

The Inhibitory Effect of External Audit Quality on Corporate Information Disclosure Violations—An Empirical Test Based on A-Share Listed Companies

Jingxi Xiong

*Faculty of Economics and Administration, Universiti Malaya, Kuala Lumpur, Malaysia
24056584@siswa.um.edu.my*

Abstract. Although information disclosure is crucial for capital market pricing efficiency and investor protection in recent years, the A-share market has still frequently exposed cases of financial fraud, false statements and other violations, and the market order and investors' trust have been damaged to varying degrees. Against this background, how to effectively curb corporate violations through external governance mechanisms has become an important issue. As a key external supervision force, independent audit plays an irreplaceable role in defense in preventing corporate compliance risks. For the 2015–2024 period, this paper examined A-share listed firms, measuring audit quality by the receipt of standard unqualified opinions and estimating the impact on disclosure violations through logit and probit regressions. This paper finds that the higher the audit quality, the lower the possibility of information disclosure violations. This is mainly because strict audit procedures can restrain opportunistic management behavior, thereby reducing the risk of violations. After controlling for fixed characteristics at the annual and industrial levels and re-estimating with a probit model, this result has not changed. This study enriches the relevant literature of external corporate governance, and provides empirical evidence for regulatory authorities to optimize differentiated inspection strategies and investors to assess the risk of corporate violations.

Keywords: External Audit Quality, Violation of Information Disclosure, Corporate Governance, Standard Unqualified Opinion

1. Introduction

The quality of information disclosure is a prerequisite for the effective operation of the capital market. It not only compresses the space of information asymmetry, but also holds the bottom line of the protection of investors' interests. However, although the regulators continue to strengthen the requirements for information disclosure, in recent years, China's A-share market financial fraud, false statements and other violations are still repeated [1]. The number of illegal information disclosure cases investigated and dealt with by the CSRC remains high every year. The market pricing mechanism has been impacted, and the confidence of small and medium-sized investors has also been hit. In this context, exploring the external governance mechanism that can effectively curb

the violation of information disclosure has become an urgent issue of common concern in academia and practice.

As an important external supervision force, independent audit plays a key role in alleviating agency conflict and reducing the opportunism space of management. The accuracy of the owner's decision-making is closely related to the information disclosure quality, which thereby depends on whether the certified public accountants are really diligent in the audit work [1]. In recent years, with the implementation of the new securities law and the compaction of the "gatekeeper" responsibility, the legal risks and reputation constraints faced by auditors have been significantly enhanced, and the information content and market deterrence effect of audit opinions have also undergone profound changes [2]. The new securities law implementation has greatly affected the future development orientation and the CPA industry direction, especially in terms of information disclosure and punishment [3]. The linkage between audit quality and corporate information disclosure is widely explored within existing scholarly work. As for the issue of "whether audit quality can directly affect information disclosure", some scholars have found that too much management power will lower the quality of Information Disclosure, and the more the audit quality is not in place, the more prominent the problem is [4]. There are more than one economic cost for information disclosure violations. Taking audit fees as an example, the audit fees of illegal enterprises tend to rise; one of the key reasons is the damage to the company's reputation - the study found that reputation damage just acts as a "bridge" between illegal behavior and the rise of audit fees [5]. The impact of audit quality is not only at the enterprise level, but also in the whole market. The study found that the higher the audit quality of listed companies, the lower the risk of stock price crash -- and the quality of accounting information disclosure plays a significant part in the transmission [6]. In addition, from the perspective of information disclosure at the industry level, some scholars found that targeted information disclosure in the industry can improve information transparency and the information spillover effect, and auditors are more likely to find abnormalities, which improves audit quality [7]. In terms of audit selection, enterprises with poor performance tend to hire large-scale accounting firms to cope with the pressure of risk disclosure [8]. At the same time, audit quality also has an important impact on enterprise value. Effective external audit can assist enterprises in enhancing financial information quality, maintaining and enhancing enterprise value [9]. However, most of the existing literature starts with indirect indicators such as earnings quality to test the governance role of audit, financial restatement, or accounting information transparency, and the empirical research on the direct link between external audit and information disclosure violations directly investigated and dealt with by regulators is still relatively limited. In order to make up for the above research gap, this paper directly links the external audit quality with the information disclosure violations of listed companies recognized by the regulatory authorities, and tests the governance effect of audit with a more practical approach. Following this line of thought, this study selects the A-share listed firms over the period 2015-2024 as research samples and makes an empirical analysis, takes "whether to obtain standard unqualified audit opinion" as the proxy variable of external audit quality, constructs logit and probit multiple regression models, controls the year and industry fixed effect, and empirically tests the audit quality inhibitory effect on information disclosure violations. This paper aims to explore the independent deterrent effect of accurately identifying high-quality audit after stripping the confusing factors such as enterprise financial characteristics and corporate governance structure [10]. From the perspective of principal-agent theory and information asymmetry theory, this study puts forward the following research hypotheses: H1: under other conditions unchanged, the higher the quality of external audit, the lower the probability of information disclosure violations.

2. Research design

2.1. Sample selection and data source

A-share listed firms serve as the initial sample for this empirical study. To ensure data quality, this paper applied the following filters: first, the financial and insurance companies were excluded. Second, enterprises with ST and *st financial anomalies. There are 36284 valid samples in this paper. The Corporate Information Disclosure Violation data, financial data, corporate governance data and external audit opinion type data used in this paper are all from the CSMAR database.

2.2. Variable definition

Explained variable: Information Disclosure Violation. If the enterprise has information disclosure violations in the current year, it is assigned a value of 1, otherwise, it is 0.

Explanatory variable: external audit quality (audit_qual). If auditors issue standard unqualified audit opinions, the value is assigned as 1, and if auditors issue non-standard audit opinions, it is 0.

Control variables include property right nature (SOE), customer concentration (concentration), enterprise size (size), asset liability ratio (Lev), profitability (ROE), operating income growth (growth), and the proportion of independent directors (indep). The specific definitions and calculation methods of each variable are shown in Table 1.

Table 1. Variable definitions and measurement

Variable type	Variable name	Variable symbol	Variable calculation method and description
Explained variable	Information Disclosure Violation	Violation	Virtual variable, take 1 for information disclosure violations in the current year, otherwise take 0
Explanatory variable	External audit quality	audit_qual	Dummy variable, the value of the standard unqualified audit opinion issued by the auditor is 1, otherwise it is 0
	company size	Size	Continuous variable, natural logarithm of total operating income in the current year
	Asset liability ratio	Lev	Lev continuous variable, total liabilities at the end of the year/total assets at the end of the year
control variable	Profitability	Roe	Roe continuous variable, net profit of the current year/total shareholders' equity at the end of the year (return on net assets)
	Growth rate of operating revenue	Growth	(current year's operating revenue - last year's operating revenue)/last year's operating revenue
	Nature of property rights	SOE	Virtual variable, the actual controller is state-owned, take 1, otherwise take 0

Table 1. (continued)

control variable	Board independence	Indep	Number of independent directors/total number of directors
	Customer concentration	Concentration	Continuous variable, total sales of top five customers/total operating revenue

2.3. Model construction

Given that the dependent variable, information disclosure violation, is a typical 0-1 binary dummy variable, this paper constructs the following logit multiple regression model for benchmark empirical test.

$$\text{Logit}(\text{violation}_{i,t}=1)=\beta_0+\beta_1\text{audit}_{\text{qual}_{i,t}}+\sum\beta_k\text{Control}_{i,t}+\text{IndustryFE}+\text{YearFE}+\varepsilon_{I,T} \quad (1)$$

In formula (1), subscripts I and t represent the enterprise and year, respectively. $\text{Logit}(\text{violation}_{i,t}=1)$ Is the explained variable, which indicates the logarithmic probability of corporate disclosure violations; $\text{audit}_{\text{qual}_{i,t}}$ the key explanatory variable captures external audit quality. $\text{Control}_{i,t}$ It is a group of control variables, covering the nature of property rights, customer concentration, enterprise size, asset-liability ratio, profitability, revenue growth rate and the proportion of independent directors. β_0 Is the intercept item, β_1 Is the core concern coefficient. If β_1 significant and negative, it shows that a high-quality external audit can significantly inhibit corporate violations. In addition, the model controls for the year (YearFE) and the industry fixed effect (IndustryFE), and makes a cluster-robust standard error adjustment at the company level (stkcd).

3. Empirical results and analysis

3.1. Descriptive statistics

Table 2. descriptive statistical results

	(1)	(2)	(3)	(4)	(5)
Variables	Sample size	Average	Standard deviation	Minimum value	Maximum value
lev	36,284	0.404	0.203	0.0545	0.917
roe	36,284	0.0366	0.192	-1.432	0.326
growth	36,284	0.137	0.378	-0.607	2.300
size	36,284	21.51	1.475	18.41	25.75
indep	36,284	37.92	5.343	33.33	57.14
soe	36,284	0.291	0.454	0	1
violation	36,284	0.190	0.392	0	1

Table 2. (continued)

concentration	36,284	0.604	0.456	0.0174	1.933
audit_qual	36,284	0.968	0.175	0	1

Table 2 shows that the main variables show good statistical laws. Among them, the average value of corporate information disclosure violations is low, and most enterprises remain compliant. The mean value of the core explanatory variable, audit quality, is close to 1, and the vast majority of enterprises have obtained standard unqualified opinions. From the perspective of control variables, customer concentration shows that the sample enterprises have a certain degree of dependence on large customers, and the values of asset liability ratio, enterprise size, return on net assets and other indicators are within the normal range, and no extreme abnormal values are found. On the whole, the characteristics of these data are consistent with China's capital market actual solution and there is no obvious sample selection error, which is suitable for further multiple regression test.

3.2. Principal regression analysis

Table 3. Logit benchmark regression results

	(1)
Variables	Violation
audit_qual	-1.171*** (-15.147)
soe	-0.276*** (-5.992)
concentration	-0.005 (-0.125)
size	-0.120*** (-7.474)
lev	1.647*** (14.718)
roe	-0.897*** (-10.066)
growth	0.079*

Table 3. (continued)

	(1.909)
indep	0.005*
	(1.712)
Constant	1.592***
	(4.140)
Observations	36,252
Year FE	YES
Industry FE	YES

Robust Z-statistics in brackets, *** p<0.01, ** p<0.05, * p<0.1

Table 3 presents the logit regression results. Audit_qual coefficient was -1.171, and the significance level reached 1%. In other words, under the premise of the same other conditions, high-quality audit services can really play a strong external governance effect. Through strict audit and reputation deterrence, it can directly restrict the opportunistic motivation of management, so as to significantly curb the information disclosure violations of enterprises. The core hypothesis H1 of this paper has been confirmed by strong empirical data. Look at the control variables. The coefficient symbols of most variables, such as enterprise size and profitability, are in line with previous literature expectations, indicating that large-scale and profitable enterprises usually have a more standardized information disclosure mechanism, and the probability of violation is relatively low. The overall empirical conclusion is highly consistent with the macro reality of China's current strictly regulated market.

3.3. Robustness test

Table 4. robustness test results of probit model

	(1)
Variables	Probit
audit_qual	-0.704***
	(-15.211)
soe	-0.153***
	(-6.050)
concentration	-0.003
	(-0.145)

Table 4. (continued)

size	-0.068*** (-7.574)
lev	0.937*** (14.870)
roe	-0.548*** (-10.752)
growth	0.050** (2.179)
indep	0.003 (1.601)
Constant	0.918*** (4.206)
Observations	36,252
Year FE	YES
Industry FE	YES

Rbust Z-statistics in brackets,*** p<0.01, ** p<0.05, * p<0.1

After replacing the logit model with a probit model, this paper makes a further robustness test on the benchmark results. From the probit multiple regression results in Table 4. Table 4 shows the probit model regression result. After controlling for year and industry fixed effects, the audit_qual coefficient is -0.704, meaning it is still significant at the level of 1%. This shows that the audit inhibitory effect on violations is relatively solid, not supported by time trends or industry differences. The coefficient direction and significance of the control variables are also similar to those of the benchmark regression. On the whole, the core conclusion of this paper has not changed substantially due to the change of the measurement model, and the empirical results have good robustness.

4. Conclusion

This paper is concerned with whether the external audit quality can inhibit the enterprises' information disclosure violations. This paper uses 36284 observations of A-share listed companies. After controlling for the year and the fixed effect of the industry, the results of logit and probit models are highly consistent: the audit_qual coefficient is significantly negative at the 1% level. In other words, even if macro trends and industry differences are eliminated, high-quality audit (such as obtaining standard unqualified opinions) can still form effective supervision pressure and reputation constraints on management, thus reducing the probability of information disclosure violations. The main test hypothesis H1 has been strongly confirmed. This study enriches the relevant literature of external corporate governance and provides empirical evidence for the regulatory authorities to optimize the differentiated audit

Based on the research conclusion, the following two suggestions are put forward:: First, the regulatory authorities should optimize the differentiated audit strategy, take the type of external audit opinion as an important pre indicator to assess the risk of corporate violations, and implement precise supervision on high-risk enterprises that obtain non-standard audit opinions; Second, listed companies should actively introduce high-quality external audit, give full play to the external governance effectiveness and the role of "gatekeeper" of independent auditors, strengthen reputation constraints to restrict the self-interest motivation of management, and standardize information disclosure behavior and prevent compliance risks from the source.

References

- [1] Sun, Y., & Sun, Y. J. (2022). CPAs' diligent and conscientious thinking. *Cooperative Economy and Technology*, (15), 186–187.
- [2] Liu, X. H. (2022). Research on the impact of the implementation of the new securities law on the CPA industry and countermeasures. *Accounting Research*, (5), 82–84.
- [3] Wang, C. F., Ge, Q. C., & Guo, Y. N. (2022). Administrative supervision measures and auditor reputation damage. *Accounting Research*, (10), 144–156.
- [4] Dong, T. Y., Wang, Y. T., & Sun, C. H. (2022). Social media attention and audit quality: A test from the perspective of public opinion pressure. *Auditing Research*, (2), 71–80.
- [5] Huang, C., & Wang, M. Y. (2022). The impact of information disclosure violations on audit fees. *Securities Market Herald*, (2), 56–66.
- [6] Chen, Z. X., & Xu, B. (2023). Accounting information disclosure quality, audit quality and stock price crash risk. *Business Accounting*, (22), 70–73.
- [7] Huang, H., & Zhao, L. (2023). Industry specific information disclosure and audit quality: A study based on a "quasi natural experiment". *Auditing Research*, (3), 136–147.
- [8] Yao, Y., & He, M. (2021). Does risk information disclosure need the protection of audit? *Future and Development*, 45(10), 74–84, 73.
- [9] Lin, Z. Q., & Yu, C. P. (2021). An empirical study on the impact of earnings management on financial restatement: Based on the regulatory role of audit quality. *Journal of Changsha University of Science and Technology (Social Science Edition)*, 36(1), 102–109.
- [10] Zhu, J. (2020). The dark side of corporate financialization: Evidence from information disclosure violations of listed companies. *Financial Economics Research*, 35(1), 146–160.