast earnings per share

Switch	An indicator variable when the company's external auditor is switched
Size	The natural logarithm of total assets
State_owned	An indicator variable if the largest shareholder is the government
Tshare	The percentage of tradable shares
Zscore	Altman's Z score

Table 2
Descriptive Statistics
Panel A. Dependent Variable

Overall Statistics	Obs	Mean	Std. Dev.	Min	Max
audit_lag	8952	87.06	24.23	0	241
accounting_year 2004					
audit_lag	1351	84.82	26.09	9	223
accounting_year 2005					
audit_lag	1317	87.83	24.51	0	241
accounting_year 2006					
audit_lag	1448	87.87	24.49	10	119
accounting_year 2007					
audit_lag	1545	86.60	25.19	10	239
accounting_year 2008					
audit_lag	1591	89.52	21.18	13	126
accounting_year 2009					
audit_lag	1700	85.68	23.82	10	119

Table 2 (Continued)
Panel B. Independent Variables

Variable	Observations	Mean	Std. Dev.	Min	Max
asset_return	8945	0.0465	0.0988	-1.0210	0.4927
loss	9015	0.1362	0.3430	0	1
leverage	8920	0.5476	0.3585	0.0510	5.5043
zscore	8949	1.7546	2.3892	-26.9615	12.3027
contingent_liability	8843	0.1773	0.3820	0	1
opinion	9152	0.0905	0.2869	0	1
audit_fee	7788	13.2027	0.7809	10.3090	19.2405
Nsubsidiaries	7794	10.6848	13.5730	1	223
auditor	9152	0.9301	0.2550	0	1
change	8649	0.0946	0.2926	0	1
Tshare	8972	0.5288	0.2171	0	1
state_owned	9010	0.5355	0.4988	0	1
concentration	9010	0.3775	0.1608	0.0082	1
independent	8889	0.3554	0.0510	0	0.7143
Nmeeting	9003	8.4752	3.5237	1	36
good_news	4699	0.4541	0.4979	0	1
surprise	5649	-0.0832	0.4205	-22.48	1.54
size	9013	21.4079	1.3622	10.8422	30.0979
exchange	8860	0.0710	0.2570	0	1
restatement	9153	0.1112	0.3144	0	1
regulatory_pressure	9015	0.0978	0.2971	0	1

Table 3 Correlation Matrix													
	audit_lag	asset_return	loss	leverage	zscore	contingent_liabilities	opinion	audit_fee	nsubsidiaries	auditor	change		
audit_lag	1.0000												
asset_return	-0.2299*	1.0000											
loss	0.2384*	-0.6410*	1.0000										
leverage	0.1160*	-0.3105*	0.2662*	1.0000									
zscore	-0.1686*	0.4665*	-0.3723*	-0.8043*	1.0000								
contingent_liabilities	0.1138*	-0.1562*	0.1634*	0.2902*	-0.2736*	1.0000							
opinion	0.2277*	-0.3916*	0.4147*	0.4344*	-0.4589*	0.2680*	1.0000						
audit_fee	0.0817*	0.0873*	-0.0775*	0.0616*	0.0302*	0.1682*	-0.0730*	1.0000					
nsubsidiaries	0.0600*	0.0297*	-0.0523*	0.041*	0.0102	0.0933*	-0.0481*	0.3874*	1.0000				
auditor	-0.0297*	-0.0652*	0.0577*	0.0123	-0.0478*	-0.1383*	0.0566*	-0.5668*	-0.1828*	1.0000			
change	0.0642*	-0.0670*	0.0562*	0.0543*	-0.0654*	0.0682*	0.0922*	-0.0308*	-0.0212	0.0156	1.0000		
Tshare	0.0441*	-0.0443*	0.0395*	0.0365*	-0.0718*	0.0505*	-0.0137	0.0612*	0.1329*	0.0349*	-0.0415*		
state_owned	-0.0277*	0.0066	-0.0361*	-0.0578*	0.0555*	-0.0488*	-0.0941*	0.0751*	0.0261*	-0.0642*	0.0241*		
concentration	-0.0914*	0.1288*	-0.1160*	-0.1114*	0.1462*	-0.0872*	-0.1344*	0.1193*	-0.0458*	-0.1124*	0.0034		
independent	0.0191	-0.0079	-0.0057	0.0025	-0.0175	0.0376*	-0.0001	0.0551*	0.0305*	-0.0296*	0.0034		
Nmeeting	-0.0301*	0.0000	-0.0055	0.0679*	-0.0576*	0.0760*	-0.0107	0.1532*	0.1550*	-0.0679*	0.0342*		
good_news	-0.0929*	0.2575*	-0.2189*	-0.0258	0.0952*	0.0064	-0.1118*	0.0979*	0.0926*	-0.0736*	0.0034		
surprise	-0.1013*	0.4902*	-0.3698*	-0.2122*	0.2653*	-0.0505*	-0.2770*	0.0306*	0.0299*	-0.0411*	-0.0577*		
size	-0.0197	0.1620*	-0.1819*	-0.014	0.1388*	0.0241*	-0.2571*	0.7216*	0.3521*	-0.4218*	-0.0283*		
exchange	0.0883*	0.0005	0.0011	-0.0151	-0.0164	0.1382*	0.0137	0.4751*	0.1445*	-0.3894*	0.0166		
restatement	0.0165	-0.0713*	0.0635*	0.0382*	-0.0687*	0.0334*	0.0471*	-0.0019	0.0146	0.0043	0.0242*		
regulatory_pressure	0.0001	0.0835*	-0.0372*	-0.0065	0.0216*	0.0158	-0.0192	0.1890*	-0.0281*	-0.1683*	-0.0077		

	Tshare	state_owed	concentration	independent	Nmeeting	good_news	surprise	size	exchange	restatement	regulatory_pressure
Tshare	1.0000										
state_owed	-0.2075*	1.0000									
concentration	-0.4301*	0.2907*	1.0000								
independent	0.0531*	-0.0842*	-0.0032	1.0000							
Nmeeting	0.1333*	-0.0513*	-0.0743*	0.0420*	1.0000						
good_news	-0.0094	0.0493*	0.0470*	-0.0446*	0.0184	1.0000					
surprise	-0.0494*	0.0081	0.0413*	-0.0063	-0.0136	0.2338*	1.0000				
size	0.0812*	0.2163*	0.2127*	0.0052	0.1694*	0.1323*	0.0661*	1.0000			
exchange	0.0464*	0.0683*	0.0406*	0.0184	0.0328*	0.0641*	0.0312*	0.2636*	1.0000		
restatement	0.0324*	-0.0085	-0.0228*	-0.0086	0.0510*	-0.0042	-0.0365*	-0.0217*	-0.0191	1.0000	
regulatory_pressure	-0.0643*	0.0932*	0.0890*	-0.0058	0.0123	0.0077	0.0294*	0.2285*	0.0806*	-0.013	1.0000

Table 4**Model 1 Determinants of Audit Reporting Lag**

Independent Variables:		Predicted Sign	Coefficients	P-value	
	intercept	?	3.888	0.000	*
Audit Risk	asset_return	-	-0.634	0.000	*
	loss	+	0.047	0.154	
	leverage	?	-0.100	0.079	
	zscore	-	0.000	0.966	
	contingent_liability	+	0.041	0.036	*
Audit Complexity	opinion	+	0.156	0.001	*
	audit_fee	+	0.046	0.007	*
	Nsubsidiaries	+	0.001	0.004	*
Audit Expertise	auditor	+	0.030	0.370	
	change	+	0.049	0.045	*
China Variables	Tshare	?	-0.002	0.965	
	state_owned	?	0.018	0.237	
Corporate Governance	concentration	?	-0.017	0.738	
	independent	-	-0.081	0.557	
	Nmeeting	-	-0.009	0.000	*
Earnings Surprise	good_news	-	-0.039	0.007	*
	surprise	-	-0.008	0.754	
Information Demand	size	-	0.004	0.664	
	exchange	?	0.029	0.406	
Earnings Quality	restatement	+	-0.035	0.117	
	regulatory_pressure	?	-1.459	0.000	*
Dependent Variable:		Ln_audit_lag			
Number of obs		2826			
F(30, 2795)		9.380			
Prob > F		0.000			
R-squared		0.092			
Adj R-squared		0.082			

Table 5									
Adverse Consequences									
Panel A. Receipt of Non-standard Audit Opinion									
Model 2, Option 1	Coefficients	P-value	Model 2, Option 2	Coefficients	P-value	Model 2, Option 3	Coefficients	P-value	
intercept	0.373	0.000	*intercept	0.255	0.000	*intercept	0.370	0.000	*
long_audit_lag (top 5%) (t-1)	0.040	0.001	*long_audit_lag (top 10%) (t-1)	0.025	0.002	*long_audit_lag (top 15%) (t-1)	0.022	0.002	*
Control Variables (t)									
opinion (t-1)	0.422	0.000	*opinion (t-1)	0.421	0.000	*opinion (t-1)	0.422	0.000	*
asset_return	-0.238	0.000	*asset_return	-0.237	0.000	*asset_return	-0.235	0.000	*
loss	0.111	0.000	*loss	0.112	0.000	*loss	0.112	0.000	*
revenue	-0.011	0.001	*revenue	-0.011	0.001	*revenue	-0.010	0.002	*
leverage	0.040	0.006	*leverage	0.038	0.008	*leverage	0.037	0.010	*
zscore	-0.003	0.243	zscore	-0.003	0.234	zscore	-0.003	0.193	
size	0.000	0.943	size	0.000	0.959	size	0.000	0.968	
auditor	-0.018	0.086	auditor	-0.018	0.083	auditor	-0.018	0.079	
equity	0.276	0.000	*equity	0.277	0.000	*equity	0.277	0.000	*
cash_flow	0.018	0.004	*cash_flow	0.018	0.004	*cash_flow	0.017	0.005	*
Prob > F	0.000		Prob > F	0.000		Prob > F	0.000		
R-squared	0.486		R-squared	0.486		R-squared	0.486		
Adj R-squared	0.484		Adj R-squared	0.484		Adj R-squared	0.485		
Dependent Variable:Opinion (t)									
Note: All control variables are for period t except for opinion (t-1)									

Table 5 (Continued)									
Panel B. Financial Statement Restatement									
Model 3, Option 1	Coefficients	P-value	Model 3, Option 2	Coefficients	P-value	Model 3, Option 3	Coefficients	P-value	
intercept	0.189	0.050	* intercept	0.189	0.051	intercept	0.088	0.435	
long_audit_lag (top 5%) (t-1)	0.042	0.034	* long_audit_lag (top 10%) (t-1)	0.019	0.164	long_audit_lag (top 15%) (t-1)	0.013	0.262	
Control Variables (t-1)			Control Variables (t-1)			Control Variables (t-1)			
restatement	0.041	0.001	* restatement	0.042	0.001	* restatement	0.042	0.001	*
inventory	0.020	0.524	inventory	0.023	0.473	inventory	0.022	0.491	
asset_return	-0.067	0.225	asset_return	-0.070	0.208	asset_return	-0.070	0.212	
growthrate	0.000	0.002	* growthrate	0.000	0.003	* growthrate	0.000	0.003	*
loss	0.012	0.443	loss	0.011	0.480	loss	0.011	0.468	
leverage	-0.010	0.488	leverage	-0.010	0.491	leverage	-0.008	0.550	
size	-0.005	0.235	size	-0.005	0.236	size	-0.005	0.244	
opinion	-0.002	0.898	opinion	-0.002	0.898	opinion	-0.001	0.950	
auditor	-0.018	0.291	auditor	-0.019	0.282	auditor	-0.019	0.279	
stfirm	0.065	0.000	* stfirm	0.067	0.000	* stfirm	0.067	0.000	*
location	0.076	0.000	* location	0.076	0.000	* location	0.076	0.000	*
Prob > F	0.000		Prob > F	0.000		Prob > F	0.000		
R-squared	0.030		R-squared	0.030		R-squared	0.030		
Adj R-squared	0.027		Adj R-squared	0.027		Adj R-squared	0.027		
Dependent Variable: Restatement (t)									

Table 6
Sensitivity Tests
Panel A. Exclude ST Firms

Independent Variables:		Predicted Sign	Coefficients	P-value	
	intercept	?	3.867	0.000	*
Audit	asset_return	-	-0.788	0.000	*
	loss	+	0.031	0.351	
Risk	leverage	?	-0.085	0.164	
	zscore	-	0.003	0.730	
	contingent_liability	+	0.042	0.031	*
Audit	opinion	+	0.163	0.002	*
	audit_fee	+	0.047	0.005	*
Complexity	Nsubsidiaries	+	0.001	0.007	*
Audit	auditor	+	0.030	0.369	
Expertise	change	+	0.043	0.084	
China Variables	Tshare	?	0.011	0.787	
	state_owned	?	0.021	0.162	
Corporate Governance	concentration	?	0.000	0.794	
	independent	-	-0.066	0.630	
Earnings Surprise	Nmeeting	-	-0.009	0.000	*
	good_news	-	-0.035	0.016	*
Information Demand	surprise	-	-0.020	0.434	
	size	-	0.003	0.763	
Earnings Quality	exchange	?	0.027	0.436	
	restatement	+	-0.032	0.151	
	regulatory_pressure	?	-0.001	0.973	
Dependent Variable:		Ln_audit_lag			
Number of obs		2771			
Prob > F		0.000			
R-squared		0.092			
Adj R-squared		0.083			

Table 6 (Continued)**Panel B. Drop Earnings Surprise Variables**

Independent Variables:		Predicted Sign	Coefficients	P-value	
	intercept	?	3.438	0.000	*
Audit	asset_return	-	-0.477	0.000	*
	loss	+	0.092	0.000	*
Risk	leverage	?	-0.046	0.055	
	zscore	-	0.002	0.569	
	contingent_liability	+	0.021	0.108	
Audit	opinion	+	0.116	0.000	*
	audit_fee	+	0.053	0.000	*
Complexity	Nsubsidiaries	+	0.001	0.024	*
Audit	auditor	+	0.023	0.351	
Expertise	change	+	0.052	0.001	*
China Variables	Tshare	?	0.014	0.645	
	state_owned	?	0.010	0.320	
Corporate Governance	concentration	?	-0.114	0.001	*
	independent	-	-0.107	0.246	
	Nmeeting	-	-0.008	0.000	*
Information	size	-	-0.002	0.704	
Demand	exchange	?	0.039	0.085	
Earnings	restatement	+	-0.017	0.257	
Quality	regulatory_pressure	?	(omitted)		
Dependent Variable:		Ln_audit_lag			
Number of obs		5622			
Prob > F		0.000			
R-squared		0.090			
Adj R-squared		0.086			

Table 6 (Continued)**Panel C. Auditor Change (Alternative Definition)**

Independent Variables:		Predicted Sign	Coefficients	P-value	
	intercept	?	3.895	0.000	*
Audit Risk	asset_return	-	-0.635	0.000	*
	loss	+	0.047	0.152	
	leverage	?	-0.100	0.081	
	zscore	-	0.000	0.953	
	contingent_liability	+	0.041	0.034	*
Audit Complexity	opinion	+	0.155	0.001	*
	audit_fee	+	0.046	0.007	*
	Nsubsidiaries	+	0.001	0.005	*
Audit Expertise	auditor	+	0.025	0.456	
	change	+	0.049	0.043	*
China Variables	Tshare	?	-0.001	0.978	
	state_owned	?	0.018	0.230	
Corporate Governance	concentration	?	-0.017	0.737	
	independent	-	-0.080	0.562	
	Nmeeting	-	-0.009	0.000	*
Earnings Surprise	good_news	-	-0.039	0.007	*
	surprise	-	-0.008	0.750	
Information Demand	size	-	0.004	0.664	
	exchange	?	0.026	0.445	
Earnings Quality	restatement	+	-0.035	0.118	
	regulatory_pressure	?	-1.459	0.000	*
Dependent Variable:		Ln_audit_lag			
Number of obs		2826			
Prob > F		0.000			
R-squared		0.092			
Adj R-squared		0.082			

Table 6 (Continued)									
Panel D. Audit Opinion (Alternative Definition)									
Model 2, Option 1	Coefficients P-value		Model 2, Option 2	Coefficients P-value		Model 2, Option 3	Coefficients P-value		
intercept	-0.092	0.064	intercept	-0.108	0.030	* intercept	-0.108	0.031	*
long_audit_lag (top 5%) (t-1)	0.025	0.004	* long_audit_lag (top 10%) (t-1)	0.008	0.161	long_audit_lag (top 15%) (t-1)	0.008	0.118	
Control Variables (t)			Control Variables (t)			Control Variables (t)			
opinion (t-1)	0.337	0.000	* opinion (t-1)	0.338	0.000	* opinion (t-1)	0.340	0.000	*
asset_return	-0.326	0.000	* asset_return	-0.325	0.000	* asset_return	-0.324	0.000	*
loss	0.048	0.000	* loss	0.048	0.000	* loss	0.048	0.000	*
revenue	-0.001	0.766	revenue	-0.001	0.771	revenue	0.000	0.856	
leverage	0.029	0.005	* leverage	0.028	0.006	* leverage	0.027	0.008	*
zscore	0.005	0.006	* zscore	0.005	0.007	* zscore	0.004	0.009	*
size	0.001	0.823	size	0.001	0.814	size	0.000	0.879	
auditor	-0.004	0.633	auditor	-0.004	0.634	auditor	-0.004	0.625	
equity	0.114	0.000	* equity	0.116	0.000	* equity	0.115	0.000	*
cash_flow	0.018	0.000	* cash_flow	0.018	0.000	* cash_flow	0.017	0.000	*
Prob > F	0.000		Prob > F	0.000		Prob > F	0.000		
R-squared	0.316		R-squared	0.316		R-squared	0.317		
Adj R-squared	0.314		Adj R-squared	0.314		Adj R-squared	0.315		
Dependent Variable: Opinion (t)									
Note: All control variables are for period t except for opinion (t-1)									

Table 6 (Continued)									
Panel E. Audit Opinion and Long_Audit_Lag (t-2)									
Model 2, Option 1	Coefficients P-value		Model 2, Option 2	Coefficients P-value		Model 2, Option 3	Coefficients P-value		
intercept	0.210	0.001	* intercept	0.340	0.000	* intercept	0.350	0.000	*
long_audit_lag (top 5%) (t-2)	0.030	0.039	* long_audit_lag (top 10%) (t-2)	0.029	0.001	* long_audit_lag (top 15%) (t-2)	0.021	0.008	*
Control Variables (t)			Control Variables (t)			Control Variables (t)			
opinion (t-1)	0.420	0.000	* opinion (t-1)	0.417	0.000	* opinion (t-1)	0.417	0.000	*
asset_return	-0.204	0.000	* asset_return	-0.208	0.000	* asset_return	-0.202	0.000	*
loss	0.099	0.000	* loss	0.098	0.000	* loss	0.098	0.000	*
revenue	-0.012	0.001	* revenue	-0.012	0.002	* revenue	-0.012	0.002	*
leverage	0.030	0.051	leverage	0.030	0.050	* leverage	0.028	0.073	
zscore	-0.003	0.229	zscore	-0.003	0.272	zscore	-0.004	0.187	
size	0.002	0.597	size	0.003	0.582	size	0.002	0.668	
auditor	-0.017	0.143	auditor	-0.017	0.148	auditor	-0.017	0.140	
equity	0.310	0.000	* equity	0.308	0.000	* equity	0.313	0.000	*
cash_flow	0.010	0.148	cash_flow	0.009	0.158	cash_flow	0.009	0.169	
Prob > F	0.000		Prob > F	0.000		Prob > F	0.000		
R-squared	0.486		R-squared	0.486		R-squared	0.486		
Adj R-squared	0.484		Adj R-squared	0.484		Adj R-squared	0.485		
Dependent Variable:Opinion (t)									
Note: All control variables are for period t except for opinion (t-1)									

Table 6 (Continued)									
Panel F. Restatement and Long_Audit_Lag (t-2)									
Model 3, Option 1	Coefficients	P-value	Model 3, Option 2	Coefficients	P-value	Model 3, Option 3	Coefficients	P-value	
intercept	0.220	0.033	* intercept	0.225	0.030	* intercept	0.097	0.434	
long_audit_lag (top 5%) (t-2)	0.008	0.728	long_audit_lag (top 10%) (t-2)	0.000	0.996	long_audit_lag (top 15%) (t-2)	0.004	0.782	
Control Variables (t-1)			Control Variables (t-1)			Control Variables (t-1)			
restatement	0.055	0.000	* restatement	0.057	0.000	* restatement	0.057	0.000	*
inventory	0.005	0.878	inventory	0.006	0.860	inventory	0.006	0.850	
asset_return	-0.076	0.195	asset_return	-0.078	0.185	asset_return	-0.078	0.187	
growthrate	0.000	0.112	growthrate	0.000	0.112	growthrate	0.000	0.111	
loss	0.013	0.413	loss	0.013	0.429	loss	0.013	0.431	
leverage	-0.005	0.738	leverage	-0.005	0.747	leverage	-0.005	0.742	
size	-0.006	0.186	size	-0.006	0.168	size	-0.006	0.169	
opinion	-0.007	0.711	opinion	-0.007	0.725	opinion	-0.008	0.694	
auditor	-0.034	0.074	auditor	-0.034	0.073	auditor	-0.034	0.072	
stfirm	0.058	0.001	* stfirm	0.058	0.001	* stfirm	0.058	0.002	*
location	0.081	0.000	* location	0.082	0.000	* location	0.081	0.000	*
Prob > F	0.000		Prob > F	0.000		Prob > F	0.000		
R-squared	0.031		R-squared	0.031		R-squared	0.031		
Adj R-squared	0.027		Adj R-squared	0.028		Adj R-squared	0.028		
Dependent Variable: Restatement (t)									

Table 6 (Continued)									
Panel G. Restatement Redefined - Excluding clerical errors									
Model 3, Option 1	Coefficients	P-value	Model 3, Option 2	Coefficients	P-value	Model 3, Option 3	Coefficients	P-value	
intercept	0.168	0.072	intercept	0.167	0.074	intercept	0.074	0.498	
long_audit_lag (top 5%) (t-1)	0.042	0.025	* long_audit_lag (top 10%) (t-1)	0.016	0.241	long_audit_lag (top 15%) (t-1)	0.009	0.419	
Control Variables (t-1)			Control Variables (t-1)			Control Variables (t-1)			
restatement	0.046	0.000	* restatement	0.047	0.000	* restatement	0.047	0.000	*
inventory	0.005	0.863	inventory	0.007	0.807	inventory	0.006	0.832	
asset_return	-0.051	0.341	asset_return	-0.055	0.311	asset_return	-0.054	0.316	
growthrate	0.000	0.002	* growthrate	0.000	0.002	* growthrate	0.000	0.002	*
loss	0.011	0.472	loss	0.010	0.493	loss	0.011	0.473	
leverage	-0.006	0.663	leverage	-0.006	0.676	leverage	-0.004	0.751	
size	-0.004	0.326	size	-0.004	0.332	size	-0.004	0.339	
opinion	-0.002	0.909	opinion	-0.001	0.949	opinion	0.000	0.988	
auditor	-0.022	0.182	auditor	-0.023	0.176	auditor	-0.023	0.175	
stfirm	0.067	0.000	* stfirm	0.069	0.000	* stfirm	0.069	0.000	*
location	0.068	0.000	* location	0.068	0.000	* location	0.068	0.000	*
Prob > F	0.000		Prob > F	0.000		Prob > F	0.000		
R-squared	0.028		R-squared	0.028		R-squared	0.028		
Adj R-squared	0.025		Adj R-squared	0.025		Adj R-squared	0.025		
Dependent Variable: Restatement (t)									

Table 6 (Continued)									
Panel H. Restatement Redefined - Excluding Clerical Errors and Other Trivial Restatements									
Model 3, Option 1	Coefficients		P-value	Model 3, Option 2	Coefficients		P-value	Model 3, Option 3	Coefficients
intercept	0.023	0.772	0.000	intercept	0.022	0.782	0.000	intercept	-0.019
long_audit_lag (top 5%) (t-1)	0.057	0.000	0.000	* long_audit_lag (top 10%) (t-1)	0.020	0.068	0.000	long_audit_lag (top 15%) (t-1)	0.014
Control Variables (t-1)				Control Variables (t-1)				Control Variables (t-1)	
restatement	0.056	0.000	0.000	* restatement	0.057	0.000	0.000	* restatement	0.058
inventory	-0.023	0.372	0.372	inventory	-0.020	0.421	0.400	inventory	-0.021
asset_return	-0.053	0.239	0.239	asset_return	-0.057	0.207	0.213	asset_return	-0.056
growthrate	0.000	0.000	0.000	* growthrate	0.000	0.000	0.000	* growthrate	0.000
loss	0.009	0.488	0.488	loss	0.008	0.506	0.488	loss	0.009
leverage	0.001	0.954	0.954	leverage	0.001	0.926	0.850	leverage	0.002
size	0.001	0.770	0.770	size	0.001	0.759	0.739	size	0.001
opinion	0.007	0.636	0.636	opinion	0.008	0.566	0.510	opinion	0.009
auditor	-0.002	0.878	0.878	auditor	-0.003	0.847	0.840	auditor	-0.003
stfirm	0.029	0.031	0.031	* stfirm	0.031	0.020	0.020	* stfirm	0.031
location	0.049	0.000	0.000	* location	0.049	0.000	0.000	* location	0.049
Prob > F	0.000			Prob > F	0.000			Prob > F	0.000
R-squared	0.025			R-squared	0.024			R-squared	0.024
Adj R-squared	0.022			Adj R-squared	0.021			Adj R-squared	0.021
Dependent Variable: Restatement (t)									

Figure 1

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