Will Audit Background Executives Affect the Quality of Corporate Disclosure?

Based on the Empirical Evidence of Chinese Manufacturing Listed Companies

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Abstract. Based on the theory of senior management echelon and the theory of behavioral consistency, this paper holds that the background characteristics of audit background senior managers are unique because of their identity transformation from the supervisor to the regulated. It is necessary to further study the relationship between audit background executives and the quality of accounting information disclosure. This paper selects A-share listed companies in Shenzhen manufacturing industry from 2015 to 2018 as the research object, uses ordered logit model to analyze the impact of audit background executives on the quality of enterprise information disclosure, and integrates the property right nature to test the difference between them. The results show that: there is a significant negative correlation between the audit background and the quality of corporate information disclosure; at the same time, under the condition of distinguishing the nature of corporate property rights, there are differences in the impact of audit background executives on the quality of corporate information disclosure. In contrast, the negative effect of audit background executives on the quality of information disclosure in non-state-owned enterprises is more significant. This paper expands the research fields of the characteristics of senior executives' professional background and the quality of information disclosure, enriches the literature of the economic consequences of senior executives with audit background, and provides useful policy reference for improving the cost of violation of laws and regulations and the quality of information disclosure, and promoting the healthy and orderly development of capital market.

Keywords: Audit Background Executives · Disclosure Quality · Ordered Logit Model · Nature of Ownership · Corporate Governance

1 Introduction

Accounting information has become the focus of attention for investors, creditors, the public, regulators and other relevant stakeholders. In the current modern corporate system, adverse selection and moral hazard arising from information asymmetry between investors and management have in turn led investors to place higher demands on the

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quality of accounting information disclosure. The reason is that reliable and truthful, comprehensive and compliant accounting information disclosure is an important way to reveal the actual financial situation and operation of an enterprise, as well as an important reflection of the transparency of its accounting information.

2 Theoretical Analysis and Research Hypothesis

2.1 Audit Background Senior Executives and the Quality of Accounting Disclosures

Auditors will maintain their previous professional habits to remain alert to potential risks arising from inaccurate and erroneous financial statement information, which produces a cautionary constraint effect (Xuan, 2019) [1]. Klassen (2016) argues that senior executives with an auditing background who violate standards can seriously damage their own professional reputation when they are punished by the regulator and can seriously hinder their future career development [2]. Menon, Williams (2004), Gerger et al. (2008) argue that auditors with extensive experience in financial work have strong professional skills, who know better improve the disclosure of corporate information. It is also argued that senior executives with an audit background are familiar with the audit process and audit methods of the firm, they possess strong anti-audit capabilities (Lennox, 2005; Basioudis, 2007) [3, 4] that may use their mastery of accounting methods to circumvent the auditor's scrutiny and as a result, compromise the quality of accounting information disclosure. Secondly, Senior executives may adopt aggressive strategies to whitewash statements and provide false accounting information under the incentive of remuneration (Chun, 2015; Shahzad, 2019) [5, 6]. In addition, when the internal controls of listed senior executives are weak, senior executives with an auditing background may also reduce the quality of corporate disclosure out of a desire to protect their own interests (Schadewitz, 1988) [7]. Based on the above analysis, the competing hypotheses are presented here:

H1: Senior executives with an audit background will affect the quality of corporate disclosure.

H1a: Senior executives having an auditor background positively affects the quality of corporate disclosure.

H1b: Senior executives having an auditor background negatively affects the quality of corporate disclosure.

2.2 Nature of Ownership, Audit Background Executives and the Quality of Accounting Disclosure

Firstly, compared to foreign capital markets, the Chinese capital market has more state-owned listed companies. Senior executives of SOEs are more focused on responding to government policies (Eng, Mak, 2003) [8] and achieving personal political advancement (Xuan, 2019) [1] without excessive pressure to operate profitably, whereas the main objective of senior executives of non-SOEs is to enhance performance to maximize corporate profits. Secondly, due to their special political affiliations and economic functions, SOEs are highly influenced by policy factors, which may lead to differences between SOE executives and non-SOE executives in terms of the extent of disclosure of information in their statements (Li Shouxi, 2018) [9]. Zhou Yan and Yin et al. (2019) also confirmed this view through empirical tests, while finding that the quality of information disclosure of SOEs is consistently better than that of non-SOEs [10, 11]. Li Shouxi (2018) found through empirical analysis that there is a significant positive association between executive audit background and corporate surplus management in non-SOEs compared to SOEs [9]. Therefore, this paper infers that audit background senior executives in non-SOEs are more motivated to manipulate profits and disclose false financial information than audit background senior executives in SOEs, thereby compromising the quality of corporate disclosed information. Further, we propose the hypothesis that:

H2: Compared with SOEs, senior executives with audit background in non-SOEs have a more significant impact on the quality of corporate information disclosure.

3 Study Design

3.1 Sample Selection and Data Sources

This paper selects the data of A-share listed manufacturing companies in Shenzhen from 2015 to 2018 as the research sample and excludes the following data: (1) ST, *ST and PT companies; (2) Companies with obvious missing data or outliers. A strict screening was conducted to finally obtain 858 listed companies and 3,432 valid observation samples. The data analysis software used in this paper is Stata15.

3.2 Main Variable

Interpreted Variable.
The evaluation criteria of the Shenzhen Stock Exchange assess the information disclosure of listed companies in six aspects: truthfulness, accuracy, completeness, timeliness, fairness and legal compliance, which are divided into four levels: excellent, good, passing and failing, corresponding to the assessment levels of A, B, C and D. According to the four assessment levels of A, B, C and D, this paper assigns a value of 3,2,1,0.

Explanatory Variables.
In this paper, the audit background of executives is set as a dummy variable. The variable takes the value of 1 if there is a senior executive with audit background in the listed company, otherwise it takes the value of 0. In the group experiments, the sample companies were divided into SOEs and non-SOEs according to the nature of ownership of the listed companies. A value of 1 is taken if it is a SOE otherwise a value of 0.

Control Variables.
The control variables selected on the senior executives' characteristics contain the sex (Sex), age (Age), and educational background (Edu) of the executives. The control

variables selected on firm characteristics in this paper contain corporate profitability (ROA), ownership concentration (Top1), corporate size (Size), senior executive salary (Salary), dual role of chairman and general manager (Dual), and Short-term liquidity of the firm (Lev).

3.3 Model Construction

As the explanatory variables in this paper are dummy variables defined according to four levels of corporate disclosure quality A, B, C and D. And its dummy variables are ordered variables of 3,2,1,0, so it is appropriate to adopt Ordered Logit model. Through the above analyses, models (1) and (2) were constructed for testing according to the previous hypothesis 1 and hypothesis 2. In the robustness test, models (3) and (4) are constructed in this paper to test the hypotheses for robustness.

$$\begin{aligned} \mathrm{IDQ} = {} & \beta_0 + \beta_1 \mathrm{Audit} + \beta_2 \mathrm{State} + \beta_3 \mathrm{Sex} + \beta_4 \mathrm{Age} + \beta_5 \mathrm{Edu} \\ & + \beta_6 \mathrm{Roa} + \beta_7 \mathrm{Top1} + \beta_8 \mathrm{Size} + \beta_9 \mathrm{Salary} + \beta_{10} \mathrm{Dual} \\ & + \beta_{11} \mathrm{Lev} + \Sigma \mathrm{year} + \mu \end{aligned} \tag{1}$$

$$\begin{aligned} \mathrm{IDQ} = {} & \beta_0 + \beta_1 \mathrm{Audit} + \beta_2 \mathrm{Sex} + \beta_3 \mathrm{Age} + \beta_4 \mathrm{Edu} \\ & + \beta_5 \mathrm{Roa} + \beta_6 \mathrm{Top1} + \beta_7 \mathrm{Size} + \beta_8 \mathrm{Salary} \\ & + \beta_9 \mathrm{Dual} + \beta_{10} \mathrm{Lev} + \Sigma \mathrm{year} + \mu \end{aligned} \tag{2}$$

$$\begin{aligned} \mathrm{IDQ} = {} & \beta_0 + \beta_1 \mathrm{Audit\_N} + \beta_2 \mathrm{State} + \beta_3 \mathrm{Sex} + \beta_4 \mathrm{Age} \\ & + \beta_5 \mathrm{Edu} + \beta_6 \mathrm{Roa} + \beta_7 \mathrm{Top1} + \beta_8 \mathrm{Size} + \beta_9 \mathrm{Salary} \\ & + \beta_{10} \mathrm{Dual} + \beta_{11} \mathrm{Lev} + \Sigma \mathrm{year} + \mu \end{aligned} \tag{3}$$

$$\begin{aligned} \mathrm{IDQ} = {} & \beta_0 + \beta_1 \mathrm{Audit} + \beta_2 \mathrm{State} + \beta_3 \mathrm{Sex} + \beta_4 \mathrm{Age} \\ & + \beta_5 \mathrm{Edu} + \beta_6 \mathrm{Roe} + \beta_7 \mathrm{Top1} + \beta_8 \mathrm{Size} \\ & + \beta_9 \mathrm{Salary} + \beta_{10} \mathrm{Dual} + \beta_{11} \mathrm{Lev} + \Sigma \mathrm{year} + \mu \end{aligned} \tag{4}$$

4 Empirical Results and Analysis

4.1 Sample Descriptive Statistics

Table 1 shows that the average value of people with audit background in the company's senior management team is 0.609 and the median value is 1. This indicates that the quality of information disclosure by companies is generally at a passing level, but the overall level of accounting information disclosure by companies needs to be improved.

Table 1. Descriptive statistics for each variable

Variable	Sample size	Average	Standard deviation	Minimum	Maximum	Median
IDQ	3432	2.091	0.637	0	3	2
Audit	3432	0.609	0.488	0	1	1
State	3432	0.205	0.404	0	1	0
Sex	3432	0.807	0.110	0.375	1	0.818
Age	3432	49.056	2.992	38.857	61	49.132
Edu	3432	3.341	0.435	0	5	3.370
Roa	3432	0.055	0.103	-1.868	1.466	0.042
Top1	3432	7.226	15.626	1	298.608	3.093
Size	3432	22.022	1.009	17.575	26.269	21.926
Salary	3432	14.384	0.640	12.124	17.103	14.347
Dual	3432	0.319	0.466	0	1	0
Lev	3432	0.362	0.185	0.001	1.622	0.352

4.2 Pearson Correlation Coefficient

From Table 2, we can find that there is a significant correlation between audit background senior management and corporate disclosure quality at the 1% level, which initially verifies hypothesis 1. In addition, there is also a significant correlation between the nature of property rights and corporate disclosure quality at the 1% level, which initially verifies hypothesis 2. Overall, the correlation coefficients between all variables are less than 0.5, which indicates that the model in this paper basically excludes serious multicollinearity. The correlation coefficients between all variables are less than 0.5, which indicates that the model in this paper basically excludes the problem of serious multicollinearity.

4.3 Multiple Regression Analysis

Table 3 presents the regression results analysis of the impact of audit background executives on corporate disclosure quality in this paper. The regression results for the full sample reveal that, controlling for other variables, audit background executives (Audit) are related to corporate information disclosure quality (ICQ) and significantly negatively correlated at the 1% level with a correlation coefficient of -0.347. This indicates that listed companies with audit background senior executives have lower corporate information disclosure quality. Hypothesis H1b is supported. Further, the full sample regression found that the nature of ownership (State) had a significant effect on the quality of corporate disclosure at the 1% level. Table 3 reveals that in the sample of SOEs, the coefficient between audit background senior executives and corporate disclosure quality is negative, at -0.226, but not significant. In the non-SOE sample, the relationship between audit background executives and corporate disclosure quality is negative at the 1% level, with a coefficient of -0.374. This indicates that the impact of audit background executives on

Table 2. Pearson correlation coefficient table

	IDQ	Audit	State	Sex	Age	Edu
IDQ	1.000					
Audit	-0.125***	1.000				
State	0.102***	-0.166***	1.000			
Sex	0.045**	-0.088***	0.216***	1.000		
Age	0.123***	-0.139***	0.258***	0.276***	1.000	
Edu	0.083***	-0.131***	0.291***	0.097***	0.057***	1.000
Roa	0.237***	-0.027	-0.051***	-0.001	-0.010	0.007
Top1	0.021	-0.077***	0.169***	0.039*	0.069***	0.039*
Size	0.180***	-0.117***	0.291***	0.131***	0.175***	0.211***
Salary	0.222***	-0.068***	0.074***	0.048**	0.118***	0.314***
Dual	-0.007	0.028	-0.235***	-0.129***	-0.162***	-0.037*
Lev	-0.106***	-0.038*	0.196***	0.123***	0.024*	0.094***

	Roa	Top1	Size	Ind	Dual	Lev
Roa	1.000					
Top1	-0.019	1.000				
Size	0.124***	0.127***	1.000			
Salary	0.168***	-0.066***	0.410***	1.000		
Dual	0.022	-0.040*	-0.099***	0.003	1.000	
Lev	-0.065***	0.087***	0.443***	0.064***	-0.020	1.000

Note: ***, **, * indicate significant correlations at 1%, 5%, and 10%, respectively.

corporate disclosure quality is more significant in non-SOEs compared to SOEs. This tentatively verifies hypothesis H2.

4.4 PSM Sample-Based Paired Tests

To mitigate the effect of sample bias on the experimental findings, the propensity score matching (PSM) method was chosen for robustness testing in this paper. Table 4 conducts a one-to-one balance test and finds that the standardized bias after matching is below 10% and the bias is reduced to a greater extent in both the treatment and control groups, with both p-values becoming larger, indicating that the covariates all pass the balance test and that propensity score matching significantly reduces the differences in characteristics between listed companies with and without executives with audit backgrounds. Table 5 provides further regression tests for model (1) based on the post-PSM paired sample and finds consistent with the previous findings.

Table 3. Results of regression analysis

	IDQ		
	Full sample	SOEs	Non-SOEs
Audit	-0.347*** (-4.62)	-0.226 (-1.40)	-0.374*** (-4.37)
State	0.389*** (3.79)		
Sex	-0.058 (-0.17)	-1.879* (-2.00)	0.259 (0.70)
Age	0.054*** (4.15)	0.056 (1.53)	0.052*** (3.70)
Edu	-0.060 (-0.65)	-0.197* (-0.93)	-0.012 (-0.11)
Roa	4.485*** (9.49)	0.627 (1.17)	7.048*** (11.95)
Top1	0.002 (0.85)	-0.000 (-0.03)	0.005 (1.23)
Size	0.371*** (8.03)	0.304*** (3.41)	0.398*** (7.13)
Salary	0.513*** (7.55)	0.641*** (4.20)	0.466*** (6.11)
Dual	0.140 (1.76)	0.454 (1.68)	0.139 (1.65)
Lev	-2.418*** (-10.73)	-2.477*** (-5.02)	-2.430*** (-9.44)
R2	0.091	0.081	0.103
N	3432	721	2711
Year/Industry	Control	Control	Control

Note: ***, **, * indicate significant correlations at 1%, 5%, and 10%, respectively.

Table 4. PSM one-to-one balance test

Variable	U unmatched / M matched	Average		Standard deviation		t-test	
		Processing group	Control group	Standard deviation	Deviation reduction	T	p > |t|
State	U	0.150	0.289	-33.9	99.3	-9.90	0.000
	M	0.150	0.149	0.2		0.09	0.931
Sex	U	0.800	0.819	-17.8	68.1	-5.04	0.000
	M	0.800	0.806	-5.7		-1.81	0.071
Age	U	48.719	49.568	-28.8	91.9	-8.18	0.000
	M	48.722	48.653	2.3		0.75	0.453
Edu	U	3.296	3.413	-27.0	99.9	-7.72	0.000
	M	3.297	3.297	-0.0		-0.01	0.992
Roa	U	0.052	0.058	-5.6	54.2	-1.61	0.108
	M	0.053	0.056	-2.6		-0.98	0.325
Top1	U	6.287	8.691	-14.5	94.8	-4.38	0.000
	M	6.289	6.413	-0.7		-0.33	0.741
Size	U	21.926	22.161	-23.3	93.5	-6.71	0.000
	M	21.928	21.913	1.5		0.51	0.612
Salary	U	14.350	14.438	-13.8	88.5	-3.92	0.000
	M	14.351	14.361	-1.6		-0.51	0.608
Dual	U	0.330	0.304	5.8	48.0	1.64	0.100
	M	0.330	0.344	-3.0		-0.95	0.341
Lev	U	0.357	0.370	-7.0	81.3	-1.99	0.046
	M	0.357	0.359	-1.3		-0.42	0.673

Table 5. Regression results based on PSM

Variable	Models (1)
Audit	-0.228* (-2.21)
State	0.321* (2.25)
Sex	0.520 (1.04)
Age	0.020 (1.05)
Edu	-0.096 (-0.72)
Roa	4.413*** (6.68)
Top1	-0.004 (-1.08)
Size	0.448*** (6.47)
Salary	0.532*** (5.32)
Dual	-0.014 (-0.12)
Lev	-2.739*** (-8.21)
R2	0.095
N	2547
Year/Industry	Control

Note: ***, **, * indicate significant correlations at 1%, 5%, and 10%, respectively.

5 Conclusion

The detailed findings are as follows: (1) There is a significant negative relationship between senior executives with audit background and corporate disclosure quality of listed companies, which indicates that senior executives with audit background characteristics will reduce the quality of corporate disclosure. (2) Compared with SOEs, non-SOEs with audit background senior executives have poorer disclosure quality and information disclosure. Moreover, compared with SOEs, non-SOEs with audit background executives have a significant negative relationship with the quality of corporate disclosure.

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