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Do auditors communicate financial misstatement risk in audit report? Evidence from subsequent accounting restatements in China

Hau Yi YEUNG

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DO AUDITORS COMMUNICATE FINANCIAL MISSTATEMENT RISK
IN AUDIT REPORT? EVIDENCE FROM SUBSEQUENT
ACCOUNTING RESTATEMENTS IN CHINA

YEUNG HAU YI

MPHIL

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by
YEUNG Hau Yi
楊巧兒

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

Lingnan University

2018

ABSTRACT

Do Auditors Communicate Financial Misstatement Risk in Audit Report? Evidence
from Subsequent Accounting Restatements in China

by

YEUNG Hau Yi

Master of Philosophy

Regulators worldwide are considering expanding current audit reporting model to include key audit matters (KAM). Proponents argue that current audit reports are standardized and uninformative to financial statement users. Auditors in current reporting regime can choose to add explanatory notes in audit reports, however, few current studies have investigated the information content of these explanatory notes. This thesis conducts a textual analysis of explanatory notes in auditor reports and examines the predictability of auditors' explanatory notes consisting of both unqualified and qualified opinions in determining the incidence of subsequent restatements. I hand collect material accounting restatements disclosed by the public companies in China from 2003 to 2017 and obtain modified audit reports from the CSMAR database during the period between 2003 and 2015. Based on a sample of 22,850 firm-years from 2003 to 2015 in China, I find that modified audit opinions, in general, can communicate financial misstatement risks, and the probability of such risks increases when the type of audit opinion is more severe. I also find that compared with unmodified audit opinion, modified ones containing explanatory notes have a higher possibility of subsequently being restated. Further, the predictive power is not the same across different types of explanatory notes. I have shown that explanatory notes including notes emphasizing contingencies and uncertainties and those relating to audit scope limitations have greater predictive power in explaining subsequent accounting restatements. My findings are robust with a set of additional tests. The findings of this thesis indicate that auditors do communicate financial misstatement risks in modified audit opinions (MAOs). Moreover, the findings are consistent with and provide evidence to support policy changes in developing new enhanced auditor reports introduced by the standard setters in China.

Keywords: Financial misstatement risk, Accounting restatements, Explanatory notes,
Modified audit report

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.



SIGNED

(YEUNG HAU YI)

Date

CERTIFICATE OF APPROVAL OF THESIS

DO AUDITORS COMMUNICATE FINANCIAL MISSTATEMENT RISK IN AUDIT
REPORT? EVIDENCE FROM SUBSEQUENT ACCOUNTING RESTATEMENTS
IN CHINA

by
YEUNG Hau Yi

Master of Philosophy

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Do Auditors Communicate Financial Misstatement Risk in Audit Report? Evidence from Subsequent Accounting Restatements in China

Chapter 1 Introduction

The International Auditing and Assurance Standards Board (IAASB) initiated new and revised audit reporting standards and related conforming amendments for reporting on audited financial statements on January 15, 2015.¹ In particular, the New ISA 701² copes with the responsibility of auditors to convey key audit matters (KAMs) of the listed entities in the auditor's report.³ The U.S. Public Company Accounting Oversight Board (PCAOB) suggested the effective date for the inclusion of critical audit matters in audited financial statements to be on or after June 30, 2019, for large accelerated companies; and December 15, 2020, for all other applicable companies (PCAOB 2017). The Chinese Institute of Certified Public Accountants (CICPA) imposed the new standard on audit reports for its A-shares and H-shares effective on or after January 1, 2017 and for its other applicable shares on or after January 1, 2018 (CICPA 2016). The actions taken by IAASB, PCAOB, CICPA and the respective regulatory bodies in other countries serve as responses to the request from investors

¹The new and revised auditor reporting standards include the New International Standard on Auditing (ISA) 701 – “Communicating Key Audit Matters (KAMs) in the Independent Auditor’s Report,” ISA 700 (Revised) – “Forming an Opinion and Reporting on Financial Statements,” and ISA 570 (Revised) – “Going Concern.”

²The effective date for the New ISA 701 generally applies to the audits of financial statements for the periods ending on or after December 15, 2016. However, this date varies among countries such as the United Kingdom (June 17, 2016); Canada (December 15, 2018), and so on.

³According to the New ISA 701, paragraph 8, the definition of KAMs refer to “those matters that, in the auditor’s professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance.” Auditors shall consider “Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with ISA 315 (Revised) (Ref: Para. A19–A22).”

and other financial statement users for more informative and relevant auditors' reports. Moreover, international professional practitioners such as EY, Deloitte, KPMG, and PwC have closely followed and welcomed the new standards in enhanced audit reports. They have also attached importance to these standard changes in the new and enhanced audit reports by providing positive feedback and updates via their official websites.⁴

While standard setters expect the revised audit reports to be more informative and valuable, I am doubtful about the informative content of prior audit reports. Were they boilerplate to the extent that they predicted? Were they as uninformative as they expected? ⁵In this thesis, I am interested in addressing the above questions in China's financial reporting and auditing standards, which are in compliance with the international ones (CSRC 2010).⁶ Moreover, China's regulators accept audit reports other than unqualified opinions in practice unlike the PCAOB in the United States. The variety of audit reports allow for more variations in my empirical tests and moreover, China has assumed an important position in emerging markets in recent decades. According to the 2017 annual statistics released by The World Federation of Exchange (WFE), the total market capitalization of the companies listed on the

⁴For example, Bob Moritz, PwC's Global Chairman, prefers the new and enhanced audit reports over the traditional ones as they provide higher transparency to the shareholders and other users of the that information, shed light on the most significant areas of study audits, explain these significances and how audits address them. He believes that the new and enhanced audit reports are of high quality, valuable and relevant.

⁵E.g. Lennox (1999) finds evidence that the information content of audit reports did not signal useful additional information about the bankruptcy probability of firms.

⁶According to the CSRC Annual Report 2010, both the convergence of the Chinese auditing standards with the international auditing standards (IAASB) and the convergence of the Chinese accounting standards with the international accounting standards commenced by the end of 2005 and 2006, respectively.

Shanghai and Shenzhen Stock Exchanges amounted to RMB56.71 trillion (USD8.70 trillion), which ranks second in the world and first among the Asia-Pacific countries.

This thesis examines whether and how auditors communicate financial misstatement risks in audit reports. Specifically, I conduct textual analysis of audit reports which issue MAOs or a more severe type of audit opinions with explanatory notes and investigate which type of audit reports could indicate a higher probability of incidences of subsequent restatements. I use the incidences of subsequent restatements as a proxy for financial misstatement risks in audited financial statements. The financial reporting environment in China is different from that in many developed western countries where the institutions to protect investors are strong. In China, many listed enterprises are state-owned with the top management assigned by the government. The unique nature of the ownership structure in Chinese public companies implies that controlling shareholders and general managers typically pursue the objectives (e.g., local job creations, social welfare of local community) of the local and central governments at the expense of minority shareholders. Moreover, many public companies often rely on relationship lending (i.e., bank loans) from state owned commercial banks to finance their potential projects rather than access to equity financing. As a result, these firms' incentive to provide transparent financial reporting is relatively low. On the other hand, CPA firms in China are relatively small in market share and consequently, they have incentives to compromise their audit quality to please clients. Although corporate managers and auditors are not easy to be sued by the public investors for suspicious accounting practices according to Chinese Company Law, they are subject to stringent public enforcement actions taken by the securities market regulators (e.g., CSRC and CICPA). Auditors, at the same time,

maintain their reputation by conducting good quality audits to retain their clients⁷ and ensure that their businesses continue to run. Under these complex situations, I am interested in investigating the information content of auditor reports and their association with audit quality in China.

By examining the quality of auditor reports in China, I associate Chinese listed companies' audit opinions with their subsequent accounting restatements. Auditors in China can issue six types of audit opinions: standard unqualified opinion, unqualified opinion with emphasis of matters, qualified opinions, qualified opinion with emphasis of matters, adverse opinion, and disclaimer opinion. Using standard unqualified opinion as a baseline, I expect qualified opinions (including qualified opinion with emphasis of matters) and adverse opinion indicate higher incidence of misstatements in the financial statements because in such cases the financial statements are not fairly presented in accordance with accounting standards. I also expect the disclaimer opinion is more likely to associate with subsequent restatements because auditors can't obtain sufficient and appropriate audit evidence to verify the financial statements. However, the association between modified unqualified opinion (i.e., unqualified opinion with emphasis of matters) and subsequent restatements is far from obvious. On the one hand, financial statements with unqualified opinion with emphasis of matters by nature are fairly presented in compliance with accounting standards and regulations and should be free from any material misstatements. On the other hand, auditors might choose to highlight the highly controversial accounting practices in the unqualified opinion to avoid issuing a more severe modified opinion to the client. This is supported by the evidence that market perceive negative information from the

⁷Previous literature shows evidence that auditor reputation produces incentives for auditing with high quality (Barton 2005; Weber et al. 2008; Skinner and Srinivasan 2012; DeFond and Zhang 2014).

modified unqualified opinion and clients do switch auditors to get more favorable audit opinions. Therefore, I expect unqualified opinion with emphasis of matters also indicates higher likelihood of misstatements in the financial statements but the likelihood is lower than other severe modified opinions. With these expectations, I hypothesize that listed firms with modified audit opinions are more likely to associate with subsequent financial restatements and the association is less for modified unqualified opinion (unqualified opinion with emphasis of matters).

On further examining the information content of auditor reports, I categorize the explanatory notes that were attached to the audit opinion into five types in accordance with Chinese auditing standards, the Independent Auditing Specific Guidelines Chapter 7 on Audit Report and the Chinese Certified Public Accountant Practice Guideline V – Audit Report, both issued in 2003. The five types of explanatory notes include (1) accounting policy inconsistency, (2) emphasis of important matters, (3) audit-related issues, (4) financial distress and (5) violation of accounting principles in China (APC). I expect that to some extent each type of explanatory note can predict the incidence of subsequent restatements that indicate the information usefulness of the notes. I also hypothesize that explanatory notes added to the unqualified opinions are less likely to associate with subsequent restatements than those attached to other severe modified audit opinions (e.g., qualified, adverse, and disclaimer opinions).

I test my hypotheses by analyzing the A-share firms listed on the Shanghai and Shenzhen Stock Exchanges during 2003–2015. I perform textual analysis and classifications on the explanatory notes in the auditor reports and restatement announcements. Consistent with my expectations, I find that companies with MAOs tend to have higher likelihood of subsequent restatements. Furthermore, listed firms with more severe types of audit opinions are associated with a higher probability of

subsequent restatements. I also find that explanatory notes regarding the emphasis of important matters and audit-related issues have a higher likelihood of reporting subsequent restatements than other notes. In addition, conditional on MAOs, the emphasis of important matters has a stronger association with and a higher predictive power for subsequent restatements than other explanatory notes. Collectively, my evidences suggest auditors indeed communicate financial misstatements risk in current audit reporting model, even in a weak institutional environment. My findings are robust with alternative research regression models; consistent with additional tests for SOEs and non-SOEs; and robust to subsamples without auditor switches. Besides these, my findings in main results are more aligned with non-top ten audit firms in the cross-sectional analysis.

This thesis contributes to the existing literature on the informativeness of MAOs. First, I use the incidence of subsequent restatements as a proxy for financial misstatement risks, and subsequently, financial reporting quality. Prior literature has discussed the usefulness of MAOs from different perspectives. According to Chen et al. (2016), MAOs reflect credit risks of companies; the more severe the audit opinions, the higher the credit risks of companies. Some researchers focus on the specific type of MAOs – going-concern (GC) opinions, and discover that GC opinions lead to negative reactions of the equity investors (Loudder et al. 1992; Menon and Williams 2010; Chen et al. 2016). Pei and Hamill (2013) find that MAOs have market effects, such that disclaimer opinions initiate negative influences on stock prices most significantly. Prior studies demonstrate the usefulness of MAOs in different ways, but almost none analyze the details of the explanatory notes in the MAOs. To be thorough, I have gone a step further from the traditional research by not only taking into account the MAOs, but also studying the details and information content of the explanatory

notes attached to the MAOs. I believe my thesis is the first in China to investigate the relevance and predictability of MAOs and their explanatory notes for financial misstatement risks.

My thesis extends and complements Czerney et al.'s (2014) study on auditor explanatory language. While the scope of Czerney et al.'s (2014) study extended to examining auditors' explanatory language in unqualified audit reports in the United States during 2000–2009, my thesis investigates auditors' explanatory notes in all modified audit reports (including both unqualified and qualified audit reports) in China during 2003–2015. Moreover, while Czerney et al.'s (2014) study is limited to unqualified audit reports, my thesis examines six types of audit opinions and their accompanying explanatory notes for financial misstatement risks. I believe my study serves as an extension of Czerney et al.'s (2014) by providing more variations and comparisons among different types of audit reports. Next, the United States has been known as the largest securities market in the world, and yet, it represents a mature and well-developed capital market. While China is a good representative of emerging markets with weak institutional environment, its total market capitalization on the Shanghai and Shenzhen Stock Exchanges amounted to RMB 37.25 trillion (equivalent to USD 6.00 trillion), and ranks second highest globally, next only to the U.S.'s Nasdaq of USD 6.98 trillion in 2014 (World Federation of Exchanges Annual Statistics Guide 2015).⁸ To summarize, examining the differences in financial reporting standards, political features, and securities markets in the United States and China makes my study unique.

Given that the IAASB has published new and revised auditor reporting standards and related conforming amendments to report on audited financial statements, my

⁸<https://www.world-exchanges.org/home/index.php/statistics/annual-statistics>

findings are consistent with and provide evidence to support policy changes in developing new and enhanced auditor reports with tailor-made information content. Compared to the prior auditor reports under the old standards (which usually proved to be boilerplate and uninformative), the revised auditor reports appear to have predictive power in communicating financial misstatement risks. For instance, my results show that both explanatory notes on the emphasis of important matters (the majority emphasizing contingencies and uncertainties) and audit-related issues (mainly audit scope limitation) are significantly associated with subsequent restatements, and therefore, financial misstatement risks. Standard setters and practitioners may take them as references for further extending information disclosures from these two approaches.

The remainder of this thesis proceeds as follows. Chapter 2 describes the institutional background. Chapter 3 reviews the related literature and develops the hypotheses. Chapter 4 discusses the research design and data. Chapter 5 presents the descriptive statistics and the univariate analysis. Chapter 6 reports the multivariate results, and chapter 7 outlines the conclusions and limitations.

Chapter 2 Institutional Background

2.1 Audit Reporting Standards in China

According to the Chinese auditing standards, the Independent Auditing Specific Guidelines Chapter 7 on Audit Report issued in 2003, the issuance of audit opinions follows a set of specific guidelines.

Rule 17 states that certified public accountants (CPAs) should issue an audit report with unqualified opinions when the following situations arise: (1) financial statements are prepared in compliance with the enterprise's accounting standards and related accounting regulations promulgated by the Chinese authorities, and are fairly presented in all major aspects of the financial, operating, and cash flows status of the audited firm; (2) CPAs implement their audit work as planned, in accordance with the independent auditing standards, and without restrictions during the audit process, and (3) there are no important matters that should be adjusted or disclosed but have not been.

Rule 18 states that the audited firm deserves a qualified audit opinion, if one of the following situations takes place: (1) the adoption of accounting policies, use of accounting estimates, or disclosure of the financial statements do not comply with the national accounting standards and related accounting regulations promulgated by Chinese authorities. Although the impact is significant, it does not necessarily lead to issuing an audit report with an adverse opinion and (2) because of limited audit scope, the auditor is unable to obtain sufficient and appropriate audit evidence. Although the impact is significant, it does not necessarily lead to issuing an audit report with a disclaimer opinion.

Rule 19 states that if the prepared financial statements do not comply with the requirements of the accounting standards and related accounting regulations

promulgated by Chinese authorities, and fail to provide a fair representation of the financial status, operating results, and cash flows of the audited entity as a whole, the CPAs should issue an adverse opinion for the audit report.

Rule 20 states that if the auditor's scope of audit is restricted and the impact of limited audit scope may be very significant and extensive, it could lead to a disclaimer opinion. As the CPAs cannot obtain sufficient and appropriate audit evidence, they cannot form an audit opinion on whether the financial statements are fairly presented or not.

In addition to Rule 17 – Rule 20, the China Certified Public Accountants Practice Guideline V – Audit Report – states that the unqualified audit report consists of two types – standard unqualified opinions and unqualified opinions with an emphasis on matter paragraph (EMP) audit report (section 2.11). CPAs can add an explanatory paragraph after the opinion segment of the qualified opinion audit report (section 2.24). The guidelines in section 2.5 specify that when there is an audit report with an adverse opinion or disclaimer opinion, the CPAs should not add any explanatory paragraphs after the opinion segment, and they should not separately express views on any specific accounting item, so as not to influence the correct understanding of the financial statement users. To conclude, six types of audit opinions are classified together: (1) standard unqualified opinions, (2) unqualified opinions with an EMP, (3) qualified opinions, (4) qualified opinions with an EMP, (5) adverse opinions, and (6) disclaimer opinions. Such classifications of audit opinions are consistent with the audit opinion data provided by the China Stock Market and Accounting Research (CSMAR) Solution. Moreover, these six audit opinion types lay the groundwork for the classifications in the hypothesis tests in Chapter 4.

Moreover, the Chinese auditing standards, the Independent Auditing Specific Guidelines Chapter 7 on Audit Report and the Chinese Certified Public Accountant Practice Guideline V – Audit Report, both issued in 2003, also provide guidance for giving explanatory notes.

Rule 22 of the Independent Auditing Specific Guidelines Chapter 7 on Audit Report states the following: First, when there are matters or circumstances that may lead to significant doubts about the ability of continuing operations of the audited company, and do not affect the opinions that have been issued, CPAs should add the EMP after the comment section of the audit report. Second, when there are uncertainties (other than continuing operations issues) that may result in a significant impact on the accounting statements, and do not affect the published opinions, CPAs should consider adding an EMP after the comment section of the audit report to emphasize the uncertainties. Third, CPAs should indicate that the EMP should only be used to remind users of the financial statements but not affect the published opinions. Fourth, except for the two situations specified in Rule 22, CPAs should not add any explanatory paragraph after the comment section of the audit report to avoid misunderstandings arising among financial statement users.

Regarding Rule 22, I categorize the explanatory notes from the EMP into two types – (1) the financial distress from the first point of Rule 22 and (2) the emphasis important matter from the second point of Rule 22.

Furthermore, the Chinese Certified Public Accountant Practice Guideline V – Audit Report – has also specified five situations for adding the explanatory paragraph after the comment segment of the unqualified audit report (section 2.161) and the qualified audit report (section 2.24): (1) There are circumstances that may introduce significant doubts about the ability to continue operations; (2) there are contingent

liabilities that may have significant impact on the financial statements; (3) there are changes in accounting policies and accounting estimates that have a significant impact on the financial statements; (4) there are major inconsistencies between other information disclosed in the audited financial statements and the audited financial statements themselves; and (5) there is emphasis on other major issues, usually including major related party transactions, events after the reporting period, correction of major accounting errors, and so on.

From the above guideline and descriptions, I further categorize points (3) and (4) above as the note of the accounting policy inconsistency. Furthermore, consistent with Rule 22, situations such as point (1) are classified as the note of financial distress; and circumstances such as points (2) and (5) are treated as the note of the emphasis of important matters. The explanatory note of the auditing-related issues and the violation of APC are mainly connected to the reasons for issuing qualified or disclaimer opinions with reference to Rule 18 point (2) and Rule 18 point (1), respectively. Table 2, Panel B-III and IV show the specific issues in detail under each category of explanatory notes.

2.2 Financial Reporting Environment in China versus the U.S. Capital Market

In section 2.2.1 to section 2.2.4, I outline the audit opinion types and financial reporting environment, respectively. The United States, which has the largest stock market size and market capitalization globally, is chosen as the representative of developed Western countries. Although China is the core of my thesis study, it is also a representative of countries that are considered as emerging market economies.

2.2.1 Audit Opinion Types for Public Companies in the United States

According to the Codification of Statements on Auditing Standard (AU) 508, the auditor may express an unqualified opinion, an explanatory paragraph added to the

auditor's standard report, a qualified opinion, an adverse opinion or a disclaimer opinion on financial statements. An unqualified opinion is expressed when "the financial statements present fairly, in all material respects, the financial position, results of operations, and cash flows of the entity in conformity with generally accepted accounting principles (GAAP)." A qualified opinion is expressed when (1) "there is a lack of sufficient appropriate evidential matter or there are restrictions on the scope of the audit that have led the auditor to conclude that he or she cannot express an unqualified opinion and he or she has chosen not to disclaim an opinion (paragraphs .22-.34)"; or (2) "the auditor believes, on the basis of his or her audit, that the financial statements contain a departure from GAAP, the effect of which is material, and he or she has chosen not to express an adverse opinion (paragraphs .35-.57)". An adverse opinion is expressed when "in the auditor's judgment, the financial statements taken as a whole are not presented fairly in conformity with GAAP." A disclaimer opinion is issued when "an auditor may decline to express an opinion whenever he or she is unable to form, or has not formed, an opinion as to the fairness of presentation of the financial statements in conformity with GAAP." Overall, the auditing standards in China and the United States for providing guidelines to the auditors in expressing audit opinions are generally the same. Thus, the U.S. Securities and Exchange Commission (SEC) formally accepts types of audit reports other than unqualified opinions issued to public listed companies, and the auditors have to state the reasons for the departure from the unqualified opinion (Public Company Accounting Oversight Board Auditing Standard (AS) 3105 – Departures from Unqualified Opinions and Other Reporting Circumstances). However, in practice, data regarding opinions other than unqualified are rare in the United States. With reference to audit analytics, a note states that "companies that have been issued a qualified or disclaimed opinion cannot

be identified using the data set. It is very rare that a company would submit disclaimed or qualified opinions to regulators and shareholders. In such cases the company will file NT (form 12b, Notification of late filing) and or terminate the auditor.” Prior literature has also investigated the phenomenon of “opinion shopping” – companies’ strategic use of auditor dismissals to avoid unfavorable audit opinion in the U.S. market (Lennox 2000; Lennox 2002). In reality, owing to the unavailability of data of qualified or disclaimed opinions and companies’ behavior of opinion shopping, unqualified opinion is the only applicable type of audit opinion observed in U.S. public companies.

2.2.2 Audit Opinion Types for Public Companies in China

The CSRC accepts six types of audit reports in China (Chinese Auditing Standards, Chapter 7, Rules 17-20), namely, standard unqualified opinions, unqualified opinions with an EMP, qualified opinions, qualified opinions with an EMP, adverse opinions, and disclaimer opinions. Not only do the rules and regulations provide the grounds to these six types of audit opinions, but practically speaking, auditors also issue opinions other than unqualified ones. During 2003–2015, a total of 1,422 A-share firms received MAOs for their annual financial statements, with an average percentage of 6.22% among all A-share firms listed on the Shanghai and Shenzhen Stock Exchanges. The number of MAOs was within the range of 81 to 159 every year. Data regarding different types of audit opinions for public listed firms are available on the CSMAR Solutions. Therefore, six types of audit opinions can be viewed in both form and substance.

The variety of audit opinions available in China allows me to assess the cross-sectional variations in the associations between different types of MAOs and the incidence of subsequent accounting restatements, which cannot be performed in the

U.S. with only one type of MAO – the unqualified opinion with EMP. With this major difference of audit opinion types, I focus on China for the scope of my thesis study and this enables more information to be gleaned from comparisons among the predictive power of MAOs.

2.2.3 Financial Reporting Environment in the United States

Following the public scandals in the early 2000s in the United States, including the cases pertaining to Enron, Tyco International, and WorldCom, the U.S. Senate and House of Representatives put together a reform act, namely the Sarbanes-Oxley (SOX) Act, in 2002 to uphold public confidence in financial reporting quality. The SOX Act regulates and improves financial disclosures and strengthens corporate governance to deter corporations from committing accounting fraud. The SOX Act stimulated the functioning of the PCAOB and changed the emphasis for auditors of U.S. public companies from self-regulated to subject to external and independent oversight by the PCAOB. Thereafter, the U.S. Senate and House have governed more strictly on listed companies and auditors on financial reporting activities. According to Section 302, title III of the SOX Act, “Corporate Responsibility for Financial Reports” requires the organization to have signing officers to verify the financial statements and related information fairly present the financial situations and the consequences in all material aspects; to evaluate the internal controls of the company and report the findings, all deficiencies and any fraudulent activities. Based on Section 404, title IV of the SOX Act, “Enhanced Financial Disclosures” requires the auditors to assess and report the effectiveness of the internal controls. In addition, Section 802 of the SOX Act, “Corporate and Criminal Fraud Accountability,” imposes penalties of fines and/or up to 20 years imprisonment for records, documents, or tangible objects alteration, destruction, mutilation, concealment, or falsification with the intention to hinder,

obstruct, or cause impact to a legal investigation. Section 802 also imposes penalties of fines and/or imprisonment up to 10 years on any accountant who intentionally and purposely violates the requirements of maintenance of all audit evidence or review papers for a five-year period. To conclude, the financial reporting requirements in the United States have been strengthened while the rules and law enforcement have set heavy penalizations against fraudulent accounts from 2002 onwards. The SOX Act provides a strong institutional financial reporting environment in the United States.

2.2.4 Financial Reporting Environment in China

2.2.4.1 The financial reporting incentives of Chinese public companies

China had long adopted a centrally planned economy wherein economic decisions were not made by free market transactions between consumers and business owners but decided by the Chinese government, who in turn gave instructions to business managers. In the late 1970s and early 1980s, China implemented economic reforms that gave enterprise managers discretion over sources of finance, production, price setting, and labor (Chen et al. 2006). Following the open door policy in 1979, state-owned enterprises (SOEs) tried privatization by reorganizing themselves as limited liabilities companies with the substantial objective of profits making.⁹ In addition, many of these companies were subsequently listed and raised share capital from both domestic and foreign investors. The economic reforms and the open door policy assisted enterprises in China to become privatized from the central government, both in terms of internal operations and management, and external financial fundraising and

⁹Prior to the reforms in Chinese enterprises, state-owned enterprises (SOEs) played an important role in maintaining social stability and providing social welfare over profit-making (Bai et al. 2000; Chen et al. 2006).

ownership. However, this privatization was only “partial” in nature (Bortolotti and Faccio 2004; Chen et al. 2006), as the government and state remained the major and ultimate shareholders of many SOEs. For example, according to Chen et al. (2006), on average, about 60% of the shares in the listed firms were ultimately owned by the state. This shareholding was composed of about 50% held directly by the central or local governments and their ministries and bureaus, while the remaining half was held by legal entities, with the government as the ultimate owner. According to Chan et al. (2006), the Chinese government still takes controls of listed companies by appointing their general managers and having a major presence in the board of directors and supervisory committees. This situation persisted in 2010 and the chairmen and top management of many SOEs were actually members of the Communist Party (Channel NewsAsia, August 18, 2017).¹⁰ “Partial privatization” of SOEs is a unique characteristic of Chinese listed enterprises.

The unique ownership structure in Chinese public companies resulted in maximizing shareholders’ value not being the sole objective of companies. The controlling shareholders (i.e., SOE) and managers may need to consider job creation and social welfare of the community by sacrificing minority shareholders’ interests. Apart from this, controlling shareholders often expropriate minority shareholders’ interests to enjoy private benefits because of the huge wedge between controlling ownership and cash flow rights in Chinese public companies (Jensen and Meckling 1976). Therefore, to conceal their unlawful activities, controlling shareholders and managers have little incentive to provide transparent financial reporting to minority shareholders (public investors). Moreover, SOE firms usually rely on relationship

¹⁰News reports further state that the largest 100 SOEs in China formally amended their articles of association last year to emphasize the importance of “party building” activities, suggesting that the state performs certain strong power of controls on the SOEs.

lending (i.e., bank loans) from state-owned commercial banks to finance their potential projects rather than resort to equity market financing. Therefore, they have relatively little incentive to provide high quality financial reporting to reduce the cost of equity capital (Allen et al. 2005; Allen et al. 2017).

2.2.4.2 CPA Industry and audit quality in China

The economic reforms and the open door policy in late 1970s not only restructured SOEs, but also initiated the demand for independent audit services in China for the major purpose of tax collection (Defond et al. 2000; Chan et al. 2006). In the early 1980s, most audit firms lacked the necessary capital and required sponsorship from government agencies while establishing themselves. This practice greatly induced government agencies' influence on auditors' judgment and audit opinions (Tang 1999; Chan et al. 2006). In 1995, the government recognized the importance of developing audit professions that were independent, of high quality, and credible. As a result, in 1998, the Ministry of Finance (MOF) and the CSRC began to disaffiliate government agencies from their sponsoring audit firms (Chan et al. 2006). The MOF and CSRC further issued regulations and set hurdles for audit firms to meet to apply or renew their licenses to perform audits for listed firms.¹¹ To fulfill the regulations imposed in a short period of time, audit firms commonly increase their firm size through mergers (Chan et al. 2006). Overall, unlike audit firms in Western countries, audit firms in China are relatively small in scale and the market shares of each audit firm are fairly small. Under the regulations imposed by MOF and CSRC, auditors, besides providing

¹¹In 1997, audit firms were required to have more than eight individual qualified CPAs to sign audit reports for the listed firms as the requirement to apply for licenses. In June 2000, this number increased from eight to twenty individual qualified CPAs. In addition, the audit firms were required to achieve annual revenues of over RMB 8 million (Chan et al. 2006).

high-quality auditing services, must also focus on factors that increase their market share to ensure the renewal of their audit licenses by the central government.

In the mid-1990s, China implemented a set of new and stringent auditing standards that attempted to improve credibility in capital markets. However, Defond et al. (2000) find that larger auditors that issued modified opinions, to a large extent, lose their market share of IPO clients upon adopting these standards. They further show that IPO firms switch from larger auditors to smaller ones, “flight from audit quality,” in exchange for clean audit opinions. These results can be explained by the lack of incentives to demand independent auditors in China. In the early 2000s, the opinion shopping behavior of listed firms did not stop. According to Chan et al. (2006), local auditors, rather than non-local ones, tend to issue favorable audit reports to local government-owned firms. They also find that the opinion shopping behavior of local government-owned firms can succeed by switching from a non-local auditor to a local one. Collectively, the opinion shopping behavior of listed firms is prevalent in China, which is consistent with the notion that Chinese public companies have low incentives to provide transparent financial reporting.

2.2.4.3 The regulatory oversight of auditors in China

Unlike the U.S. capital markets, the private litigation environment against auditors and corporate managers in China is weak. Corporate laws in China do not allow for class litigation against auditors and managers for accounting frauds. One of the conditions for the successful litigation against companies/auditors is that the companies (defendants) must be charged with fraud by Chinese regulators. These conditions create considerable barriers for investors to sue companies with suspicious accounting practices. Therefore, private litigation cases against companies for accounting fraud and auditors for ignorance are rare in China’s capital markets (Sun

and Qiang 2011). However, corporate managers and auditors are subject to enforcement action and inspection by the CSRC and the CICPA, which have intensified in recent years.

The CSRC has played a major role in regulating the securities market in China since 1998 (Chen et al. 2006). Its objectives include drawing up relevant laws, regulations, and policies for the securities markets; implementing vertical administrative work for domestic securities institutions; carrying out comprehensive supervision of the securities markets; monitoring the behaviors of the listed firms and their shareholders for the fulfillment of related obligations; working with the corresponding authorities in examining and approving the qualifications of the auditing firms; inspecting and penalizing the parties or firms that violate the relevant laws and regulations, and so on. Furthermore, according to CSRC's 2014 annual report, it carried out daily supervision and inspection of 31 audit engagements. It finally imposed regulatory actions on 8 audit firms and 42 CPAs. Sun and Qiang (2011) show that during 2003–2008, a total of 19 CPA firms were penalized by the CSRC owing to audit failures in annual financial reporting, and 394 public companies (on average, 65 companies each year) and their managers were booked for accounting fraud by the CSRC. Similarly, Zhang (2018) reports that nearly 835 firm-year observations were charged with financial fraud by the CSRC during 2009–2014. Both studies show that the CSRC enforcement actions against auditors and corporate managers have intensified recently.

Both the intentions and work performed by the CSRC indicate that it has put in efforts to maintain regulations for the securities markets in China.

The CICPA, like the PCAOB in the United States, also conducts inspections on CPA firms' audits of public companies to improve audit quality. According to the CPA

firm audit performance inspection rule (CICPA 2009), CICPA conducts inspections of CPA firms qualified in audits of public companies at least once every three years and even frequently for CPA firms that (1) had been found to have deficiencies in audits during the previous inspections and (2) have not remedied those deficiencies yet. The CICPA samples included around five CPA firms that were qualified in inspections of audits of public companies based on a few risk factors¹². The scope of CICPA inspection includes quality control systems in CPA firms and compliance with Chinese auditing standards, CPA professional ethics standards, and audit quality control standards. When CICPA inspection staff discover deficiencies in audit quality control systems and violations of auditing and CPA professional ethics standards, they will require CPA firms to remedy these deficiencies and initiate substantial penalties (admonition, notification criticism, public condemnation) for noncompliance with auditing standards and professional ethics.

¹²Ten risk factors. Please translate section 14.

http://www.cicpa.org.cn/Industry_regulation/Industry_regulation/200907/t20090730_16786.html

Chapter 3 Literature Review and Hypothesis Development

3.1 Financial Reporting Quality

Biddle et al. (2009) defines “financial reporting quality as the precision with which financial reporting conveys information about the firm’s operations, in particular its expected cash flows, and that inform equity investors.” Jonas and Blanchet (2000) state that “...quality financial reporting is full and transparent financial information that is not designed to obfuscate or mislead users” (Tasios and Bekiaris 2012). Financial reporting quality is a broad field of study and different academic scholars have expressed their definitions in different ways. Nevertheless, “precise,” “true and fair,” and “not to mislead users” are often key components in defining financial reporting quality.

Prior literature has also indicated the importance of high-quality financial reporting in the capital markets (Lambert et al. 2007; Ng 2011; Maffett 2012;). Lambert et al. (2007) suggests that with higher information quality, namely having more precise signals, market risks and therefore costs of capital would be lowered in the traditional capital asset pricing model (CAPM) framework. Ng (2011) finds that information quality and liquidity risks are negative and economically significant. Maffett (2012) suggests that the public financial reporting environment, both firm-level and county-level features, significantly affects the ability of institutional investors to have profitable trading advantages.

Not only have the academic scholars long discussed the importance of financial reporting in providing useful information for capital market investors, but so have the financial reporting standards setters. According to International Financial Reporting

Standards (IFRS),¹³ “high-quality financial information is the lifeblood of capital markets.” The mission of IFRS is to carry transparency, reinforce accountability, and contribute efficiency to financial markets globally by improving IFRS. Hence, both academic researchers and financial reporting standard setters share the perspective that higher-quality financial reporting will benefit capital market investors.

3.2 Financial Restatements and Audit Quality

While striving for high quality financial reporting is an important objective to the academia, the standard setters and practitioners, one indicator – accounting misstatement/ financial restatement, is usually taken place as the measure. In prior studies, financial restatements have long been used as a proxy for audit quality. According to DeAngelo (1981b), fewer subsequent restatements is an indicator of better audit quality. Audit quality is defined as a joint probability of auditor competence (the ability of the auditor to identify the existing problem) and auditor independence (whether the auditor would report the detected problem or not). Keeping other factors constant, a more (less) competent and more (less) independent auditor is more (less) likely to detect and correct a misstatement, hence reducing (accumulating) subsequent restatements. Therefore, a higher occurrence of financial restatements can be measured as poorer audit quality or vice versa. Lobo and Zhao (2013), consistent with DeAngelo (1981b)’s definition on audit quality, propose an operational definition – “with a stronger negative association between audit fees and restatements reflecting higher audit quality”.

¹³International Financial Reporting Standards’ (IFRS) mission is also to develop trust, encourage growth, and stabilize the financial interests of the general public worldwide in the long-run. For more details, please refer to the following official website: <http://www.ifrs.org/about-us/who-we-are/>

Further in DeFond and Zhang (2014), restatements measure actual audit quality, unlike proxies such as stock price reaction and cost of capital which measure perceived audit quality. Restatements are relatively more direct and egregious measures of audit quality since they represent those problems the auditor failed to identify and correct and hidden in the financial statements during the audit process. DeFond and Zhang (2014) state that restatements have a major benefit is that “they are usually strong evidence of poor audit quality”. And a subset of restatements “identify the presence of management fraud, which is an advantage because many users and regulators believe that fraud prevention is the auditor’s first priority”. All in all, the accounting restatements are direct indicators for audit quality and commonly used measures in prior literatures with variety of research settings.

Kinney Jr. et al. (2004) investigate whether non-audit services would deteriorate the auditor’s independence and constitute decreased quality of financial reporting. This study involves restatements in the model by assuming restatements of previously issued financial statements represent low-quality financial reporting. Kinney Jr. et al. (2004) find that the fees for financial information system design and implementation services or internal audit services have no statistically significant positive association with restatements. Another finding is that tax services fee is negatively statistically significant associated with restatements. Therefore, banning or restricting tax services (a type of non-audit services) from a client’s audit firm may lower the financial reporting quality or increase the cost of professional services to firms without respective benefits from improved audit firm independence.

Archambeault et al. (2008) explore the association between audit committee incentive-based compensation and accounting restatements in financial statements. This study specifically uses restatements as the measure of the financial reporting

failure. Archambeault et al. (2008) provide evidence that both audit committee short-term and long-term stock option grants have a positive association with the accounting restatements. It is because when the company issue short-term stock options to the audit committee as the compensation, the audit committee members may focus on the short-term performance and oversight the audit quality. While for the long-term stock option grants, with uncertain payoffs, the audit committee members have less motivation to monitor and supervise the management, and in turn, increase the likelihood of financial reporting failure. This study suggests to offer a compensation mix and emphasize on the carefulness on designing and administrating the audit committee member compensation programs.

Chin and Chi (2009) concentrate on examining the association between the Big Four auditors' industry expertise (by firm-level expertise; by partner-level expertise; and by both) and the accounting restatements. Chin and Chi (2009) find that the probability of restatements is negatively associated with the existence of industry audit experts, where the effects at the partner level are stronger than that at the firm level. Audit firms have economic incentives to develop and market their industry expertise at partner level, advance from industry expertise at the firm level and office level. Chin and Chi (2009) also believe that the incentive for financial statement users to invest in companies audited by lead industry experts may be greater than other companies, because the earlier companies are less likely to have restatements.

3.3 Informativeness of Audit Reports

The auditor report is definitely a crucial element in the financial reporting framework. It represents the output and deliverable of the independent auditor after performing audit services for listed firms, to the shareholders, investors, and the interested public. Prior studies have long discussed whether auditor reports provide

relevant information to stakeholders (Francis 2004; Church et al. 2008; DeFond and Zhang 2014). Some scholars are still doubtful about whether auditing non-financial information enhances value (DeFond and Zhang 2014).

Lennox (1999) examined the accuracy and information content of audit reports by investigating their predictability on bankruptcy. He found that the audit reports did not signal useful incremental information about the probability of bankruptcy. Lennox (1999) justified two reasons for the failure of audit reports. First, audit reports did not reveal publicly available information about financial distress, including the variations on the probability of bankruptcy across industry sectors and during different economic conditions (economic recession or recovery). Second, auditors had incentives to repeat the same audit opinions. This strong persistence in reporting resulted in audit reports unsuccessful to identify failing companies.

However, some studies provide evidence that audit opinions do in fact influence financial statement users: the more severe the audit opinion is, the higher is the credit risk for lenders (Chen et al. 2006); the issuance of a GC opinion would lead to a negative reaction from equity investors (Loudder et al. 1992; Menon and Williams 2010; Chen et al. 2016). Current research on China auditor reports focuses on market reactions to MAO (Pei and Hamill 2013) and the effects of MAOs on financial constraints (Lin et al. 2011).

Menon and Williams (2010) show that investors will have negative market reactions for the first time toward firms with GC audit reports. This paper further investigates why investors react so to GC audit reports by analyzing the reasons for auditors to give out GC audit reports. The cited reasons by auditors are categorized into four types, namely, poor financial performance, financial problems, operating problems, and others. It was found that when auditors provide GC audit reports and

disclose that a firm is facing financing problems, market reactions are more severe. This paper also shows that more negative market reactions would take place when the major firm's ownership is composited by institutional investors.

Weber and Willenborg (2003) investigate the informativeness of the audit report enclosed in the prospectus associated with a firm's initial public offering. This study finds evidence that larger auditors better transmit and estimate the investment viability of their small-market capitalization IPO clients. Weber and Willenborg (2003) also find that larger auditors provide more informative opinions, which means that their pre-IPO opinions are more properly associated with pre-IPO distress and more predictive of post-IPO stock performance.

Fang et al. (2017) focus on investigating audit opinions relating to related party transactions. They find that audit opinions that particularly discuss related party transactions related to sales or related loans are more likely to have MAOs. This study also discovers that related party transactions' MAOs have higher predictive power for future related party transactions – related restatements than MAOs that do not discuss related party transactions.

To summarize, scholars show that valuable information has been delivered to financial statement users from different perspectives. Nevertheless, few studies have conducted textual analysis of audit reports and explanatory notes in the financial setting in China.

3.3 Hypothesis Development

In this section, I formulate my research hypotheses in exploring the overall audit quality in China and examining the information content of the explanatory notes inside the audit opinions. Based on the Chinese auditing standards, the Independent Auditing Specific Guidelines Chapter 7 on Audit Report and the Chinese Certified Public

Accountant Practice Guideline V – Audit Report, both issued in 2003, I provide the grounds to classify and form six types of audit opinions (including standard unqualified opinions, unqualified opinions with EMP, qualified opinions, qualified opinions with EMP, adverse opinions, and disclaimer opinions) and five types of explanatory notes (including accounting policy inconsistency; emphasizing important matters; auditing-related issues; financial distress, and violation of APC) for the dependent variables. I expect that listed firms with MAOs will be more likely to have subsequent accounting restatements. I also expect that listed firms with more serious audit opinion types are more likely to have subsequent accounting restatements. Furthermore, I expect the explanatory notes in the audit opinions are comprehensive enough to communicate financial misstatement risks, but in different degrees of influence. The research hypotheses are discussed below.

3.3.1 Modified Audit Opinions (MAOs) and Restatements in China

Based on the Chinese Auditing Standard, the Independent Auditing Specific Guidelines Chapter 7 on Audit Report (2003) provides the basic grounds for classifying audit opinions into six types: (1) standard unqualified opinions, (2) unqualified opinions with an EMP, (3) qualified opinions, (4) qualified opinions with an EMP, (5) adverse opinions, and (6) disclaimer opinions. Among these six types of audit opinions, only (1) standard unqualified opinion is an unmodified audit opinion that does not involve modifying any part of the audit opinions and standardizing the format of the audit report. The other five types (2) – (6) of audit opinions are all MAO. The auditor either adds an EMP to the audit report to arouse the financial statement users' attention on matters they would like to highlight, or states the reasons for giving a qualified opinion in the audit opinion paragraph, or both. Among the five types of MAO, only one audit opinion type is unqualified, but modified, i.e., the unqualified

audit opinion with an EMP. Figure 1 portrays the classification of the six types of audit opinions.

[FIGURE 1]

Based on the Chinese Auditing Standard, if financial statements are not free from material misstatements, the auditor should consider issuing a qualified, qualified with EMP, disclaimer, or adverse opinion. Supported by this definition, I expect that normally a qualified, qualified with EMP, disclaimer, and adverse opinion would contain accounting misstatements. When the unqualified opinion with EMP is an unqualified opinion and its emphasis matter should only be used to remind financial statement users but not affect the published opinions (Rule 22, Chapter 7 of the Chinese Auditing Standard 2003), the unqualified opinion with EMP should not involve material accounting misstatements in the financial statements on the grounds of the auditing standards. However, prior literature does provide evidence that the unqualified audit opinion with EMP has a negative market reaction (Song and Yun 2005, Pei and Hamill 2013) and has more significant negative information than clean audit opinions (Pei and Hamill 2013).

Given that the listed firms would prefer to have a clean audit opinion instead of a qualified audit opinion due to the higher cost of receiving a qualified audit opinion, including the cost of borrowing, the cost of stock prices drops. While the auditor, on the one hand, may please the client and issue an unqualified audit opinion, he or she may, on the other hand, consider protecting his or her reputation. To strike a balance between the two, the auditor may choose to issue the unqualified opinion with EMP, where the existence of EMP may no longer only highlight specific matters to the financial statement users, but with financial misstatement implications. In keeping

with the above arguments, I expect that listed firms with MAOs (including unqualified audit opinion with EMP) are more likely to have a higher financial misstatement risk and thus, a higher probability to incur subsequent accounting restatements. Hence, my first hypothesis is as follows:

Hypothesis 1a (H1a): All other factors being constant, modified audit reports are more associated with subsequent accounting restatements than standard unqualified audit reports.

Although audit opinion shopping behavior exists in China (Defond et al. 2000; Chan et al. 2006), auditors do face the regulations enforced by the CSRC. I expect that unqualified reports with EMP will have higher incidence of subsequent accounting restatements than the standard clean audit opinion; while qualified reports (including qualified, qualified with EMP, disclaimer, and adverse opinion) will have a higher likelihood of incurring subsequent accounting restatements than the unqualified with EMP. I anticipate that the more severe the audit opinion type, the higher the probability of subsequent accounting restatements. To examine this expectation, I further separate the MAOs into their original forms of audit opinion type and observe the associations between the audit opinion types and the subsequent accounting restatements. Therefore, part two of my first hypothesis is stated below:

Hypothesis 1b (H1b): All other factors being constant, the unqualified opinion with EMP is less likely to associate with subsequent accounting restatements than qualified opinion/ qualified opinion with EMP/ disclaimer opinion/ adverse opinion reports.

3.3.2 Explanatory Notes and Financial Misstatement Risks

To further investigate the information content of explanatory notes in audit opinions, especially with regard to indicating financial misstatement risks, I categorize

the explanatory notes in accordance with the Chinese auditing standards. First, the accounting policy inconsistency represents notes that discuss the change in accounting policies and accounting estimates that have substantial influence on financial statements. As a result of the failure to adopt a new accounting policy or misinterpret the change in accounting policy, accounting policy inconsistency will end up with incomparable accounting numbers of the same account in financial statements over two consecutive years. Such inconsistencies can lead to accounting errors and mistakes that require retrospective adjustments, and thus, accounting restatements may occur to correct these false accounting transactions. Therefore, I expect the explanatory notes about accounting policy inconsistency to have a positive association with the subsequent accounting restatements.

Second, with regard to emphasizing important matters, such explanatory notes include issues emphasizing company mergers and acquisitions, related party transactions, litigation and regulatory activities, contingency and uncertainties, and so on. As the emphasized incidents on the notes are usually related to accounting items with complicated accounting treatments and multifaceted accounting standards, accounting errors and misstatements are made and hidden in between. Thus, I expect that the explanatory notes about emphasizing important matters have higher misstatement risks and are positively associated with the subsequent accounting restatements. In addition, the prior literature provides evidence that the MAOs with related party transactions have higher associations with related party transactions' related restatements (Fang et al. 2017).

Third, with regard to the auditing-related issues, these types of explanatory notes are mainly about audit scope limitations wherein auditors may face difficulties in obtaining sufficient and appropriate audit evidence in their auditing process (Rule 18

point (2)). When auditors fail to obtain sufficient and appropriate audit evidence, doubts are raised as to whether their respective areas are free from material misstatements. Thus, I expect that the notes regarding auditing-related issues are positively related to the subsequent accounting restatements.

Fourth, with regard to financial distress, this includes the explanatory notes stating that the auditor suspects the sustainable operations and/or financial stability of the listed firms; alternatively, the auditor finds evidence that the listed firms involve debt restructuring or bankruptcy (Rule 22 point (1)). In the prior literature, listed firms that issued MAOs, and especially GC opinions, are associated with less favorable loan terms, e.g., higher interest spreads, wherein the audit opinions together with their explanatory notes serve as information guidelines for private lenders for debt contracting (Chen et al. 2016). From the perspective of these information guidelines for indicating financial misstatement risks, the poor or good financial conditions of firms tend to have no relation with high- or low-quality financial reporting. Therefore, I expect that the explanatory notes about financial distress are not related to subsequent accounting restatements.

Fifth, regarding the violation of APC, this explanatory note is about the accounting treatments of listed firms that are inconsistent with the APC and with the related accounting regulations promulgated in China (Rule 18 point (1)). When the auditor mentions the violation parts in the notes, the related sections involve accounting errors and mistakes – to correct those errors to achieve consistency with the APC, accounting restatements are generated. Thus, I expect that the notes about violation of the APC are positively associated with the subsequent accounting restatements.

All in all, among the five types of explanatory notes, I expect that notes about accounting policy inconsistency and violation of the APC have the strongest predictive power for subsequent accounting restatements. The notes about emphasis on important matters and auditing-related issues have moderate positive associations with the subsequent accounting restatements. Furthermore, the notes about financial distress have no association with the financial misstatement risks. I would like to examine the above expectations on the types of notes by presenting my second hypothesis as follows:

Hypothesis 2a (H2a): All other factors being constant, the contents of explanatory notes in modified audit reports are heterogeneously predictive of the subsequent accounting restatements.

Furthermore, I infer from the expectations in **H1b** that the unqualified opinion with EMP has a lower predictive power than qualified opinions (including qualified opinion, qualified opinion with EMP, adverse opinion, and disclaimer opinion). I expect that the same types of explanatory notes in qualified opinions have a higher predictive power of subsequent accounting restatements than those in unqualified opinions. Hence, part two of my second hypothesis is as follows:

Hypothesis 2b (H2b): All other factors being constant, the contents of explanatory notes in qualified audit reports have higher predictive power of the subsequent accounting restatements than those in unqualified audit reports.

Chapter 4 Research Design and Data

4.1 Research Design

4.1.1 Test of Hypothesis 1

Recalling **H1** in that MAOs are more indicative of subsequent accounting restatements than unqualified opinion, I use the logistic regression model (1) with both industry and year fixed effects¹⁴ to examine this hypothesis. The dependent variable, $RESTATEMENT_{it}$, equals one if the financial statements in current year t have been restated subsequently, and zero otherwise. To test **H1**, I formulate the tests into a two-step approach. First, I define *MAOs* as all types of opinions except standard unqualified audit opinions (*STANDARD_UNQUALIFIED*). It follows that *MAOs* include unqualified opinions with an EMP (*UNQUALIFIED_EMP*), qualified opinions (*QUALIFIED*), qualified opinions with an EMP (*QUALIFIED_EMP*), adverse opinions (*ADVERSE*), and disclaimer opinion (*DISCLAIMER*). Therefore, I categorize audit reports into two types only, namely, unmodified audit opinion (*i.e.*, *STANDARD_UNQUALIFIED*) and modified audit opinion and form only one independent variable indicator, *MAOs*, where *MAOs* equals to one when one of the modified audit opinions is issued to a firm, and zero otherwise. The base sample is the firm-years with standard unqualified audit reports where *MAOs* equals zero. Further, *MAOs* equals one if it falls into any of the mentioned opinions other than *STANDARD_UNQUALIFIED*. I expect that the coefficient of my independent variable

¹⁴I also use ordinary least square regression (OLS) with industry and year fixed effects to estimate the coefficients on MAO, which directly indicate the incremental likelihood of misstatements discovered subsequently for companies receiving MAOs. In addition, in the robustness tests, I include firm fixed effects and firm random effects in the logistic regression models and OLS regression models to control for the unobservable stable and unstable firm characteristics that may correlate with both MAOs and accounting restatements.

of interest is significantly positive, $\beta_1 > 0$, because I hypothesize that compared with firms having *STANDARD_UNQUALIFIED*, firms with *MAOs* are more likely to discover accounting misstatements in the current financial statements than in the subsequent periods. The logistic regression model (1) for the first-step test of **H1** is as follows:

$$RESTATEMENT_{it} = \alpha + \beta_1 \times MAO_{it} + CONTROLS_{it} + \sum INDUSTRY_j + \sum YEAR_t + \varepsilon_{it}. \quad (1)$$

In the second-step of testing **H1**, I examine which type of *MAO* communicates a higher incidence of subsequent restatements. In doing so, I separate *MAOs* into five types according to their original forms of audit opinions. Again, the baseline sample is the firm-years with standard unqualified auditor reports. Thus, four independent variables of interest are generated in total, including *UNQUALIFIED_EMP*, *QUALIFIED*, *QUALIFIED_EMP*, and *DISCLAIMER*.¹⁵ The variable $UNQUALIFIED_EMP_{it} = 1$ if firm-years are issued with an unqualified auditor report with EMPs, and zero otherwise. The variable $QUALIFIED_{it} = 1$ if firm-years are issued with the qualified auditor reports, and zero otherwise. The variable $QUALIFIED_EMP_{it} = 1$ if firm-years are issued with qualified auditor reports with EMPs. The variable $DISCLAIMER_{it} = 1$ if firm-years are issued with the disclaimer auditor reports, and zero otherwise. As I expect that compared to the standard unqualified auditor reports, the other four types of audit reports – *UNQUALIFIED_EMP*; *QUALIFIED*; *QUALIFIED_EMP*; and *DISCLAIMER* – have

¹⁵As no audit report for financial years 2003–2015 contains adverse opinions, the total categorized modified audit opinions are reduced from five types to four types only. The zero observation of adverse opinion may be due to improved competence of listed firms in preparing their financial statements or the consequences of opinion shopping behavior in China.

a higher probability of incurring subsequent accounting restatements of the current-year financial statements, the respective coefficients of β_1 , β_2 , β_3 , and β_4 are expected to be greater than zero. I also hypothesize that qualified and disclaimer opinions convey higher incidences of accounting restatements of current financial statements than unqualified opinion with emphasis of matters. Thus, I test the relative magnitude of coefficients from β_1 versus $\beta_2 - \beta_4$ to investigate which type of auditor's report has the strongest power to predict subsequent restatements. I expect β_1 to be significantly less than $\beta_2 - \beta_4$. The corresponding logistic regression model (2) for the second-step test of **H1** is as follows:

$$\begin{aligned}
 RESTATEMENT_{it} = & \alpha + \beta_1 \times UNQUALIFIE_EMP_{it} + \beta_2 \times \\
 & QUALIFIED_{it} + \beta_3 \times QUALIFIE_EMP_{it} + \beta_4 \times \\
 & DISCLAIMER_{it} + CONTROLS_{it} + \sum INDUSTRY_j + \\
 & \sum YEAR_t + \varepsilon_{it}.
 \end{aligned} \tag{2}$$

I include control variables that affect the likelihood of accounting misstatements in both (1) and (2), which are discussed in detail in section 4.3. In addition to the logistic regression model, I also use the ordinary least square (OLS) model for additional support to observe how the probability of having restatements changes when the MAOs increase from zero to one.

4.1.2 Test of Hypothesis 2

To examine **H2** where the contents of explanatory notes are heterogeneously predictive of the subsequent accounting restatements, I categorize the explanatory notes into five types of issues based on Chinese audit reporting

standards:¹⁶¹⁷ accounting policy inconsistency (*ACC_POL_INCON*) emphasizing important matters (*EM_IMPO_MAT*), audit-related issues (*AUDIT_REL_ISS*), financial distress issues (*FIN_DIS*), and violations of accounting principles in China (*VIO_APC*). Panel B-III and IV, Table 2 shows the detailed issues under each category.

In model (3), the variable *ACC_POL_INCON* equals one if explanatory notes discuss accounting policy inconsistency issues, and zero otherwise. The variable *EM_IMPO_MAT* equals one if the explanatory notes emphasize important matters such as related party transactions and contingencies and uncertainties, and zero otherwise. The variable *AUDIT_REL_ISS* equals one if explanatory notes discuss auditing-related issues such as the use of other auditors' work and audit scope limitation, and zero otherwise. The variable *FIN_DIS* equals one if explanatory notes discuss financial distress factors, and zero otherwise. The variable *VIO_APC* equals one if explanatory notes identify violations of the China accounting standards, and zero otherwise. In keeping with Hypothesis 2, I expect MAOs involving explanatory notes on *ACC_POL_INCON*, or *EM_IMPO_MAT*, or *AUDIT_REL_ISS*, or *VIO_APC* to have a higher probability of incurring subsequent accounting restatements than audit reports without such explanatory notes. As the inconsistency of accounting policy may lead to problematic accounting items on the current financial statements, emphasizing

¹⁶Explanatory notes are not limited to an EMP. They are present in all kinds of MAOs, but are not restricted to those opinions with an EMP alone. For instance, for the auditor reports of firms with qualified opinions, the auditor has to add an explanatory paragraph before the opinion paragraph to explain plainly the reasons why qualified opinions are issued. Such an explanatory paragraph is treated as part of the explanatory notes and included in my analysis.

¹⁷According to Rule 21 of the Independent Auditing Specific Guidelines Chapter 7 on Audit Report issued in 2003 in the Chinese Auditing Standard, in an auditor report with qualified, adverse, or disclaimer opinions, the auditor should add an explanatory paragraph before the opinion paragraph to clearly explain all the reasons that led to the opinion expressed. If possible, the auditor should indicate the extent of the impact on financial statements.

matters about related parties, contingencies, and so on, may cause the respective accounts or liability balances to change, and the audit-related issues and violation of the APC may induce the current accounting items to be misstated and finally lead to subsequent accounting restatements. Therefore, the coefficients of β_1 , β_2 , β_3 , and β_5 are expected to be greater than zero. Explanatory notes related to financial distress describe overall financial situations of the firms, and therefore, I do not form any expectation of positive or negative sign on its coefficients towards the subsequent accounting restatements, and β_4 may be less than or greater than zero. Similarly, I also compare the relative magnitude of the coefficients from β_1 to β_5 to investigate which type of explanatory notes has the greatest power to predict subsequent restatements. The corresponding logistic regression model (3) to test **H2** is as follows:

$$\begin{aligned}
 RESTATEMENT_{it} = & \alpha + \beta_1 \times ACC_POL_CON_{it} + \beta_2 \times \\
 & EM_IMPO_MAT_{it} + \beta_3 \times AUDIT_REL_ISS_{it} + \beta_4 \times \\
 & FIN_DIS_{it} + \beta_5 \times VIO_APC_{it} + CONTROLS + \\
 & \sum INDUSTRY_j + \sum YEAR_t + \varepsilon_{it}.
 \end{aligned}
 \tag{3}$$

Hypothesis **2b** suggests that the materiality of the explanatory notes should be conditional on the types of audit opinions. I expect that the explanatory notes included in the qualified, adverse and disclaimer opinions should be more likely to indicate subsequent restatements than the notes included in unqualified opinions with emphasis of matters. To test **H2b**, I augment model (3) by including the interactions between *MAOs* and categories of explanatory notes in *MAOs*. In model (4), the categories of

explanatory notes remain the same as those in model (3), including *accounting policy inconsistency* (*ACC_POL_INCON*), *emphasis of important matters* (*EM_IMPO_MAT*), *auditing-related issues* (*AUDIT_REL_ISS*), *financial distress* (*FIN_DIS*), and *violations of accounting principles* (*VIO_APC*). Audit opinions have been categorized into three groups: standard unqualified opinions (*STANDARD_UNQUALIFIED*), unqualified opinions with emphasis of matters (*UNQUALIFIED_EMP*), and other modified opinions (*OTHER_MAOs*) including qualified, qualified with EMPs, adverse, and disclaimer opinions. I test the heterogeneous prediction power of auditors' explanatory notes conditional on the three types of auditors' reports. The coefficients of interest are β_1 , β_2 , and γ_1 to γ_{10} . Similarly, I also include the control variables that affect the likelihood of accounting misstatements in models (3) and (4), which are the same as those in model (1) and (2). Definitions of variables used in model (3) and (4) are shown in the Appendix. The regression model (4) is as follows:

$$\begin{aligned}
 RESTATEMENT_{it} = & \alpha + \beta_1 \times UNQUALIFIED_EMP_{it} + \beta_2 \times \\
 & OTHER_MAOs_{it} + \gamma_1 \times UNQUALIFIED_EMP_{it} \times \\
 & ACC_POL_CON_{it} + \gamma_2 \times UNQUALIFIED_EMP_{it} \times \\
 & EM_IMPO_MAT_{it} + \gamma_3 \times UNQUALIFIED_EMP_{it} \times \\
 & AUDIT_REL_ISS_{it} + \gamma_4 \times UNQUALIFIED_EMP_{it} \times \\
 & FIN_DIS_{it} + \gamma_5 \times UNQUALIFIED_EMP_{it} \times \\
 & VIO_GAAP_{it} + \gamma_6 \times OTHER_MAOs_{it} \times \\
 & ACC_POL_CON_{it} + \gamma_7 \times OTHER_MAOs_{it} \times \\
 & EM_IMPO_MAT_{it} + \gamma_8 \times OTHER_MAOs_{it} \times \\
 & AUDIT_REL_ISS_{it} + \gamma_9 \times OTHER_MAOs_{it} \times
 \end{aligned}$$

$$\begin{aligned}
& FIN_DIS_{it} + \gamma_{10} \times OTHER_MAOs_{it} \times VIO_GAAP_{it} + \\
& CONTROLS + \sum INDUSTRY_j + \sum YEAR_t + \varepsilon_{it}
\end{aligned}
\tag{4}$$

Further to the logistic regression model, I also include the OLS model for additional support to detect how the probability of having restatement changed when the explanatory notes and interactions between *MAOs* and categories of explanatory notes in *MAOs* increase from zero to one.

4.2 Data Collection

4.2.1 Data Sources

Both dependent variable, *RESTATEMENT*, and independent variable, *EXPLANATORY NOTE*, in the audit report are not available from the existing databases. Thus, I (1) physically collect the accounting restatements information disclosed in the corporate announcements¹⁸ and (2) conduct the classifications and process the details of the explanatory notes extracted from annual audit reports.

For *RESTATEMENT*, I first generate a summary table of listed firms that are involved in restatements from the WIND database, including stock code, restatement announcement date, and the link to access the original restatement announcement documents. Next, I read the restatements announcements and obtain the period of misstatement in financial statements, the magnitude of misstatements, and the

¹⁸ According to point 20, Rule 30, Chapter 4 of The Listed Company Information Disclosure Requirement issued by the CSRC, the listed firm needs to make a public announcement immediately of any major events that may affect its market price of shares. The scope of major event includes misstatements that may have occurred in the previous disclosed financial statements. The listed firm needs to notify the investor about the cause, current status, impact, and corrections of these major events.

misstated accounts and transactions. The variable of interest, *RESTATEMENT*, therefore, can be attained correspondingly by examining the misstatement period. The restatement information can also be cross-checked with the announcements that are publicly available on the CNINFO website.

For *EXPLANATORY NOTE*, I collect audit reports with MAOs from the CSMAR Solution. Subsequently, I read the explanatory note of modified audit reports and manually classify the notes into five types according to the Chinese audit reporting standards. Thus, the *EXPLANATORY NOTE* of the sample firms can be obtained and documented accordingly. I obtain all control financial control variables and stock prices from the CSMAR database.

4.2.2 Sample Selection

I focus my study on A-share firms listed on the Shanghai and Shenzhen Stock Exchanges from 2003 to 2015. I choose my sample period to begin in 2003 because the new audit reporting standards structure with six types of audit opinions are used thereafter and material restatements are required to be disclosed in corporate events announcements commencing 2003.¹⁹ ²⁰ I end the sample period in 2015 because

¹⁹Prior to 2003, there were seven types of audit opinions: standard unqualified opinions; qualified opinions, adverse opinions, disclaimer opinions, unqualified opinions with explanation notes, qualified opinions with explanation notes, and adverse opinions with explanatory notes. From 2003 onwards, six types of audit opinions are available: standard unqualified opinions, qualified opinions, adverse opinions, disclaimer opinions, unqualified opinions with emphasis of matter paragraph, and qualified opinions with emphasis of matter paragraph.

²⁰On the Shanghai and Shenzhen Stock Exchanges, two types of shares, A-shares and B-shares, are traded. A-shares are denominated in Chinese Yuan and are mainly traded by domestic investors, while B-shares are denominated in USD in the Shanghai Stock Exchange and HKD in the Shenzhen Stock Exchange, mainly opened to foreign investors. In October 2009, ChiNext market was inaugurated on the Shenzhen Stock Exchange, which served as a critical platform for those growth enterprises that were listed and drove innovation. As the three types of shares have different backgrounds, features, and

sample firms should have data for at least two years after the audit report date to allow appropriate time for the firm or its auditor to identify problems that could constitute a restatement. To fulfill the same requirement, I also exclude 139 firm-year observations missing CSMAR Solution data in the subsequent two years. Finally, 17 observations that have missing data in any control variables are excluded from the analysis. The ultimate sample size for the study is 22,850 firm-year observations, with details shown in TABLE 1.

[TABLE 1]

4.3 Control Variables

Control variables in six aspects are added to the regression models (1) – (4) (1). First, I control for variables regarding the firm’s characteristics, including firm size (*SIZE*) and firm age (*AGE*) in the tests (Czerney et al. 2014; Fang et al. 2017). Larger and older firms are equipped with relatively well-established accounting systems to avoid financial misstatements.

Second, I add control variables pertaining to the firm’s economic conditions, which are return on assets (*ROA*), book-to-market ratio (*BOOK_MKT*), leverage (*LEVERAGE*), a dummy for positive accruals (*POSITIVE_ACCR*), an indicator for net loss for the year (*LOSS*), and the growth rate of the firm (*GROWTH*). Prior literature has documented that there is a lower probability of misreports from firms having higher profitability, i.e., a higher *ROA* (Kinney and McDaniel 1989). I also expect that firms making profits, but not losses (*LOSS*) are less likely to issue financial misstatements. However, a few sections of the literature find mixed signs and relations between the *ROA* and misstatements (Erickson et al. 2006). According to Kinney and McDaniel

requirements, I consider carrying out my study on A-shares in both the Shanghai and Shenzhen Stock Exchanges.

(1989) and Defond and Jiambalvo (1991), growth (*GROWTH*) and restatements are negatively associated. I also expect that firms with lower *BOOK_MKT* are less likely to issue financial misstatements,²¹ as a lower book-to-market ratio can imply that the market value is stronger than the book value, indicating that the market believes the firm has brilliant development and growth prospects in future. Such firms can generate greater profits and finally raise their book values, and are less likely to commit accounting fraud. With respect to leverage, it is expected that *LEVERAGE* and restatements are positively related (Burns and Kedia 2006; Lennox and Pittman 2010; Cao et al. 2012; Czerney et al. 2014; Fang et al. 2017) because highly leveraged firms have greater incentives to misstate to avoid technical default (covenants violations) . I further include the *POSITIVE_ACCR* as one of the control variables because the prior literature shows that firms manage accruals to increase earnings. *POSITIVE_ACCR* equals one if the firm's reported net profits are greater than the reported net cash flow from operating activities (Czerney et al. 2014).

Third, I also control for factors related to financing activities, whether the firm has issued new shares during the year (*ISSUE_SHARE*), and whether the firm is involved in a merger or acquisition (*MERGE_ACQ*). Following prior studies (Fang et al. 2017), *ISSUE_SHARE* equals one if the firm has issued new shares in the financial year, and zero otherwise. *MERGE_ACQ* equals one if the firm has been involved in any merger and acquisition activity, and zero otherwise.

Fourth, I control for factors relevant to audit characteristics, i.e., whether the firm is audited by one of the international Big Four accounting firms (*BIG_FOUR*) and the total audit fee of the firm (*AUDIT_FEE*). Following the prior literature, *BIG_FOUR*

²¹Book-to-market ratio/market-to-book ratio is a common proxy in measuring growth (Cao et al. 2012, page 962).

and financial misstatements are negatively related because the Big Four auditors have good-quality insurance programs (Fang et al. 2017). *AUDIT_FEE* also has a negative association with financial misstatements because greater audit efforts should help detect earnings misstatements (Cao et al. 2012).

Fifth, I control for the firm's corporate governance factors, including the number of independent directors divided by the total number of directors on the firm's board (*INDEP_DIR*) and whether the board's chairman and the general manager are the same person (*BOARD_CHAIR*). Consistent with prior studies, I expect that firms with more independent boards and better corporate governance have less financial misstatements (Beasley 1996; Klein 2002; Cao et al. 2012; Fang et al. 2017).

Sixth, I control for the characteristics of shareholders, which include whether the firm's ultimate controlling shareholder is a government entity, i.e., a state-owned enterprise (*SOE*), and the percentage of ownership held by the controlling shareholder of the firm (*OWNER*). With reference to Wang and Wu (2011), *SOE* has a positive correlation with financial misstatements. I further expect that the percentage of ownership held by the controlling shareholders and financial misstatements have a negative association (Fang et al. 2017), as the higher the shareholding percentage of the controlling shareholders, the narrower the wedge between controlling ownership and cash flow rights, and thus, the lower the incentive to expropriate minority shareholders and misstate earnings.

Chapter 5 Descriptive Statistics and Univariate Analysis

5.1 Modified Audit Opinions (MAOs) by Year

Table 2 – Panel A presents the descriptive statistics of four types of modified audit opinions (*MAOs*) in China, year wise, from 2003 to 2015. In general, the highest percentage of MAOs among the sample years falls under 2005, which accounts for 11.93% (159 out of 1,333 opinions). The number of MAOs over all types of opinions has an increasing trend from 6.56% (81 out of 1,235 opinions) in 2003 to 11.93% in 2005. However, a turning point was reached in 2006. Since then, the percentage of MAOs has been decreasing gradually every year, from 9.86% in 2006 to 3.92% in 2015. This declining trend in MAOs reflects the impact of the introduction of new Chinese accounting standards and the public companies internal control guidance rendered in 2006. These new accounting standards converge with the IFRS and may, on average, improve the earnings quality of public companies. Similar to Sections 302 and 404 of the SOX Act, the internal control guidance introduced by the stock exchanges require that managers and auditors assess public companies' internal controls and identify and report significant weaknesses, in a report to investors. Clearly, the internal control assessment enhances companies' internal control over financial reporting and improves earnings quality.

The average percentage of MAOs in the sample years is 6.22% (1,422 out of 22,850 opinions). Regarding each type of MAO, the average percentage of qualified opinion (*qualified*), qualified opinion with emphasis of matter paragraph (*qualified with EMP*) and disclaimer opinion (*disclaimer*) is 0.97%, 0.38%, and 0.72%, respectively. In respect to unqualified opinion with an EMP (*unqualified with EMP*), the number of listed firms resulting in such MAOs is within the range from the lowest of 50 in 2003 to the highest of 89 in 2007. Regarding a percentage over the total

number of listed companies in the respective years, *unqualified with EMP* scored a high of 5.79% (89 out of 1,537 opinions) in 2007 compared to scores in all years in the sample period and among all types of MAOs. *Unqualified with EMP* was retained at relatively high percentages of above 5% in the four consecutive years from 2004 to 2007. The switch took place in 2009 and the percentage showed a decreasing trend after that and even scored below 3% during 2013–2014. The number of adverse opinions for the sample years is nil.

[TABLE 2 – Panel A]

5.2 Modified Audit Opinions (MAOs) by Explanatory Notes

Panel B-I of Table 2 shows the descriptive statistics for MAOs of explanatory notes, by category. Among a total of 1,422 MAOs from 2003 to 2015, there were 1,986 explanatory notes. As there may be more than one explanatory note generated for every MAO in a particular year, the total number of explanatory notes are more than the total number of MAOs. Among the six classified types of explanatory notes, notes related to financial distress have the highest frequency of 974 incidences (49.04%), followed by notes related to emphasizing important matters with 491 incidences (24.72%), and notes related to auditing-related issues with 322 incidences (16.21%). For *unqualified with EMP*, over 60% of the explanatory notes are related to financial distress and nearly 33.33% of them emphasize important matters. For *qualified and disclaimer opinions*, the two most frequent explanatory notes are related to auditing-related matters (33.33%) and financial distress (32.43%).

[TABLE 2 – Panel B-I]

Panel B-II of Table 2 reports the explanatory notes among each type of MAO. Within *qualified* opinion, 37.80% of its explanatory notes are about auditing-related

issues (127 instances), followed by 22.92% (77 instances) notes related to financial distress and 22.02% (74 instances) notes emphasizing important matters. *Qualified with EMP*, the most frequent type of explanatory note, falls into the auditing-related issues category with 61 instances (28.50%), followed by 58 instances (27.10%) of financial distress, and 53 instances of emphasizing important matters (24.77%). For the *disclaimer* opinion, financial distress occurs most frequently among the six types of explanatory notes, with 152 instances (45.37%). Auditing-related issues occur with the second highest frequency of 107 instances (31.94%), and emphasizing important matters comes third with a frequency of 43 instances (12.84%). Explanatory notes related to accounting policy inconsistency, violation of the APC, and other issues occur much less frequently than other types of MAOs.

[TABLE 2 – Panel B-II]

Panel B-III of Table 2 shows the explanatory notes for MAOs in detail. Financial distress is the most frequent type of explanatory note among MAOs, especially for unqualified opinions with emphasis of matters. While looking into details of its classification, notes that are gravely suspicious of sustainable operations have the highest incidence of 536 instances, followed by notes that mention financial difficulties and operational uncertainties with 237 instances, and notes that discuss firm involvement of debt restructuring or bankruptcy with 201 instances. The second most frequent explanatory note is emphasizing important matters in which contingencies and uncertainties of 319 instances are the major causes for both unqualified opinions with emphasis of matters and qualified and adverse opinions. The third highest occurrence of notes is that of auditing-related matters wherein audit scope limitation is the most cited reason for the qualified and disclaimer opinions. Finally,

171 explanatory notes in MAOs mention violations of accounting standards and rules wherein the lack of original documents for accounting transactions is the most cited reason.

[TABLE 2 – Panel B-III]

Panel B-IV Table 2 displays a breakdown of explanatory notes for each type of MAO (four types). For *unqualified with EMP*, the most frequent notes express grave suspicions on the sustainability of operations of 398 instances under the financial distress category, followed by emphasizing contingencies and uncertainties with 210 instances under the emphasizing important matters category, followed by notes mentioning financial difficulties and operational uncertainties with 153 instances under the financial distress category. When it comes to *qualified* opinion and *qualified with EMP*, notes related to audit scope limitation within the audit-related issues category occur most frequently for both opinions, with 119 and 55 instances, respectively. The second highest occurrence of notes for both opinions is emphasizing contingencies and uncertainties under the emphasizing important matters category, with 49 instances for *qualified* and 34 instances for *qualified with EMP*. The third most frequent notes mention grave suspicions about the sustainability of operations in 44 instances for *qualified* opinion and mentioning financial difficulties and operational uncertainties in 27 instances for *qualified with EMP*. With respect to *disclaimer* opinion, notes about audit scope limitation in 95 instances are the most frequent, followed by grave suspicions about the sustainability of operations in 69 instances. Further, in the financial distress category, there were 53 instances of cases involving debt restructuring or bankruptcy.

[TABLE 2 – Panel B-IV]

5.3 Audit Opinions and Misstatements

Panel A of Table 3 demonstrates the univariate analysis of audit opinions and accounting misstatements. The number of accounting misstatements that occurred over the sample period from 2003 to 2015 was 1,402 instances out of the total audit reports of 22,850, which constitutes a 6.14% occurrence of misstatements. Audit opinions are categorized into two types only – standard unqualified opinions and MAO (includes unqualified opinion with EMP, qualified opinion, qualified opinion with EMP and disclaimer opinions). The univariate test shows that 5.35% of listed firms that received a standard unqualified opinion on their financial statements had restated their financial statements in a subsequent period. In contrast, 17.93% of the listed firms that received MAOs had subsequently restated their financial statements. In summary, compared to standard unqualified opinions, audit reports issued with MAOs had a 12.58% higher possibility of issuing misstatements. A chi-square test is performed and the results are significant at 1%.²²

[TABLE 3 – Panel A]

Panel B of Table 3 illustrates the misstatement frequency by audit opinion type. Unlike Panel A, Panel B further categorizes MAOs into four types – *unqualified with EMP*, *qualified*, *qualified with EMP*, and *disclaimer* opinions. Approximately 12.64% of the listed firms receiving *unqualified with EMP* had subsequent restatements of their financial statements for the same fiscal year (120 instances out of 949 observations).

²²The null hypothesis asserts the independence of the variables under consideration (i.e., audit opinion and subsequent restatement are independent of each other). The chi-square test statistics is 366.414 and I reject the null hypothesis at a 1% significance level. In other words, the statement “audit opinion is independent from accounting misstatement” is rejected at the 1% significance level.

A higher percentage of 27.03% for *qualified* had subsequent restatements (60 instances out of 222 observations). Misstatements occurrence scores an even higher frequency of 31.03% (27 instances out of 87 observations) and 29.27% (48 instances out of 164 observations) when listed firms received *qualified with EMP* and *disclaimer* opinions, respectively. All in all, the result exhibits an upward tendency of accounting restatements when listed firms are issued with a more severe type of audit opinion.

[TABLE 3 – Panel B]

5.4 Descriptive Statistics for Variables

Table 4 presents the general descriptive statistics for the dependent variable, *RESTATEMENT*, independent variable, *MAOs*, and other control variables. Both *RESTATEMENT* and *MAOs* are binary variables, and their values equaled one when the incidence happened, and zero otherwise. Mean values of approximately 6.1% and 6.2% for *RESTATEMENT* and *MAOs*, respectively, are noted. In the sample size of 22,850, firms on average have *AGE* of 10.05, *GROWTH* ratio of 17.7%, return on assets (*ROA*) of 4.2%, and book-to-market ratio of 1.01. Regarding the audit characteristics, the international Big Four accounting firms take up a market share of approximately 6.6%. The number of independent directors on average hold 36.1% of the total number of director positions on a firm's board. Around 55% of the listed firms are *SOE*. For the general descriptive statistics of other control variables, please refer to Table 4 for details.

[TABLE 4]

Chapter 6 Multivariate Results

6.1 Association between MAOs and Restatements

Table 5 exhibits coefficients estimates for model (1), which investigates the association between MAOs of the current-year audit report and the subsequent restatement of the current-year financial statements. My results for the test of **H1** in the first-step test appear in Columns (1), (2), and (3). Column (1) represents the results of the test for H1 by using logistic regression, testing the independent variable of interest plainly together with controlling industry and year fixed effects. Column (1) serves as the baseline model. Column (2) refers to the results of the test for H1 by using logistic regression again but further adds the six types of control variables that are specified previously in Chapter 4.3. Column (3) displays the results of the test for H1 by using OLS regression to interpret the marginal effects of MAO on the likelihood of concurrent accounting misstatements. In Column (1), the coefficient for *MAOs* is positive and statistically significant (with $p < 0.01$), indicating that financial statements associated with modified audit reports are more likely to be subsequently restated than those with unmodified audit reports (i.e., standard unqualified opinions). The marginal effect on *MAOs* is calculated.²³ Marginally, the financial statements issued with *MAOs* have a 9.347% higher probability of incurring subsequent restatements than those with standard unqualified opinions.

After considering and adding other control variables to the baseline model, in Column (2) of Table 5, the coefficient of *MAOs* is still positive and statistically

²³In the logistic regression model, the coefficient of explanatory variable (*MAOs*) provides the direction on the change of the probability of response variables (Restatements), with the positive sign indicating higher probability and the negative sign indicating lower probability. However, the coefficient does not deal with the marginal change on the effect on Restatements. Thus, marginal effects are calculated to interpret the magnitude of the change.

significant (with $p < 0.01$), implying that financial statements with MAOs are still associated with a higher likelihood of subsequent restatement (with a marginal effect of 4.284%) than those with standard unqualified opinions. With respect to the control variables,²⁴ I find the likelihood of accounting restatement increases with *BOOK_MKT* (with $p < 0.01$), *LEVERAGE* (with $p < 0.1$), and decreases with *GROWTH* (with $p < 0.1$), *AUDIT_FEE* (with $p < 0.05$), and *OWNER* (with $p < 0.01$). In addition, firms making net loss (*LOSS*), and involving mergers and acquisitions activities (*MERGE_ACQ*), are associated with a greater possibility of subsequent restatements at the 1% level. Firms engaged in raising funds through issuance of shares (*ISSUE_SHARE*) and carrying out annual audits by Big Four auditors (*BIG_FOUR*) are less likely to report subsequent restatements at the 5% and 1% levels, respectively.

²⁴Note that non-missing dummy variables have been generated for controls *SIZE*, *BOOK_MKT*, *AUDIT_FEE*, *INDEP_DIR*, and *OWNER*, to capture the missing value effects of the respective controls. Specifically, I generate an indicator/ dummy variable for each of the five controls which have missing values. The dummy variable, namely ‘non-missing dummy variable’, equals one for observation contains value and equal zero for observation does not have value. By assigning dummy variables for controls that contain missing values, and adding interactions between the dummy and the controls, the missing value effects of the respective controls are captured without reducing the sample size. This method of handling missing values is called dummy variable adjustment (Cohen and Cohen 1983; Cohen et al. 2003; Greene 2003) which is commonly used for empirical research studies. According to Abrevaya and Donald (2017), approximately 40% of all papers across the four top empirical economics journals – American Economic Review, Journal of Human Resources, Journal of Labour Economics, and Quarterly Journal of Economics, have data missingness, over the three-year period from 2006 to 2008. And roughly 20% of the papers with missing data use the dummy variable method to handle missing data. To retain the sample size, I also adopt this missing variable method for handling the missing data. For robustness check, I rerun the main test (1) to (4) by dropping all the observations with missing values. The sample size decreases by 5,698, from originally 22,850 to 17,152 observations. The result tables also indicate positive and significant associations between the MAOs and explanatory notes and the subsequent accounting restatements which are robust to the main tests. Please refer to table 13 for details.

In the Column (3) of Table 5, I use OLS regression to test **H1** in the first-step test. If the MAOs increase to one unit (i.e., change from standard unqualified opinions to modified audit opinions), the likelihood of subsequent restatement increases by 5.2%, which is statistically significant at the 1% level. The result in Column (3) is consistent with that in Columns (1) and (2). Regarding the control variables, firms with a larger *SIZE* and higher *BOOK_MKT* tend to have a higher likelihood of subsequent restatements, both at the 1% level. Firms that are more mature (greater *AGE*), have better financial performance (larger *ROA*), faster growth (higher *GROWTH*), a higher controlling percentage of ultimate controlling shareholders (higher *OWNER*), and are less likely to report subsequent restatements, all at the 1% level. Moreover, firms with incidences of issuance of shares (*ISSUE_SHARE*) in the current year, are associated with a lower likelihood of subsequent restatements.

[TABLE 5]

6.2 Association between Each Type of MAO and Restatements

Table 6 reports the coefficient estimates for the second-step test in testing **H1**. In model (2), I further separate the single indicator, *MAOs*, into four original forms – *UNQUALIFIED_EMP*, *QUALIFIED*, *QUALIFIED_EMP*, and *DISCLAIMER*. I estimate the associations between these four different types of MAOs of the current-year audit report and the subsequent restatements of the current-year financial statements. The results are displayed in Columns (1), (2), and (3).²⁵ In Column (1), the four types of MAOs, including *UNQUALIFIED_EMP*, *QUALIFIED*,

²⁵Similar to Table 5, Column (1) of Table 6 is the baseline model that merely includes the independent variables and controls the industry and year fixed effects under the logistic regression. Column (2) represents the results of the logistic regression that additionally includes the six specified types of control variables. Column (3) refers to the results of the test by using OLS regression.

QUALIFIED_EMP, and *DISCLAIMER*, are positively associated with the subsequent restatements and are statistically significant at the 1% level. When the audit report changes from standard unqualified opinion to *UNQUALIFIED_EMP*, the probability of subsequent restatements marginally increases by 5.78%. Similarly, compared with standard unqualified opinions, *QUALIFIED*, *QUALIFIED_EMP*, and *DISCLAIMER* opinions marginally increase the probability of subsequent restatements of current financial statements by 17.18%, 18.00%, and 17.07%, respectively. The marginal effects indicate that a more severe type of audit opinion is associated with a higher probability of incurring subsequent restatements.²⁶ Chi-square tests are performed for the coefficients among the independent variables. The results show that the coefficient of *QUALIFIED* is significantly larger than the coefficient of *UNQUALIFIED_EMP* at the 1% level, with chi-square test statistics of 15.68. Similarly, the coefficients of both *QUALIFIED_EMP* and *DISCLAIMER* are significantly larger than that of *UNQUALIFIED_EMP* at the 1% level, with chi-square test statistics of 9.51 and 14.06, respectively.

The results in Column (2) of Table 6 are with the same directions as per Column (1). By adding other control variables in the logistic regression in model (2), the four independent variables of interests are still positive and statistically significant at 1% level. With respect to the magnitude effects, compared with standard unqualified opinions, the likelihood of incurring subsequent restatements are marginally higher for *UNQUALIFIED_EMP* (by 2.29%), *QUALIFIED* (by 9.95%), *QUALIFIED_EMP* (by 9.32%), and *DISCLAIMER* (by 6.38%). The implications are retained as per the baseline model that financial statements with a more severe type of audit opinion are

²⁶ A more severe type of audit opinion refers to qualified opinions, including *QUALIFIED*, *QUALIFIED_EMP*, and *DISCLAIMER* opinions. Less severe types of audit opinions are the unqualified ones, including standard unqualified opinions and *UNQUALIFIED_EMP*.

more likely to be subsequently restated than those that have a less severe type of opinion. Chi-square tests demonstrate that compared with the coefficient of *UNQUALIFIED_EMP*, the coefficients are significantly larger for *QUALIFIED* (at 1%, with chi-square statistics of 13.94), *QUALIFIED_EMP* (at 1%, with chi-square statistics of 7.31), and *DISCLAIMER* (at 5%, with chi-square statistics of 4.34). For the control variables, both signs and significances are as the same as the logistic regression for the first-step test of (1) – Column (2) of Table 5.

In Column (3) of Table 6, I re-examine the model (1b) by using the OLS regression. Most of the results are consistent with the baseline model in Column (1) and full logistic model in Column (2), with the exception of the statistical significance for *UNQUALIFIED_EMP*, which does not hold. I find that when *UNQUALIFIED_EMP* increases to one unit (shifts from standard unqualified opinions to unqualified opinions with an EMP), the likelihood of restatements increases by 1.7%. When audit reports become *QUALIFIED* from standard unqualified opinions, the likelihood of subsequent restatement increases by 12.5% with $p < 0.01$. When audit reports are modified to *QUALIFIED_EMP* and *DISCLAIMER*, the likelihood of subsequent restatement increases by 15.5% with $p < 0.01$ and 14.2% with $p < 0.01$, respectively. Chi-square tests are performed between the coefficients of *UNQUALIFIED_EMP* and *QUALIFIED*; the coefficients of *UNQUALIFIED_EMP* and *QUALIFIED_EMP*; and the coefficients of *UNQUALIFIED_EMP* and *DISCLAIMER*. The coefficients of *QUALIFIED*, *QUALIFIED_EMP*, and *DISCLAIMER* are significantly larger than that of *UNQUALIFIED_EMP* at the 1% level, with chi-square test statistics of 10.97, 7.16, and 9.70, respectively. The results indicate that although *UNQUALIFIED_EMP* is associated with subsequent material restatements, this association is weaker than the associations between *QUALIFIED* or

QUALIFIED_EMP or *DISCLAIMER* and restatements. Thus, auditors, to some extent, can make a good judgment call when issuing audit opinions, i.e., incurring less type II errors. Concerning the control variables, except for *ROA* and *ISSUE_SHARE* with a reduced significance to the 10% and 5% levels, all signs and significance levels are consistent with the OLS regression for the first-step test of **(1)** – Column (3) of Table 5.

It is noted that the opinion, *UNQUALIFIED_EMP*, is supposed to be free from material misstatements according to the corresponding auditing standards, and the EMP serves in providing additional information that auditors would like to emphasize. However, the empirical results do indicate a significant and positive correlation between *UNQUALIFIED_EMP* and incidence of subsequent restatements in both the logistic regressions in model **(1)** under Column (1) and (2). This phenomenon can be explained by the opinion shopping behavior in China documented in the prior literature. The listed firm is originally issued with a qualified opinion by the auditor; however, it is not satisfied and appoints another auditor to repeat the audit work. Moreover, the second auditor avails of the opportunity to lessen the consequences by issuing an unqualified opinion, but adds the EMP to the audit report as an alternative. Therefore, there are cases wherein financial statements originally deserving a qualified opinion may get an unqualified one with an EMP in the end, as a result of the opinion shopping behavior of the listed firms.

[TABLE 6]

6.3 Association between Explanatory Notes and Restatements

Table 7 presents the results that examine the association between the categorized five types of explanatory notes and the subsequent restatements, the first-step test of **H2** – model **(3)**. In accordance with models **(1)** and **(2)**, Column (1) is the baseline

model; Column (2) refers to the logistic regression with add-ons of other control variables; and Column (3) represents the OLS regression. In Column (1) of Table 7, the coefficient estimates on the five types of explanatory notes are all positive, but each of them carries different marginal effects and statistical significances. When the incidence of *ACC_POL_INCON* takes place, the likelihood of subsequent restatements marginally increases by 14.67% with a p value <0.05. The incidence of *EM_IMPOR_MAT*, *AUD_RELAT_ISSUE*, and *FIN_DISTRESS* increases the probability of incurring subsequent restatements by 6.05% (with p < 0.01), 7.00% (with p <0.01), and 3.57% (with p <0.01), respectively. Barring the explanatory note – *VIO_APC*, its coefficient estimate is positive but not significant. The insignificant result may be due to firms delisting and exiting the stock market owing to their financial statements violating the accounting principles in China.

Table 7 – Column (2) displays the results of model (3) by using logistic regression with the inclusion of control variables. The coefficient estimates of *ACC_POL_INCON*, *EM_IMPOR_MAT*, and *AUD_RELAT_ISSUE* remain positive and statistically significant. However, the significances of *FIN_DISTRESS* and *VIO_APC* do not hold. The incidence of *ACC_POL_INCON*, *EM_IMPOR_MAT*, and *AUD_RELAT_ISSUE* increases the likelihood of restatement by 12.87% (with p < 0.05), 4.52% (with p < 0.01), and 3.88% (with p < 0.01), respectively. Regarding the control variables, with the exception of *LEVERAGE* with increased significance to the 1% level, all signs and significance levels are the same as the logistic regression for the first-step test of (1) – Column (2) of Table 5.

In Column (3) of Table 7, I estimate the model (3) using OLS regression. The results indicate that only the coefficient estimates of *EM_IMPOR_MAT* and *AUD_RELAT_ISSUE* are statistically significant at the 5% and 1% levels. If

EM_IMPOR_MAT increases to one unit, I expect the probability of incidence of subsequent restatements to increase by 4.4%. If *AUD_RELAT_ISSUE* increases to one unit, I expect the probability of financial statements being subsequently restated to increase by 10.3%. For the control variables, both signs and significances are as the same as the OLS regression for the first-step test of (1) – Column (3) of Table 5.

To summarize, the predictive power among the five types of explanatory notes is different. The incidence of *EM_IMPOR_MAT* and *AUD_RELAT_ISSUE* have a stronger influence and are more likely to report a subsequent restatement compared with the incidence of other explanatory notes, with results consistent among the tests in Columns (1), (2), and (3). Thus, the information content with respect to *EM_IMPOR_MAT* and *AUD_RELAT_ISSUE* are more relevant to subsequent restatements.

[TABLE 7]

6.4 Association between Explanatory Notes Conditional on MAOs and Restatements

Table 8 shows the results of examining the association between the five types of explanatory notes conditional on MAOs and subsequent restatements, the second-step test of **H2** – model (4). Similar to the previous tables, Columns (1), (2), and (3) represent the baseline model, the logistic regression with add-ons of other control variables, and the OLS regression model, respectively. In Column (1), both coefficient estimates of *UNQUALIFIED_EMP* and *OTHER_MAOs* are positive and statistically significant at the 1% level,²⁷ with marginal effects of 11.40% and 13.52%, respectively. Among the ten interactions between explanatory notes and MAO, only

²⁷*OTHER_MAOs* refers to the combination of three types of modified audit opinions, including qualified opinions, qualified opinions with an EMP, and disclaimer opinions.

two are statistically significant. If the audit report is with *OTHER_MAOs* and includes the explanatory note about *EM_IMPOR_MAT*, the likelihood of subsequent restatements increases by 3.77% (with $p < 0.05$). If the audit report is with *UNQUALIFIED_EMP* and includes the explanatory note about *VIO_APC*, the likelihood of subsequent restatements decreases by 3.27% (with $p < 0.1$).

Based on Column (2) of Table 8, both *UNQUALIFIED_EMP* and *OTHER_MAOs* are associated with a higher likelihood of subsequent restatement with marginal effects of 7.67% (with $p < 0.5$) and 8.08% (with $p < 0.01$), respectively. Regarding the interactions, four out of ten interactions report with significances. If the audit report is with *OTHER_MAOs* and includes the explanatory note about *EM_IMPOR_MAT*, the likelihood of subsequent restatements increases by 3.50% (with $p < 0.05$). The incidence of *UNQUALIFIED_EMP* \times *FIN_DISTRESS*, *UNQUALIFIED_EMP* \times *VIO_APC*, and *OTHER_MAOs* \times *FIN_DISTRESS* are less likely to report a subsequent restatement at the 5% level, with marginal effects of -2.63%, -3.27%, and -2.14% respectively. These results further show that financial distress factors do not communicate financial misstatement risk. As most violations of accounting standards (*VIO_APC*) in unqualified opinion with EMP refer to the lack of original documents for accounting transactions, they do not necessarily result in misstatements. Concerning the control variables, with the exception of *LEVERAGE* with increased significance to the 5% level, all signs and significance levels are the same as the logistic regression for the first-step test of (1) – Column (2) of Table 5.

In Column (3) of Table 8, I re-examine the **H2** in the second-step test by using the OLS regression. If *UNQUALIFIED_EMP* increases to one unit, the subsequent restatement increases by 7.5%, which is statistically significant at the 10% level. If *OTHER_MAOs* increases to one unit, the subsequent restatement increases by 10.7%,

which is statistically significant at the 5% level. The results of audit opinions in Column (3) are consistent with those in Column (1) and (2). Regarding the interactions, only those *EM_IMPOR_MAT* that are conditional on the opinions of *OTHER_MAOs* are statistically significant ($p < 0.1$). If *OTHER_MAOs* \times *EM_IMPOR_MAT* increases to one unit, the subsequent restatement increases by 8.4%. For the control variables, with the exception of both *ROA* and *ISSUE_SHARE* with a reduced significance to the 5% level, all signs and significance levels are the same as the OLS regression for the first-step test of (1) – Column (3) of Table 5.

To conclude, only one intercept, *OTHER_MAOs* \times *EM_IMPOR_MAT*, has consistent results among the three tests in the baseline model – Column (1), full model in logistic regression – Column (2) and OLS regression – Column (3). The result implies that *EM_IMPOR_MAT* conditional on *OTHER_MAOs* has a stronger association with the likelihood of subsequent restatements than other explanations.

[TABLE 8]

6.5 Robustness Tests

6.5.1 Using Alternative Regression Models

I conduct robust tests by using two different models to rerun the regressions of tests (1), (2), (3), and (4) and control for unobservable stable/unstable firm-specific characteristics that may be correlated with both audit opinions and subsequent accounting restatements. The two alternative models are (1) random effects logit model and (2) fixed effects logit model. Table 9, Panel A to Panel D, displays the results of the robustness checks for tests (1), (2), (3), and (4), respectively. Table 9 – Panel A shows consistent results with that in the main test (1) where the coefficients of MAOs in both the random effects logit model and the fixed effects logit model are

positive and significant at the 1% level. Table 9 – Panel B displays results as the same direction and significance as that in the main test (2) except the coefficient of *UNQUALIFIED_EMP* is less statistically significant at the 10% level under the fixed effects logit model. Similarly, in Table 9 – Panel C and Table 9 – Panel D, the coefficient of the independent variables of interest have the same sign of directions as that in the main tests (3) and (4), but the level of statistical significance varies in the main tests. Overall, the results of the main tests are robust by using alternative models.

[TABLE 9]

6.5.2 Partitioning the samples into two subsamples for SOEs and Non-SOEs

SOEs and Non-SOEs have significant differences regarding the management cultures, company objectives, and so on. Thus, as an additional test, I divide the samples into two subsamples for SOEs (12,569 observations, i.e. 55.01%) and Non-SOEs (10,281 observations, i.e. 44.99%) to see how the association between the audit opinions and explanatory notes and the incidence of subsequent restatements changes. Table 10, Panel A to Panel D, reports the results for this sensitivity test. Table 10 – Panel A shows that *MAOs* are significantly and positively associated with subsequent accounting restatements at 1% level for both SOEs and Non-SOEs under the logistic regression model in column (2). In Table 10 – Panel B, column (2), SOEs with *QUALIFIED*, *QUALIFIED_EMP*, and *DISCLAIMER* have higher likelihood of subsequent restatement at significant level of 1%, 1% and 5%, respectively. While for the non-SOEs, except the coefficient of *UNQUALIFIED_EMP* is positive and statistically significant at 5%, the remaining three independent variables of interests are all positive and statistically significant at 1%. Table 10 – Panel C, reveals that two types of explanatory notes – *EM_IMPORT_MAT* and *AUD_RELAT_ISSUE* have stronger predictive power to report subsequent restatements than other types of

explanatory notes for both SOEs and Non-SOEs. Table 10 – Panel D, demonstrates that only SOEs with *EM_IMPORT_MAT* that are conditional on the opinions of *OTHER_MAOs* are statistically significant ($p < 0.1$) in logistic regression. All in all, the results of subsample tests for SOEs and Non-SOEs are consistent with the results of main tests, but with generally less significances. Each type of MAO of non-SOEs tends to have stronger association with subsequent restatements than that of SOE, yet, the explanatory notes of SOEs are generally with higher likelihood of incidence of subsequent restatements than those notes of non-SOEs.

[TABLE 10]

6.5.3 Focusing on subsamples that without Audit Firm switches

When a listed firm receives one of the modified opinions from the auditor, it may prevent from the suffering of a higher cost of borrowing, the potential drop in the stock price by switching to another audit firm. The listed firm expects to obtain an unqualified opinion from the new auditor. At the same time, the new auditor may correct misstatement and initiate restatements for the prior year financial statements. Therefore, the incidence of subsequent restatements may be partially explained by the auditor switch. To examine this situation, I focus on the subsamples (18,598 observations, i.e. 81.39%) where there is no audit firm switch and see if the associations between *MAOs* together with their explanatory notes and the incidence of subsequent restatements hold. Table 11, Panel A to Panel D, presents the results of such subsamples for tests (1), (2), (3), and (4) correspondingly. Table 11 – Panel A shows consistent results with that in the main test (1) where the coefficients of MAOs are all positive and statistically significant at 1% level. Table 11 – Panel B demonstrates the same results in agreement with the main test under the baseline model. While the coefficients of *UNQUALIFIED_EMP*, *QUALIFIED*, *QUALIFIED_EMP*, and

DISCLAIMER remain all positive under the Logit and OLS models as per the main test, but some of their coefficients are with less statistical significance. Concerning the predictive power of explanatory notes towards the subsequent accounting restatements, the results in Table 11 – Panel C reveal the consistent results with that in the main test, except the statistical significances of *ACC_POL_INCON* under the baseline and Logit models and *EM_IMPOR_MAT* under the OLS model, do not hold. Table 11 – Panel D presents that the results of the intercept, *OTHER_MAOs x EM_IMPOR_MAT*, does not hold. To conclude, by concentrating on subsamples of those without auditor switch, the associations between *MAOs* and explanatory notes and subsequent accounting restatements in majority still hold, but some of their statistical significance are weakened.

[TABLE 11]

6.5.4 Partitioning the samples into two subsamples for Top Ten and Non-Top Ten Audit Firms

Unlike the audit services in the U.S. market which are dominated by the international Big Four accounting firms, audit firms in China are characterized as relatively small in scale and with low market shares. Hence, a cross-sectional test to partition the samples between listed firms audited by top ten and non-top ten audit firms are performed.²⁸ Table 12, Panel A to Panel D, displays the corresponding results of this cross-sectional test for top ten audit firms (with 10,434 observations, approximately 45.66%) and non-top ten audit firms (12,416 observations, about 54.34%). Surprisingly, majority of the results for tests on subsamples for top ten audit firms do not comply with the results in main tests (1), (2), (3), and (4). Table 12 – Panel

²⁸Top ten audit firms are defined as the first ten audit firms which have the highest market shares of the audit services in China A-shares firms listed on the Shanghai and Shenzhen Stock Exchange, using the total net assets of the listed firms as the measurement units, on a yearly basis.

A, in the subsamples for top ten audit firms, shows that the coefficient of *MAOs* in both logistic with controls and OLS model are positive but not significant. Similarly, in table 12 –Panel B, in the subsamples for top ten audit firms, only the coefficient of *QUALIFIED*, is positive and statistically significant at 5% in the logistic with controls model, the significances of other types of *MAOs* do not hold. Also, unlike the results in main tests, Table 12 – Panel C reveals that *ACC_POL_INCON*, *AUD_RELAT_ISSUE*, and *VIO_APC* are significantly associated with subsequent restatements at 1%, 5%, and 10% respectively, for the subsamples of top ten audit firms in logistic with controls model. The insignificant results for top ten audit firms may be explained by the *MAOs* allocations. Among the 1,422 *MAOs* in the total samples, more than two-thirds (i.e., 950 instances) are issued by non-top ten audit firms, and only around one-third of the *MAOs* (i.e., 472 instances) are issued by top ten audit firms. With few *MAOs* in the subsamples of top ten audit firms, the power of the tests is therefore weakened. In additions, the results may indicate the good audit quality of top ten audit firms. Specifically, table 2 – Panel B shows that *UNQUALIFIED_EMP* has insignificant relation with subsequent restatements, but *QUALIFIED* is positively and significantly correlated with subsequent restatements. These results demonstrate that the judgment of top ten audit firms in deciding the opinion type are highly and effectively reflecting the classifications stated in the Chinese Auditing Standards. While for non-top ten audit firms, most of the test results are consistent with that in the four main tests.

[TABLE 12]

Chapter 7 Conclusions and Limitations

This thesis examines whether MAOs and the explanatory notes in audit reports are informative and can communicate financial misstatement risks to shareholders, investors, and the interested general public. In the weak institutional and financial reporting environment in China, audit quality has often been questioned in prior literature (Wang and Wu 2011). However, auditors in China tend to protect their reputation to achieve business continuity and reap the economic benefits of providing high-quality audit services. I hypothesize that auditors are able to convey financial misstatement risks via audit reports, wherein the more severe the audit opinions, the more likely the incidence of subsequent accounting restatements will take place. I also hypothesize that explanatory notes provide information content to financial statement users, and different explanatory notes carry different predictive powers pertaining to financial misstatement risks. My empirical results generated from univariate and multivariate regression tests support these hypotheses.

The results of my thesis add to the growing body of literature on the effects of MAOs, the determinants of subsequent accounting restatements, and thus, the financial reporting quality. My findings that MAOs are more likely to have subsequent accounting restatements than the standard unqualified audit opinions indicate that MAOs imply financial misstatement risks. This is the first study in China to discuss the usefulness of MAOs from the perspective of accounting restatements, which is different from prior studies that examined the effects of MAOs on financial constraints (Lin et al. 2011), the impact of going-concern reports on bankruptcy (Lennox 1999), and market reactions to MAOs (Pei and Hamill 2013).

Second, my findings that explanatory notes in China, including the emphasis of important matter and audit-related issues, have positive associations with the

subsequent accounting restatements, demonstrate that auditor reports in the current financial reporting regime are informative of misstatement risk, which contradicts the normal belief of scholars and financial statement users that the current audit reporting model is boilerplate. Moreover, the flexibility that the auditors are given to add explanatory notes besides audit opinions also reveals the previous auditor reports are not as boilerplate as expected. Such findings provide the foundation and consistency in support of the changing trends on the new and enhanced auditor reports imposed by the standard setters in China in 2016. Effective January 1, 2017, all auditors were expected to express key or critical audit matters in audit reports.

Third, my findings reveal that the overall audit quality in China is good because more severe types of MAOs have higher associations with subsequent accounting restatements. In prior studies, “audit quality refers to the quality of the auditor’s opinion (i.e., assurance), not the opinion itself.” (DeFond and Zhang 2014). When I measure the audit quality, it may not be fair to merely say that having more MAOs indicates higher audit quality or vice versa. On the contrary, material misstatement is usually one of the proxies in measuring audit quality – the occurrence of material misstatements is a strong indication of poor audit quality. Some may argue that if the auditors did their jobs well, they should be able to discover and correct accounting errors and misstatements in the first place during the audit, and hence, no subsequent financial restatements are needed. Subsequent restatements therefore indicate that auditors are not conducting a due diligence audit: they are either incompetent at work or dependent on clients (Watts and Zimmerman 1981; DeAngelo 1981a; DeAngelo 1981b). However, this claim neglects to consider that auditors’ decision in issuing different types of audit opinions to different firms (where different audit opinions and expressions do not carry the same meaning). It may not be reasonable to merely claim

that the more the misstatements, the poorer the audit quality. Instead, it is more appropriate to comment that the auditor does not do a decent job under the following conditions: the auditor expresses an unqualified opinion in favor of a company and the company subsequently generates restatements. This is in contrast to the case wherein an auditor expresses a qualified opinion for a corporation. In my thesis setting, I consider both factors – the types of audit opinions issued by auditors and the incidence of subsequent accounting restatements, and test the association between them. In this situation, I develop a more meaningful reflection of audit quality. Audit quality is the frequency of the subsequent restatements that take place after considering the types of audit opinions and explanatory notes, and not the audit opinion or the restatement itself.

My thesis focuses on investigating the relationship between MAOs with their explanatory notes and financial misstatement risks by measuring the incidence of subsequent accounting restatements. I recognize that a U.S. study has further inspected the relationship between the explanatory languages in auditor reports and the capital market reactions from investors (Czerney et al. 2018). I also recognize that due to data unavailability, only a few studies can be presently conducted to examine whether the new and enhanced audit reports provide useful and valuable information to shareholders and financial statement users. Future research may investigate the above issues from the perspective of the China setting, which is a strong representative of emerging global markets.

APPENDIX

Variable Definitions

DEPENDENT VARIABLES

RESTATEMENT Equals 1 if firm i's fiscal year t financial statements are with subsequent restatement, and 0 otherwise;

EXPLANATORY VARIABLES

MAOs Equals 1 if the audit opinion of firm i's fiscal year t is unqualified opinion with emphasis of matter paragraph or qualified opinion or qualified opinion with emphasis of matter paragraph or disclaimer opinion, and 0 otherwise;

UNQUALIFIED_EMP Equals 1 if the audit opinion of firm i's fiscal year t is unqualified opinion with emphasis of matter paragraph, and 0 otherwise;

QUALIFIED Equals 1 if the audit opinion of firm i's fiscal year t is qualified opinion, and 0 otherwise;

QUALIFIED_EMP Equals 1 if the audit opinion of firm i's fiscal year t is qualified opinion with emphasis of matter paragraph, and 0 otherwise;

DISCLAIMER Equals 1 if the audit opinion of firm i's fiscal year t is disclaimer of opinion, and 0 otherwise;

ACC_POL_INCON Equals 1 if the audit report of firm i's fiscal year t has explanatory note discussed accounting policy inconsistency issues, and 0 otherwise;

EM_IMPORT_MAT Equals 1 if the audit report of firm i's fiscal year t has emphasize important matters, and 0 otherwise;

AUD_RELAT_ISSUE Equals 1 if the audit report of firm i's fiscal year t has discussed auditing related issues, and 0 otherwise;

FIN_DISTRESS Equals 1 if the audit report of firm i's fiscal year t has discussed financial distress factors, and 0 otherwise;

VIO_APC Equals 1 if the audit report of firm i's fiscal year t has identified violations of APC, and 0 otherwise;

OTHER_MAOs Equals 1 if the audit opinion of firm i's fiscal year t is qualified opinion or qualified opinion with emphasis of matter paragraph or disclaimer opinion, and 0 otherwise;

(The table is continued on the next page.)

APPENDIX (continued)

CONTROL VARIABLES

<i>SIZE</i>	The size of the firm <i>i</i> , measured as the natural logarithm of the firm' market value as of the end of fiscal year <i>t</i> ;
<i>AGE</i>	The number of years since firm <i>i</i> first appeared in CSMAR, up to and including fiscal year <i>t</i> ;
<i>ROA</i>	The return on assets of firm <i>i</i> , measured as total profits and financial expenses scaled by total assets as of the end of fiscal year <i>t</i> ;
<i>BOOK_MKT</i>	The book-to-market ratio of the firm <i>i</i> , measured as total assets scaled by market capitalization as of the end of fiscal year <i>t</i> ;
<i>LEVERAGE</i>	The total liabilities scaled by total assets;
<i>POSITIVE ACCR</i>	Equals 1 if firm <i>i</i> 's fiscal year <i>t</i> reported net profits is greater than reported net cash flow from operating activities, and 0 otherwise;
<i>LOSS</i>	Equals 1 if firm <i>i</i> 's fiscal year <i>t</i> reported net loss, and 0 otherwise;
<i>GROWTH</i>	The differences between the ending total assets and the beginning total assets and scaled by beginning total assets of firm <i>i</i> as of the end of fiscal year <i>t</i> ;
<i>ISSUE_SHARE</i>	Equals 1 if firm <i>i</i> 's fiscal year <i>t</i> issues new shares, and 0 otherwise;
<i>MERGE_ACQ</i>	Equals 1 if firm <i>i</i> 's fiscal year <i>t</i> has a merger or acquisition, and 0 otherwise;
<i>BIG_FOUR</i>	Equals 1 if firm <i>i</i> 's fiscal year <i>t</i> is audited by the International Big Four CPA firm, and 0 otherwise;
<i>AUDIT_FEE</i>	The natural logarithm of the total audit fees of firm <i>i</i> as of the end of fiscal year <i>t</i> ;
<i>INDEP_DIR</i>	The number of independent directors divided by the total number of directors (including board chairman) in the firm's board of directors as of the end of fiscal year <i>t</i> ;
<i>BOARD_CHAIR</i>	Equals 1 if firm <i>i</i> 's board chairman is the same person of the general manager as of fiscal year <i>t</i> , and 0 otherwise;
<i>SOE</i>	Equals 1 if firm <i>i</i> 's ultimate controlling shareholder is a government entity as of fiscal year <i>t</i> , and 0 otherwise;
<i>OWNER</i>	The percentage of ownership held by the controlling shareholder of firm <i>i</i> as of fiscal year <i>t</i> ;
<i>Year Dummies</i>	Year dummy of the fiscal year-ends from 2003 to 2015; and
<i>Industry Dummies</i>	Industry dummy, where: IND1 = agriculture, IND2 = mining, IND3 = manufacturing, IND4 = utilities, IND5 = construction, IND6 = transportation and storage, IND7 = information technology, IND8 = wholesale and retail trade, IND9 = finance and insurance, IND10 = real estate, IND11 = social service, IND12 = communication and cultural, and IND13 = comprehensive industries.

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FIGURE 1 – Classification of Audit Opinions

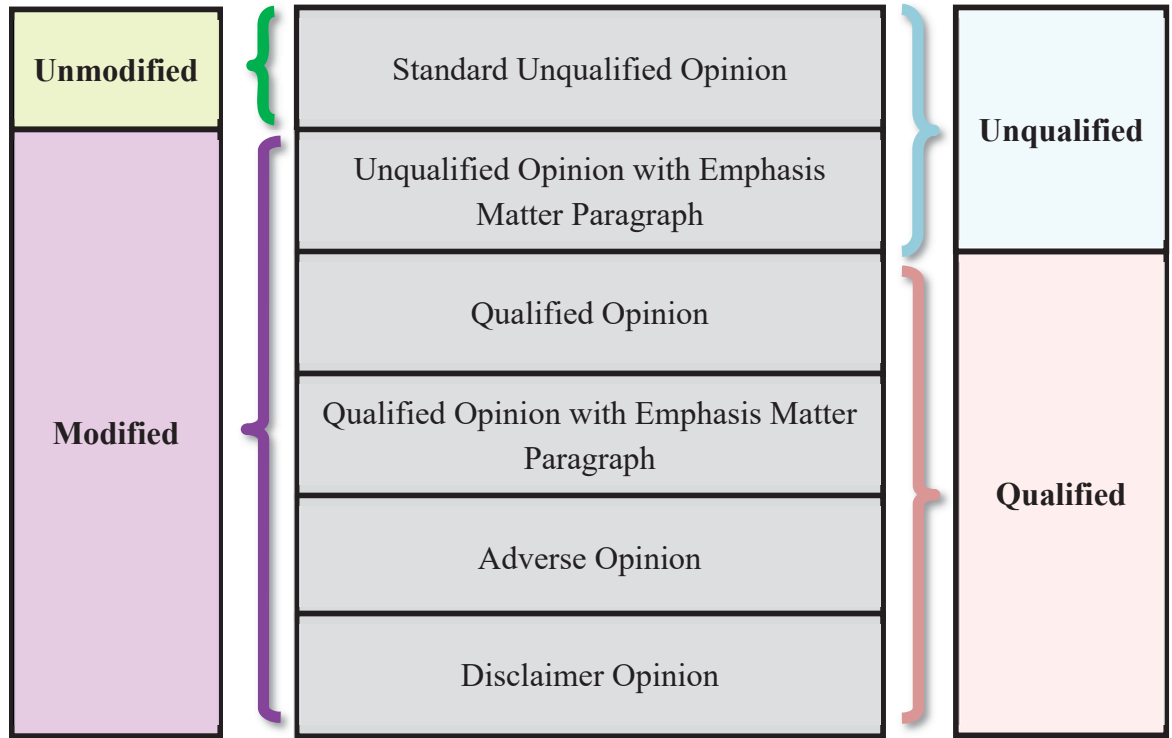


TABLE 1**Sample Design**

Firm-year observations with requisite data in CSMAR Solution, Wind database and cninfo website for 2003 through 2015	25,483
Less observations which are not A-shares listed in Shanghai and/ or Shenzhen Stock Exchange	(2,477)
Less observations for which without financial statement data in the two subsequent years	(139)
Less observations which missing data in any variables	<u>(17)</u>
Final Sample	22,850

TABLE 2**Descriptive Statistics for Modified Audit Opinions in China****Panel A: Types of MAOs by Year (percentage in parentheses)**

<i>Year</i>	<i>Total Number of Listed_Co</i>	<i>Unqualif ied with EMP (%)</i>	<i>Qualifi ed (%)</i>	<i>Qualifie d with EMP (%)</i>	<i>Disclai mer (%)</i>	<i>Total Number of MAOs (%)</i>
2003	1,235	50 (4.05)	9 (0.73)	10 (0.81)	12 (0.97)	81 (6.56)
2004	1,332	67 (5.03)	27 (2.03)	22 (1.65)	17 (1.28)	133 (9.98)
2005	1,333	73 (5.48)	42 (3.15)	16 (1.20)	28 (2.10)	159 (11.93)
2006	1,420	75 (5.28)	29 (2.04)	8 (0.56)	28 (1.97)	140 (9.86)
2007	1,537	89 (5.79)	12 (0.78)	1 (0.07)	15 (0.98)	117 (7.61)
2008	1,590	77 (4.84)	16 (1.01)	0 (0.00)	17 (1.07)	110 (6.92)
2009	1,686	83 (4.92)	6 (0.36)	7 (0.42)	19 (1.13)	115 (6.82)
2010	1,910	82 (4.29)	17 (0.89)	6 (0.31)	6 (0.31)	111 (5.81)
2011	2,042	87 (4.26)	12 (0.59)	7 (0.34)	4 (0.20)	110 (5.39)
2012	2,109	70 (3.32)	11 (0.52)	1 (0.05)	3 (0.14)	85 (4.03)
2013	2,129	57 (2.68)	18 (0.85)	2 (0.09)	5 (0.23)	82 (3.85)
2014	2,204	63 (2.86)	16 (0.73)	2 (0.09)	7 (0.32)	88 (3.99)
2015	2,323	76 (3.27)	7 (0.30)	5 (0.22)	3 (0.13)	91 (3.92)
Total	22,850	949 (4.15)	222 (0.97)	87 (0.38)	164 (0.72)	1,422 (6.22)

The number of audit reports with an adverse opinion from 2003 to 2015 is nil.

TABLE 2
Descriptive Statistics for Modified Audit Opinions in China
Panel B-I: Two Types of MAOs by Categories of Explanatory Notes
Types of MAOs

<i>Type of Explanatory Notes</i>	Unqualified with EMP		Qualified, Qualified with EMP & Disclaimer		Total	
	Total	Percent	Total	Percent	Total	Percent
Accounting policy inconsistency	15	1.36%	10	1.13%	25	1.26%
Emphasizing important matters	321	29.16%	170	19.21%	491	24.72%
Auditing related issues	27	2.45%	295	33.33%	322	16.21%
Financial distress	687	62.40%	287	32.43%	974	49.04%
Violation of APC	49	4.45%	122	13.79%	171	8.61%
Other issues	2	0.18%	1	0.11%	3	0.15%
Total	1,101	100%	885	100%	1,986	100%

TABLE 2
Descriptive Statistics for Modified Audit Opinions in China

Panel B-II: Four Types of MAOs by Categories of Explanatory Notes

<i>Types of Explanatory Notes</i>	Unqualified with EMP			Qualified			Qualified with EMP			Disclaimer			Total	
	Total	Percent	Total	Percent	Total	Percent	Total	Percent	Total	Percent	Total	Percent	Total	Percent
Accounting policy inconsistency	15	1.36%	6	1.79%	2	0.93%	2	0.60%	25	1.26%	25	1.26%	25	1.26%
Emphasizing important matters	321	29.16%	74	22.02%	53	24.77%	43	12.84%	491	24.72%	491	24.72%	491	24.72%
Auditing related issues	27	2.45%	127	37.80%	61	28.50%	107	31.94%	322	16.21%	322	16.21%	322	16.21%
Financial distress	687	62.40%	77	22.92%	58	27.10%	152	45.37%	974	49.04%	974	49.04%	974	49.04%
Violation of APC	49	4.45%	51	15.18%	40	18.69%	31	9.25%	171	8.61%	171	8.61%	171	8.61%
Other issues	2	0.18%	1	0.30%	0	0.00%	0	0.00%	3	0.15%	3	0.15%	3	0.15%
Total	1,101	100%	336	100%	214	100%	335	100%	1,986	100%	1,986	100%	1,986	100%

TABLE 2
Descriptive Statistics for Modified Audit Opinions in China

Panel B-III: Two Types of MAOs by Details of Explanatory Notes

Types of Explanatory Notes	Unqualified with		Qualified, Qualified		Total	
	EMP		with EMP &			
	Total	Percent	Total	Percent	Total	Percent
Accounting policy inconsistency	15	1.36%	10	1.13%	25	1.26%
Adoption of new or change in accounting policy	2		0		2	
Amendments on financial statements in prior financial periods	9		9		18	
Reclassification of accounting items in disclosure notes	0		1		1	
Change in accounting estimates	4		0		4	
Emphasizing important matters	321	29.16%	170	19.21%	491	24.72%
Emphasizing company mergers and acquisitions	4		3		7	
Emphasizing related party transactions	23		15		38	
Emphasizing litigation and regulatory activities	9		1		10	
Emphasizing managerial material accounting estimates	16		14		30	
Emphasizing contingencies and uncertainties	210		109		319	
Emphasizing important accounting treatments	34		19		53	
Emphasizing contingent liabilities	15		8		23	
Emphasizing assets disposal	1		0		1	
Emphasizing material investment	9		1		10	
Auditing related issues	27	2.45%	295	33.33%	322	16.21%
Use of other auditor's work	6		8		14	
Audit scope limitation	7		269		276	
Other supplementary information	3		6		9	
Unsolved issues leading MAOs in prior year (opening balance)	2		8		10	
Opening balance involving material misstatements	1		3		4	
Solved issues leading MAOs in prior year (opening balance)	8		1		9	
Financial distress	687	62.40%	287	32.43%	974	49.04%
Seriously suspicious on sustainable operations	398		138		536	

(The table is continued on the next page.)

TABLE 2 Panel B-III (continued)

Types of Explanatory Notes	Unqualified with		Qualified, Qualified		Total	
	EMP		with EMP &			
	Total	Percent	Total	Percent	Total	Percent
Financial difficulties and operation uncertainties	153		84		237	
Involve debt restructuring or bankruptcy	136		65		201	
Violation of APC	49	4.45%	122	13.79%	171	8.61%
Accounting treatment inconsistent with APC	9		29		38	
Accounting transactions lack original documents	33		46		79	
Violation of other regulations	1		15		16	
Suspicious accounting practices	0		12		12	
Accounting estimates inconsistent with APC and unreasonable	6		15		21	
Disclosures inconsistent with APC and related regulations	0		5		5	
Other issues	2	0.18%	1	0.11%	3	0.15%
Audit opinion involves two set of financial statements	1		0		1	
Prior financial reports had former certified public accountant	1		1		2	
Total	1,101	100%	885	100%	1,986	100%

TABLE 2
Descriptive Statistics for Modified Audit Opinions in China

Panel B-IV: Four Types of MAOs by Details of Explanatory Notes

<i>Types of Explanatory Notes</i>	<i>Types of MAOs</i>					
	Unqualified with			Qualified with		
	Total	EMP	Percent	Total	EMP	Percent
Accounting policy inconsistency	15	1.36%	6	1.79%	2	0.93%
Adoption of new or change in accounting policy	2		0		0	
Amendments on financial statements in prior financial periods	9		6		1	
Reclassification of accounting items in disclosure notes	0		0		1	
Change in accounting estimates	4		0		0	
Emphasizing important matters	321	29.16%	74	22.02%	53	24.77%
Emphasizing company mergers and acquisitions	4		3		0	
Emphasizing related party transactions	23		9		5	
Emphasizing litigation and regulatory activities	9		0		0	
Emphasizing managerial material accounting estimates	16		5		4	
Emphasizing contingencies and uncertainties	210		49		34	
			2		2	0.60%
			0		0	
			2		2	
			0		0	
			1		1	
			4		4	
			43		43	12.84%
			0		0	
			7		7	24.72%
			1		1	
			38		38	
			10		10	
			30		30	
			26		26	
			319		319	

(The table is continued on the next page.)

TABLE 2 Panel B-IV (continued)

<i>Types of Explanatory Notes</i>	Unqualified with EMP		Qualified		Qualified with EMP		Disclaimer		Total	
	Total	Percent	Total	Percent	Total	Percent	Total	Percent	Total	Percent
Emphasizing important accounting treatments	34		5		7		7		53	
Emphasizing contingent liabilities	15		2		3		3		23	
Emphasizing assets disposal	1		0		0		0		1	
Emphasizing material investment	9		1		0		0		10	
Auditing related issues	27	2.45%	127	37.80%	61	28.50%	107	31.94%	322	16.21%
Use of other auditor's work	6		2		1		5		14	
Audit scope limitation	7		119		55		95		276	
Other supplementary information	3		2		1		3		9	
Unsolved issues leading MAOs in prior year (opening balance)	2		3		3		2		10	
Opening balance involving material misstatements	1		1		0		2		4	
Solved issues leading MAOs in prior year (opening balance)	8		0		1		0		9	
Financial distress	687	62.40%	77	22.92%	58	27.10%	152	45.37%	974	49.04%
Seriously suspicious on sustainable operations	398		44		25		69		563	
Financial difficulties and operation uncertainties	153		27		27		30		237	
Involve debt restructuring or bankruptcy	136		6		6		53		201	

(The table is continued on the next page.)

TABLE 2 Panel B-IV (continued)

<i>Types of Explanatory Notes</i>	Unqualified with EMP		Qualified		Qualified with EMP		Disclaimer		Total	
	Total	Percent	Total	Percent	Total	Percent	Total	Percent	Total	Percent
Violation of APC	49	4.45%	51	15.18%	40	18.69%	31	9.25%	171	8.61%
Accounting treatment inconsistent with APC	9		9		8		13		38	
Accounting transactions lack original documents	33		17		18		11		79	
Violation of other regulations	1		11		3		1		16	
Suspicious accounting practices	0		5		5		2		12	
Accounting estimates inconsistent with APC and unreasonable	6		8		5		2		21	
Disclosures inconsistent with APC and related regulations	0		2		1		2		5	
Other issues	2	0.18%	1	0.30%	0	0.00%	0	0.00%	3	0.15%
Audit opinion involves two set of financial statements	1		0		0		0		1	
Prior financial reports had former certified public accountant	1		1		0		0		2	
Total	1,101	100%	336	100%	214	100%	335	100%	1,986	100%

TABLE 3**Descriptive Statistics for Misstatement****Panel A: Univariate Analysis of Misstatement and Audit Opinion**

	Without Misstatement		With Misstatement		<i>Total</i>
	<i>Frequency</i>	<i>%</i>	<i>Frequency</i>	<i>%</i>	
Standard Unqualified Opinion	20,281	94.65%	1,147	5.35%	21,428
Modified Audit Opinion	1,167	82.07%	255	17.93%	1,422
	21,448	93.86%	1,402	6.14%	22,850

Chi-square test

$$X^2 = 366.414$$

$$Pr = 0.000***$$

TABLE 3
Descriptive Statistics for Misstatement
Panel B: Misstatement Frequency by Audit Opinion Type

Audit Opinion	Total	With Misstatement		% Audit Opinion
	<i>frequency</i>	<i>frequency</i>	<i>%</i>	
<i>Standard Unqualified</i>	21,428	1,147	5.35%	93.78%
<i>Unqualified with EMP</i>	949	120	12.64%	4.15%
<i>Qualified</i>	222	60	27.03%	0.97%
<i>Qualified with EMP</i>	87	27	31.03%	0.38%
<i>Disclaimer</i>	164	48	29.27%	0.72%
Total	22,850	1,402	6.14%	100.00%

TABLE 4
Descriptive Statistics for Dependent, Independent and Control Variables

	<i>N</i>	<i>Mean</i>	<i>Std. Dev.</i>	<i>5%</i>	<i>25%</i>	<i>Median</i>	<i>75%</i>	<i>95%</i>	
Dependent and Independent Variables									
<i>RESTATEMENT</i>	22,850	0.061	0.240	0.000	0.000	0.000	0.000	1.000	
<i>MAOs</i>	22,850	0.062	0.242	0.000	0.000	0.000	0.000	1.000	
Control Variables									
<i>SIZE</i>	22,850	21.806	2.828	20.271	21.266	21.977	22.774	24.255	
<i>AGE</i>	22,850	10.048	5.694	1.000	5.000	10.000	14.000	20.000	
<i>ROA</i>	22,850	0.042	0.066	-0.060	0.023	0.043	0.069	0.130	
<i>BOOK_MKT</i>	22,850	1.007	0.987	0.103	0.394	0.712	1.278	2.886	
<i>LEVERAGE</i>	22,850	0.503	0.252	0.133	0.331	0.496	0.646	0.860	
<i>POSITIVE_ACCR</i>	22,850	0.416	0.493	0.000	0.000	0.000	1.000	1.000	
<i>LOSS</i>	22,850	0.117	0.321	0.000	0.000	0.000	0.000	1.000	
<i>GROWTH</i>	22,850	0.177	0.346	-0.168	0.002	0.099	0.241	0.816	
<i>ISSUE_SHARE</i>	22,850	0.110	0.313	0.000	0.000	0.000	0.000	1.000	
<i>MERGE_ACQ</i>	22,850	0.676	0.468	0.000	0.000	1.000	1.000	1.000	
<i>BIG_FOUR</i>	22,850	0.066	0.248	0.000	0.000	0.000	0.000	1.000	
<i>AUDIT_FEE</i>	22,850	12.416	3.670	0.000	12.848	13.305	13.743	14.880	
<i>INDEP_DIR</i>	22,850	0.361	0.055	0.308	0.333	0.333	0.375	0.444	
<i>BOARD_CHAIR</i>	22,850	0.171	0.377	0.000	0.000	0.000	0.000	1.000	
<i>SOE</i>	22,850	0.550	0.497	0.000	0.000	1.000	1.000	1.000	
<i>OWNER</i>	22,850	0.377	0.185	0.000	0.249	0.372	0.511	0.683	

TABLE 5

Association between MAOs and Restatements

	<i>predicted sign</i>	<i>Dependent Variable = RESTATEMENT</i>				
		<i>marginal</i>		<i>marginal</i>		
		<i>(1)</i>	<i>eff.</i>	<i>(2)</i>	<i>eff.</i>	<i>(3)</i>
<i>MAOs</i>	?	1.204***	9.347%	0.725***	4.284%	0.052***
		(12.094)		(5.664)		(3.702)
<i>SIZE#</i>	?			-0.020		0.021***
				(0.302)		(4.028)
<i>AGE</i>	?			-0.002		-0.044***
				(0.197)		(2.757)
<i>ROA</i>	?			-0.676		-0.132***
				(1.189)		(2.590)
<i>BOOK_MKT#</i>	?			0.210***		0.022***
				(3.980)		(4.846)
<i>LEVERAGE</i>	?			0.274*		-0.003
				(1.717)		(0.156)
<i>POSITIVE_ACCR</i>	?			0.041		-0.001
				(0.588)		(0.291)
<i>LOSS</i>	?			0.388***		0.004
				(3.461)		(0.449)
<i>GROWTH</i>	?			-0.194*		-0.022***
				(1.729)		(4.096)
<i>ISSUE_SHARE</i>	?			-0.297**		-0.011***
				(2.503)		(2.624)
<i>MERGE_ACQ</i>	+			0.210***		0.005
				(3.064)		(1.203)
<i>BIG_FOUR</i>	-			-0.881***		-0.013
				(3.195)		(0.757)
<i>AUDIT_FEE#</i>	-			-0.182**		-0.004
				(2.030)		(0.627)
<i>INDEP_DIR#</i>	-			-0.110		-0.016
				(0.145)		(0.305)
<i>BOARD_CHAIR</i>	?			0.088		-0.001
				(0.743)		(0.129)

(The table is continued on the next page.)

TABLE 5 (continued)

	<i>predicted sign</i>	<i>Dependent Variable = RESTATEMENT</i>		
		<i>marginal eff.</i> (1)	<i>marginal eff.</i> (2)	<i>marginal eff.</i> (3)
<i>SOE</i>	?		0.066 (0.673)	-0.005 (0.329)
<i>OWNER#</i>	?		-0.954*** (3.294)	-0.087*** (3.461)
<i>Constant</i>		-1.382*** (4.903)	-2.070*** (3.807)	0.236*** (3.864)
<i>Observations</i>		22,850	22,850	22,850
<i>Industry Dummies</i>		YES	YES	YES
<i>Year Dummies</i>		YES	YES	YES
<i>Number of Firms</i>				2,371
<i>Pseudo R-squared/ (R-squared)</i>		0.065	0.088	(0.031)

Robust z-statistics in parentheses. Standard errors are clustered by firm. Year and industry indicators are included in the model but omitted for brevity. Pseudo R-squared is shown in column (1) and (2); R-squared is presented in column (3).

Non-missing dummy variables have been generated for controls SIZE, BOOK_MKT, AUDIT_FEE, INDEP_DIR and OWNER, for capturing the missing value effects of the respective controls.

****, **, * Denote $p < 0.01$, $p < 0.05$, and $p < 0.1$, respectively.*

TABLE 6

Association between Each Type of MAO and Restatements

	<i>predicted sign</i>	<i>Dependent Variable = RESTATEMENT</i>				
		<i>(1)</i>	<i>marginal eff.</i>	<i>(2)</i>	<i>marginal eff.</i>	<i>(3)</i>
<i>UNQUALIFIED_EMP</i>	?	0.849*** (6.432)	5.784%	0.433*** (2.717)	2.286%	0.017 (1.138)
<i>QUALIFIED</i>	?	1.701*** (9.453)	17.176%	1.269*** (6.705)	9.946%	0.125*** (4.013)
<i>QUALIFIED_EMP</i>	?	1.741*** (6.523)	17.996%	1.212*** (4.375)	9.317%	0.155*** (3.053)
<i>DISCLAIMER</i>	?	1.692*** (8.132)	17.068%	0.942*** (3.636)	6.375%	0.142*** (3.394)
<i>SIZE#</i>	?			-0.024 (0.354)		0.021*** (3.941)
<i>AGE</i>	?			-0.001 (0.115)		-0.044*** (2.805)
<i>ROA</i>	?			-0.497 (0.863)		-0.091* (1.790)
<i>BOOK_MKT#</i>	?			0.208*** (3.911)		0.022*** (4.918)
<i>LEVERAGE</i>	?			0.291* (1.755)		-0.006 (0.350)
<i>POSITIVE_ACCR</i>	?			0.039 (0.550)		-0.001 (0.289)
<i>LOSS</i>	?			0.379*** (3.361)		0.004 (0.452)
<i>GROWTH</i>	?			-0.193* (1.705)		-0.021*** (4.005)
<i>ISSUE_SHARE</i>	?			-0.288** (2.424)		-0.010** (2.467)
<i>MERGE_ACQ</i>	+			0.216*** (3.132)		0.005 (1.375)

(The table is continued on the next page.)

TABLE 6 (continued)

	<i>predicted</i>	<i>Dependent Variable = RESTATEMENT</i>		
		<i>sign</i>	<i>marginal</i>	<i>marginal</i>
			<i>eff.</i>	<i>eff.</i>
		(1)	(2)	(3)
<i>BIG_FOUR</i>	-		-0.862*** (3.141)	-0.014 (0.791)
<i>AUDIT_FEE#</i>	-		-0.193** (2.152)	-0.004 (0.731)
<i>INDEP_DIR#</i>	-		-0.107 (0.142)	-0.018 (0.331)
<i>BOARD_CHAIR</i>	?		0.093 (0.786)	-0.001 (0.088)
<i>SOE</i>	?		0.087 (0.883)	-0.002 (0.147)
<i>OWNER#</i>	?		-0.961*** (3.323)	-0.088*** (3.505)
<i>Constant</i>		-1.429*** (5.031)	-2.004*** (3.767)	0.245*** (4.059)
<i>Observations</i>		22,850	22,850	22,850
<i>Industry Dummies</i>		YES	YES	YES
<i>Year Dummies</i>		YES	YES	YES
<i>Number of Firms</i>				2,371
<i>Pseudo R-squared/ (R-squared)</i>		0.069	0.090	(0.035)

Robust z-statistics in parentheses. Standard errors are clustered by firm. Year and industry indicators are included in the model but omitted for brevity. Pseudo R-squared is shown in column (1) and (2); R-squared is presented in column (3).

Non-missing dummy variables have been generated for controls *SIZE*, *BOOK_MKT*, *AUDIT_FEE*, *INDEP_DIR* and *OWNER*, for capturing the missing value effects of the respective controls.

***, **, * Denote $p < 0.01$, $p < 0.05$, and $p < 0.1$, respectively.

TABLE 7
Association between Explanatory Notes and Restatements

	<i>predicted</i> <i>sign</i>	<i>Dependent Variable = RESTATEMENT</i>				
		<i>marginal</i>		<i>marginal</i>		<i>(3)</i>
		<i>(1)</i>	<i>eff.</i>	<i>(2)</i>	<i>eff.</i>	
<i>ACC_POL_INCON</i>	?	1.532** (2.348)	14.674%	1.481** (2.049)	12.866%	0.106 (1.046)
<i>EM_IMPOR_MAT</i>	?	0.862*** (4.837)	6.045%	0.740*** (4.122)	4.516%	0.044** (1.991)
<i>AUD_RELAT_ISSUE</i>	?	0.953*** (5.011)	7.000%	0.658*** (3.530)	3.882%	0.103*** (3.494)
<i>FIN_DISTRESS</i>	?	0.582*** (3.732)	3.566%	-0.037 (0.212)	-0.161%	-0.001 (0.037)
<i>VIO_APC</i>	?	0.268 (1.069)	1.448%	0.197 (0.784)	0.946%	0.030 (0.801)
<i>SIZE#</i>	?			-0.032 (0.479)		0.020*** (3.771)
<i>AGE</i>	?			-0.001 (0.121)		-0.044*** (2.806)
<i>ROA</i>	?			-0.577 (1.000)		-0.111** (2.233)
<i>BOOK_MKT#</i>	?			0.185*** (3.471)		0.020*** (4.583)
<i>LEVERAGE</i>	?			0.488*** (2.829)		0.006 (0.319)
<i>POSITIVE_ACCR</i>	?			0.051 (0.733)		-0.001 (0.198)
<i>LOSS</i>	?			0.434*** (3.928)		0.005 (0.578)
<i>GROWTH</i>	?			-0.219* (1.899)		-0.021*** (4.086)
<i>ISSUE_SHARE</i>	?			-0.304** (2.555)		-0.011*** (2.616)
<i>MERGE_ACQ</i>	+			0.206*** (2.986)		0.005 (1.222)

(The table is continued on the next page.)

TABLE 7 (continued)

	<i>predicted sign</i>	<i>Dependent Variable = RESTATEMENT</i>		
		<i>marginal eff.</i>	<i>marginal eff.</i>	
		(1)	(2)	(3)
<i>BIG_FOUR</i>	-		-0.850*** (3.122)	-0.013 (0.753)
<i>AUDIT_FEE#</i>	-		-0.197** (2.195)	-0.005 (0.834)
<i>INDEP_DIR#</i>	-		-0.190 (0.250)	-0.022 (0.398)
<i>BOARD_CHAIR</i>	?		0.100 (0.848)	-0.001 (0.097)
<i>SOE</i>	?		0.069 (0.702)	-0.003 (0.212)
<i>OWNER#</i>	?		-0.979*** (3.383)	-0.088*** (3.504)
<i>Constant</i>		-1.408*** (4.915)	-2.058*** (3.778)	0.237*** (3.961)
<i>Observations</i>		22,850	22,850	22,850
<i>Industry Dummies</i>		YES	YES	YES
<i>Year Dummies</i>		YES	YES	YES
<i>Number of Firms</i>				2,371
<i>Pseudo R-squared/ (R-squared)</i>		0.065	0.089	(0.033)

Robust z-statistics in parentheses. Standard errors are clustered by firm. Year and industry indicators are included in the model but omitted for brevity. Pseudo R-squared is shown in column (1) and (2); R-squared is presented in column (3).

Non-missing dummy variables have been generated for controls SIZE, BOOK_MKT, AUDIT_FEE, INDEP_DIR and OWNER, for capturing the missing value effects of the respective controls.

****, **, * Denote $p < 0.01$, $p < 0.05$, and $p < 0.1$, respectively.*

TABLE 8

Association between Explanatory Notes conditional on MAOs and Restatements

	<i>predicted</i>	<i>Dependent Variable = RESTATEMENT</i>				
		<i>sign</i>	<i>marginal</i>		<i>marginal</i>	
			<i>(1)</i>	<i>eff.</i>	<i>(2)</i>	<i>eff.</i>
<i>UNQUALIFIED_EMP</i>	?	1.355*** (3.288)	11.397%	1.097** (2.547)	7.665%	0.075* (1.704)
<i>OTHER_MAOs</i>	?	1.487*** (5.019)	13.519%	1.121*** (3.685)	8.076%	0.107** (1.990)
<i>UNQUALIFIED_EMP x ACC_POL_INCON</i>	?	0.900 (1.110)	6.438%	1.267 (1.388)	9.948%	0.054 (0.388)
<i>UNQUALIFIED_EMP x EM_IMPOR_MAT</i>	?	-0.320 (0.854)	-1.320%	-0.267 (0.695)	-1.033%	-0.050 (1.253)
<i>UNQUALIFIED_EMP x AUD_RELAT_ISSUE</i>	?	-0.077 (0.127)	-0.351%	-0.081 (0.129)	-0.339%	0.002 (0.022)
<i>UNQUALIFIED_EMP x FIN_DISTRESS</i>	?	-0.521 (1.293)	-1.992%	-0.852** (2.050)	-2.627%	-0.064 (1.525)
<i>UNQUALIFIED_EMP x VIO_APC</i>	?	-1.100* (1.905)	-3.274%	-1.285** (2.092)	-3.266%	-0.058 (1.055)
<i>OTHER_MAOs x ACC_POL_INCON</i>	?	0.696 (1.063)	4.529%	0.614 (0.870)	3.556%	0.067 (0.473)
<i>OTHER_MAOs x EM_IMPOR_MAT</i>	?	0.605** (2.249)	3.767%	0.608** (2.253)	3.497%	0.084* (1.719)
<i>OTHER_MAOs x AUD_RELAT_ISSUE</i>	?	0.194 (0.762)	1.003%	0.101 (0.396)	0.462%	0.032 (0.706)
<i>OTHER_MAOs x FIN_DISTRESS</i>	?	-0.210 (0.811)	-0.907%	-0.649** (2.237)	-2.141%	-0.043 (0.876)
<i>OTHER_MAOs x VIO_APC</i>	?	0.004 (0.013)	0.019%	0.139 (0.463)	0.646%	0.011 (0.213)
<i>SIZE#</i>	?			-0.028 (0.420)		0.020*** (3.793)
<i>AGE</i>	?			-0.003 (0.242)		-0.043*** (2.782)
<i>ROA</i>	?			-0.624 (1.078)		-0.102** (2.074)
<i>BOOK_MKT#</i>	?			0.191*** (3.553)		0.021*** (4.673)
<i>LEVERAGE</i>	?			0.437** (2.550)		0.002 (0.121)

(The table is continued on the next page.)

TABLE 8 (continued)

	<i>predicted</i>	<i>Dependent Variable = RESTATEMENT</i>				
		<i>marginal</i>		<i>marginal</i>		
		<i>sign</i>	<i>(1)</i>	<i>eff.</i>	<i>(2)</i>	<i>eff.</i>
<i>POSITIVE_ACCR</i>	?			0.043		-0.001
				(0.622)		(0.243)
<i>LOSS</i>	?			0.386***		0.004
				(3.446)		(0.417)
<i>GROWTH</i>	?			-0.207*		-0.021***
				(1.804)		(4.064)
<i>ISSUE_SHARE</i>	?			-0.295**		-0.010**
				(2.484)		(2.535)
<i>MERGE_ACQ</i>	+			0.212***		0.005
				(3.070)		(1.298)
<i>BIG_FOUR</i>	-			-0.877***		-0.014
				(3.232)		(0.791)
<i>AUDIT_FEE#</i>	-			-0.195**		-0.005
				(2.171)		(0.783)
<i>INDEP_DIR#</i>	-			-0.218		-0.022
				(0.285)		(0.408)
<i>BOARD_CHAIR</i>	?			0.093		-0.001
				(0.785)		(0.067)
<i>SOE</i>	?			0.083		-0.002
				(0.847)		(0.155)
<i>OWNER#</i>	?			-0.964***		-0.086***
				(3.324)		(3.429)
<i>Constant</i>		-1.425***		-2.049***		0.238***
		(5.090)		(3.839)		(4.017)
<i>Observations</i>		22,850		22,850		22,850
<i>Industry Dummies</i>		YES		YES		YES
<i>Year Dummies</i>		YES		YES		YES
<i>Number of Firms</i>						2,371
<i>Pseudo R-squared/ (R-squared)</i>		0.070		0.093		(0.036)

Robust z-statistics in parentheses. Standard errors are clustered by firm. Year and industry indicators are included in the model but omitted for brevity. Pseudo R-squared is shown in column (1) and (2); R-squared is presented in column (3).

Non-missing dummy variables have been generated for controls *SIZE*, *BOOK_MKT*, *AUDIT_FEE*, *INDEP_DIR* and *OWNER*, for capturing the missing value effects of the respective controls.

***, **, * Denote $p < 0.01$, $p < 0.05$, and $p < 0.1$, respectively.

TABLE 9
Robustness Check

Panel A: Alternative Models testing the Association between MAOs and Restatements

	(1)	(2)
	<i>Random Effects Logit Model</i>	<i>Fixed Effects Logit Model</i>
<i>MAOs</i>	0.676*** (5.369)	0.486*** (3.804)
<i>Control Variables</i>	Y	Y
<i>Year Dummies</i>	Y	Y
<i>Observations</i>	22,850	7,465
<i>Number of Firms</i>	2,371	622

Robust z-statistics in parentheses

***, **, * Denote $p < 0.01$, $p < 0.05$, and $p < 0.1$, respectively.

Panel B: Alternative Models testing the Association between each type of MAO and Restatements

	(1)	(2)
	<i>Random Effects Logit Model</i>	<i>Fixed Effects Logit Model</i>
<i>UNQUALIFIED_EMP</i>	0.387*** (2.618)	0.252* (1.688)
<i>QUALIFIED</i>	1.195*** (5.490)	0.855*** (3.942)
<i>QUALIFIED_EMP</i>	1.225*** (3.933)	0.924*** (2.992)
<i>DISCLAIMER</i>	1.006*** (3.675)	0.887*** (3.202)
<i>Control Variables</i>	Y	Y
<i>Year Dummies</i>	Y	Y
<i>Observations</i>	22,850	7,465
<i>Number of Firms</i>	2,371	622

Robust z-statistics in parentheses

***, **, * Denote $p < 0.01$, $p < 0.05$, and $p < 0.1$, respectively.

(The table is continued on the next page.)

TABLE 9 (continued)

Panel C: Alternative Models testing the Association between Explanatory notes and Restatements

	(1) <i>Random Effects Logit Model</i>	(2) <i>Fixed Effects Logit Model</i>
<i>ACC_POL_INCON</i>	1.181* (1.915)	0.826 (1.362)
<i>EM_IMPOR_MAT</i>	0.593*** (3.494)	0.381** (2.248)
<i>AUD_RELAT_ISSUE</i>	0.677*** (3.353)	0.456** (2.287)
<i>FIN_DISTRESS</i>	-0.018 (0.110)	0.033 (0.202)
<i>VIO_APC</i>	0.282 (1.016)	0.190 (0.692)
<i>Control Variables</i>	Y	Y
<i>Year Dummies</i>	Y	Y
<i>Observations</i>	22,850	7,465
<i>Number of Firms</i>	2,371	622

Robust z-statistics in parentheses

***, **, * Denote $p < 0.01$, $p < 0.05$, and $p < 0.1$, respectively.

Panel D: Alternative Models testing the Association between Explanatory notes conditional on MAOs and Restatements

	(1) <i>Random Effects Logit Model</i>	(2) <i>Fixed Effects Logit Model</i>
<i>UNQUALIFIED_EMP</i>	1.269*** (2.770)	1.027** (2.286)
<i>OTHER_MAOs</i>	1.021*** (3.036)	0.781** (2.333)
<i>UNQUALIFIED_EMP x ACC_POL_INCON</i>	0.533 (0.585)	0.157 (0.173)

(The table is continued on the next page.)

TABLE 9 Panel D (continued)

	(1) <i>Random Effects Logit Model</i>	(2) <i>Fixed Effects Logit Model</i>
<i>UNQUALIFIED_EMP x EM_IMPOR_MAT</i>	-0.649 (1.575)	-0.720* (1.785)
<i>UNQUALIFIED_EMP x AUD_RELAT_ISSUE</i>	-0.395 (0.566)	-0.621 (0.938)
<i>UNQUALIFIED_EMP x FIN_DISTRESS</i>	-0.978** (2.209)	-0.750* (1.731)
<i>UNQUALIFIED_EMP x VIO_APC</i>	-1.182* (1.657)	-0.973 (1.369)
<i>OTHER_MAOs x ACC_POL_INCON</i>	0.600 (0.687)	0.534 (0.616)
<i>OTHER_MAOs x EM_IMPOR_MAT</i>	0.619** (2.105)	0.543* (1.849)
<i>OTHER_MAOs x AUD_RELAT_ISSUE</i>	0.182 (0.633)	0.054 (0.187)
<i>OTHER_MAOs x FIN_DISTRESS</i>	-0.602** (2.018)	-0.353 (1.185)
<i>OTHER_MAOs x VIO_APC</i>	0.194 (0.593)	0.070 (0.219)
<i>Control Variables</i>	Y	Y
<i>Year Dummies</i>	Y	Y
<i>Observations</i>	22,850	7,465
<i>Number of Firms</i>	2,371	622

Robust z-statistics in parentheses

***, **, * Denote $p < 0.01$, $p < 0.05$, and $p < 0.1$, respectively.

TABLE 10

Additional Test

Panel A: Association between MAOs and Restatements for SOE and Non-SOE

	<i>SOE</i>			<i>Non-SOE</i>		
	(1) <i>Baseline Logit</i>	(2) <i>Logit</i>	(3) <i>OLS</i>	(1) <i>Baseline Logit</i>	(2) <i>Logit</i>	(3) <i>OLS</i>
<i>MAOs</i>	1.062*** (7.373)	0.596*** (3.194)	0.044** (2.009)	1.396*** (9.868)	0.872*** (4.995)	0.067*** (3.604)
<i>Control Variables</i>	NO	YES	YES	NO	YES	YES
<i>Year Dummies</i>	YES	YES	YES	YES	YES	YES
<i>Industry Dummies</i>	YES	YES	YES	YES	YES	YES
<i>Observations</i>	12,569	12,569	12,569	10,281	10,281	10,281
<i>Number of Firms</i>			1,287			1,435

Robust z-statistics in parentheses

***, **, * Denote $p < 0.01$, $p < 0.05$, and $p < 0.1$, respectively.

TABLE 10

Additional Test

Panel B: Association between Each Type of MAO and Restatements for SOE and Non-SOE

	<i>SOE</i>			<i>Non-SOE</i>		
	(1)	(2)	(3)	(1)	(2)	(3)
	<i>Baseline Logit</i>	<i>Logit</i>	<i>OLS</i>	<i>Baseline Logit</i>	<i>Logit</i>	<i>OLS</i>
<i>UNQUALIFIED_EMP</i>	0.712*** (3.910)	0.305 (1.357)	0.011 (0.502)	1.042*** (5.214)	0.578** (2.500)	0.038* (1.795)
<i>QUALIFIED</i>	1.597*** (5.699)	1.165*** (3.959)	0.157*** (2.878)	1.902*** (7.873)	1.401*** (5.523)	0.128*** (3.297)
<i>QUALIFIED_EMP</i>	1.794*** (3.974)	1.245*** (2.642)	0.162** (1.992)	1.739*** (5.012)	1.164*** (3.250)	0.075 (1.276)
<i>DISCLAIMER</i>	1.765*** (5.214)	0.982** (2.290)	0.087 (1.059)	1.768*** (6.612)	1.013*** (3.135)	0.155*** (3.116)
<i>Control Variables</i>	NO	YES	YES	NO	YES	YES
<i>Year Dummies</i>	YES	YES	YES	YES	YES	YES
<i>Industry Dummies</i>	YES	YES	YES	YES	YES	YES
<i>Observations</i>	12,569	12,569	12,569	10,281	10,281	10,281
<i>Number of Firms</i>			1,287			1,435

Robust z-statistics in parentheses

***, **, * Denote $p < 0.01$, $p < 0.05$, and $p < 0.1$, respectively.

TABLE 10
Additional Test

Panel C: Association between Explanatory Notes and Restatements for SOE and Non-SOE

	<i>SOE</i>			<i>Non-SOE</i>		
	(1)	(2)	(3)	(1)	(2)	(3)
	<i>Baseline Logit</i>	<i>Logit</i>	<i>OLS</i>	<i>Baseline Logit</i>	<i>Logit</i>	<i>OLS</i>
<i>ACC_POL_INCON</i>	1.726** (2.042)	1.479* (1.695)	0.152 (1.036)	1.212 (1.084)	1.562 (1.247)	0.040 (0.384)
<i>EM_IMPOR_MAT</i>	0.764*** (3.089)	0.654*** (2.584)	0.050* (1.719)	0.986*** (3.982)	0.819*** (3.545)	0.038 (1.230)
<i>AUD_RELAT_ISSUE</i>	0.937*** (3.318)	0.645*** (2.310)	0.115** (2.251)	0.944*** (3.413)	0.683*** (2.573)	0.074*** (2.015)
<i>FIN_DISTRESS</i>	0.519*** (2.401)	-0.118 (0.484)	-0.027 (0.995)	0.699*** (3.027)	0.056 (0.214)	0.032 (1.247)
<i>VIO_APC</i>	0.123 (0.330)	0.131 (0.341)	0.004 (0.077)	0.357 (1.103)	0.131 (0.408)	0.049 (1.084)
<i>Control Variables</i>	NO	YES	YES	NO	YES	YES
<i>Year Dummies</i>	YES	YES	YES	YES	YES	YES
<i>Industry Dummies</i>	YES	YES	YES	YES	YES	YES
<i>Observations</i>	12,569	12,569	12,569	10,281	10,281	10,281
<i>Number of Firms</i>			1,287			1,435

Robust z-statistics in parentheses

***, **, * Denote $p < 0.01$, $p < 0.05$, and $p < 0.1$, respectively.

TABLE 10

Additional Test

Panel D: Association between Explanatory Notes conditional on MAOs and Restatements for SOE and Non-SOE

	<i>SOE</i>			<i>Non-SOE</i>		
	(1)	(2)	(3)	(1)	(2)	(3)
	<i>Baseline Logit</i>	<i>Logit</i>	<i>OLS</i>	<i>Baseline Logit</i>	<i>Logit</i>	<i>OLS</i>
<i>UNQUALIFIED_EMP</i>	1.216** (2.137)	1.096* (1.797)	0.053 (0.919)	1.333** (2.258)	1.013* (1.675)	0.081 (1.174)
<i>OTHER_MAOs</i>	1.624*** (3.478)	1.291*** (2.662)	0.191** (2.058)	1.560*** (4.002)	1.090*** (2.774)	0.072 (1.081)
<i>UNQUALIFIED_EMP x ACC_POL_INCON</i>	1.635 (1.335)	1.663 (1.197)	0.157 (0.669)	0.056 (0.051)	0.750 (0.665)	-0.028 (0.265)
<i>UNQUALIFIED_EMP x EM_IMPOR_MAT</i>	-0.426 (0.891)	-0.458 (0.923)	-0.028 (0.544)	0.002 (0.003)	0.035 (0.062)	-0.046 (0.736)
<i>UNQUALIFIED_EMP x AUD_RELAT_ISSUE</i>	0.653 (0.854)	0.597 (0.741)	0.145 (1.270)	-1.136 (0.976)	-1.117 (0.940)	-0.127 (1.360)
<i>UNQUALIFIED_EMP x FIN_DISTRESS</i>	-0.525 (0.922)	-1.003* (1.664)	-0.058 (1.077)	-0.324 (0.577)	-0.629 (1.139)	-0.038 (0.607)
<i>UNQUALIFIED_EMP x VIO_APC</i>	-1.627 (1.551)	-1.817 (1.618)	-0.143** (1.967)	-0.585 (0.798)	-0.876 (1.146)	0.007 (0.080)

(The table is continued on the next page.)

TABLE 10 Panel D (continued)

	<i>SOE</i>			<i>Non-SOE</i>		
	(1)	(2)	(3)	(1)	(2)	(3)
	<i>Baseline Logit</i>	<i>Logit</i>	<i>OLS</i>	<i>Baseline Logit</i>	<i>Logit</i>	<i>OLS</i>
<i>OTHER_MAOs x ACC_POL_INCON</i>	0.756 (0.991)	0.559 (0.699)	0.101 (0.580)	0.993 (0.631)	1.265 (0.669)	-0.004 (0.017)
<i>OTHER_MAOs x EM_IMPOR_MAT</i>	0.644 (1.568)	0.699* (1.688)	0.089 (1.171)	0.502 (1.425)	0.472 (1.352)	0.054 (0.839)
<i>OTHER_MAOs x AUD_RELAT_ISSUE</i>	-0.183 (0.453)	-0.273 (0.655)	-0.007 (0.094)	0.426 (1.253)	0.363 (1.076)	0.040 (0.745)
<i>OTHER_MAOs x FIN_DISTRESS</i>	-0.201 (0.514)	-0.780* (1.819)	-0.184** (2.312)	-0.283 (0.802)	-0.597 (1.506)	0.017 (0.268)
<i>OTHER_MAOs x VIO_APC</i>	-0.007 (0.015)	0.211 (0.422)	0.031 (0.355)	-0.054 (0.148)	-0.058 (0.159)	0.013 (0.215)
<i>Control Variables</i>	NO	YES	YES	NO	YES	YES
<i>Year Dummies</i>	YES	YES	YES	YES	YES	YES
<i>Industry Dummies</i>	YES	YES	YES	YES	YES	YES
<i>Observations</i>	12,569	12,569	12,569	10,281	10,281	10,281
<i>Number of Firms</i>			1,287			1,435

Robust z-statistics in parentheses

***, **, * Denote $p < 0.01$, $p < 0.05$, and $p < 0.1$, respectively.

TABLE 11

Additional Test for using subsample without Auditor Switches

Panel A: Association between MAOs and Restatements

	(1) <i>Baseline Logit</i>	(2) <i>Logit</i>	(3) <i>OLS</i>
<i>MAOs</i>	1.094*** (9.325)	0.658*** (4.129)	0.041*** (2.761)
<i>Control Variables</i>	NO	YES	YES
<i>Year Dummies</i>	YES	YES	YES
<i>Industry Dummies</i>	YES	YES	YES
<i>Observations</i>	18,598	18,598	18,598
<i>Number of Firms</i>			2,368

Robust z-statistics in parentheses

***, **, * Denote $p < 0.01$, $p < 0.05$, and $p < 0.1$, respectively.

Panel B: Association between Each Type of MAO and Restatements

	(1) <i>Baseline Logit</i>	(2) <i>Logit</i>	(3) <i>OLS</i>
<i>UNQUALIFIED_EMP</i>	0.781*** (4.916)	0.371* (1.912)	0.010 (0.645)
<i>QUALIFIED</i>	1.786*** (8.258)	1.389*** (5.786)	0.143*** (3.788)
<i>QUALIFIED_EMP</i>	1.325*** (3.793)	0.871** (2.396)	0.088 (1.426)
<i>DISCLAIMER</i>	1.390*** (5.468)	0.616* (1.838)	0.088* (1.854)
<i>Control Variables</i>	NO	YES	YES
<i>Year Dummies</i>	YES	YES	YES
<i>Industry Dummies</i>	YES	YES	YES
<i>Observations</i>	18,598	18,598	18,598
<i>Number of Firms</i>			2,368

Robust z-statistics in parentheses

***, **, * Denote $p < 0.01$, $p < 0.05$, and $p < 0.1$, respectively.

(The table is continued on the next page.)

TABLE 11 (continued)

Panel C: Association between Explanatory Notes and Restatements

	(1) <i>Baseline Logit</i>	(2) <i>Logit</i>	(3) <i>OLS</i>
<i>ACC_POL_INCON</i>	1.084 (1.269)	0.910 (1.028)	0.028 (0.247)
<i>EM_IMPOR_MAT</i>	0.719*** (3.106)	0.626*** (2.678)	0.010 (0.425)
<i>AUD_RELAT_ISSUE</i>	1.064*** (4.309)	0.780*** (3.180)	0.116*** (3.236)
<i>FIN_DISTRESS</i>	0.561*** (3.017)	-0.042 (0.188)	0.006 (0.336)
<i>VIO_APC</i>	-0.446 (1.169)	-0.491 (1.311)	-0.045 (1.243)
<i>Control Variables</i>	NO	YES	YES
<i>Year Dummies</i>	YES	YES	YES
<i>Industry Dummies</i>	YES	YES	YES
<i>Observations</i>	18,598	18,598	18,598
<i>Number of Firms</i>			2,368

Robust z-statistics in parentheses

***, **, * Denote $p < 0.01$, $p < 0.05$, and $p < 0.1$, respectively.

Panel D: Association between Explanatory Notes conditional on MAOs and Restatements

	(1) <i>Baseline Logit</i>	(2) <i>Logit</i>	(3) <i>OLS</i>
<i>UNQUALIFIED_EMP</i>	0.834* (1.682)	0.574 (1.124)	0.034 (0.714)
<i>OTHER_MAOs</i>	2.064*** (5.717)	1.770*** (4.709)	0.202*** (3.144)
<i>UNQUALIFIED_EMP x ACC_POL_INCON</i>	0.885 (0.774)	1.068 (0.798)	-0.001 (0.009)
<i>UNQUALIFIED_EMP x EM_IMPOR_MAT</i>	0.064 (0.152)	0.151 (0.354)	-0.035 (0.797)

(The table is continued on the next page.)

TABLE 11 Panel D (continued)

	(1) <i>Baseline Logit</i>	(2) <i>Logit</i>	(3) <i>OLS</i>
<i>UNQUALIFIED_EMP x AUD_RELAT_ISSUE</i>	0.629 (0.978)	0.647 (0.982)	0.135 (1.406)
<i>UNQUALIFIED_EMP x FIN_DISTRESS</i>	-0.083 (0.174)	-0.407 (0.829)	-0.021 (0.457)
<i>UNQUALIFIED_EMP x VIO_APC</i>	-1.693* (1.666)	-1.769* (1.722)	-0.086* (1.656)
<i>OTHER_MAOs x ACC_POL_INCON</i>	-0.191 (0.237)	-0.350 (0.436)	-0.001 (0.005)
<i>OTHER_MAOs x EM_IMPOR_MAT</i>	-0.022 (0.064)	-0.026 (0.074)	-0.036 (0.642)
<i>OTHER_MAOs x AUD_RELAT_ISSUE</i>	0.031 (0.100)	-0.076 (0.237)	0.001 (0.026)
<i>OTHER_MAOs x FIN_DISTRESS</i>	-0.655** (2.017)	-1.111*** (2.909)	-0.102* (1.696)
<i>OTHER_MAOs x VIO_APC</i>	-0.719 (1.645)	-0.624 (1.414)	-0.093 (1.589)
<i>Control Variables</i>	NO	YES	YES
<i>Year Dummies</i>	YES	YES	YES
<i>Industry Dummies</i>	YES	YES	YES
Observations	18,598	18,598	18,598
<i>Number of firms</i>			2,368

Robust z-statistics in parentheses
***, **, * Denote $p < 0.01$, $p < 0.05$, and $p < 0.1$, respectively.

TABLE 12
Cross-sectional Test for samples audited by Top 10 VS. Non-Top 10 Audit Firm
Panel A: Association between MAOs and Restatements

	<i>Top 10 Audit Firm</i>			<i>Non-Top 10 Audit Firm</i>		
	<i>(1)</i>	<i>(2)</i>	<i>(3)</i>	<i>(1)</i>	<i>(2)</i>	<i>(3)</i>
	<i>Baseline Logit</i>	<i>Logit</i>	<i>OLS</i>	<i>Baseline Logit</i>	<i>Logit</i>	<i>OLS</i>
<i>MAOs</i>	1.159*** (5.776)	0.365 (1.346)	0.023 (1.222)	1.167*** (10.611)	0.834*** (5.647)	0.067*** (3.343)
<i>Control Variables</i>	NO	YES	YES	NO	YES	YES
<i>Year Dummies</i>	YES	YES	YES	YES	YES	YES
<i>Industry Dummies</i>	YES	YES	YES	YES	YES	YES
<i>Observations</i>	10,434	10,434	10,434	12,416	12,416	12,416
<i>Number of Firms</i>			1,752			1,748

Robust z-statistics in parentheses

***, **, * Denote $p < 0.01$, $p < 0.05$, and $p < 0.1$, respectively.

TABLE 12
Cross-sectional Test for samples audited by Top 10 VS. Non-Top 10 Audit Firm
Panel B: Association between Each Type of MAO and Restatements

	<i>Top 10 Audit Firm</i>			<i>Non-Top 10 Audit Firm</i>		
	(1)	(2)	(3)	(1)	(2)	(3)
	<i>Baseline Logit</i>	<i>Logit</i>	<i>OLS</i>	<i>Baseline Logit</i>	<i>Logit</i>	<i>OLS</i>
UNQUALIFIED_EMP	0.784*** (3.011)	0.071 (0.211)	-0.001 (0.045)	0.814*** (5.465)	0.549*** (2.976)	0.028 (1.270)
QUALIFIED	1.775*** (4.679)	1.101** (2.571)	0.087* (1.826)	1.655*** (7.965)	1.306*** (6.018)	0.148*** (3.760)
QUALIFIED_EMP	1.461** (2.139)	0.707 (0.892)	0.153* (1.652)	1.686*** (5.759)	1.332*** (4.286)	0.171*** (2.651)
DISCLAIMER	1.776*** (4.041)	0.271 (0.487)	0.028 (0.438)	1.624*** (6.961)	1.117*** (3.885)	0.163*** (3.111)
<i>Control Variables</i>	NO	YES	YES	NO	YES	YES
<i>Year Dummies</i>	YES	YES	YES	YES	YES	YES
<i>Industry Dummies</i>	YES	YES	YES	YES	YES	YES
<i>Observations</i>	10,434	10,434	10,434	12,416	12,416	12,416
<i>Number of Firms</i>			1,752			1,748

Robust z-statistics in parentheses

***, **, * Denote $p < 0.01$, $p < 0.05$, and $p < 0.1$, respectively.

TABLE 12

Cross-sectional Test for samples audited by Top 10 VS. Non-Top 10 Audit Firm
Panel C: Association between Explanatory Notes and Restatements

	<i>Top 10 Audit Firm</i>			<i>Non-Top 10 Audit Firm</i>		
	(1)	(2)	(3)	(1)	(2)	(3)
	<i>Baseline Logit</i>	<i>Logit</i>	<i>OLS</i>	<i>Baseline Logit</i>	<i>Logit</i>	<i>OLS</i>
<i>ACC_POL_INCON</i>	3.221*** (5.007)	3.380*** (5.161)	0.245 (1.364)	0.603 (0.736)	0.624 (0.781)	0.028 (0.229)
<i>EM_IMPOR_MAT</i>	0.550* (1.748)	0.451 (1.465)	-0.007 (0.301)	0.878*** (4.206)	0.795*** (3.760)	0.056* (1.757)
<i>AUD_RELAT_ISSUE</i>	1.147*** (3.157)	0.898** (2.218)	0.107** (2.121)	0.935*** (4.392)	0.649*** (3.186)	0.109*** (2.979)
<i>FIN_DISTRESS</i>	0.555* (1.825)	-0.597 (1.529)	0.008 (0.323)	0.561*** (3.272)	0.150 (0.780)	0.008 (0.292)
<i>VIO_APC</i>	0.969** (2.087)	0.841* (1.736)	0.113* (1.719)	0.020 (0.066)	-0.076 (0.261)	-0.004 (0.074)
<i>Control Variables</i>	NO	YES	YES	NO	YES	YES
<i>Year Dummies</i>	YES	YES	YES	YES	YES	YES
<i>Industry Dummies</i>	YES	YES	YES	YES	YES	YES
<i>Observations</i>	10,434	10,434	10,434	12,416	12,416	12,416
<i>Number of Firms</i>			1,752			1,748

Robust z-statistics in parentheses

***, **, * Denote $p < 0.01$, $p < 0.05$, and $p < 0.1$, respectively.

TABLE 12

Cross-sectional Test for samples audited by Top 10 VS. Non-Top 10 Audit Firm
Panel D: Association between Explanatory Notes conditional on MAOs and Restatements

	<i>Top 10 Audit Firm</i>			<i>Non-Top 10 Audit Firm</i>		
	(1)	(2)	(3)	(1)	(2)	(3)
	<i>Baseline Logit</i>	<i>Logit</i>	<i>OLS</i>	<i>Baseline Logit</i>	<i>Logit</i>	<i>OLS</i>
<i>UNQUALIFIED_EMP</i>	1.061 (1.076)	0.662 (0.636)	-0.032 (0.617)	1.369*** (2.934)	1.179** (2.413)	0.119* (1.929)
<i>OTHER_MAOs</i>	-0.697 (0.723)	-1.117 (1.174)	-0.189** (2.533)	1.820*** (5.710)	1.492*** (4.663)	0.182*** (2.844)
<i>UNQUALIFIED_EMP x ACC_POL_INCON</i>	1.699 (1.327)	2.492* (1.904)	0.183 (0.986)	0.493 (0.420)	0.627 (0.470)	0.015 (0.071)
<i>UNQUALIFIED_EMP x EM_IMPOR_MAT</i>	-0.423 (0.454)	-0.450 (0.469)	-0.006 (0.120)	-0.260 (0.626)	-0.203 (0.474)	-0.084 (1.531)
<i>UNQUALIFIED_EMP x AUD_RELAT_ISSUE</i>	-	-		0.572 (0.792)	0.474 (0.627)	0.079 (0.578)
<i>UNQUALIFIED_EMP x FIN_DISTRESS</i>	-0.242 (0.257)	-0.865 (0.903)	0.044 (0.949)	-0.592 (1.318)	-0.787* (1.677)	-0.092 (1.566)
<i>UNQUALIFIED_EMP x VIO_APC</i>	-0.012 (0.010)	-0.104 (0.088)	0.071 (0.782)	-1.422** (2.129)	-1.612** (2.317)	-0.137** (2.039)

(The table is continued on the next page.)

TABLE 12 Panel D (continued)

	<i>Top 10 Audit Firm</i>			<i>Non-Top 10 Audit Firm</i>		
	(1)	(2)	(3)	(1)	(2)	(3)
	<i>Baseline Logit</i>	<i>Logit</i>	<i>OLS</i>	<i>Baseline Logit</i>	<i>Logit</i>	<i>OLS</i>
<i>OTHER_MAOs x ACC_POL_INCON</i>	-	-		-0.108	-0.026	-0.049
				(0.146)	(0.034)	(0.356)
<i>OTHER_MAOs x EM_IMPOR_MAT</i>	1.027*	1.227**	0.142**	0.372	0.407	0.073
	(1.686)	(2.025)	(2.063)	(1.251)	(1.389)	(1.259)
<i>OTHER_MAOs x AUD_RELAT_ISSUE</i>	1.915**	1.851**	0.230***	-0.127	-0.238	-0.012
	(2.295)	(2.328)	(3.018)	(0.454)	(0.860)	(0.223)
<i>OTHER_MAOs x FIN_DISTRESS</i>	0.512	-0.761	0.081	-0.308	-0.507	-0.069
	(0.855)	(1.033)	(1.122)	(1.063)	(1.595)	(1.137)
<i>OTHER_MAOs x VIO_APC</i>	1.092*	1.207	0.196***	-0.175	-0.114	-0.020
	(1.790)	(1.639)	(2.588)	(0.528)	(0.349)	(0.312)
<i>Control Variables</i>	NO	YES	YES	NO	YES	YES
<i>Year Dummies</i>	YES	YES	YES	YES	YES	YES
<i>Industry Dummies</i>	YES	YES	YES	YES	YES	YES
<i>Observations</i>	10,418	10,418	10,434	12,416	12,416	12,416
<i>Number of Firms</i>			1,752			1,748

Robust z-statistics in parentheses

***, **, * Denote $p < 0.01$, $p < 0.05$, and $p < 0.1$, respectively.

TABLE 13

Additional Test for using Sample without Missing Values

Panel A: Association between MAOs and Restatements

	(1) <i>Baseline Logit</i>	(2) <i>Logit</i>	(3) <i>OLS</i>
<i>MAOs</i>	1.388*** (11.610)	0.770*** (4.884)	0.068*** (4.053)
<i>Control Variables</i>	NO	YES	YES
<i>Year Dummies</i>	YES	YES	YES
<i>Industry Dummies</i>	YES	YES	YES
<i>Observations</i>	17,152	17,152	17,152
<i>Number of Firms</i>			2,328

Robust z-statistics in parentheses

***, **, * Denote $p < 0.01$, $p < 0.05$, and $p < 0.1$, respectively.

Panel B: Association between Each Type of MAO and Restatements

	(1) <i>Baseline Logit</i>	(2) <i>Logit</i>	(3) <i>OLS</i>
<i>UNQUALIFIED_EMP</i>	1.041*** (6.413)	0.471** (2.414)	0.031* (1.697)
<i>QUALIFIED</i>	1.729*** (7.433)	1.247*** (4.929)	0.121*** (3.088)
<i>QUALIFIED_EMP</i>	2.192*** (6.588)	1.567*** (4.679)	0.232*** (3.482)
<i>DISCLAIMER</i>	1.860*** (6.468)	0.814** (2.369)	0.154*** (2.786)
<i>Control Variables</i>	NO	YES	YES
<i>Year Dummies</i>	YES	YES	YES
<i>Industry Dummies</i>	YES	YES	YES
<i>Observations</i>	17,152	17,152	17,152
<i>Number of Firms</i>			2,328

Robust z-statistics in parentheses

***, **, * Denote $p < 0.01$, $p < 0.05$, and $p < 0.1$, respectively.

(The table is continued on the next page.)

TABLE 13 (continued)

Panel C: Association between Explanatory Notes and Restatements

	(1) <i>Baseline Logit</i>	(2) <i>Logit</i>	(3) <i>OLS</i>
<i>ACC_POL_INCON</i>	2.528*** (4.729)	2.526*** (3.755)	0.225* (1.851)
<i>EM_IMPOR_MAT</i>	1.082*** (5.101)	0.964*** (4.525)	0.057** (2.187)
<i>AUD_RELAT_ISSUE</i>	0.788*** (2.931)	0.476* (1.797)	0.070* (1.809)
<i>FIN_DISTRESS</i>	0.888*** (4.790)	0.027 (0.123)	0.037 (1.619)
<i>VIO_APC</i>	0.276 (0.771)	0.211 (0.608)	0.042 (0.861)
<i>Control Variables</i>	NO	YES	YES
<i>Year Dummies</i>	YES	YES	YES
<i>Industry Dummies</i>	YES	YES	YES
<i>Observations</i>	17,152	17,152	17,152
<i>Number of Firms</i>			2,328

Robust z-statistics in parentheses

***, **, * Denote $p < 0.01$, $p < 0.05$, and $p < 0.1$, respectively.

Panel D: Association between Explanatory Notes conditional on MAOs and Restatements

	(1) <i>Baseline Logit</i>	(2) <i>Logit</i>	(3) <i>OLS</i>
<i>UNQUALIFIED_EMP</i>	1.020* (1.782)	0.693 (1.156)	0.032 (0.485)
<i>OTHER_MAOs</i>	1.444*** (3.597)	1.045** (2.454)	0.117 (1.596)
<i>UNQUALIFIED_EMP x ACC_POL_INCON</i>	1.492* (1.673)	1.964** (1.972)	0.133 (0.793)
<i>UNQUALIFIED_EMP x EM_IMPOR_MAT</i>	0.066 (0.112)	0.219 (0.357)	-0.012 (0.185)

(The table is continued on the next page.)

TABLE 13 Panel D (continued)

	(1) <i>Baseline Logit</i>	(2) <i>Logit</i>	(3) <i>OLS</i>
<i>UNQUALIFIED_EMP x AUD_RELAT_ISSUE</i>	0.070 (0.062)	-0.059 (0.061)	0.046 (0.343)
<i>UNQUALIFIED_EMP x FIN_DISTRESS</i>	-0.057 (0.102)	-0.557 (0.946)	-0.006 (0.095)
<i>UNQUALIFIED_EMP x VIO_APC</i>	-0.263 (0.426)	-0.511 (0.762)	0.045 (0.633)
<i>OTHER_MAOs x ACC_POL_INCON</i>	1.986*** (3.143)	1.887** (2.368)	0.371*** (7.754)
<i>OTHER_MAOs x EM_IMPOR_MAT</i>	0.758** (2.050)	0.777** (2.111)	0.088 (1.323)
<i>OTHER_MAOs x AUD_RELAT_ISSUE</i>	-0.047 (0.139)	-0.122 (0.354)	-0.036 (0.565)
<i>OTHER_MAOs x FIN_DISTRESS</i>	0.284 (0.815)	-0.397 (1.048)	0.041 (0.673)
<i>OTHER_MAOs x VIO_APC</i>	-0.112 (0.280)	0.053 (0.132)	-0.021 (0.293)
<i>Control Variables</i>	NO	YES	YES
<i>Year Dummies</i>	YES	YES	YES
<i>Industry Dummies</i>	YES	YES	YES
<i>Observations</i>	17,152	17,152	17,152
<i>Number of Firms</i>			2,328

Robust z-statistics in parentheses

***, **, * Denote $p < 0.01$, $p < 0.05$, and $p < 0.1$, respectively.