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Client importance and audit quality in highly connected jurisdictions

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CLIENT IMPORTANCE AND AUDIT QUALITY IN HIGHLY CONNECTED JURISDICTIONS

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CLIENT IMPORTANCE AND AUDIT QUALITY IN HIGHLY CONNECTED JURISDICTIONS

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ABSTRACT

Client Importance and Audit Quality in Highly Connected Jurisdictions

by

YUEN Kelly Grani

Master of Philosophy

The study focuses on the audit quality issue in three culturally and commercially highly connected jurisdictions with very different legal systems which affect auditors. Hong Kong practices common law, Taiwan practices civil law, and the People's Republic of China (Mainland China) practices a socialist legal system. Taiwan adopts a civil law system with heavy influence by common law countries. It is therefore motivating to assess how auditors in each of the three connected jurisdictions with distinctive legal environments handle the audit quality for important clients. Accounting scandals and auditing frauds are perceived to be driven by aggressive companies and misrepresentation of audit reports. However, a locale's legal system and law enforcements should affect the services auditors provide to their clients, particularly 'important' clients. I find that in all three jurisdictions, the more important the client to its auditor, the lower the audit quality as measured by restatement of financial statements. However, I find mixed results when using other measures of audit quality.

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original work based primarily on my own research, and I warrant that all citations of previous research, published or unpublished, have been duly acknowledged.

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YUEN Kelly Grani

Date

CERTIFICATE OF APPROVAL OF THESIS

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Client Importance and Audit Quality in Highly Connected Jurisdictions

Chapter 1 Introduction

The aftermath of Enron with Arthur Anderson in 2001 (Asthana, Balsam and Kim, 2009), Lehman Brothers with Ernst and Young in 2008 (Sikka, 2009), Barclay's Libor manipulation in2012 (Vasudev and Rodriguez, 2013) and Tesco case in 2014 (Mohamed and Handley-Schachler, 2015) with PricewaterhouseCoopers, did not stop corporate managers and external auditors from augmenting financial data and keeping their companies on a going concern basis. In Asia, Toshiba had hidden billions of dollars in losses due to internal audit failure in 2011 (Jennings, 2015), while Baker Tilly failed to detect significant related-party transactions for Mainland China North East Petroleum Holdings Ltd, prompting the U.S Securities and Exchange Commission(US SEC) to file a lawsuit in 2014 (Carcello, Carver and Lennox, 2014). In fact, US SEC has been displeased for years that whenever a U.S.-listed Chinese company is involved in a scandal, the U.S. Public Company Accounting Oversight Board is not able to access to any of its auditing documents for follow-through investigations (Zarroli, 2012). Consequently, on top of accounting frauds, auditing scandals are also hitting the news headlines hard and frequent, to an extent that investors and the public have taken it as 'habitual' news.

The consequence of collusion between companies and auditors will not only bring in waves of financial crisis (namely, the 1997 Asian financial crisis, the 2000 recession, the 2001 dot-com bubble, the 2007 global financial crisis, and now the European debt crisis) it will also drag investors into distrust of listed companies' financial statements, as well as reputable auditors' renowned audit opinion. If the public stops trusting the accountants, fewer investments may be made, affecting our economy. Audit failures and collusion between managers and auditors are, in fact,

not fully litigated in courts. There is still a significant confusion in numerous courts about the auditor's specific role and responsibility in the failure of audit reports (Brown, 2007). Some auditors are willing to accept side-payments from their clients in exchange for their acceptance of risk of collusion with the client's management (Antle, 1984).

Standard setters and the court often drive the public's attention by putting the blame solely on the auditor and on the client. However, the root cause of such scandals may be due to the legal system, law enforcement, and the key mechanisms that affect the implementation of accounting standards (Daske, Hail, Leuz and Verdi, 2008). With the focus on client importance and audit quality in highly connected jurisdictions, this thesis is therefore an important investigation as it attempts to identify an underlying cause of auditing frauds, and provide suggestions for regulators on how they may modify the enforcement schemes of legal systems, such that collusion between companies and auditors can be reduced.

Previous studies and literature have focused on the effect of accounting scandals primarily in the United States and the United Kingdom, while other studies have investigated the relationship of client importance and audit quality either in common law societies, in civil law jurisdictions, or in the People's Republic of China (Mainland China) alone. However, none of these have directly compared the audit quality for important clients in jurisdictions with different legal systems simultaneously in one investigation. Using data from Mainland China, Hong Kong and Taiwan during 2008-2013, I find that the more important the client is to its auditor, the lower the audit quality, as measured by the Restatement of Financial Statements (RESTATE) in all three jurisdictions. In Hong Kong, however, the more important the client is to its auditor, the higher the quality of audit report as

measured by modified audit opinion (MAO), This is an interesting result indicating that although Hong Kong auditors are conservative in terms of issuing MAO, their certified financial statements are subject to more restatements for more important clients. The fact that Mainland China, Taiwan, and HK are under the "one nation different systems" policy, cultural and political aspects have shaped their legal system differently. As such, the thesis argues that the different legal systems play a direct role in influencing audit quality. Furthermore, I do take into consideration that different local auditors are subject to different external factors and influences, such as auditor's legal liability, market and economic factors, as well as political considerations. The thesis will therefore include relevant control variables in the regression tests.

My study contributes to the literature in several ways. The thesis contributes to accounting literature, with a wider perspective than a single-country study on whether important audit clients actually manage to obtain cleaner audit reports from reputable auditors in jurisdictions that are highly connected culturally and commercially but with different legal systems. The results of my study should be useful to regulators by providing new perspectives on how differences in these jurisdictions affect the relationship between audit quality and client importance. Previous literature and findings were limited in single-country settings. The thesis is therefore an answer to the call for further cross-country research in audit quality and client importance (DeFond and Francis, 2005). Moreover, the thesis examines whether the audit quality for important clients may vary when different measures of audit quality are used.

The rest of the thesis is organized as follows. In Chapter two, a brief description of the three locales and their respective legal jurisdictions are introduced, followed by

the development of the hypotheses in Chapter three. The research methods and model specification are then explained in Chapter four, and the models are derived and justified. In Chapter five, the thesis presents the sample data, the descriptive statistics and the empirical test results. Robustness tests are then followed in Chapter six, while Chapter seven concludes the thesis.

Chapter 2 Institutional Backgrounds and Literature Review

The thesis is based on three culturally and commercially connected jurisdictions: Hong Kong represents the common law jurisdiction, Mainland China represents the socialist legal system, and Taiwan represents the civil law jurisdiction. The three jurisdictions have distinct features such as auditors' legal liability, market regulations and political influences, where the origins of the laws are relatively clear and unique.

2.1 The Common Law Region

Hong Kong (HK) is a major financial hub with a highly liquid financial market and rapid business growth in the past decades, with both national businesses and international enterprises setting foot into HK. While being returned to the People's Republic of China (Mainland China), HK today is still following the English common law system. The Hong Kong Institute of Certified Public Accountants (HKICPA) has fully adapted the International Financial Reporting Standards (IFRS), through localizing them into Hong Kong Financial Reporting Standards (HKFRS) and the Hong Kong Standard of Auditing (HKSA). Therefore, as a common law region, and a Chinese city with heavy western influences, HK is an interesting locale to be included in this thesis's research sample.

2.2 The Socialist Legal Region

With the highest percentage of the global population in one country, multinational enterprises are keen on expanding and entering Mainland China for business development. In fact, Mainland China's accounting developments play a major role in the economy's structural changes over the years (Nobes and Parker, 2012). On

January 1 2007, Mainland China moved from using the Chinese Accounting Standards (CAS) into using the new accounting standards which is equivalent to IFRS; While in accordance with the principle of continuous and comprehensive convergence, the Chinese Auditing Standards Board has completed the revision of Chinese Standards of Auditing (CSAs), and achieved full convergence with the clarified International Standards on Auditing (ISAs) (IFAC, 2010). The purpose of converging the Chinese standards with international standards is to better communicate with international investors – a crucial part of Mainland China's economic development and future growth plans.

Although Mainland China adopts the socialist legal system, with the aim to internationalize their economy, their rules of law have undergone rapid changes and developments. The accounting standards in Mainland China are still under the control of the Ministry of Finance, indicating a prevailing centralist culture of a bureaucratic economy. In other words, a small panel of officials ultimately decide or heavily influence the Mainland China's legal system and accounting regulations.

Furthermore, with an attempt to internationalize the 'centrally planned' Chinese economy into a "market" economy, previous accounting practices are being revised. The Chinese Ministry of Finance chose to converge the CAS with IFRS. Although this may facilitate and encourage overseas investors to invest in Chinese companies, small firms and local businesses find it difficult to transit into the new system, hence may not be able to prepare their financial statements that give a true and fair view of their underlying transactions.

2.3 The Civil Law Region

Taiwan is a capitalist region with a recent transition from a 'planned' to a 'free-market' economy, where its accounting standards are regulated by the Financial Accounting Standards Committee (FASC) with little government control. Taiwan's rule of law is relatively well-established and developed. Until today, USA is one of the strongest and biggest trade partners with Taiwan. In fact, the USA has substantial influence on Taiwan's financial reporting and auditing regulations: Taiwan's current accounting standards refer to both IAS and the US GAAP, and that their financial accounting does not follow its tax accounting (Nobes and Parker, 2012).

The difference between Taiwan and Mainland China's legal and political systems has impacts on their respective accounting practice (Sawani, 2009). Without doubt, Taiwan's accounting practice is part of its legal system. Since 2009, Taiwan has established a mandatory adoption of US GAAP or the IFRS and IAS standards for listed companies, while other unlisted companies and financial institutions are permitted to adopt the US GAAP or IFRS from 2013.

Therefore, with the abovementioned considerations, while recognizing that they have different social and economic development, Mainland China and Taiwan will be an excellent representation of well-connected jurisdictions in Asia to be included in this thesis's sample data.

2.4 Incentives for Auditors in the three locales

As Firth (2002) demonstrates, on top of the level of audit fees that will alter the auditor's behavior in delivering a clean audit opinion, auditors from the three locales will also have different incentives in treating their important clients differently. This thesis has identified three major categories of incentive to prompt external auditors

to treat important clients differently: legal liabilities, market and economic factors, and political considerations.

2.4.1 Legal Liabilities

Whether or not the auditor will face greater risk of legal liability due to professional negligence, affects their behaviors on important clients. Given that high audit quality depends on the proper implementation of established auditing standards, more efforts need to be given by the Chinese regulators to ensure effective and quality compliance with its CSA (World Bank Financial Management unit, 2009). Since 2007, Mainland China has developed and revised its legislative and regulatory framework for Company Law, Securities Law, Tax Law, Accounting Law, and the Law of the People's Republic of China on Certified Public Accountants, with the hope to converge with the international market. The Ministry of Finance, together with the Chinese Institute of Certified Public Accountants (CICPA), review the performance of external auditors who audit listed Mainland Chinese companies every three years. Furthermore, under Mainland China's Company Law Article 166, the management and the auditors are required to submit an audited annual report to its shareholders; failure to do so will permit shareholders to put the company and the auditors under litigation, industrial discipline, civil liabilities, as well as public condemnation.

Also, the Ministry of Finance in Mainland China require the audit engagement partner to be rotated every five years. Similar to international auditing standards, listed companies in Mainland China are required to establish an Audit Committee, explicitly to oversee whether the audit procedure is conducted independently. Also align with the International Federation of Accountants' requirement regarding

conflict of interest, Mainland auditors are not permitted to provide non-audit services to their audit clients.

According to CICPA Article 23 and 24, auditing firms must be established in the form of partnership, or of limited liability. It is required that audit reports are issued in the name of the audit firm, where the audit firm must be registered with the Ministry of Finance, in order to be qualified as a statutory auditor. Such audit firm must also include at least two qualified CICPA partners. Since the principal auditor must sign the audit report issued (Gillis, 2014), negligence and non-compliance of accounting standards will put audit partners and his engagement team under the spotlight, possibly facing civil and criminal liabilities. It is therefore required by the CICPA, that audit firms should establish a pool of funds for professional liabilities, as well as purchasing professional liability insurances. Since 1998/1999, a disaffiliation exercise for Mainland China CPA firms took place, requiring all firms to either be formed under unlimited liability partnership form of organization or under limited liability legal form (Firth, Mo and Wong, 2012). Similarly, in year 2010, Mainland CPA firms are required to transit into Special general partnership form. The promulgation and implementation of this requirement increased auditor's risk and liabilities significantly. The significant increase of risk exposure for Mainland CPA firms played a significant impact on the auditor's reporting behavior, increasing the audit quality (He, Pan and Tian, 2014). Additionally, Firth et al. (2012) demonstrates that audit firms in unlimited liability legal form tend to be more conservative than audit firms with limited liabilities. In turn, unlimited liability auditors will be more vigilant and prudent when issuing an unmodified audit report. This directly affects the audit quality of listed companies in Mainland China. Likewise, the Mainland Supreme People's Court established a new clause on trials

involving audit services in 2007, where the investors (the plaintiff) has the capacity to sue negligent auditors (defendant) under a civil law suit and demand for compensation.

On the other hand, HK auditor's legal liability to their clients is based on a broad principle of "failure to use reasonable care" (Johnston and Parker, 2007). This indicates that as long as the auditor is able to defend himself for being prudent and provide legitimate reasons, despite infringing specific accounting standards, the court may deem him innocent. Such common law practice is the direct opposite from the socialist legal system and the civil law's "box-ticking" approach, where auditors from Mainland China and Taiwan must strictly comply with their respective standards. Furthermore, under the HK company law, auditors' scope of being liable to parties other than their clients, is minimal (Johnston and Parker, 2007). In fact, HK auditor's liability is "restricted to cases where the auditor has assumed responsibility to the particular third party", such as auditor's knowledge of which the third party's reliance placed on the audit report. But in practice, such liability "has proved difficult to establish". This allows HK auditors to hide away from responsibilities. In contrast, the Mainland law specifically states that the "an auditor is liable to its clients and other interested parties if [the auditor] fails to comply with the accounting standards, and knowingly or negligently produces an inaccurate audit report". In other words, Mainland China auditors have direct responsibility to shareholders of the listed companies, over their false and misleading financial statements.

Given that Taiwan's accounting standards follow the US-GAAP closely, after the implementation of SOX in the USA, Taiwan has made amendments to its accounting standards as well. From 2003, it is mandatory for audit partners of listed

companies to rotate every five years, audit reports must disclose the name of the audit firm and the audit partner, and that the client's financial statements will be scrutinized and reviewed by Taiwan Stock Exchange (Chi et. al., 2009). Also, it is compulsory to state both the audit firm and the audit partner's names in the audit report, as shareholders will be fully compensated by the negligent auditor/ company director, if the shareholder wins the civil lawsuit(Taiwan Principal Company Law and Regulations, Section 4 Article 215). This prompts Taiwan auditors to be conservative towards issuing unqualified audit opinions, which give rise to higher audit quality.

2.4.2 Market and Economic Factors

Pearson and Trompeter (1994) found that highly competitive (and not concentrated) audit markets tend to offer lower audit fees. A highly concentrated market is when a few large audit firms have a large number of listed companies as their audit clients, within a jurisdiction. In contrast, a decentralized market has higher competition among the audit firms within a jurisdiction. Small audit firms therefore have the ability to compete with say Big 4 auditors in tendering for more clients. Consequently, given that clients are open to switching auditors and select the inexpensive tenders (the auditors), audit firms will compete against each other through providing a wider range of accounting-related services, better quality audits and reduced audit fee. As auditors are competing among themselves in offering lower-priced audits to their potential clients, another of their selling point is product differentiation – to provide clients with high quality services with a premium price (Lee, 1996). In other words, highly concentrated markets may give rise to higher audit fees and possibly lower audit quality reports, due to the lack of competition

among the audit firms. With a presumption that market competitiveness and market concentration are negatively correlated to one another, the thesis uses market concentration to measure the competitiveness of the auditing industry. As such, market concentration is defined as whether the Big N audit firms are dominating the auditing industry, implying that if the top N firms have significant market share, a highly concentrated market exists.

HK is known to have one of the most concentrated markets in China, where the Big 4 auditors have great dominance in providing audit services to listed companies. The Big 4 audit firms in China on the other hand, only share 30% of all accounting profits in the Mainland (HKTDC, 2003), indicating Big N audit firms in Mainland China have a relatively small market share (Chen, Chi and Lin, 2012). This suggests that the lack of competition in the auditing industry in HK prompts auditors in issuing lower quality audit reports. A justification to this line of reasoning is the Closer Economic Partnership Arrangement (CEPA) reached between CICPA and HKICPA in year 2010, where Mainland China companies listed on the Hong Kong Stock Exchange could "prepare financial statements in accordance with Mainland China's accounting standards and engage in a CPA firm on the Mainland to perform auditing services" (HKTDC, 2014). The implication of the CEPA on HK auditors is its escalation of pressure and competition between HK auditors and Mainland Chinese auditors in tendering for Mainland-based clients. HK auditors may further lower its budget and audit fees, hence sacrificing the quality of audit reports. Continuing with the abovementioned factor regarding market competition, numerous HK auditors are facing competitive pressure in targeting Mainland Chinese clients, especially SMEs and SOEs. In response, one of HK auditor's product differentiation is by offering clients a wide range of professional services, including "auditing, tax

consultancy, advisory, bookkeeping and training" to boost its competitiveness (HKTDC, 2003). As stated by the HKICPA's Code Of Ethics, however, auditors auditing listed companies should not provide non-audit services to their clients, as it poses a threat to independence, familiarity threat, self-review threat, and threat of financial dependence.

2.4.3 Political Considerations

Bushman and Piotroski (2005)find that in civil law jurisdictions, which tend to have more state-owned enterprises (SOEs), will "speed the recognition of good news and slow the recognition of bad news" relative to common law jurisdictions. This suggests that the high number of SOEs in Mainland China may give rise to lower audit quality, as 'bad' news are concealed. In contrast, Abdul-Wahab et al. (2009) suggested that politically connected SOEs are perceived as high-risk clients to auditors. Auditors may be inclined to charge politically connected clients with higher audit fees, as they generally have inadequate corporate governance and greater agency conflicts between managers and shareholders. As such, additional monitoring costs and auditing hours are required, constituting to higher audit fees. However, as mentioned by Pearson and Trompeter (1994), higher audit fees do not necessarily give rise to high audit quality.

Auditors' incentives in treating important clients differently in the three highly connected jurisdictions are summarized as below:

Summary of Incentives for Auditors

Incentives / Locales	Auditor legal liability	Market and Economic Factors	Political Considerations
Mainland	1) Mandatory submission of audited annual report to shareholders, but shareholders' approval of annual report is not required ; 2) Audit engagement partner to be rotated every 5 years; 3) Required establishment of an Audit Committee to oversee audit procedures ; 4) Auditors are not permitted to provide non-audit services to audit clients; 5) Audit firms must be established in the form of special general partnership or limited liability company; 6) Audit firms must be registered with the MOF, and be a statutory auditor ; 7) Principal auditor must sign the audit report, where the audit firm and audit partner's names are disclosed in the audit report.	1) Clients competing for high quality yet inexpensive tenders; 2) Big 4 firms have relatively small market share.	1) Higher number of SOEs present in the market; 2) Recognizing 'good' news much faster than disclosing 'bad' news; 3) SOE clients are perceived to be high-risk clients by auditors.

Summary of Incentives for Auditors (Continued)			
Taiwan	1) Closely follows US-GAAP and SOX; 2) Mandatory for audit partners to rotate every 5 years ; 3) Taiwan Stock Exchange reviews listed company's financial statements ; 4) Audit firm and audit partner's names are disclosed in the audit reports.	1) Increasing trend of market concentration, dominated by the Big N accounting firms (Lee, 2010) ; 2) Has an oligopoly market, especially in the audit, tax, management consultancy, and corporate registration field ; 3) High number of mergers of accounting firms, combining professional expertise and fostering audit market competitiveness (Chang, Chen, and Chan, 2009; Wootton et al., 1994).	1) Domestic audit firms build alliance with accounting firms in the USA ; 2) Significant amendments on CPA regulations, drawing government authorities' and the public's attention. (Lee, 2010).
Hong Kong	1) Unlike Mainland China's "box-ticking" approach, legal liability is judged on the principle of "failure to use reasonable skill and care"; 2) Minimal scope of liabilities to stakeholders, other than their clients.	1) Highly concentrated market; 2) Big 4 firms have great dominance in the audit market ; 3) The CEPA between CICPA and HKICPA increased competitiveness and pressure for HK auditors ; 4) HK auditors attempt to attract clients through providing audit clients with non-audit services as well.	1) Minimal number of SOEs present in the market ; 2) 'Bad' news are recognized and disclosed immediately, increasing audit conservatism.

2.5 Literature Review

Auditors have cost advantages over competitors and earn quasi rents (audit fees in excess of audit costs) in subsequent audits in terms of the significant client-specific start-up costs. Hence, auditors are not expected to be perfectly independent of their clients, because the latter one can terminate their bilateral relationship (DeAngelo, 1981). Therefore, the larger share the client occupies in an auditor's business, the stronger the incentive the auditor has to retain that client, thus possibly compromise audit quality. For instance, auditors who issued a qualified audit report to an important client, and subsequently the client disagrees with their modified report, the client may be inclined to go shopping for unmodified clean reports. In order to retain such clients and to reduce specific client's engagement start-up costs, auditors may compromise their independence by issuing clean audit reports. Audit quality therefore decreases.

However, previous literatures exhibit mixed evidence. DeAngelo (1981) demonstrated that audit quality is not independent of auditor's economic dependence on client, as they have a fear of losing the important client. Likewise, Chung and Kallapur (2003) examined client importance in terms of client's total fees to firm's total revenue, as well as the ratio of non-audit fees to firm's total revenues. Both measures are highly correlated, implying that auditors who are economically dependent on clients may be willing to compromise their independence. Salehi (2009) suggests that external auditors who provide their audit client non-audit services, such as tax and advisory services, the quality and independence of their audit reports become questionable. The audit report's accountability and full disclosures become biased, and there is a strong negative effect on audit independence as the auditor provides more professional services for the same client. Moreover, Sharma, et al.

(2011) demonstrates the strong and positive relationship between client importance and earnings management, with the presence of the audit committee as a moderator. On the other hand, Gaver and Paterson (2007) argues that audit quality is not compromised when the client is economically significant to the auditor; suggesting that audit quality is not affected by client size, but by client's personal relationship with the auditor. Chen, Sun, and Wu (2010) also suggests that audit quality is not solely affected by client's economic importance. The economic and legal system of a locale are strongly associated with the audit quality too. In fact, they established a relationship that in the mid-1990s, modified audit opinions were negatively correlated with auditor's high economic dependence on important clients. That is, lower audit quality for important clients in the mid-1990s. As the economic and market policies became more transparent and investor-friendly in the early 2000s, auditor's tendency in issuing MAOs is positively associated with client's economic importance in Mainland China. Similarly, Reynolds and Francis (2001) suggests that auditors will not issue favorable audit reports to important clients, as large clients give rise to more litigation risks. Auditors are unwilling to compromise their reputation and goodwill.

As suggested by Wu, Zeng and Wang (2014), numerous previous literature reviews have had opposing views and evidence. Whether or not there is an actual significant relationship between the two variables is still a question to answer. It is also worthy to note that previous literatures have not explored the relationship between client importance and audit quality in HK. It is therefore novel for this paper to investigate HK's audit quality for important clients. Hence, this paper focuses on the relationship between client importance and audit quality in three highly connected locales with different legal jurisdictions, by using Modified Audit Opinion

(MAO), Restatement of financial statements (RESTATE), and discretional accruals (DACC), as measures of audit quality. The research design of this thesis is further strengthened and differentiated from previous studies through the consideration and incorporation of auditor's legal liability, market and economic factors, and political considerations into the sensitivity analysis.

Chapter 3 Hypothesis Development

3.1 Audit Quality

In auditing, there are two competing forces that will affect the auditor's behavior towards important clients when they discover client's non-compliances: economic dependence and reputation protection (Reynolds and Francis, 2001). The auditors will make their decisions depending on the trade-off between their gains and losses. When the benefit is in excess of the loss, the auditors will decide to compromise their independence and reputation for an important client, thus audit quality will be dampened. Although multiple factors will affect audit quality, such as the skills and experience of auditors, and the audit methodology, audit quality is a complex concept which cannot boil down to one definition (Elshafie and Nyadroh, 2014). While DeAngelo (1981) determines audit quality to be "the market assessed joint probability that a given auditor will both discover a breach in the client's accounting system, and report the breach", HKICPA addresses quality with two standards: HKSQC 1, addressing quality control procedures across the whole audit firm, and HKSA 220, focusing quality control in the context of individual audit engagements.

3.2 Client Importance and Audit Quality

Previous empirical studies found a positive relationship between client importance and audit quality. Firth (2002) demonstrates that the level of "audit fees" will alter the auditor's behavior, possibly increasing the chance of delivering a clean audit opinion as audit fees are increased. Such factors are considered by the diligent Big 4 auditors, who apprehend that the cost of facing legal proceedings and reputation loss through issuing unmodified audit opinions to companies with

misreported financial statements does not outweigh the benefit of receiving higher audit fees from important clients. This is especially true in common law countries where law enforcement acts are more stringent with high penalties over financial misrepresentations. While Khurana and Raman (2006) found that higher audit fee paying clients have greater threat to audit independence, hence sabotaging the auditor's reporting credibility, Gaver and Paterson (2007) confirmed Reynolds and Francis (2001)'s paper that auditors are more vigilant towards larger sized client's accounting discretion. Lys and Watts (1994)'s findings is further consistent with the argument that larger clients are subject to higher audit and litigation risk, hence auditors are more conservative when auditing important clients. Furthermore, high litigation risk may lead to actual litigations and the risk of losing audit fees. Shu (2000) therefore established that auditors do attempt to disassociate and resign from clients with high risk and greater legal exposures. Evidence from Reynolds and Francis (2001) and DeFond and Francis (2005) shows losing an important client is more impactful at audit partner level and at local audit office levels, rather than to the audit firm as a whole. Chan (2010) further solidifies that local audit offices with greater economic dependence on important clients will treat such clients favorably.

3.3 Other Incentives Affecting Audit Quality

Further to this reasoning, the legal environment and law enforcement between common law, civil law, and the socialist legal jurisdictions are different. As compared to developed economies such as HK, Mainland China's CPA firms face intense competition due to the low audit market concentration, where none of the auditors can monopolize the audit market. Big 4 audit firms in Mainland China hold on average 30% of the market share, indicating the clients have a high bargaining

power, and are able to impose pressure on auditors fighting for their slice of cake (Chen et al., 2007). Moreover, as Mainland China's audit regulations are in the process of amendment since late 1990s, listed companies attempt to avoid regulatory attention and scrutiny through avoiding modified audit opinions. Also, audit firms who are inclined to issue modified audit reports tend to lose market share and important clients (DeFond, Wong and Li, 1999), therefore, auditors' reliance on important client further increases in Mainland China. Additionally, Mainland China did not have a formal legal infrastructure in the early years to support their capital market development (Chen, 2003), indicating that litigation against accounting fraud and market manipulation was not significant: regulatory enforcement, auditor penalties, and criminal or civil litigation faced by Mainland auditors are therefore low (Pristor and Xu, 2005). As a matter of fact, Mainland China's legal framework for civil or criminal liability is still perceived to be at its development stage (Li and He, 2000).

HK, as a Special Administrative Region, has preserved the Sino-British Joint Declaration from 1984, which was a binding international agreement with the approval from the United Nations. The Declaration guides HK's economic, political, and its legal system. Since 1st July, 1997, the Joint Declaration still continues to lead the HK's legal system under the Basic Law (Leung, 1997). The fundamental value of the Common Law is the concept of the "rule of law", where the laws in HK must operate under a separate system from the political system. This therefore guarantees the well-bring of investors and layman in HK, as the common law is perceived to be judged in a fair and unbiased manner.

On the other hand, Taiwan's civil law system focuses on statues rather than case law. This indicates that judges in courts will refer to the Constitution book, before

judging by the codes, statues, and ordinances. Taiwan's legal system has undergone reforms and changes, with the hope of improving judicial transparency, judicial fairness, and judicial integrity (Columbus School of Law, 2003). As such, Taiwan has established separate courts for civil cases and 'specialized' cases, which in turn increased investor and the public's confidence with its judiciary. The thesis therefore considers Taiwan as a median between Mainland China's and HK's legal systems.

However, audit firms also have several other incentives to protect their reputation and to reduce their litigation risk, such as market and economic factors and political considerations. Questionable audits can impair an office's reputation and adversely affect its ability to obtain and retain clients in its local market (Reynolds and Francis 2001). DeFond, Wong and Li (1999) mentioned that large auditors in Mainland China who had a history of issuing modified audit opinions, their market share will decline overtime. In other words, subsequent to the implementation of new auditing standards and costly penalties for implementation of new auditing standards and costly penalties for non-compliance of auditing standards, clients will tend to seek out for smaller auditors in order to reduce their chances of receiving a modified audit opinion. Consequently, in order to retain market share and concentration, large Mainland auditors may compromise their independence for economically important clients. Similarly, Wang, Wong and Xia (2008) found that Mainland Chinese's SOEs, who are controlled by the local government and have poorer earnings quality, have a higher tendency to hire small auditors rather than large reputable auditors, with the hope of receiving clean audit opinions. As small audit firms' financial resources and professional know-how may not be comparable to large reputable audit firms, SOEs' collusion incentive with small audit firms for

low audit quality reports may be found. In conclusion, market concentration and economic factors, and political consideration have impacts on the audit quality.

Therefore, the hypothesis is derived based on an inductive reasoning that:

H: In common law jurisdictions, the publicly listed company's audit quality decreases to a lesser extent than that of civil law jurisdictions and the socialist legal system, as auditor's economic dependence on important client increases, after considering:

(1) auditors' legal liabilities;

(2) market concentration and economic factors;

(3) political considerations.

Chapter 4 Research Methods and Model Specification

4.1 Measures of Audit Quality

While some accounting bodies define audit quality as to whether the financial report conveys constructive information to investors, others define audit quality as "addressing quality control procedures across the whole audit firm and focuses on quality control in the context of individual audit engagements" (HKSQC1, HKSA 220). As commonly found in the academic literature, this thesis will use (1) Modified Audit Opinions (DeFond et al., 2002; Reynolds and Francis, 2001; Carey and Simnett, 2006); (2) Financial Restatements (Kinney et al., 2004; Archambeault et al., 2008; Chin and Chi, 2009); and (3) Discretional Accruals (Becker et al., 1998; Francis et al., 1999), in defining AQ.

Theoretically, a high level of discretional accruals (DACC) implies the existence of earnings management and hence lower earnings quality and audit quality from the auditor. This indicates that if the auditor sees the benefit of satisfying a high-value client over potential litigation cost and public reputation, then DACC will increase as the client's importance increases. Consequently, AQ plunges.

A linear expectation model adapted from DeFond and Park (2001), to calculate unexpected accruals. The current year's accruals will be predicted through the use of the following equation:

$$NDA_i = \alpha_1 (1/A_i) + \alpha_2[(\Delta REV_i - \Delta REC_i)/ A_i] + \alpha_3 (PPE_i / A_i)$$

where,

NDA_i is the non-discretionary accruals of firm i in year t; A_i is the total assets of firm i in year t-1; ΔREV_i is the change in revenue of firm i in year t; ΔREC_i is the change in accounts receivables of firm i in year t; PPE_i is the total gross value of Property Plant Equipment for firm i in year t.

The above equation uses a listed company's change in revenue, change in accounts receivables, and total PPE, and pro-rata it to firm i's total assets. The benefit of using the linear expectation model through pro-rata is that it will enable me to compare companies to itself through the same currency, external factors, and its size (in terms of total assets), meaning it will help eliminate different country's accounting standards and accrual methods' variations.

In order to calculate DACC, the following equation is used (Cahan and Zhang, 2006):

Abnormal accruals = total accruals (in year t) –

predicted accruals (as calculated above)

where,

Total accruals = [(earnings before extraordinary items in year t) – (operating cash flows in year t)] / (total assets in year t-1)

As presented in previous literature, Holthausen and Verrecchia(1988)'s model demonstrates that the magnitude of stock price response will increase as the precision and accuracy of auditor's reported information increases. Kormendi and Lipe (1987) established a relationship between stock prices and reported earnings through the persistence of earnings. This implies that high DACC corresponds to low AQ.

An alternative method used to measure AQ is Modified Audit Opinions (MAO). The sample entities used in the thesis includes all the listed companies within HK, Mainland China and Taiwan. It is therefore assumed that reputable audit firms will have more to lose if they fail to disclose client's accounting breaches, and therefore will be motivated to issue audit reports that are true, fair and of high quality (DeAngelo, 1981). Also, due to large audit firms' public reputation and stakeholder expectations, they are more conservative in issuing clean unmodified audit reports to

their clients (Francis and Krishnan, 1999), so to strategically minimize their audit risk when issuing such documents into the market (Johnstone and Bedard, 2004). Especially in Asia, where the consequence of misrepresentation of audit reports is significant, auditors will tend to issue MAO when faced with uncertainties in a client (Chan and Wu, 2011). As such, it can be assumed that a larger number of MAOs issued by a reputable auditor indicates a higher quality of audit reports published by them. In the context of the thesis, MAO will include "Unqualified opinion with Emphasis of Matter", "Qualified opinion with Emphasis of Matter", "Qualified opinion", "Disclaimer opinion", and "Adverse opinion", as such financial statements are not presented in a clean, true, and fair manner.

The thesis's measurement and classification of MAO types may be argued as pseudo qualifications, as it combines a set of opinions of different degrees of severity into one category. However, as suggested from previous literature (Blandon and Bosch, 2013; Xie, Cai and Ye, 2010), such classification is deemed appropriate, as it reflects the auditor's reporting behavior and treatment towards important clients. Whether or not the client's matter is not material nor pervasive, the auditor's willingness to issue an unqualified opinion demonstrates a clean, true, and fair financial statement.

Lastly, Financial Restatements (RESTATE) of audit reports is another dependent dummy variable used to measure audit quality. RESTATE is when a company or an auditor discovers an error made in the financial statement from the previous year, while filing and disclosing such amendment to the public regarding the 'correct' figure (Olga, 2014). In the eye of a public investor, however, RESTATE is an indicator of negligent auditors, poor audit quality, and inadequate corporate governance policies within a company. Some investors perceive RESTATE as a sign

of auditors' reduced audit effort in an attempt to make an engagement profitable, leading to potential financial reporting problems, and a loss of confidence in the value of the audit report (Blankley, Hurtt, and MacGregor, 2012). In effect, as seen in the recent 2014 Chinese Stock Market, a high figure of RESTATE will lead to losses in firm equity valuations (Ma et al., 2014). Therefore, it can be assumed that a low figure of FR issued indicates higher AQ reports issued throughout the years.

The three different measures used to define AQ are distinctive, and attempts to capture different aspects of AQ. The purpose for pulling in DACC into the model, is to help reflect purely the entity's choices of reporting earnings alone, hence proxies for earnings quality (Keefe, 2016). DACC captures auditor's behavior, which in this case, is driven by the management's conduct. Similarly, FR is usually issued when a significant and material error has been found from previous audit reports. The company is required to restate previously issued financial statements, and correct the misstatement. Therefore, there is an assumption from investors, that FR is accompanied by material weaknesses in an entity's internal control (Ernst & Young LLP, 2015). RESTATE captures important clients' internal control and audit quality, as well as the management's behavior in complying with accounting standards. Lastly, MAO is driven by auditor's own behavior towards important client when issuing audit reports. This may capture to an extent the current year's market forces, such as competitiveness of the auditing industry– the more competitive the industry is, auditors may be less conservative.

4.2 Client Importance

The test variable, Client Importance, is measured through the percentage of a client's audit fees (CI_FEE) relative to the total revenue generated by that auditor

through auditing services (Chen, Sun, and Wu, 2010). This definition is based on the assumption that a client's level of importance is dependent on its size, which in turn, affects their affordability in allocating monetary resources to external auditing services. In effect, the following equation is used to calculate each client's level of importance to their respective external auditor:

*CI_FEE = (ABC company's audit fees / Auditor X's total audit revenue) *100%*

In order to eliminate the effect of biased audit fees and discounts given, the thesis will also use the client's total assets (CI_ASSETS) to measure client importance (Chen, Sun, and Wu, 2010). As mentioned by Chen(2010), using CI_ASSETS as a measurement of the test variable is appropriate, since a major factor considered by audit partner when setting its audit fee, is based on client's total assets.

4.3 Model Specification

This thesis runs three separate regressions for the three jurisdictions when investigating the relationship between client importance and AQ. Through separating the regressions, the effect of the control variables is more direct and specific to its respective dependent variable, as well as reducing regression biasness between the three jurisdictions (Chan and Wu, 2011). Furthermore, separating the jurisdictions into three regressions allow fewer restrictions in differentiating and defining the regression slopes and the error structures. The coefficients of the regression can also be compared easily.

The focal purpose of the thesis is to examine whether there is a relationship between client importance and audit quality in the socialist legal system, the common law and the civil law jurisdictions. Three alternative measures are used to

determine the audit quality. Below defines an estimated regression model on AQ, measured by modified audit opinion (MAO). **Model (1)** estimates relationship between MAO and client importance with the regression (Romanus, 2007):

$$MAO = \beta_0 + \beta 1 * CI\_FEE\ (CI\_ASSETS) + \beta 2 * neweffort + \beta 3 * Big4 + \beta 4 * auditor\_change + \beta 5 * size + \beta 6 * loss + \beta 7 * growth + \beta 8 * lev + \beta 9 * sales\_volatility + \beta 10 * age + \beta 11 * boardmeeting + \varepsilon$$

From model (1), the dependent variable is substituted by one of the three measures of AQ: (MAO), while Client Importance is measured by CI_FEE or CI_ASSETS, which play as two direct independent variables on AQ. Client importance (CI_FEE) measures whether the auditor is economically dependent on the audit client. Since it is assumed that the client's size is the primary driver of audit fees, the thesis proxies CI_FEE as the percentage of fees generated by one client relative to the total fees generated by the audit firm's all clients. Similarly, client importance (CI_ASSETS) is measured by the percentage of audited assets of one client relative to the total audited assets by the audit firm. This measurement is based on the assumption that clients with higher total assets values tend to pay higher audit fees due to its complex business nature and increased audit risk. Model (1) therefore includes such independent variables which are shown in Table 1.

[Insert Table 1 here]

The variable "neweffort" is included in the regression model, and differs from CI_ASSET, as neweffort is calculated as audit fee divided by total asset of a client; while CI_ASSET is calculated by a client's total assets divided by the total of all clients' assets audited by an audit firm. Hence, neweffort shows how much audit fee is needed for every unit of client's assets, reflecting its business complexity and audit effort required.

"Big4" is a dummy variable, where the value 1 is given when one of the Big 4 auditors is engaged; 0 otherwise while "auditor_change" is a dummy variable which controls for opinion shopping by clients within the auditing industry in that jurisdiction, taking into account the level of difficulty for an important client to switch auditors. Switching auditors from one year to another denotes 1, while no change of external auditor denotes 0. A significant negative coefficient of "auditor_change" suggests poorer AQ when changes occur, as it reduces audit reporting persistence. Likewise, companies may have been unsatisfied with their previously received MAOs, hence wanted to switch auditors for opinion shopping (Chen et al., 2015).

The variable "Size" is used to control for different company sizes. This is due to the fact that large sized companies have the capability to offer better deals with their auditors, hence creating a higher dependency on the client. To eliminate the effect of some companies prefer holding liquid assets such as inventory or cash, the thesis includes only the client's non-current assets in "size".

"Loss" is also included as a dummy variable, to take into account of companies not making a profit (profit of < 0) in the twelve-month period. With an assumption that auditors will be more likely to issue a going-concern audit opinion for loss making companies, managers will have higher motivation to manipulate financial figures. Earnings quality and audit quality therefore decreases, where a negative coefficient of "loss" suggests poorer AQ.

"Growth" takes into account different company's growth rate and operation efficiencies. Growth = (Assets year t – Assets year t-1) / (Assets year t-1)

"Lev" is used because a higher leverage ratio indicates a higher risk of violating its debt covenants, hence increasing its probability of earnings management and

bankruptcy; Lev is also used to control for the client's financial risk. Lev = Debt / Total assets. A significantly positive coefficient for Lev indicates poorer AQ under RESTATE and DACC, while a negative Lev coefficient indicates poorer AQ under MAO.

"Sales_volatility" controls the growth and the volatility of the entity's yearly sales. The thesis uses the standard deviation of last three years' sales in defining sales_volatility.

"Age" is the natural logarithm of the number of years the entity has been listed in its respective stock exchange. It is predicted that the operating performance of a listed company tends to deteriorate after the year of IPO, and will have incentives to manage its earnings (Chen, Chen, and Su, 2001). Since some companies are newly listed, and to eliminate the result of having a 0 value, age =natural logarithm of (years of company being publicly listed + 1).

"Boardmeeting" is the natural logarithm of the number of board meetings the management has in a particular year. Since some companies may not have held any meetings, and to eliminate the result of having a 0 value, boardmeeting = natural logarithm (number of board meetings per annum + 1).

As MAO increases, AQ increases accordingly. This is due to the fact that auditors who strive for high audit quality reports will have the propensity to issue more modified audit opinions when faced with uncertainties (DeFond, Wong and Li, 1999). The relationship between CI_FEE or CI_ASSETS, and MAO, is expected to be positive under common law jurisdiction. The thesis assumes that if the client is more important to an audit firm, auditors will tend to be more conservative and unbiased in their audit reports, driving up the number of MAOs issued by auditors. This is due to the fact that high audit fee (CI_FEE) and larger clients (high

CI_ASSETS) attract more scrutiny and attention from the market, from investors, and from regulatory bodies. Hence, in order to stay away from legal proceedings, reputable auditors are more motivated to act diligently.

Model (2) tests the relationship between client importance and RESTATE, with a regression model. MAO and RESTATE are inversely related, as the higher the MAO, higher the AQ, while higher the RESTATE, the lower the AQ will be. Nonetheless, both RESTATE and +DACC have very similar independent variables, where:

$$\text{RESTATE} = \beta_0 + \beta_1 * \text{CI\_FEE (CI\_ASSETS)} + \beta_2 * \text{neweffort} + \beta_3 * \text{Big4} + \beta_4 * \text{auditor\_change} + \beta_5 * \text{size} + \beta_6 * \text{loss} + \beta_7 * \text{growth} + \beta_8 * \text{lev} + \beta_9 * \text{sales\_volatility} + \beta_{10} * \text{age} + \beta_{11} * \text{boardmeeting} + \varepsilon$$

The dependent variable, RESTATE, is a dummy variable. It indicates whether a company or the auditor has discovered errors and mistakes in previously issued financial statement, hence amend and disclose such restatements to its stakeholders. If restatement is found and amended, 1 is given to the client's year, 0 otherwise.

As MAO and RESTATE are negatively correlated, the thesis hypothesizes that important clients in common law jurisdictions tend to receive less RESTATE, indicating higher AQ.

Model (3) tests the relationship between client importance and DACC, with a regression model, where:

$$\text{positive\_DACC} = \beta_0 + \beta_1 * \text{CI\_FEE (CI\_ASSETS)} + \beta_2 * \text{neweffort} + \beta_3 * \text{Big4} + \beta_4 * \text{auditor\_change} + \beta_5 * \text{size} + \beta_6 * \text{loss} + \beta_7 * \text{growth} + \beta_8 * \text{lev} + \beta_9 * \text{sales\_volatility} + \beta_{10} * \text{age} + \beta_{11} * \text{boardmeeting} + \beta_{12} * \text{lag\_DACC} + \varepsilon$$

"Lag_DACC" is adopted from the Modified Jones Model, which stated that the origins of different revenue would bring a variety of operating capital, causing changes in accruals and perhaps earnings management (Chen, 2010). Lag_DACC is included to isolate discretionary accruals with extreme performances, among the sample firms (Beneish, 1997). Therefore,

lag_DACC = $DA_{i,t-1}$, where

$$DA_i = Ta_{i,t}/A_{i,t-1}-\{\alpha_1 (1/A_{i,t-1}) + \alpha_2[(\Delta REV_i - \Delta REC_i)/ A_{i,t-1}] + \alpha_3 (PPE_i / A_{i,t-1})\}$$

In terms of independent variables based on government and political influences, previous literature established a relationship that the audit quality in some of the SOE firms in the Mainland China are affected by significant political influences (Chan et al, 2006). Although some companies are politically connected with civil governments and are able to obtain favorable audit opinions, companies under the common-law governments may be susceptible to detailed investigation and financial scrutiny from the regulatory bodies.

By focusing the investigation in Asia, while comparing the legal system between civil law and common law societies, the sample firms used to measure AQ for this thesis will base only on publicly listed companies between the years 2008 to 2013 across the three locales. During the collection of samples, Hong Kong's financial statements are collected manually through their audit reports on their company websites and from the Hong Kong Stock Exchange Main Board database. Taiwan's financial data are collected from the Taiwan Economic Journal Database (TEJ), while Mainland China's financial data are collected from the Shanghai Stock Exchange and ShenZhen Stock Exchange from China Stock Market and Accounting Research Database (CSMAR), and Winds Database.

Since indirect independent variables (such as the different locale's economic and GDP growth, government and political influences, and auditor's respective market shares) are not yet taken into account, the sensitivity test in the next section will further elaborate on it. The SPSS statistics software's natural log for values will be used to transform some data, while the STATA software will be used to integrate various variables together in order to run the regression.

Chapter 5 Descriptive Statistics and Main Results

5.1 Descriptive Statistics

Table 2 (Panel A HK; Panel B Mainland China; Panel C Taiwan) presents the descriptive statistics for the test variable, client importance (CI_FEE, CI_ASSETS), and the dependent variable AQ (DACC, MAO, RESTATE).

[Insert Table 2 here]

The variable RESTATE has a mean value of 0.017 for HK, 0.024 for Mainland China, and 0.013 for Taiwan. This indicates that on average, 1.7% of the listed companies in HK, 2.4% of Mainland China's listed companies, and 1.3% of Taiwan's listed companies, had to restate their financial statements from one year to another. It is expected that HK's restatement percentage is less than that of Mainland China's, however, it is interesting to see that Taiwan (as a civil law jurisdiction), has a lower percentage than HK. This may be due to the fact that HK's accounting standards has had significant and numerous changes in recent years, namely 2008-2013.

Similarly, the mean value for DACC for HK, Mainland China, and Taiwan, is 9.4%, 8%, and 5.7%, respectively. As a high DACC indicates lower AQ, HK's high percentage of discretionary accrual of 9.4% is unanticipated. However, it is expected to see that Mainland China's 8% DACC is higher than Taiwan's 5.7%.

On the other hand, the mean value of MAO for companies in HK, Mainland China, and Taiwan, is 3.9%, 5.4%, and 57%. As higher MAO indicates higher AQ, it is surprising to see that HK has a significantly lower MAO percentage than Mainland China's MAO, while Taiwan has exceeded our expectations. A justification for HK's low MAO, indicating low AQ, may be the fact that during the sample years used, HK was facing an economic downturn. As more than half of HK's listed companies are

headquartered in Mainland China, in order to attract and retain such important Chinese clients, HK auditors may be more lenient towards the clients. Taiwan's significantly high MAO of 57%, is due to the fact that auditors in Taiwan may issue a "Modified Unqualified Audit Opinion", if one of the seven scenarios are satisfied according to Taiwan's Statement of Audit Standard (SAS) 33 (Lai et al., 2009).

Furthermore, the mean value of Taiwan's annual "boardmeeting" of 2.110 and Mainland China's 2.261, is slightly larger than that of HK's 1.997. Mainland China's Code of Corporate Governance for Listed Companies states that "board of directors shall meet periodically and shall convene interim meetings timely" (China Securities Regulatory Commission, 2002), while Taiwan's Regulations Governing Procedure for Board of Directors Meetings of Public Companies states that "A board of directors shall meet at least quarterly, which shall be set out in the rules of procedure" (Taiwan Stock Exchange, 2012). If the quorum of one-half of all the directors are not present, the chair shall recall a meeting thereafter. This may imply that HK's corporate governance policy is less stringent and procedural. Thus, Mainland China and Taiwan Stock Exchange's rules and regulations on corporate governance may be an explanation to the slightly more annual "boardmeeting".

5.2 Univariate Tests

Table 3 lists the Univariate Test results. The thesis's large sample data and result expresses the P-value as significant, if **p < 0.05 and *** p<0.01. The P-value of <0.1 is classified as marginal significance.

[Insert Table 3 here]

It is evident that there is a significant difference between HK and Taiwan's MAO. With the t-value of -0.531, there is a 1% significant level difference between the two jurisdictions. This implies that important clients in HK obtain less MAOs, than those in Taiwan. This does not satisfy H1, that important clients under a common law jurisdiction have higher quality audit reports under the measurement of MAO. Since HKICPA requires certain line items to be corrected and restated retrospectively, auditors must abide by the changes in accounting standards, as set out by HKICPA. Since the sample data are collected between the years of 2008 to 2013, where HKICPA made numerous changes in accounting policies, such as HKSA 540's Accounting estimates, and HKAS 18's Revenue recognition, these may have affected my results in denoting a high RESTATE for important clients. In fact, this factor displays a limitation in this research study, as it was not possible to differentiate the source of auditor's restatements. According to HKSA 560 and HKSA 710, other than stating in the Emphasis of Matter paragraph in the audit report, "auditor should issue a modified report on the current period financial statement, modified with respect to the corresponding figures included therein" (HKICPA, 2005). In other words, auditors indicate the existence of auditor's restatement, but may not necessarily state the reasons behind it.

5.3 Regression Results

Table 4 shows the main regression results. Given the HK table for MAO, I expected a positive coefficient with CI_FEE and CI_ASSETS, as higher MAO should be received from important clients. With a p-value of 0.011 and 0.000 for CI_FEE and CI_ASSETS respectively, these results gave me a 5% and 1% level of significance. Therefore, MAO satisfies my hypothesis.

[Insert Table 4 here]

Moreover, HK's RESTATE has a p-value of 0.021 with CI_FEE, giving a 5% significant level. RESTATE has a p-value of 0.001 with CI_ASSETS, giving a 1% significant level.

With a positive coefficient of CI_FEE and CI_ASSET with RESTATE, it indicates that as important client's audit fee increases, the probability of financial statement restatement increases, which decreases the AQ. This does not support my Hypothesis, as I expected a negative coefficient for RESTATE in HK. A justification for more restatements in HK is due to the difference of the rule of law between common law and civil law, where noncompliance of accounting standards and its monetary damages are interpreted differently between the different jurisdictions. HK, Mainland China, and Taiwan's principles governing damages for the breach are compensatory instead of punitive, indicating that negligent auditors are only required to compensate the "actual" damages to the claimant. This being said, the compensation is equal to the loss caused by the breach, provided that the loss was reasonably foreseeable at the time of the event, and that the plaintiff could not have avoided such risk. However, common law differs from civil law's definition in "breaching" the law: in order for the claimant to successfully sue HK auditors, the auditor's breach must clearly have been the *operative* and *practical* cause of the loss, not the event that "merely created an opportunity for loss to be suffered". This indicates that it is more difficult for claimants in common law societies to demand for compensation from negligent auditors, which directly induces auditor's behavior in being less conservative in issuing unmodified audit opinions.

For the measure of AQ using positive_DACC, the relationship between positive_DACC with CI_ASSETS has a p-value of 0.040, yielding a 5% significance.

This suggests that important clients in HK, as measured by their total assets, do tend to manage their earnings upwards, reducing its earnings quality.

For the Mainland China and Taiwan, a positive coefficient is obtained between RESTATE and CI_FEE/ CI_ASSETS. This shows that important clients in Mainland China and Taiwan tend to receive more restatements, indicating lower AQ. With 1% significant level in Mainland China and a 5% significant level in Taiwan, this supports H. The results of Mainland China and Taiwan, both shows that MAO and DACC are not significantly related to CI_FEE or CI_ASSETS. In spite of this, RESTATE is positively and significantly correlated to important clients in Mainland China and Taiwan, implying low AQ. This satisfies the Hypothesis, where in civil law jurisdictions and in the socialist legal jurisdiction, publicly listed company's audit quality decreases, as auditor's economic dependence on important client increases.

Chapter 6 Robustness Test& Sensitivity Analysis

As stated in Chapter 4.3, the thesis has separated the three jurisdictions into three different regression analyses. In a sensitivity test I combine the sample of the three jurisdictions and run the regression to test the association between Client Importance and Audit Quality as follows:

$$AQ = \alpha 0 + \alpha 1 * CI\_FEE\ (CI\_ASSETS) + \alpha 2 * HK + \alpha 3 * Taiwan + \alpha 4 * HK * CI\_FEE\ (CI\_ASSETS) + \alpha 5 * Taiwan * CI\_FEE\ (CI\_ASSETS) + controlled\ variables$$

where,

AQ = MAO; or RESTATE; or positive_DACC

The above combined AQ regression uses Mainland China as a base/controlled group, as HK versus Mainland China/ Taiwan's legal systems are vastly different, whereas Mainland China and Taiwan's differences are limited to the implementation of the law. Therefore, α4 compares CI and AQ between HK and Mainland China, while α5 compares CI and AQ between Taiwan and Mainland China.

The results presented in Table 5 shows that there are no significant differences between HK, Mainland China, and Taiwan's AQ in terms of RESTATE and positive_DACC. However, comparing HK to Mainland China under MAO, HK*CI_ASSETS yields a positive coefficient of 3.455 with p-value of 0.001, as well as a positive coefficient of 1.522 with p-value of 0.078, giving a 10% significance. This indicates that as compared to Mainland China, HK's important clients tend to receive more MAO. However, there is no significance difference between Taiwan and Mainland China. This result is generally consistent with those of separate regressions.

[Insert Table 5 here]

The DACC from Table 2 are absolute values, where no direction of earnings management has been considered; only the degree of earnings management is investigated. To have a more in-depth investigation of the significance of DACC on client importance (CI_FEE / CI_ASSETS), a robustness test has been performed to take into account the direction and the degree of DACC simultaneously. The reason for examining the negative DACC in this sensitivity analysis is because companies may be inclined to manage its profits through deflating their earnings downwards for tax avoidance purposes or to smooth out revenues across several years.

As shown in Table 6, under Taiwan's civil law locale, the coefficient of signed DACC (DACC < 0) on client importance (CI_FEE) is -0.038, yielding a significant p-value of 0.001. This indicates that the more important the client is, in terms of audit fee, more earnings management and discretionary accrual was found in the financial statements. Audit quality therefore decreases. However, under the HK common law locale and the Mainland China's socialist legal system locale, a p-value of 0.451 and 0.211 were respectively obtained, showing no significant relationship between client importance (CI_FEE) and negative DACC.

[Insert Table 6 here]

To further support the significance and accuracy of the above results, a sensitivity test (Table 7) is conducted by including four additional control variables:

(a) LLP, a dummy variable that controls the different legal form of the CPA firms, such as limited liability or partnerships. Firth et al. (2012) find that auditors with unlimited liability are more conservative than their counterparts in issuing clean audit reports.

(b) MKTCON, the market concentration of auditors and their extent to which they are 'controlling' the auditing industry. This also reveals the intensity of the CPA firms' competition within their locale. DeFond, Wong, and Li (1999) shows that larger auditors tend to report a higher proportion of modified opinions, perhaps due to potential significant reputational and litigation losses. Also, a higher concentration of auditors auditing listed companies in the market indicates market dominance, as well as their ability to influence the auditing industry. A high market concentration therefore indicates higher propensity of earnings management and low audit quality.

(c) GDP, denotes the local GDP and its economic strength in a particular year in a specific locale. Leuz, Nanda, and Wysocki (2003) found that market development is associated with earnings quality and audit quality. For instance, if HK's GDP falls in a particular year, while Mainland China's GDP rises, companies are induced into moving to a thriving market, hence switching from HK auditors to Mainland auditors. In order for the weaker GDP HK to retain clients, HK auditors may therefore be inclined to be more lenient over their important clients, subsequently reducing AQ. Hence, lower GDP presumes to yield lower audit quality reports. This is especially valid for listed companies in HK since 2010, when the Hong Kong Stock Exchange announced its decision on mutual recognition of the Mainland Chinese Accounting Standards and audit firms as one of its accepted accounting standards.

(d) SOE, taking into account the political factors in Mainland China, where state-owned enterprises are owned, managed, and heavily influenced by the Government, who also appoints the SOE's external auditors. It is therefore anticipated that SOEs are important clients in Mainland China, and they give rise to lower audit quality reports.

The abovementioned four variables are included in the sensitivity test, as auditors from different locales are motivated to treat their important clients differently, mainly due to auditor's legal liabilities, market and economic factors, and political considerations. After all, "the supply of audit quality is a function of both the auditor's incentives for independence and their competency" (DeFond and Zhang, 2014).

As shown in Table 7, upon including MKTCON and the GDP variables in the regression for the sample of HK, a coefficient of 1.782 (p-value of 0.021**) and 0.017 (p-value of 0.084*) is obtained on client importance (CI_ASSETS) for RESTATE and positive_DACC, respectively. This indicates that the more important the client is, in terms of CI_ASSETS, the number of financial report restatements (RESTATE) and earnings management (+DACC) increases.

[Insert Table 7 here]

Moreover, Mainland China's sensitivity tests shows that there is a significant relationship between client importance (CI_ASSETS) and RESTATE, with a coefficient of 1.092 (p-value of 0.028), indicating that audit quality decreases as client importance increases.

Lastly, Taiwan's sensitivity test result shows the coefficients on CI_FEE and CL_ASSETS are not significant for all three measures of audit quality. However, MKTCON has a positive coefficient and a p-value of 0.002, giving a 1% significant relationship with RESTATE. This indicates that auditors with higher market dominance tend to be "less conservative" in issuing clean audit reports, which increases RESTATE and lowers AQ. On the other hand, GDP has a negative coefficient of 12.157, a p-value of 0.000 with a 1% significant relationship with

MAO. This contracts to my presumption that lower GDP yields lower audit quality reports. In the case of Taiwan, low GDP index gave a higher MAO, hence increasing AQ. With the low GDP growth, unemployment rate increases, and the labor market deteriorates in Taiwan throughout the years, investors are reluctant to commit into risky investments. As such, in order to maintain market stability and reduce economic contraction, auditors are inclined to be more conservative when issuing audit reports, with a hope to regain market confidence from public investors.

The main test from Table 4 included financial institutions in my sample firms. However, considering the fact that financial institutions are characterized and classified into different industries among the different locales, a sensitivity test (Table 8) is conducted, where the three jurisdiction's listed financial institutions are excluded from the sample data. Nonetheless, the result is still consistent with Table 4.

Chapter 7 Conclusion

The thesis analyses and directly compares the audit quality for important clients in jurisdictions with different legal systems simultaneously in one investigation. Using data from Mainland China, Hong Kong and Taiwan during 2008-2013, I find that in HK, Mainland China and Taiwan, the more important the client is to its auditor, the lower the audit quality, as measured by the restatement of financial statements (RESTATE). However, in Hong Kong, the more important the client is to its auditor, the higher the quality of audit report as measured by modified audit opinion (MAO), indicating that Hong Kong auditors are conservative in issuing MAO. Client Importance and positive_DACC has no significant relationship under all three jurisdictions.

The fact that Mainland China, Hong Kong, and Taiwan are under the "one nation with different systems", history and political factors have shaped their legal systems differently. As such, the thesis provides evidence that different legal systems play a direct role in influencing audit quality.

Furthermore, I do take into consideration that auditors in different locale are subject to different external influences, such as auditor's legal liability, market and economic factors, as well as political considerations. After including the external influences (MKTCON, GDP, LLP, SOE) into the sensitivity analysis, results are still consistent to my main tests. Regulators and local standard setters should be aware of the different institutional environments that affect audit quality for their important clients.

Nonetheless, the thesis does have limitations. Other than the four variables that are taken into account in the sensitivity analysis (MKTCON, GDP, LLP, SOE), other

external factors may also affect the relationship between client importance and AQ, which were not included in the regression investigation.

Table 1
Variable Definitions

Variables	Explanation
AQ	Audit Quality indicates whether the control and content of auditor's report on each engagement is high. AQ is measured by Discretionary accruals, Modified Audit Opinions, and Financial Restatements.
DACC	Discretionary (Abnormal) Accruals is an absolute value, which reveals the existence of accrual-based earnings management in a company. It is measured by the total accruals (in year *t*) less predicted accruals, where predicted accruals = $NDAi = \alpha 1\ (1/Ai) + \alpha 2[(\Delta REVi - \Delta RECi)/ Ai] + \alpha 3\ (PPEi / Ai)$ Where total accruals = *[(earnings before extraordinary items in year t) – (operating cash flows in year t)] / (total assets in year t-1)*
A	The total assets of firm i in year t
NDAi	The non-discretionary accruals of firm i in year t
ΔREVi	The change in revenue of firm i in year t
ΔRECi	The change in accounts receivables of firm i in year t
PPEi	The gross value of fixed assets for firm i in year t
MAO	Modified Audit Opinions contributes to the measurement of AQ. It indicates whether the auditor have issued a modified audit opinion to their client, including "Unqualified opinion with Emphasis of Matter", "Qualified opinion with Emphasis of Matter", "Qualified opinion", and "Disclaimer opinion"
RESTATE	Financial restatement is a dummy variable, contributing to the measurement of AQ. It indicates whether a company or an auditor discovers an error made in the financial statement in the previous year, hence needing to disclose such amendment to its stakeholders. If there is a restatement from the previous year, 1 will be given to the firm
CI_FEE	A measure of Client importance, on whether a particular client contributes a significant percentage of income for the auditor. It is measured by a listed company's audit fees, divided by the auditor's total audit revenue in a given year
CI_ASSETS	A measure of Client importance, on whether larger clients (with more total assets) affects AQ
neweffort (%)	Calculated by audit fee divided by total asset of client, showing whether auditors charge clients a higher rate if they are larger in scale. This variable is in percentage term
Big4	A dummy variable, where the value 1 is given when one of the Big 4 auditors is engaged; 0 otherwise
Auditor_change	A dummy variable controlling for opinion shopping by clients within the auditing industry in that jurisdiction, taking into account the level of difficulty for an important client to switch auditors. Switching auditors from one year to another denotes 1, while no change of external auditor denotes 0
size	A natural logarithm variable to control different entity sizes, taking into account only the client's non-current assets
Loss	A dummy variable to take into account the company is not making a profit (profit of < 0) in the twelve-month period
Growth	Accounting for different company's growth rate and operation efficiencies. Growth = (Assets year t – Assets year t-1) / (Assets year t-1)

Table 1 (continued)

Lev	To control for the client's financial risk, because a higher Debt to Total Asset ratio indicates a higher risk of violating its debt covenants, hence increasing its probability of earnings management. Lev = Debt / Total assets
sales_volatility	Controls the growth and the volatility of the entity's yearly sales, and uses the standard deviation of last three years' sales
age	The natural logarithm of the number of years the entity has been listed in its respective stock exchange age = years of company being publicly listed + 1
boardmeeting	A natural logarithm of the number of board meetings the management has in a particular year boardmeeting = number of board meetings per annum + 1
lag_DACC	Lagged discretionary accrual is included to isolate discretionary accruals with extreme performances lag_DACC = $DA_{i,t-1}$, where $DA_{i,t} = TA_{i,t}/A_{i,t-1} - [a_i (1/A_{i,t-1}) + b_{1,i} (\Delta REV_{i,t}/A_{i,t-1} - \Delta REC_{i,t}/A_{i,t-1}) + b_{2,i} (PPT_{i,t}/A_{i,t-1})]$
LLP	A dummy variable, controlling different organizational and legal form of the CPA firms, such as limited liability form or partnership formations. Limited Liability Partnership audit firms denotes 1, while other forms of organizations denote 0
MKTCON	The market concentration of auditors and their extent to which they are 'controlling' the auditing industry. It also reveals the intensity of the CPA firms' competition within their locale. This variable is in percentage term, where, MKTCON = total audit revenue for an individual audit firm / total audit revenue for all audit firms in its respective jurisdiction
GDP	Accounting for the local GDP and its economic strength in a particular year in a specific locale
SOE	Taking into account the political factors in Mainland China, where state-owned enterprises are owned and managed by the Central Government

Table 2
Description Statistics

Panel A: Hong Kong

	mean	SD	p25	p50	p75
RESTATE	0.017	0.130	0.000	0.000	0.000
MAO	0.039	0.194	0.000	0.000	0.000
DACC	0.094	0.124	0.024	0.055	0.113
positive_DACC	0.047	0.096	0.000	0.000	0.053
CI_fee	0.057	0.163	0.003	0.008	0.026
CI_assets	0.045	0.165	0.000	0.000	0.005
neweffort (%)	19.398	31.807	3.976	9.465	20.483
Big4	0.487	0.500	0.000	0.000	1.000
auditorchange	0.079	0.270	0.000	0.000	0.000
size	21.456	2.109	20.059	21.282	22.714
loss	0.236	0.425	0.000	0.000	0.000
growth	0.285	0.894	-0.012	0.107	0.277
lev	0.473	0.374	0.242	0.423	0.622
sales_volatility	0.265	0.496	0.046	0.115	0.266
age	2.218	0.900	1.792	2.398	2.833
boardmeeting (ln)	1.997	0.535	1.609	1.792	2.303
lag_DACC	0.102	0.134	0.025	0.057	0.120

Panel B: Mainland China

	mean	SD	p25	p50	p75
RESTATE	0.024	0.153	0.000	0.000	0.000
MAO	0.054	0.226	0.000	0.000	0.000
DACC	0.080	0.092	0.023	0.051	0.101
positive_DACC	0.039	0.074	0.000	0.000	0.049
CI_fee	0.044	0.088	0.008	0.019	0.041
CI_assets	0.040	0.105	0.003	0.009	0.029
neweffort (%)	3.835	4.859	1.382	2.530	4.459
Big4	0.015	0.121	0.000	0.000	0.000
auditorchange	0.134	0.341	0.000	0.000	0.000
size	21.799	1.259	20.945	21.696	22.559
loss	0.106	0.308	0.000	0.000	0.000
growth	0.195	0.488	0.009	0.100	0.228
lev	0.495	0.248	0.321	0.492	0.647
sales_volatility	0.238	0.535	0.052	0.104	0.201
age	2.149	0.779	1.792	2.485	2.708
boardmeeting (ln)	2.261	0.320	2.079	2.303	2.485
lag_DACC	0.087	0.155	0.023	0.052	0.102

Table 2 (continued)

Panel C: Taiwan

	mean	SD	p25	p50	p75
RESTATE	0.013	0.114	0.000	0.000	0.000
MAO	0.570	0.495	0.000	1.000	1.000
DACC	0.057	0.056	0.017	0.040	0.078
positive_DACC	0.028	0.050	0.000	0.000	0.038
CI_fee	0.043	0.142	0.003	0.004	0.009
CI_assets	0.030	0.127	0.000	0.000	0.002
neweffort (%)	11.323	12.448	2.876	7.432	14.998
Big4	0.103	0.304	0.000	0.000	0.000
auditorchange	0.035	0.185	0.000	0.000	0.000
size	15.410	1.713	14.230	15.112	16.201
loss	0.231	0.422	0.000	0.000	0.000
growth	0.073	0.229	-0.044	0.036	0.139
lev	0.436	0.190	0.298	0.429	0.556
sales_volatility	0.190	0.208	0.066	0.127	0.227
age	2.343	0.875	2.079	2.485	2.890
boardmeeting (ln)	2.110	0.331	1.792	2.079	2.303
lag_DACC	0.056	0.055	0.017	0.039	0.076

Table 3
UnivariateTests

Variables	T-Test		T-Test		T-Test	
	HK	TW	Mainland	TW	Mainland	HK
RESTATE	0.017	0.013	0.024	0.013	0.024	0.017
	0.004* (0.059)		0.011*** (0.000)		0.007*** (0.001)	
MAO	0.039	0.570	0.054	0.570	0.054	0.039
	-0.531*** (0.000)		-0.516*** (0.000)		0.015*** (0.000)	
positive_DACC	0.047	0.028	0.039	0.028	0.039	0.047
	0.019*** (0.000)		0.010*** (0.000)		-0.009*** (0.000)	
CI_fee	0.057	0.043	0.044	0.043	0.044	0.057
	0.014*** (0.000)		0.001 (0.613)		-0.013*** (0.000)	
CI_assets	0.045	0.030	0.040	0.030	0.040	0.045
	0.015*** (0.000)		0.010*** (0.000)		-0.005** (0.012)	
neweffort	19.398	11.323	3.835	11.323	3.835	19.398
	8.075*** (0.000)		-7.488*** (0.000)		-15.563*** (0.000)	
Big4	0.487	0.103	0.015	0.103	0.015	0.487
	0.384*** (0.000)		-0.088*** (0.000)		-0.472*** (0.000)	
auditorchange	0.079	0.035	0.134	0.035	0.134	0.079
	0.044*** (0.000)		0.099*** (0.000)		0.056*** (0.000)	
size	21.456	15.410	21.799	15.410	21.799	21.456
	6.047*** (0.000)		6.390*** (0.000)		0.343*** (0.000)	
loss	0.236	0.231	0.106	0.231	0.106	0.236
	0.005 (0.496)		-0.125*** (0.000)		-0.130*** (0.000)	
growth	0.195	0.073	0.285	0.073	0.285	0.195
	0.212*** (0.000)		0.121*** (0.000)		-0.090*** (0.000)	
lev	0.473	0.436	0.495	0.436	0.495	0.473
	0.037*** (0.000)		0.059*** (0.000)		0.022*** (0.000)	
sales_volatility	0.265	0.190	0.238	0.190	0.238	0.265
	0.075*** (0.000)		0.048*** (0.000)		-0.027*** (0.000)	
age	2.218	2.343	2.149	2.343	2.149	2.218
	-0.125*** (0.000)		-0.194*** (0.000)		-0.069*** (0.000)	
boardmeeting	1.997	2.110	2.261	2.110	2.261	1.997
	-0.113*** (0.000)		0.151*** (0.000)		0.264*** (0.000)	

*, **, *** Denote two-tailed statistical significance at the 10 percent, 5 percent, and 1 percent levels, respectively.

Table 4

Main Tests for the Association between Client Importance and Audit Quality in Three Jurisdictions

Panel A: Hong Kong

	MAO	MAO	RESTATE	RESTATE	positive_DACC	positive_DACC
CI_FEE	1.235**		1.884**		0.008	
	(0.011)		(0.021)		(0.332)	
CI_ASSETS		1.761***		2.530***		0.020**
		(0.000)		(0.001)		(0.040)
neweffort	-0.000	0.000	-0.021*	-0.021*	0.000	0.000
	(0.980)	(0.915)	(0.074)	(0.082)	(0.146)	(0.125)
Big4	-0.768***	-0.746***	0.477	0.546	0.000	0.001
	(0.006)	(0.007)	(0.249)	(0.189)	(0.988)	(0.837)
auditor_change	0.536**	0.556**	-0.732	-0.700	0.001	0.001
	(0.045)	(0.037)	(0.350)	(0.373)	(0.819)	(0.816)
size	-0.105	-0.123	-0.008	-0.016	-0.001	-0.001
	(0.277)	(0.207)	(0.958)	(0.918)	(0.464)	(0.418)
loss	1.009***	1.009***	0.775*	0.806*	-0.003	-0.003
	(0.000)	(0.000)	(0.075)	(0.064)	(0.360)	(0.373)
growth	0.017	0.001	0.153	0.140	0.013***	0.013***
	(0.824)	(0.987)	(0.257)	(0.297)	(0.000)	(0.000)
lev	2.187***	2.198***	1.519***	1.544***	0.007	0.007
	(0.000)	(0.000)	(0.006)	(0.005)	(0.117)	(0.117)
sales_volatility	0.214	0.228	0.047	0.044	0.019***	0.019***
	(0.170)	(0.138)	(0.885)	(0.892)	(0.000)	(0.000)
age	0.122	0.135	-0.549**	-0.584**	-0.008***	-0.008***
	(0.493)	(0.453)	(0.015)	(0.010)	(0.000)	(0.000)
boardmeeting	0.663***	0.675***	-1.028**	-1.071**	-0.000	-0.000
	(0.000)	(0.000)	(0.014)	(0.011)	(0.917)	(0.899)
lag_DACC					0.026**	0.025**
					(0.027)	(0.032)
Constant	-3.875*	-3.626	-1.495	-1.238	0.064**	0.066**
	(0.087)	(0.111)	(0.693)	(0.745)	(0.029)	(0.025)
Industry	Yes	Yes	Yes	Yes	Yes	Yes
Year	Yes	Yes	Yes	Yes	Yes	Yes
Observations	2935	2935	1829	1829	2905	2905
Pseudo(Adjusted) R^2	0.313	0.318	0.103	0.116	0.083	0.084

Panel B: Mainland China

	MAO	MAO	RESTATE	RESTATE	positive_DACC,	positive_DACC,
CI_FEE	0.104		1.530***		0.006	
	(0.866)		(0.006)		(0.493)	
CI_ASSETS		-0.104		1.462***		0.011
		(0.866)		(0.001)		(0.159)
Neweffort	0.063***	0.063***	-0.025	-0.025	0.001*	0.001*
	(0.000)	(0.000)	(0.189)	(0.185)	(0.069)	(0.068)
Big4	.	.	-0.717	-0.657	-0.003	-0.003
	.	.	(0.480)	(0.518)	(0.633)	(0.676)
auditorchange	0.532***	0.532***	0.214	0.216	-0.001	-0.001
	(0.000)	(0.000)	(0.261)	(0.255)	(0.631)	(0.630)
Size	-0.665***	-0.662***	-0.223***	-0.245***	-0.001	-0.001
	(0.000)	(0.000)	(0.008)	(0.004)	(0.354)	(0.267)
Loss	1.344***	1.345***	0.950***	0.959***	-0.014***	-0.014***
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)

Table 4 (continued)

growth	-0.871***	-0.873***	-0.091	-0.098	0.040***	0.040***
	(0.000)	(0.000)	(0.650)	(0.625)	(0.000)	(0.000)
lev	3.541***	3.541***	0.714***	0.708***	-0.011***	-0.011***
	(0.000)	(0.000)	(0.006)	(0.006)	(0.007)	(0.007)
sales_volatility	-0.054	-0.054	-0.116	-0.110	0.003	0.003
	(0.720)	(0.719)	(0.514)	(0.537)	(0.121)	(0.118)
age	0.620***	0.621***	0.244	0.250	-0.003	-0.003
	(0.000)	(0.000)	(0.117)	(0.109)	(0.119)	(0.120)
boardmeeting	0.361*	0.364*	0.517**	0.522**	0.006**	0.006**
	(0.061)	(0.058)	(0.021)	(0.020)	(0.026)	(0.026)
lag_DACC					0.023***	0.023***
					(0.000)	(0.000)
Constant	6.519***	6.460***	0.048	0.513	0.047**	0.051**
	(0.000)	(0.000)	(0.980)	(0.785)	(0.043)	(0.029)
Industry	Yes	Yes	Yes	Yes	Yes	Yes
Year	Yes	Yes	Yes	Yes	Yes	Yes
Observations	8963	8963	9006	9006	6897	6897
Pseudo(Adjusted)R^2	0.414	0.414	0.080	0.081	0.122	0.122

Panel C: Taiwan

	MAO	MAO	RESTATE	RESTATE	positive_DACC	positive_DACC
CI_FEE	0.756		2.680**		-0.011	
	(0.105)		(0.019)		(0.166)	
CI_ASSETS		0.574		1.927		-0.003
		(0.230)		(0.167)		(0.692)
neweffort	-0.033**	-0.033**	-0.086	-0.092	-0.001**	-0.001**
	(0.023)	(0.022)	(0.257)	(0.211)	(0.042)	(0.049)
Big4	0.186	0.184	3.643***	3.481***	-0.001	-0.001
	(0.358)	(0.364)	(0.000)	(0.000)	(0.784)	(0.810)
auditorchange	0.873**	0.920**	1.941	2.335**	0.000	-0.001
	(0.034)	(0.025)	(0.134)	(0.043)	(0.986)	(0.872)
size	0.064	0.058	-0.903**	-0.928**	-0.006***	-0.006***
	(0.315)	(0.360)	(0.013)	(0.011)	(0.000)	(0.000)
loss	0.088	0.087	2.123***	2.315***	0.002	0.002
	(0.591)	(0.596)	(0.003)	(0.001)	(0.575)	(0.598)
growth	-0.938***	-0.948***	-0.031	0.228	0.074***	0.074***
	(0.007)	(0.007)	(0.981)	(0.867)	(0.000)	(0.000)
lev	-0.337	-0.310	1.045	0.120	0.004	0.004
	(0.385)	(0.424)	(0.598)	(0.950)	(0.550)	(0.559)
sales_volatility	-0.765*	-0.755*	3.288**	2.987**	0.027***	0.026***
	(0.052)	(0.055)	(0.017)	(0.028)	(0.001)	(0.001)
age	0.454***	0.456***	-0.286	-0.276	0.001	0.001
	(0.000)	(0.000)	(0.592)	(0.605)	(0.682)	(0.704)
boardmeeting	0.326*	0.338*	2.329***	2.284***	-0.001	-0.001
	(0.065)	(0.055)	(0.002)	(0.002)	(0.847)	(0.774)
lag_DACC					0.057**	0.056**
					(0.028)	(0.030)
Constant	-1.871	-1.795	6.865	7.768	0.101***	0.099***
	(0.121)	(0.136)	(0.221)	(0.163)	(0.000)	(0.000)
Industry	Yes	Yes	Yes	Yes	Yes	Yes
Year	Yes	Yes	Yes	Yes	Yes	Yes
Observations	1812	1812	513	513	1358	1358
Adjusted (Pseudo) R^2	0.168	0.167	0.384	0.365	0.128	0.127

Table 5
Combined Regression for the Three Jurisdictions' Association between Client Importance and Audit Quality

	MAO	MAO	RESTATE	RESTATE	positive_DACC	positive_DACC
HK*CI_FEE	1.522*		-0.765		-0.000	
	(0.078)		(0.579)		(0.974)	
TW*CI_FEE	-0.173		1.001		-0.016	
	(0.851)		(0.300)		(0.241)	
HK*CI_ ASSETS		3.455***		0.031		0.002
		(0.001)		(0.980)		(0.870)
TW*CI_ ASSETS		1.158		-0.084		-0.013
		(0.290)		(0.941)		(0.298)
HK	0.198	0.122	-0.878*	-0.926**	-0.003	-0.003
	(0.561)	(0.714)	(0.060)	(0.043)	(0.454)	(0.363)
TW	3.011***	3.023***	0.573	0.550	-0.018***	-0.020***
	(0.003)	(0.003)	(0.626)	(0.639)	(0.010)	(0.005)
CI_FEE	-0.327		1.450**		0.006	
	(0.581)		(0.015)		(0.545)	
CI_ASSETS		-1.563*		1.313***		0.012
		(0.056)		(0.006)		(0.138)
neweffort	-0.010**	-0.009*	-0.021*	-0.021*	0.000***	0.000***
	(0.041)	(0.071)	(0.058)	(0.074)	(0.002)	(0.002)
big4	-0.561**	-0.546**	-0.392	-0.476	-0.004*	-0.003
	(0.032)	(0.033)	(0.247)	(0.185)	(0.091)	(0.186)
auditor_change	0.484***	0.485***	0.164	0.178	0.000	0.000
	(0.000)	(0.000)	(0.360)	(0.316)	(0.990)	(0.993)
size	-0.355***	-0.345***	-0.167**	-0.184***	-0.001*	-0.001**
	(0.000)	(0.000)	(0.016)	(0.009)	(0.087)	(0.046)
loss	0.875***	0.878***	0.882***	0.894***	-0.010***	-0.010***
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
growth	-0.169	-0.185	-0.005	-0.016	0.027***	0.027***
	(0.138)	(0.106)	(0.962)	(0.885)	(0.000)	(0.000)
lev	3.005***	2.998***	0.809***	0.781***	-0.003	-0.003
	(0.000)	(0.000)	(0.001)	(0.002)	(0.418)	(0.421)
sales_volatility	-0.154	-0.142	-0.051	-0.049	0.012***	0.012***
	(0.288)	(0.316)	(0.748)	(0.757)	(0.000)	(0.000)
age	0.597***	0.594***	0.003	-0.001	-0.004***	-0.004***
	(0.000)	(0.000)	(0.982)	(0.997)	(0.001)	(0.001)
boardmeeting	0.319**	0.324**	0.098	0.100	0.003	0.003
	(0.024)	(0.022)	(0.596)	(0.588)	(0.108)	(0.111)
lag_DACC					0.029***	0.029***
					(0.003)	(0.003)
Constant	0.092	-0.123	-0.543	-0.124	0.056***	0.059***
	(0.943)	(0.924)	(0.753)	(0.942)	(0.000)	(0.000)
Observations	14373	14373	13037	13037	11764	11764
Pseudo(Adjusted) R^2	0.471	0.472	0.096	0.095	0.100	0.100

*, **, *** Denote two-tailed statistical significance at the 10 percent, 5 percent, and 1 percent levels, respectively.

Table 6
Client Importance and Audit Quality based on Negative DACC

	Mainland		Hong Kong		Taiwan	
	DACC<0	DACC<0	DACC<0	DACC<0	DACC<0	DACC<0
CI_FEE	0.025		0.015		-0.038***	
	(0.211)		(0.451)		(0.001)	
CI_ASSETS		0.011		0.001		-0.033***
		(0.518)		(0.966)		(0.009)
neweffort	-0.002***	-0.002***	-0.000*	-0.000*	-0.001**	-0.001**
	(0.000)	(0.000)	(0.090)	(0.098)	(0.014)	(0.015)
Big4	-0.024*	-0.023*	-0.003	-0.004	-0.003	-0.003
	(0.092)	(0.098)	(0.705)	(0.586)	(0.607)	(0.583)
Auditor_change	-0.016***	-0.016***	-0.016	-0.015	0.003	0.004
	(0.003)	(0.003)	(0.169)	(0.178)	(0.727)	(0.707)
Size	0.012***	0.012***	0.013***	0.014***	-0.001	-0.001
	(0.000)	(0.000)	(0.000)	(0.000)	(0.353)	(0.480)
Loss	-0.022***	-0.022***	-0.015*	-0.015*	0.001	0.001
	(0.000)	(0.000)	(0.052)	(0.052)	(0.855)	(0.847)
Growth	-0.069***	-0.069***	-0.035***	-0.035***	0.020*	0.020*
	(0.000)	(0.000)	(0.000)	(0.000)	(0.063)	(0.066)
Lev	-0.074***	-0.074***	-0.057***	-0.057***	0.000	-0.001
	(0.000)	(0.000)	(0.000)	(0.000)	(0.992)	(0.933)
sales_volatility	-0.013**	-0.013**	-0.023***	-0.023***	-0.028**	-0.029**
	(0.010)	(0.011)	(0.004)	(0.004)	(0.024)	(0.019)
Age	-0.004	-0.004	0.002	0.002	0.002	0.001
	(0.286)	(0.294)	(0.623)	(0.615)	(0.570)	(0.660)
boardmeeting	0.003	0.003	-0.004	-0.004	-0.001	-0.001
	(0.670)	(0.661)	(0.490)	(0.513)	(0.148)	(0.106)
lag_DACC	0.014	0.014	-0.089***	-0.089***	-0.123***	-0.119***
	(0.210)	(0.207)	(0.001)	(0.001)	(0.000)	(0.001)
Constant	-0.284***	-0.284***	-0.260***	-0.262***	-0.013	-0.018
	(0.000)	(0.000)	(0.000)	(0.000)	(0.782)	(0.697)
Industry	Yes	Yes	Yes	Yes	Yes	Yes
Year	Yes	Yes	Yes	Yes	Yes	Yes
Observations	3628	3628	2044	2044	732	732
Adjusted R^2	0.178	0.177	0.169	0.168	0.210	0.204

*, **, *** Denote two-tailed statistical significance at the 10 percent, 5 percent, and 1 percent levels, respectively.

Table 7
Sensitivity Test on Liability, Market Competitiveness, Economic Development, and Political Considerations

Panel A: Hong Kong

	MAO	MAO	RESTATE	RESTATE	Positive_ DACC	Positive_DACC
CI_FEE	0.493		1.056		0.008	
	(0.306)		(0.223)		(0.333)	
CI_ASSETS		1.082***		1.782**		0.017*
		(0.024)		(0.021)		(0.084)
neweffort	0.003	0.003	-0.019	-0.019	0.000	0.000
	(0.329)	(0.321)	(0.123)	(0.118)	(0.424)	(0.389)
Big4	-0.944**	-0.937**	0.677	0.687	-0.001	-0.001
	(0.037)	(0.036)	(0.302)	(0.286)	(0.834)	(0.875)
MKTCON	-2.195	-1.918	-5.352**	-4.897*	-0.003	-0.002
	(0.262)	(0.320)	(0.047)	(0.064)	(0.862)	(0.921)
auditor_change	0.566**	0.570**	-0.839	-0.828	0.005	0.005
	(0.017)	(0.016)	(0.283)	(0.290)	(0.340)	(0.328)
Size	0.084	0.063	0.076	0.058	-0.002*	-0.002*
	(0.348)	(0.483)	(0.658)	(0.734)	(0.062)	(0.052)
Loss	1.011***	1.011***	0.738*	0.758*	-0.005*	-0.005
	(0.000)	(0.000)	(0.094)	(0.085)	(0.100)	(0.108)
Growth	-0.011	-0.019	0.114	0.108	0.018***	0.018***
	(0.878)	(0.791)	(0.405)	(0.429)	(0.000)	(0.000)
Lev	2.166***	2.173***	1.415**	1.458***	0.003	0.003
	(0.000)	(0.000)	(0.011)	(0.009)	(0.435)	(0.432)
sales_volatility	0.192	0.198	0.049	0.044	0.015***	0.015***
	(0.171)	(0.155)	(0.883)	(0.894)	(0.000)	(0.000)
Age	0.031	0.029	-0.578**	-0.618***	-0.007***	-0.007***
	(0.841)	(0.853)	(0.012)	(0.008)	(0.000)	(0.000)
boardmeeting	0.449***	0.454***	-1.064**	-1.091***	-0.000	-0.000
	(0.003)	(0.003)	(0.011)	(0.009)	(0.928)	(0.938)
GDP	0.882	0.896	6.355	6.304	0.055**	0.055**
	(0.611)	(0.605)	(0.322)	(0.325)	(0.026)	(0.024)
lag_DACC					0.041***	0.040***
					(0.000)	(0.000)
Constant	-18.459	-18.265	-82.441	-81.377	-0.536*	-0.541*
	(0.392)	(0.397)	(0.300)	(0.306)	(0.082)	(0.078)
Year	Yes	Yes	Yes	Yes	Yes	Yes
Industry	Yes	Yes	Yes	Yes	Yes	Yes
Observations	3699	3699	1829	1829	3641	3641
Adjusted (Pseudo) R^2	0.313	0.316	0.113	0.122	0.051	0.051

Table 7 (continued)

Panel B: Mainland China

	MAO	MAO	RESTATE	RESTATE	positive_DACC	positive_DACC
CI_FEE	0.185		1.015		0.001	
	(0.775)		(0.103)		(0.885)	
CI_ASSETS		-0.012		1.092**		0.006
		(0.985)		(0.028)		(0.453)
neweffort	0.055***	0.055***	-0.019	-0.020	0.001**	0.001**
	(0.000)	(0.000)	(0.318)	(0.297)	(0.027)	(0.030)
Big4	0.701**	0.703**	-0.504	-0.448	-0.008**	-0.008**
	(0.048)	(0.047)	(0.343)	(0.399)	(0.044)	(0.046)
LLP	0.246	0.242	0.726**	0.733**	0.001	0.001
	(0.331)	(0.341)	(0.015)	(0.014)	(0.808)	(0.810)
MKTCON	-0.646	-0.839	-8.066***	-7.938***	-0.036	-0.029
	(0.762)	(0.687)	(0.010)	(0.009)	(0.325)	(0.409)
auditor_change	0.504***	0.505***	0.174	0.174	-0.001	-0.001
	(0.001)	(0.001)	(0.368)	(0.368)	(0.635)	(0.635)
size	-0.718***	-0.715***	-0.173*	-0.197**	0.001	0.000
	(0.000)	(0.000)	(0.058)	(0.033)	(0.630)	(0.767)
loss	1.344***	1.345***	0.918***	0.922***	-0.013***	-0.013***
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
growth	-0.797***	-0.801***	-0.111	-0.112	0.039***	0.039***
	(0.000)	(0.000)	(0.580)	(0.577)	(0.000)	(0.000)
lev	3.550***	3.550***	0.679***	0.677***	-0.011***	-0.011***
	(0.000)	(0.000)	(0.009)	(0.010)	(0.004)	(0.004)
sales_volatility	-0.033	-0.033	-0.129	-0.123	0.003	0.003
	(0.829)	(0.828)	(0.473)	(0.494)	(0.184)	(0.180)
age	0.661***	0.661***	0.274*	0.278*	-0.002	-0.002
	(0.000)	(0.000)	(0.092)	(0.088)	(0.298)	(0.304)
boardmeeting	0.345*	0.348*	0.482**	0.485**	0.006**	0.006**
	(0.075)	(0.071)	(0.032)	(0.031)	(0.032)	(0.033)
GDP	0.219	0.227	-2.216***	-2.210***	-0.006	-0.005
	(0.656)	(0.644)	(0.000)	(0.000)	(0.392)	(0.396)
SOE	-0.040	-0.040	-0.074	-0.072	-0.004**	-0.004**
	(0.759)	(0.758)	(0.634)	(0.642)	(0.049)	(0.050)
lag_DACC					0.022***	0.022***
					(0.000)	(0.000)
Constant	2.554	2.375	33.647***	34.058***	0.104	0.107
	(0.745)	(0.762)	(0.000)	(0.000)	(0.316)	(0.302)
Year	Yes	Yes	Yes	Yes	Yes	Yes
Industry	Yes	Yes	Yes	Yes	Yes	Yes
Observations	9037	9037	8951	8951	6870	6870
Adjusted (Pseudo) R^2	0.416	0.416	0.087	0.088	0.058	0.058

Table 7 (continued)

Panel C: Taiwan

	MAO	MAO	RESTATE	RESTATE	positive_DACC	positive_DACC
CI_FEE	-0.209		0.534		-0.006	
	(0.728)		(0.692)		(0.507)	
CI_ASSETS		-0.312		-1.068		0.005
		(0.587)		(0.583)		(0.639)
neweffort	-0.028**	-0.028**	-0.028	-0.028	-0.001**	-0.001**
	(0.049)	(0.048)	(0.676)	(0.678)	(0.032)	(0.031)
Big4	0.388	0.372	2.456	1.958	0.003	0.005
	(0.191)	(0.192)	(0.111)	(0.195)	(0.624)	(0.309)
LLP	-0.274	-0.296	1.559	1.410	0.006	0.005
	(0.662)	(0.636)	(0.526)	(0.519)	(0.621)	(0.648)
MKTCON	-3.532***	-3.530***	-20.920***	-20.507***	0.004	0.004
	(0.000)	(0.000)	(0.002)	(0.002)	(0.761)	(0.713)
auditor_change	0.763*	0.756*	0.824	0.855	0.001	0.000
	(0.069)	(0.071)	(0.553)	(0.523)	(0.920)	(0.988)
size	0.097	0.098	-0.581	-0.507	-0.006***	-0.006***
	(0.141)	(0.136)	(0.140)	(0.199)	(0.000)	(0.000)
loss	0.099	0.103	1.600**	1.622**	0.002	0.002
	(0.549)	(0.538)	(0.025)	(0.023)	(0.591)	(0.600)
growth	-0.941***	-0.935***	0.652	0.740	0.074***	0.073***
	(0.007)	(0.008)	(0.621)	(0.571)	(0.000)	(0.000)
lev	-0.509	-0.520	0.578	0.088	0.005	0.005
	(0.196)	(0.188)	(0.775)	(0.964)	(0.511)	(0.467)
sales_volatility	-0.649	-0.643	3.255**	3.307**	0.026***	0.025***
	(0.101)	(0.104)	(0.022)	(0.019)	(0.001)	(0.002)
age	0.433***	0.433***	0.122	0.040	0.001	0.001
	(0.000)	(0.000)	(0.824)	(0.941)	(0.674)	(0.665)
boardmeeting	0.023	0.022	0.138**	0.123*	0.000	0.000
	(0.200)	(0.206)	(0.050)	(0.085)	(0.825)	(0.848)
GDP	-12.146***	-12.127***	-3.507	-3.918	0.001	0.002
	(0.000)	(0.000)	(0.490)	(0.437)	(0.940)	(0.904)
lag_DACC					0.056**	0.055**
					(0.027)	(0.031)
Constant	156.242***	155.995***	53.036	57.867	0.080	0.067
	(0.000)	(0.000)	(0.428)	(0.384)	(0.751)	(0.789)
Year	Yes	Yes	Yes	Yes	Yes	Yes
Industry	Yes	Yes	Yes	Yes	Yes	Yes
Observations	1812	1812	513	513	1358	1358
Adjusted (Pseudo) R^2	0.183	0.183	0.409	0.410	0.048	0.048

*, **, *** Denote two-tailed statistical significance at the 10 percent, 5 percent, and 1 percent levels, respectively.

Table 8
Sensitivity Test on the Association between Client Importance and Audit Quality in Three Jurisdictions Excluding Financial Institutions

Panel A: Hong Kong

	MAO	MAO	RESTATE	RESTATE	positive_DACC	positive_DACC
CI_FEE	0.555		1.056		0.007	
	(0.251)		(0.223)		(0.378)	
CI_ASSETS		1.102**		1.782**		0.016*
		(0.025)		(0.021)		(0.098)
neweffort	-0.001	-0.001	-0.019	-0.019	0.000	0.000
	(0.779)	(0.798)	(0.123)	(0.118)	(0.302)	(0.274)
Big4	-0.947**	-0.940**	0.677	0.687	-0.001	-0.001
	(0.041)	(0.041)	(0.302)	(0.286)	(0.768)	(0.813)
MKTCON	-2.199	-1.952	-5.352**	-4.897*	-0.002	-0.001
	(0.277)	(0.327)	(0.047)	(0.064)	(0.883)	(0.945)
auditor_change	0.561**	0.568**	-0.839	-0.828	0.002	0.002
	(0.020)	(0.018)	(0.283)	(0.290)	(0.614)	(0.597)
size	0.048	0.027	0.076	0.058	-0.002*	-0.002*
	(0.603)	(0.773)	(0.658)	(0.734)	(0.077)	(0.064)
loss	1.054***	1.051***	0.738*	0.758*	-0.004	-0.003
	(0.000)	(0.000)	(0.094)	(0.085)	(0.263)	(0.275)
growth	-0.008	-0.017	0.114	0.108	0.020***	0.020***
	(0.914)	(0.818)	(0.405)	(0.429)	(0.000)	(0.000)
lev	2.228***	2.231***	1.415**	1.458***	0.003	0.003
	(0.000)	(0.000)	(0.011)	(0.009)	(0.468)	(0.464)
sales_volatility	0.219	0.225	0.049	0.044	0.016***	0.016***
	(0.124)	(0.111)	(0.883)	(0.894)	(0.000)	(0.000)
age	0.036	0.036	-0.578**	-0.618***	-0.006***	-0.006***
	(0.820)	(0.818)	(0.012)	(0.008)	(0.001)	(0.001)
boardmeeting	0.429***	0.435***	-1.064**	-1.091***	-0.001	-0.001
	(0.005)	(0.005)	(0.011)	(0.009)	(0.694)	(0.705)
GDP	1.029	1.054	6.355	6.304	0.000	0.000
	(0.559)	(0.550)	(0.322)	(0.325)	(0.999)	(0.999)
lag_DACC					0.047***	0.047***
					(0.000)	(0.000)
Constant	-19.816	-19.745	-82.441	-81.377	0.078***	0.080***
	(0.365)	(0.367)	(0.300)	(0.306)	(0.005)	(0.005)
Year	Yes	Yes	Yes	Yes	Yes	Yes
Industry	Yes	Yes	Yes	Yes	Yes	Yes
Observations	3563	3563	1829	1829	3564	3564
Adjusted (Pseudo) R^2	0.317	0.320	0.113	0.122	0.095	0.096

Table 8 (continued)

Panel B: Mainland

	MAO	MAO	RESTATE	RESTATE	positive_DACC	positive_DACC
CI_FEE	0.153		0.977		0.002	
	(0.813)		(0.117)		(0.799)	
CI_ASSETS		-0.044		1.065**		0.007
		(0.944)		(0.033)		(0.417)
neweffort	0.050***	0.051***	-0.018	-0.019	0.001**	0.001**
	(0.001)	(0.001)	(0.343)	(0.321)	(0.035)	(0.038)
Big4	0.724**	0.726**	-0.483	-0.428	-0.008*	-0.008*
	(0.041)	(0.040)	(0.364)	(0.421)	(0.050)	(0.055)
LLP	0.257	0.252	0.746**	0.753**	0.001	0.001
	(0.311)	(0.321)	(0.012)	(0.011)	(0.841)	(0.843)
MKTCON	-1.110	-1.298	-8.743***	-8.595***	-0.035	-0.029
	(0.606)	(0.536)	(0.006)	(0.005)	(0.337)	(0.410)
auditor_change	0.487***	0.488***	0.148	0.148	-0.001	-0.001
	(0.001)	(0.001)	(0.448)	(0.449)	(0.677)	(0.676)
size	-	-	-0.172*	-0.196**	0.000	0.000
	0.728***	0.725***				
	(0.000)	(0.000)	(0.060)	(0.034)	(0.721)	(0.860)
loss	1.330***	1.331***	0.894***	0.899***	-0.013***	-0.013***
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
growth	-	-	-0.117	-0.118	0.039***	0.039***
	0.733***	0.736***				
	(0.001)	(0.001)	(0.561)	(0.557)	(0.000)	(0.000)
lev	3.572***	3.571***	0.674**	0.672**	-0.011***	-0.011***
	(0.000)	(0.000)	(0.010)	(0.010)	(0.004)	(0.004)
sales_volatility	-0.154	-0.154	-0.123	-0.117	0.003	0.003
	(0.393)	(0.392)	(0.492)	(0.512)	(0.171)	(0.167)
age	0.672***	0.672***	0.286*	0.290*	-0.002	-0.002
	(0.000)	(0.000)	(0.081)	(0.077)	(0.291)	(0.296)
boardmeeting	0.338*	0.341*	0.476**	0.478**	0.006**	0.006**
	(0.081)	(0.077)	(0.035)	(0.034)	(0.040)	(0.040)
GDP	0.229	0.237	-2.265***	-2.259***	0.000	0.000
	(0.641)	(0.630)	(0.000)	(0.000)	(0.999)	(0.999)
SOE	-0.037	-0.037	-0.066	-0.064	-0.004**	-0.004**
	(0.780)	(0.779)	(0.672)	(0.681)	(0.049)	(0.049)
lag_DACC					0.022***	0.022***
					(0.000)	(0.000)
Constant	2.652	2.473	34.368***	34.770***	0.065**	0.069**
	(0.736)	(0.753)	(0.000)	(0.000)	(0.029)	(0.022)
Year	Yes	Yes	Yes	Yes	Yes	Yes
Industry	Yes	Yes	Yes	Yes	Yes	Yes
Observations	8918	8918	8832	8832	6815	6815
Adjusted(Pseudo) R^2	0.414	0.414	0.087	0.087	0.123	0.123

Table 8 (continued)

Panel C: Taiwan

	MAO	MAO	RESTATE	RESTATE	positive_DACC	positive_DACC
CI_FEE	-0.209		0.534		-0.006	
	(0.728)		(0.692)		(0.515)	
CI_ASSETS		-0.312		-1.068		0.005
		(0.587)		(0.583)		(0.645)
neweffort	-0.028**	-0.028**	-0.028	-0.028	-0.001**	-0.001**
	(0.049)	(0.048)	(0.676)	(0.678)	(0.035)	(0.034)
Big4	0.388	0.372	2.456	1.958	0.003	0.005
	(0.191)	(0.192)	(0.111)	(0.195)	(0.630)	(0.318)
LLP	-0.274	-0.296	1.559	1.410	0.006	0.005
	(0.662)	(0.636)	(0.526)	(0.519)	(0.627)	(0.653)
MKTCON	-3.532***	-3.530***	-20.920***	-20.507***	0.004	0.004
	(0.000)	(0.000)	(0.002)	(0.002)	(0.765)	(0.718)
auditor_change	0.763*	0.756*	0.824	0.855	0.001	0.000
	(0.069)	(0.071)	(0.553)	(0.523)	(0.921)	(0.988)
size	0.097	0.098	-0.581	-0.507	-0.006***	-0.006***
	(0.141)	(0.136)	(0.140)	(0.199)	(0.000)	(0.000)
loss	0.099	0.103	1.600**	1.622**	0.002	0.002
	(0.549)	(0.538)	(0.025)	(0.023)	(0.597)	(0.606)
growth	-0.941***	-0.935***	0.652	0.740	0.074***	0.073***
	(0.007)	(0.008)	(0.621)	(0.571)	(0.000)	(0.000)
lev	-0.509	-0.520	0.578	0.088	0.005	0.005
	(0.196)	(0.188)	(0.775)	(0.964)	(0.518)	(0.474)
sales_volatility	-0.649	-0.643	3.255**	3.307**	0.026***	0.025***
	(0.101)	(0.104)	(0.022)	(0.019)	(0.002)	(0.002)
age	0.433***	0.433***	0.122	0.040	0.001	0.001
	(0.000)	(0.000)	(0.824)	(0.941)	(0.679)	(0.670)
boardmeeting	0.023	0.022	0.138**	0.123*	0.000	0.000
	(0.200)	(0.206)	(0.050)	(0.085)	(0.828)	(0.850)
GDP	-12.146***	-12.127***	-3.507	-3.918	0.000	0.000
	(0.000)	(0.000)	(0.490)	(0.437)	(0.999)	(0.999)
lag_DACC					0.056**	0.055**
					(0.030)	(0.034)
Constant	156.242***	155.995***	53.036	57.867	0.099***	0.097***
	(0.000)	(0.000)	(0.428)	(0.384)	(0.000)	(0.000)
Year	Yes	Yes	Yes	Yes	Yes	Yes
Industry	Yes	Yes	Yes	Yes	Yes	Yes
Observations	1812	1812	513	513	1358	1358
Adjusted(Pseudo) R^2	0.183	0.183	0.409	0.410	0.127	0.127

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