THE ASSOCIATION BETWEEN CORPORATE GOVERNANCE AND AUDIT QUALITY: EVIDENCE FROM TAIWAN

Yu-Shan Chang, Wuchun Chi, Long-Jainn Hwang and Min-Jeng Shiue

ABSTRACT

Purpose – *Audit quality is traditionally defined as the joint probability that an existing problem is discovered and reported by the auditor. This study examines whether and how audit quality is associated with related-party transactions and CEO duality. The first part (i.e., the ability to discover) is related to* professional judgment*, and the second part (i.e., report truthfully) is related to* independence.

Methodology/Approach – *Regression methods was used on archival data.*

Findings – *Our results reveal that for publicly held companies in environments with stronger capital market discipline, which causes greater reputation concerns and litigation risks, a CEO who is also the board chair does not hinder auditor independence. For privately held companies, however, such a CEO hinders auditor independence due to a lack of capital market discipline. The findings on related-party financing,*

on the other hand, are reversed. That is, in terms of information for an auditor, since the conflicts of interests are more severe in publicly held companies than in privately held companies, the relevance of related-party financing to a decision whether to issue a going-concern opinion is greater in publicly held companies.

Social implications – *The empirical results of publicly held companies are useful for countries with better corporate governance, while those of privately held companies are helpful for countries with relatively weak corporate governance.*

Originality/Value of paper – *Because auditors performing audit services face different litigation risks and reputation concerns, the differences in our results between the two types of clients can have implications about the suitability of these types of companies in emerging markets.*

INTRODUCTION

Audit quality is traditionally defined as the joint probability that an existing problem is discovered and reported by the auditor (DeAngelo, 1981). In academic studies of auditing, corporate governance is usually considered solely in its relation to auditor independence (see, e.g., Bedard, Chtourou, & Courteau, 2004; Carcello & Neal, 2000, 2003; Ruder, 2002). Following prior studies (DeFond, Raghunandan, & Subramanyam, 2002; Li, 2009; Reynolds & Francis, 2001), audit quality is measured by the probability of the auditors' issuing a going concern (GC) opinion. This study not only examines whether and how CEO duality influence auditors' reporting decisions, but also analyzes whether and how the level of related-party transactions is related to auditors' professional judgment. This is important because, according to auditing standards, auditors should collect *information* and use their professional judgment to draw fair conclusions about the companies that they are auditing, and express those conclusions in their reports. We investigate whether related-party transactions affect auditors' professional judgment.

The role of the two variables, CEO duality and the level of related-party transactions, are different in our study. GC opinions are not issued solely

due to auditor independence, they depend initially on professional judgment. It is only after professional judgment indicates that a GC opinion should be issued that the question of auditor independence can arise. Professional judgment is therefore prior to the issue of independence; yet, the latter is the more commonly examined variable. We believe that a complete analysis incorporating both professional judgment and independence can offer a more realistic view of the effects of corporate governance on audit quality.

Uniquely, we include both listed and unlisted companies to address our research issues, allowing us to have a better understating whether related-party transactions and CEO duality affect the likelihood of an auditor's issuing a GC opinion. This is important because Hope and Langli (2010) indicate that unlisted companies are less likely to impose reputation risks on auditors, which implies that the negative effect of CEO duality, if any, will be more severe in *privately held* companies. We expect that the usefulness of the information of the level of related-party transactions will be greater in *publicly held* companies.

To explore the issues, we examine two corporate governance variables: whether the CEO simultaneously serves as the chairperson of the board (hereafter DUAL) and related-party financing (RPF). The variable DUAL was chosen to address the debate on whether a CEO should serve as the chair of a majority-independent board. On the one hand, a dual-role CEO enhances a firm's performance by having a focused direction for the firm's strategies and operations. On the other hand, when corporate insiders other than the CEO are absent from a majority-independent board, directors become more dependent upon their link with the CEO for inside information. As a result, critical information is often hidden from the directors or falsified (Mitchell, 2005), and the CEO may therefore unduly influence the boards on many decisions (Chang & Sun, 2010). Many studies support the perspective that the dual-role CEO is negatively related to earnings quality. For example, Anderson, Deli, and Gillan (2003) find that earnings informativeness is positively related to companies with separate CEO and chair positions. Chang and Sun (2009) also find a negative relation between dual-role CEOs and earnings informativeness after SOX in cross-listed foreign companies. Since our sample is composed of financially distressed companies, the power of the board to monitor management will be weaker when a firm has a dual-role CEO. Specifically, for auditors of companies that are financially distressed, the likelihood of their compromising independence is greater when they face a dual-role CEO than when the CEO does not chair a board with an independent majority

(Elloumi & Gueyié, 2001). Therefore, we believe that the variable DUAL is useful to examine how corporate governance affects auditor independence.

RPF is used in this study not to examine auditor independence, but instead to explore whether RPF is relevant information, other things being equal, for auditors who audit financially distressed companies. Statement on Auditing Standard No. 59 (ASB, 1988) requires auditors to assess whether there is substantial doubt as to a client's ability to continue as a GC. SAS No. 59 directs auditors to evaluate four major categories of client characteristics: negative financial trends, other financial difficulties, internal problems, and external matters. In Taiwan, the source of the data in this study, related-party transactions are one characteristic that has been identified as damaging to firm value. Yeh, Lee, and Ko (2002), for example, point out that there are many irregular related-party transactions in Taiwan, and that those transactions, conducted by insiders with private information, hinder firm value. Apparently, RPF, an important variable in emerging markets (La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 1997, 1998, 1999, 2000; Peng, John Wei, & Yang, 2011), is not related to independence, but higher RPF increases the likelihood of expropriation between related companies when one or more of those companies are distressed. A large body of empirical evidence has shown that controlling shareholders may take advantage of minority shareholders through related-party transactions (Berkman, Cole, & Fu, 2009; Cheung, Rau, & Stouraitis, 2006; Johnson, La Porta, Shleifer, & Vishny, 2000).

Following prior studies (DeFond et al., 2002; Li, 2009; Reynolds & Francis, 2001), we use auditors' propensity to issue GC opinions as a proxy for auditor independence. However, GC opinions are not issued solely due to auditor independence; they depend initially on professional judgment. It is only after professional judgment indicates that a GC opinion should be issued that the question of auditor independence can arise. Professional judgment is, therefore, prior to the issue of independence, yet the latter is the more commonly examined variable. We believe that a complete analysis incorporating both professional judgment and independence can offer a more realistic view of the effects of corporate governance on audit quality.

In addition to examining both professional judgment and independence of auditors, this paper also offers a comparison of publicly held and privately held companies. We are able to do so due to a distinct feature of disclosure regulations in Taiwan: Like publicly held companies, privately held companies in Taiwan must provide audited financial statements to the public. (Details of these regulations are given in the following section.) Our evidence suggests that,

in terms of the propensity of issuing GC opinions, the effects of corporate governance variables – both as information and as factors that might influence auditor independence – on privately held companies differ from their effects on publicly held companies.

The remainder of the paper is organized as follows. The second section reviews the literature. The third section describes the research design and discusses pertinent features of the Taiwanese data. The fourth section presents the data and empirical results, and the fifth section concludes.

LITERATURE REVIEW AND THEORETICAL FRAMEWORK

This section includes four subsections: (1) audit quality and GC opinions, (2) duality role of a CEO, (3) related-party financing, and (4) the theoretical framework and hypotheses development used in this study to examine the three preceding issues.

Audit Quality and GC Opinions

DeAngelo (1981) defines audit quality as the joint probability of discovering material misrepresentations and reporting them when they exist. The first part (i.e., the ability to discover) is related to *professional judgment*, and the second part (i.e., report truthfully) is related to *independence*. Therefore, neither a lack of expertise nor a lack of independence can allow high audit quality. The question of auditors' reporting decision is related not only to auditor independence but also to profession judgment. However, as we point out in the introduction, prior auditing studies which examine the relationship between corporate governance and audit quality focus exclusively on the issue of auditor independence.

Because higher audit quality represents a greater ability and/or better independence, prior studies often use the following variables as proxies for audit quality: auditor size (DeFond, 1992; Palmrose, 1988), auditor litigation (Heninger, 2001; Palmrose, 1987), industry expertise (Ferguson, Francis, & Stokes, 2003; Palmrose, 1986), earnings response coefficient (Ghosh & Moon, 2005), abnormal accruals (Chi, Hunag, Liao, & Xie, 2009; Myers, Myers, & Omer, 2003), GC opinions (Carcello & Neal, 2003; Li, 2009), and modified audit opinions (Chen, Sun, & Wu, 2010).

Empirical studies find that GC opinions cause negative market reactions (Blay & Geiger, 2001) and indicate an increased risk of business failure (Geiger, Raghunandan, & Rama, 1998). Geiger et al. (1998) point out that, when such cases occur, these companies have an incentive to change their auditors in order to ''shop'' for a more favorable auditor opinion. Thus, a measure of whether auditors can resist the pressure from the management team and offer a correct audit opinion is commonly used to examine auditor independence. To formulate such a measure, many auditing papers start with financially distressed companies as their research sample. Lastly, because auditors face the greatest pressure when they issue a GC opinion to their clients for the first time, DeFond et al. (2002) and Li (2009) focus on first-time GC opinions.

Auditors who issue a GC will face pressure from managers because a GC opinion causes a negative reaction in stock price (Jones, 1996) and increases the cost of capital for the firm (Firth, 1980). Therefore, Barnes (2004) suggests that the issuing of GC opinions is an excellent indicator by which auditor independence may be tested. In addition, GC provides the auditor with a processing objective that leads to the purposeful evaluation of evidence, rather than a passive evaluation of evidence in the order that it is received (Hoffman, Joe, & Moser, 2003). Logically, the pressure on an auditor will be higher if the CEO simultaneously serves as the chairperson of the board. In our study, a dual CEO/chairman role decreases the likelihood that a GC opinion will be released, and thus indicates a lower level of auditor independence.

Dual Role of a CEO

The purpose of corporate governance is to protect the providers of capital to the firm, enhance the performance of the firm, and alleviate opportunistic behaviors of members of the firm. In fact, corporate governance originates in the attempt to prevent or mitigate agency problems (Berle & Means, 1932), and therefore aims to control potential conflicts of interests due to information asymmetry.

Cohen, Krishnamoorthy, and Wright (2004) indicate that one of the most important functions that corporate governance can play is to ensure the quality of the financial reporting process. According to their framework of corporate governance and financial reporting quality, within the organization boundary there are four factors that interrelate with external auditors: the audit committee, the board of directors, management, and internal

auditors. This study centers only on boards of directors and management because in Taiwan audit committees are not mandated, information on internal auditors is not publicly available, and very few companies claim that their internal control systems are weak.

Jensen (1993) believes that the CEO simultaneously serving as the chairperson of the board will lessen the monitoring function of the board. Patton and Baker (1987) find that a CEO who simultaneously serves as the chairperson of the board will sacrifice the policy of the board for his own private benefit. Based on these findings, our hypothesis is that a CEO serving such a dual role (measured by DUAL) will hinder auditor independence.

The variable DUAL has its conceptual predecessors in relevant studies of the independence of board members. Examining financially distressed companies, Carcello and Neal (2000), for example, find that the occurrence of GC is lower if the portion of nonindependent board members is higher. Carcello and Neal (2003) further point out that the dismissals of auditors who issue GCs are less frequent if the audit committee members are more independent and are financial experts. Ruder (2002) and Bedard et al. (2004) also confirm that the independence and expertise of audit committees will affect the independence of auditors.

Farber (2005) finds that fraud is correlated to a smaller portion of outside board members, a lower frequency of meetings of an audit committee, fewer financial experts in an audit committee, audits by small audit firms, and a dual-role CEO. Dey (2008) points out that the CEO's role as the chairman of the board of directors implies that the CEO has the final word in many of the decisions made by the board. Moreover, to the extent that the other members take decisions that do not antagonize the chair, the role of the CEO as the chairman of the board compromises the independence of the board. Chang and Sun (2009) explore the post-SOX associations between earnings informativeness and audit-committee independence, and find significant post-SOX – but not pre-SOX – correlation between earnings informativeness and the dual role of the CEO serving as the chair of the board. The change of magnitude in these relationships suggests that investors have lost some of their naiveté and have started to rely more on corporate-governance mechanisms to determine the quality of these companies' accounting earnings since the implementation of SOX. Chang and Sun (2010) also find a negative relation between dual-role CEOs and earnings informativeness after SOX in cross-listed foreign companies. They therefore argue that since the negative publicity of CEOs' involvement in financial scandals, investors have become suspicious that a dual-role CEO

may further jeopardize the board's fiduciary duties. Accordingly, earnings informativeness is expected to be negatively related to the disclosure of a dual-role CEO. Jenkins (2002) examines the association between earnings management and audit committee effectiveness in U.S. companies and finds that an auditor in concert with an independent audit committee better monitors abnormal accruals. We expect that the effects claimed by these authors will generally be more severe among financially distressed companies.

Related-Party Financing

The variable RPF represents related-party financing, a form of related-party transaction. Research on related-party transactions typically focuses on the transfer of wealth from minority stockholders (Chang, 2003; Cheung et al., 2006) and on earnings management (Aharony, Wang, & Yuan, 2010; Beneish & Vargus, 2002; Jian & Wong, 2010). For instance, Beneish and Vargus (2002) find that greater RPF is related to lower earnings quality. Since lower earnings quality increases the likelihood of a GC opinion being released, there should be a theoretical link between RPF and the issuing of GC opinions. In other words, to an attentive auditor, a high level of RPF should be a red flag, suggesting an increased risk of bankruptcy. Hence, RPF can clearly offer relevant information to auditors, helping them formulate a better professional judgment.

However, business groups or related-party transactions may serve useful purposes, especially in less-developed countries. Some examples are transactions within a business group or between related parties, which can allow companies to avoid dysfunctional arms-length institutions and markets (Williamson, 1985), resource integration and improvement in efficiency (Guillén, 2000), better corporate resource allocation (Stein, 1997), convenience in internal financing (Hubbard & Pahlia, 1999), and risk sharing (Khanna & Yafeh, 2005). Even when considering such advantages, however, a great deal of research points out that such a business model has its own costs, such as inefficient competition among subsidiaries (Khanna & Palepu, 2000a, 2000b), increased transaction costs resulting from risk sharing (Gunduz & Tatoglu, 2003), and overinvestment (Stulz, 1990). Empirical investigations of prior researchers use Tobin's Q, return on equity, and/or return on assets to compare the performance of business-group-type companies with that of single-businesses-type companies. Some of these studies find that the former type performs better (e.g., Chang & Choi, 1988;

Khanna & Palepu, 2000a, 2000b), while some of them find that the latter type performs better (e.g., Claessens, Djankov, Fan, & Lang, 2002). In addition, some studies find that there is no statistical relation between the two types of business models and performance (e.g., Gunduz & Tatoglu, 2003; Khanna & Rivikin, 2001). In a study particularly relevant to our sample, Yeh et al. (2002) point out that there are many irregular related-party transactions in Taiwan, and that those transactions, conducted by insiders with private information, hinder firm value. Gordon, Henry, and Palia (2004) indicate that related-party transactions inherently imply earnings manipulation and tunneling, and therefore hurt the rights of outsiders. Finally, Jian and Wong (2010) find evidence that following propping of one related party through sales to another, abnormal related lending will occur in the opposite direction. Berkman et al. (2009) view related-party financing as an unambiguous and direct method of tunneling. Accordingly, auditors will consider information on related-party transactions when deciding whether or not it is necessary to issue a GC opinion.

Theoretical Framework and Hypotheses Development

The definition of audit quality implies the necessity of such a conceptual separation of professional judgment and auditor independence. Fig. 1 shows the conceptual framework of this study. Using the issuing of GC opinions on financially distressed companies as a proxy for audit quality, which is a function of professional judgment and independence, we examine both the *informational* function and the *monitoring mechanism* of corporate governance.

To explore our issues, we examine two corporate governance variables: whether the CEO simultaneously serves as the chairperson of the board (hereafter DUAL) and RPF. The variable DUAL was chosen to address the
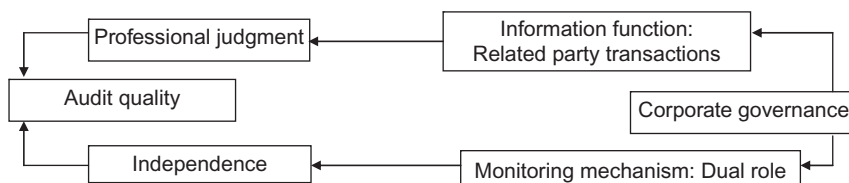

Fig. 1. Conceptual Framework.

debate on whether a CEO should serve as the chair of a majority-independent board. When corporate insiders other than the CEO are absent from a majority-independent board, directors become more dependent on their link with the CEO for inside information. As a result, critical information is often hidden from the directors or falsified (Mitchell, 2005), and the CEO may therefore unduly influence the boards on many decisions (Chang & Sun, 2010). Anderson et al. (2003) find that earnings informativeness is positively related to companies with separated CEO and chair positions. Chang and Sun (2009) also find a negative relation between dual-role CEOs and earnings informativeness after SOX in cross-listed foreign companies. Since our sample is composed of financially distressed companies, the power of the board to monitor management will be weaker when a firm has a dual-role CEO. Specifically, for auditors of companies that are financially distressed, the likelihood of their compromising independence is greater when they face a dual-role CEO than when the CEO does not chair a board with an independent majority.

RPF is used in this study not to examine auditor independence, but instead to explore whether RPF is relevant information, other things being equal, for auditors who audit financially distressed companies. This study uses the data in Taiwan. Yeh et al. (2002) point out that there are many irregular related-party transactions in Taiwan, and that those transactions, conducted by insiders with private information, hinder firm value. Accordingly, auditors will consider information on related-party transactions when deciding whether or not it is necessary to issue a GC opinion. Apparently, RPF, an important variable in emerging markets (La Porta et al., 1997, 1998, 1999, 2000; Peng et al., 2011), is not related to independence, but higher RPF increases the likelihood of expropriation between related companies when one or more of those companies are distressed.

Based on the prior literature and our conceptual framework, we developed these hypotheses:

H1. *Auditor independence approach* – There is a *negative* association between the CEO simultaneously serving as the chairperson of the board and audit partners' propensity for issuing GC opinions, ceteris paribus.

H2. *Professional judgment approach* – There is a *positive* association between the related-party financing and audit partners' propensity for issuing GC opinions, ceteris paribus.

RESEARCH METHODOLOGY AND SAMPLE SELECTION

Sample Selection

Our data includes both publicly held and privately held companies, and thus allows us to analyze whether audit quality differs for these two types of companies. The comprehensiveness of the data is due to the legal background regarding disclosure of financial statements. Until 2001, the Taiwan Company Law had mandated that all publicly held companies listed on Taiwan Stock Exchange Corporation and GreTai Securities Market and privately held companies with capital exceeding a certain threshold (NT$200 million since 1981 and NT$500 million since 2000) publicly disclose audited financial statements. Although this requirement was rescinded for privately owned companies in 2002, many privately held companies have continued to disclose their audited financial statements.[1] The *Taiwan Economic Journal* (TEJ) provides a database that collects all publicly disclosed financial statement of publicly held and privately held companies. We start our research period from 1996 because the corporate governance variables are publicly available after this year. Thus, our research period is 1996–2008. We searched the *Taiwan Economic Journal* Database for publicly held and privately held companies whose variables were actually included in the TEJ database between 1996 and 2008. Table 1 reports the selection process.

Research Design

The literature has used auditors' propensity of issuing GC opinions as an alternative proxy for auditor independence (e.g., DeFond et al., 2002; Li, 2009; Reynolds & Francis, 2001). If audit partners compromise independence because the CEO simultaneously serves as the chairperson of the board, we expect to find a *negative* association between DUAL and audit partners' propensity for issuing GC opinions.

Regarding the informational role of corporate governance, we incorporate RPF into our regression model. Beneish and Vargus (2002) argue that there is a correlation between lower earnings quality and higher levels of related-party transactions. Kahle (2000) finds that company has a high level of insider trading, with poor long-term performance being due to over-valuation. While RPF is a corporate governance variable, it plays an

Table 1.   Sample Selection Process.

Panel A: Publicly Held Companies (1996–2008)		
Original sample size		15,210
Less	Those not in financial distress	(6,741)
	Those with missing financial characteristic variables	(528)
	Those not issued a going concern opinion for the first time	(21)
	Those with missing corporate governance variables	(3,983)
Final sample size[a]		3,937
Panel B: Privately Held Companies (1996–2008)		
Original sample size		7,125
Less	Those not in financial distress	(2,859)
	Those with missing financial characteristic variables	(645)
	Those with missing audit opinion data	(1,104)
	Those not issued a going concern opinion for the first time	(35)
	Those with missing corporate governance variables	(1,923)
Final sample size[b]		559

[a]Of the 3,937 companies in our sample in panel A, 2.47% received a GC.
[b]Of the 559 companies in our sample in panel B, 3.147% received a GC.

informational role (i.e., improving professional judgment) in this study. Auditors facing financially distressed companies with poor earnings quality, other things being equal, have a greater tendency to issue a GC opinion. Therefore, we expect that, in the professional judgment of an auditor, RPF is *positively* related to GC. Our findings can support the contention that RPF plays a role in enhancing professional judgment of auditors, if, other things being equal, the auditor considers issuing a GC opinion to a financially distressed company with greater level of RPF.

In addition, to explore whether auditors' reporting decisions for publicly held companies differ from those for privately held companies, we first set up an indicator variable PRIVATE (with a value of one if the observation is a privately held company, and zero otherwise), which is then multiplied by DUAL and by RPF. Through examining the estimated coefficient of PRIVATE × DUAL and that of PRIVATE × RPF, we can compare how the listed status, public and private, affect professional judgment and independence of auditors. Likewise, we also set up an indicator variable BigN (with a value of one if the observation is audited by a large audit firm, and zero otherwise), which is then multiplied by DUAL and by RPF. The variable BigN added because Craswell, Francis, and Taylor (1995)

document that the Big N auditors charge an audit fee premium over the non-Big N auditors. Studies also show that clients of the Big N auditors have lower absolute values of discretionary accruals (Becker, DeFond, Jiambalvo, & Subramanyam, 1998) and higher ERCs (Teoh & Wong, 1993). Firth and Smith (1992) find that clients of the Big N auditors incur less IPO underpricing than clients of the non-Big N auditors. In addition, by examining the estimated coefficient of $BigN \times DUAL$ and that of $BigN \times RPF$, we can compare audit quality between large and small audit firms.

Research Model and Control variables

Regarding the control variables (LEV, SIZE, and ROA), we mainly follow four relevant papers: DeFond et al. (2002), Mutchler, Hopwood, and McKeown (1997), Altman, Haldeman, and Narayanan (1977), and McKeown, Mutchler, and Hopwood (1991). Specifically, these studies find that companies with higher leverage (LEV) increase the probability of bankruptcy and companies audited by a big audit firm (BigN) have greater likelihood to receive a GC opinion. In addition, large companies (SIZE) have more resources to avoid bankruptcy and a better ability to negotiate with audit firms, so SIZE is negatively related to GC. Finally, a more profitable company (ROA) is less likely to receive a GC opinion. The main regression model that we use, that of DeFond et al. (2002), is widely used enough to be considered a standard. Following DeFond et al. (2002), we include only financially distressed clients, which are defined as those with negative net income or negative cash flows, and focus on first-time GC opinions. We focus on companies receiving first-time GC because previous studies suggest that rendering an initial GC opinion to a client is a particularly difficult decision for the auditor (Kida, 1980; Mutchler, 1984). Auditors may hesitate to issue a GC report if management implicitly or explicitly suggests that the client will dismiss the auditor if the auditor issues a GC report. Prior research finds that clients receiving a GC report are more likely to switch auditors (Chow & Rice, 1982; Geiger et al., 1998; Mutchler, 1984). Since the pressure to auditors is the greatest for a client who is receiving its first GC report, we follow prior research (e.g., DeFond et al., 2002; Geiger & Rama, 2003; Li, 2009) and restrict our analyses to financially distressed companies and first-time recipients of GC opinions. This study runs the following logistic regression model for financially distressed clients:

The model

$$\begin{aligned}
\mathrm{GC} = {} & b_0 + b_1\,\mathrm{PRIVATE} + b_2\,\mathrm{DUAL} + b_3\,\mathrm{DUAL} \times \mathrm{PRIVATE} + b_4\,\mathrm{RPF} \\
& + b_5\,\mathrm{RPF} \times \mathrm{PRIVATE} + b_6\,\mathrm{BigN} + b_7\,\mathrm{BigN} \times \mathrm{DUAL} + b_8\,\mathrm{BigN} \times \mathrm{RPF} \\
& + b_9\,\mathrm{SIZE} + b_{10}\,\mathrm{LEV} + b_{11}\,\mathrm{ROA} + \gamma_i \sum \mathrm{Year}_i + \delta_j \sum \mathrm{Industry}_j + e \quad (1)
\end{aligned}$$

where, GC = 1, if the client receives a first-time GC opinion, and 0 otherwise; PRIVATE = 1, if the client is a privately held company, and 0 otherwise; DUAL = 1 if the CEO simultaneously serves as the chairperson of the board, and 0 otherwise; RPF = the amount of related-party financing during the year divided by end-of-year equity; SIZE = log of end-of-year total assets (thousand in NT dollars); LEV = total liabilities divided by total assets; BigN = dummy variable equal to 1 if the auditor is from a Big 4 or Big 5 audit firm, and equal to 0 otherwise; ROA = net income divided by total assets at the beginning of the year.

EMPIRICAL FINDINGS

Panels A and B of Table 1 report the sample selection process of publicly held and privately held companies, respectively. Specifically, panel A (B) shows that the original sample size is 15,210 (7,125) for the publicly held (privately held) companies. Of these, 6,741 (2,859) are not financially distressed companies and 528 (645) are missing financial characteristic variables. In addition, 1,104 observations in the private company samples are missing audit opinions. In the remaining sample of companies which are financially distressed and for which auditor opinions are available, we find that the GCs received by 21 public companies and 35 private companies are not first-time GC opinions. We finally delete those companies with missing governance variables, numbering 3,983 publicly held and 1,923 privately held companies.[2]

Descriptive Statistics

Table 2 shows univariate comparisons between the publicly held and privately held companies. GC opinions are received by 2.46% of publicly held companies and 3.04% of privately held companies. The last column of Table 2 reveals that the differences between the means (−0.006) and between

Table 2. Univariate Test.

Variables	Publicly Held Companies (N = 3,937)			Privately Held Companies (N = 559)			Difference	
	Mean	Median	SD	Mean	Median	SD	Mean	Median
GC	0.024	0.000	0.153	0.030	0.000	0.171	−0.006	0.000
DUAL	0.332	0.000	0.471	0.293	0.000	0.455	0.039*	0.000*
RPF	1.012	0.000	3.660	1.758	0.000	5.443	−0.746***	0.000
SIZE	6.486	6.429	0.516	6.357	6.286	0.577	0.129***	0.143***
LEV	0.474	0.480	0.177	0.616	0.620	0.237	−0.142***	−0.140***
ROA	1.826	2.160	9.403	−2.436	−0.840	11.869	4.262***	3.000***
BigN	0.780	1.000	0.414	0.726	1.000	0.446	0.054***	0.000***

Note: *, **, *** Significant at the 0.10, 0.05, and 0.01 level, respectively, based on a two-tailed *t*-statistic.
GC, a dummy variable equal to 1 if the client receives a first-time going concern opinion, and 0 otherwise; RPF, the amount of related-party financing during the year divided by end-of-year net assets; DUAL, a dummy variable equal to 1 if the CEO simultaneously serves as the chairperson of the board, and 0 otherwise; SIZE, log of end-of-year total assets (thousand in NT dollars); LEV, total liabilities divided by total assets; BigN, a dummy variable equal to 1 if the auditor is from a Big 4 or Big 5 audit firm, and equal to 0 otherwise; ROA, net income divided by total assets at the beginning of the year; PRIVATE, a dummy variable equal to 1 if the client is a privately held company, and 0 otherwise.

the medians (0.000) are insignificant for the publicly held and privately held companies in our research sample. The averages of DUAL, however, are different: that of publicly held companies (0.332) is larger than that of privately held companies (0.293). In addition, publicly held companies have a lower RPF (1.012) than privately companies (1.758).

Regarding financial characteristics variables, the average firm size (SIZE) of publicly held companies (6.486) is significantly larger than that of privately held companies (6.357). The findings for debt ratio (LEV) are reversed: The mean (median) of LEV of publicly held companies, 0.474 (0.480), is significantly smaller than the mean (median) of LEV of privately held companies, 0.616 (0.620). As for profitability, publicly held companies' average ROA (1.826) is greater than privately held companies' average ROA (−2.436). Finally, the mean BigN for the publicly held sample is 0.780, whereas that for the privately held sample is 0.726. A two-tailed *t*-statistic suggests that the difference of 0.054 is significant at the 0.01 level.

Correlation

We now turn to discussing simple Pearson correlation results in Table 3, where the upper right triangle of the correlation matrix shows the publicly held companies and the lower left triangle shows the privately held companies. GC is positively related to RPF (0.154, p-value < 0.01) and DUAL (0.046, p-value < 0.01) in the publicly held companies, but such relations are insignificant in the privately held companies. We hesitate to overemphasize the simple correlation analysis between the two samples, because (i) the sample size of privately held companies (559) is smaller than that of publicly held companies (3,937)[3] and (ii) the inferences on how corporate governance variables affect GC should control for financial

Table 3. Pearson Correlation Matrix.

Variables	GC	RPF	DUAL	SIZE	LEV	BigN	ROA
GC		0.154	0.046	−0.015	0.256	−0.036	−0.181
		(0.000)***	(0.003)***	(0.338)	(0.000)***	(0.022)**	(0.000)***
RPF	−0.024		0.020	−0.020	0.131	0.045	−0.177
	(0.560)		(0.191)	(0.204)	(0.000)***	(0.004)***	(0.000)***
DUAL	−0.022	0.003		−0.092	0.028	0.005	−0.014
	(0.594)	(0.937)		(0.000)***	(0.069)*	(0.741)	(0.370)
SIZE	0.044	0.040	−0.224		0.136	0.066	0.021
	(0.290)	(0.339)	(0.000)***		(0.000)***	(0.000)***	(0.183)
LEV	−0.020	0.057	−0.008	0.244		−0.069	−0.082
	(0.621)	(0.172)	(0.841)	(0.000)***		(0.000)***	(0.000)***
BigN	−0.008	0.080	0.060	0.048	−0.261		0.028
	(0.848)	(0.057)*	(0.151)	(0.249)	(0.000)***		(0.077)*
ROA	0.051	−0.048	−0.034	0.083	−0.293	0.182	
	(0.222)	(0.251)	(0.419)	(0.048)**	(0.000)***	(0.000)***	

Note: *, **, *** Significant at the 0.10, 0.05, and 0.01 level, respectively, based on a two-tailed p-value reported in parentheses.

The upper right triangle of the correlation matrix shows the publicly held companies ($N = 3,937$), and the lower left triangle shows the privately held companies ($N = 559$). GC, a dummy variable equal to 1 if the client receives a first-time going concern opinion, and 0 otherwise; RPF, the amount of related-party financing during the year divided by end-of-year net assets; DUAL, a dummy variable equal to 1 if the CEO simultaneously serves as the chairperson of the board, and 0 otherwise; SIZE, log of end-of-year total assets (thousand in NT dollars); LEV, total liabilities divided by total assets; BigN, a dummy variable equal to 1 if the auditor is from a Big 4 or Big 5 audit firm, and equal to 0 otherwise; ROA, net income divided by total assets at the beginning of the year; PRIVATE, a dummy variable equal to 1 if the client is a privately held company, and 0 otherwise.

characteristics of the companies. Therefore, we focus on the regression results. Nevertheless, in publicly held companies, we find supporting evidence that RPF has an informational role, but no evidence that DUAL hinders auditor independence.

Regression Results

Table 4 reports the empirical findings. Panel A reports the results for the full sample, and panel B provides the results for public companies and private companies separately.

Panel A shows that the estimated coefficient of PRIVATE (b_1), -0.660 (p-value $= 0.273$), is insignificant, suggesting that, in terms of their propensity to issue going concern opinions, auditors of publicly held companies are indistinguishable from auditors of private companies, other things being equal. In addition, the negative but insignificant coefficient -0.203 (p-value $= 0.711$) offers no evidence that DUAL (b_2) hinders audit independence for public companies. However, the negative sum of the estimated coefficients of DUAL and DUAL $\times$ PRIVATE ($b_2 + b_3$), -1.351, becomes *one-tailed* significant at 10% (one-tailed p-value < 0.10). Therefore, we find weak evidence (only one-tailed) to support our hypothesis that DUAL affects the audit quality. However, the dual role of a CEO does not compromise auditor independence in the public company sample.

For the informational role of RPF (b_4) in public companies, however, we find supporting evidence in the positive estimated coefficient of *RFP*, 0.083 (p-value < 0.10), but such evidence for the informational role of RPF in private companies disappears: the sum of the estimated coefficients of *RFP* and *RFP* $\times$ PRIVATE ($b_4 + b_5$), -0.021, becomes insignificant at 10% (p-value $= 0.643$).

Therefore, in public companies, consistent with our prediction, auditors have better audit quality if the publicly held companies in financial distress have more related-party financing, a finding which supports our position on the *informational* role of governance. In privately held companies, however, this role disappears. Taken together, the evidence suggests that, among financially distressed companies, it is only in those that are privately held that auditors are more likely to compromise their independence when they face a dual-role CEO than when the CEO does not chair a board with an independent majority. In addition, auditors of publicly held companies will consider RPF to be relevant information, other things being equal, for auditors who audit financially distressed companies, only if these companies

Table 4.   Logistic Regression Results.

$$GC = b_0 + b_1 \text{ PRIVATE} + b_2 \text{ DUAL} + b_3 \text{ DUAL} \times \text{PRIVATE} + b_4 \text{ RPF}$$
$$+ b_5 \text{ RPF} \times \text{PRIVATE} + b_6 \text{ BigN} + b_7 \text{ BigN} \times \text{DUAL} + b_8 \text{ BigN} \times \text{RPF}$$
$$+ b_9 \text{ SIZE} + b_{10} \text{ LEV} + b_{11} \text{ ROA} + \gamma_i \sum \text{Year}_i + \delta_j \sum \text{Industry}_j + e \quad (1)$$

Panel A: Logistic Regression Results				
Variables		Predicted Sign	Full Model	
INTERCEPT	b_0	?	−5.289***	(0.006)
PRIVATE	b_1	?	−0.660	(0.273)
DUAL	b_2	−	−0.203	(0.711)
DUAL × PRIVATE	b_3	?	−1.148	(0.264)
RPF	b_4	+	0.063*	(0.063)
RPF × PRIVATE	b_5	?	−0.084**	(0.046)
BigN	b_6	+	−0.041	(0.923)
BigN × DUAL	b_7	+	1.009	(0.103)
BigN × RPF	b_8	+	−0.011	(0.768)
SIZE	b_9	−	−0.398	(0.185)
LEV	b_{10}	+	5.633***	(0.000)
ROA	b_{11}	−	−0.063***	(0.000)
Year Effect		?	Included	
Industry Effect		?	Included	
Number of observations			4,496	
Pseudo R^2			0.318	
Joint test			Coefficient	$\Pr(\chi^2)$
$b_2 + b_3$			−1.351	(0.157)
$b_4 + b_5$			−0.021	(0.643)

Panel B: Sensitivity Test Results for Publicly Held Companies and Privately Held Companies

Variables		Predicted Sign	Public Firm		Private Firm	
INTERCEPT	b_0	?	−7.788***	(0.002)	−4.459*	(0.093)
DUAL	b_1	−	0.572*	(0.081)	−0.267	(0.724)
RPF	b_2	+	0.028	(0.174)	−0.045*	(0.092)
BIGN	b_4	+	0.047	(0.894)	−0.024	(0.969)
SIZE	b_5	−	−0.366	(0.348)	0.145	(0.738)
LEV	b_6	+	8.070***	(0.000)	−0.155	(0.927)
BigN	b_7	+	0.047	(0.894)	−0.024	(0.969)
ROA	b_8	−	−0.097***	(0.000)	0.033	(0.192)

Table 4. (*Continued*)

Panel B: Sensitivity Test Results for Publicly Held Companies and Privately Held Companies

Variables	Predicted Sign	Public Firm	Private Firm
Year Effect		Included	Included
Industry Effect		Included	Included
Number of observations		3,937	559
Pseudo R^2		0.441	0.102

Note: *, **, *** Significant at the 0.10, 0.05, and 0.01 level, respectively, based on a two-tailed *p*-value. Coefficients on industry and year dummies omitted for simplified exhibition. Two-tailed *p*-value based on the Huber–White standard errors clustering by firm reported in parentheses.

GC, a dummy variable equal to 1 if the client receives a first-time going concern opinion, and 0 otherwise; RPF, the amount of related party financing during the year divided by end-of-year net assets; DUAL, a dummy variable equal to 1 if the CEO simultaneously serves as the chairperson of the board, and 0 otherwise; SIZE, log of end-of-year total assets (thousand in NT dollars); LEV, total liabilities divided by total assets; BigN, a dummy variable equal to 1 if the auditor is from a Big 4 or Big 5 audit firm, and equal to 0 otherwise; ROA, net income divided by total assets at the beginning of the year; PRIVATE, a dummy variable equal to 1 if the client is a privately held company, and 0 otherwise.

are publicly held companies. These differences between our findings for publicly held companies and privately held companies can be explained by reputation concerns (Weber, Willenborg, & Zhang, 2008) and litigation risks (Krishnan & Krishnan, 1997; Shu, 2000), two mitigating factors that constrain auditors from compromising their independence for economically significant clients.

As for the effect of BigN, we find no evidence that the propensity of issuing GC is related to auditor size. In addition, the estimated coefficients of BigN $\times$ DUAL (b_7) and BigN $\times$ RPF (b_8), 1.009 and -0.001, respectively, are insignificant. Regarding the effect of our control variables on GC, the estimated coefficients of SIZE (-0.398, *p*-value $= 0.185$), LEV (5.633, *p*-value < 0.01), and ROA (-0.063, *p*-value < 0.00) are all consistent with the predicted sign. In sum, the greater the firm size or the more profitable the firm, the lower the probability of receiving GC opinions. The higher the debt ratio, however, the higher the probability of receiving GC opinions.

Panel B reports the results for each subsample, public and private. Although we still find no evidence that DUAL has a negative effect on GC in public companies ($b_1 = 0.572$ and *p*-value < 0.10), the weak evidence

previously seen for private companies disappears in the private company column ($b_1 = -0.001$ and p-value $= 0.724$). The estimated coefficient of RPF in the public firm column ($b_2 = 0.024$ and one-tailed p-value < 0.10) offers weak evidence (only one-tailed) that auditors who audit public companies will use RPF. However, this coefficient in the private company column ($b_2 = -0.045$ and p-value < 0.10) shows that auditors who audit private companies are not more likely to issue a going concern opinion when their clients have a greater level of RPF.

Finally, the results of the effects of SIZE, LEV, and ROA in the Public Company column are qualitatively similar to those in panel A, a similarity which reveals that, for financially distressed companies, greater firm size and more profitability are linked with a lower probability of receiving GC opinions, while debt ratio is linked with a greater probability. However, none of these correspondingly estimated coefficients is significant in the Private Company column.

Sensitivity test

One question that potentially complicates the use of related-party transactions as informative for auditors is the possibility that they have positive effects as well as negative ones. Our paper avoids this issue because we limit our sample to financially distressed companies, which would tend to enjoy few if any of the potential advantages of related-party transactions. Nevertheless, we reduce such potential complications by replacing RPF with two measures. The first one is a firm's industry-medium centered value, the inclusion of which lessens the possibility that the normal RPF of a firm may be a function of its industry; the second is an indicator variable, which equals one if RPF is larger than the value of the industry medium and zero otherwise. Unabated results from rerunning our regression model with these two new variables show that our evidence is robust.

CONCLUSION

Using a unique Taiwanese dataset, we separate our sample into publicly held and privately held companies, and show that the effects of CEO duality and the level of related-party financing on audit quality vary depending on whether a company is publicly held or privately held. This data set is unique because both unlisted and listed companies are required to be audited in

Taiwan. Thus, we are able to construct comparison whether and how the two variables have different effects on the audit quality.

The importance of our paper is twofold. First, according to auditing standards, auditors should collect information and use their professional judgment to draw fair conclusions about the companies that they are auditing, and also to express those conclusions in their reports. Then, we examine how corporate governance affects auditor independence. For professional judgment, we examine whether related-party transactions affect auditors' professional judgment. This variable is important in numerous researches in financial accounting and finance; however it has not been explored in auditing research. To examine the auditor independence issue, we examine whether and how CEO duality influence audit quality.

Second, we examine the issue in publicly held and privately held companies separately. Because auditors performing audit services face different litigation risk and reputation concern, our results between the two different types of clients can provide implications for different emerging markets. The empirical results of publicly held companies are useful for the countries with better corporate governance, while those of privately held companies are helpful for the countries with poor corporate governance.

Our results reveal that for publicly held companies, with stronger capital market discipline, which causes greater reputation concerns and litigation risks, a CEO who plays a dual role does not hinder auditor independence. For privately held companies, however, such a CEO hinders auditor independence due to a lack of capital market discipline. The findings on related-party financing, on the other hand, are completely different. Interpreting party financing from the informational role, we find that since the conflicts of interests are more severe in publicly held companies than in privately held companies, the relevance of this information to enforce audit quality is greater in publicly held companies.

NOTES

1. In other words, in Taiwan, companies that are publicly traded on the stock exchanges are referred to as listed companies and companies that are not publicly traded on the stock exchanges are referred to as unlisted companies. Thus, listed companies in Taiwanese terms are the same as public companies in U.S. terms. Unlisted companies in Taiwan are similar to private companies in some European countries such as Norway (Hope & Langli, 2010).

2. The final number of observations in the publicly held sample is 3,937, while that in the privately held sample is 559. In the final research sample, 97 (3,937 of 2.46%) companies out of 3,937 publicly held companies and 17 (559 of 3.04%) companies out

of 559 privately held companies have received a GC opinion. Since the requirements for privately held companies to file financial statements changed in 2002, data is not available for all private companies throughout the entire research period; for consistency between the data on public and private companies, we have included only those private companies that continued to provide financial statements after 2002.

   3. The sample size itself makes it more difficult to draw significant findings from the correlation analysis for the privately held companies than for the publicly held companies.

REFERENCES

Aharony, J., Wang, J., & Yuan, H. (2010). Tunneling as an incentive for earnings management during the IPO process in China. *Journal of Accounting and Public Policy*, *29*(1), 1–26.

Altman, E. I., Haldeman, R. G., & Narayanan, P. (1977). Zeta analysis: A new model to identify bankruptcy risk of corporations. *Journal of Banking and Finance*, *1*(1), 29–54.

Anderson, K. L., Deli, D. N., & Gillan, S. L. (2003). *Board directors, audit committees, and the information content of earnings*. Weinberg Center for Corporate Governance Working Paper No. 2003-04. Georgetown University, Washington DC; Arizona State University, Tempe, AZ; and University of Delaware, Newark, DE.

Auditing Standards Board (ASB). (1988). The auditors consideration of an entity's ability to continue as a going concern. Statement on Auditing Standard No. 59. New York, NY: ASB.

Barnes, P. (2004). The auditor's going concern decision and Types I and II errors: The Coase Theorem, transaction costs, bargaining power and attempts to mislead. *Journal of Accounting and Public Policy*, *23*(6), 415–440.

Becker, C., DeFond, M., Jiambalvo, J., & Subramanyam, K. R. (1998). The effect of audit quality on earnings management. *Contemporary Accounting Research*, *15*(1), 1–24.

Bedard, J., Chtourou, S. M., & Courteau, L. (2004). The effect of audit committee expertise, independence, and actively on aggressive earnings management. *Auditing: A Journal of Practice and Theory*, *23*(2), 13–35.

Beneish, M. D., & Vargus, M. E. (2002). Insider trading, earning quality, and accrual mispricing. *The Accounting Review*, *77*(4), 755–791.

Berkman, H., Cole, R. A., & Fu, L. J. (2009). Expropriation through loan guarantees to related parties: Evidence from China. *Journal of Banking and Finance*, *33*, 141–156.

Berle, A., & Means, G. (1932). *The modern corporation and private property*. New York, NY: Macmillan.

Blay, A. D., & Geiger, M. (2001). Market expectations for first-time going-concern recipients. *Journal of Accounting, Auditing and Finance*, *16*(3), 209–226.

Carcello, J. V., & Neal, T. L. (2000). Audit committee composition and auditor reporting. *The Accounting Review*, *75*(4), 453–467.

Carcello, J. V., & Neal, T. L. (2003). Audit committee characteristics and auditor dismissals following ''New'' going-concern reports. *The Accounting Review*, *78*(1), 95–117.

Chang, J. C., & Sun, H. L. (2009). Crossed-listed foreign companies' earnings informativeness, earnings management and disclosures of corporate governance information under SOX. *The International Journal of Accounting*, *44*(1), 1–32.

Chang, J. C., & Sun, H. L. (2010). Does the disclosure of corporate governance structures affect companies' earnings quality? *Review of Accounting and Finance*, *9*(3), 212–243.

Chang, S. J. (2003). Ownership structure, expropriation, and performance of group-affiliated companies in Korea. *Academy of Management Journal*, *46*(2), 238–253.

Chang, S. J., & Choi, U. (1988). Strategy, structure and performance of Korean business groups: A transaction cost approach. *The Journal of Industrial Economics*, *37*(2), 141–159.

Chen, S., Sun, S. Y. J., & Wu, D. (2010). Client importance, institutional improvements, and audit quality in China: An office and individual auditor level analysis. *The Accounting Review*, *85*(1), 127–158.

Cheung, Y. L., Rau, P. R., & Stouraitis, A. (2006). Tunneling, propping, and expropriation: Evidence from connected party transactions in Hong Kong. *Journal of Financial Economics*, *82*(2), 343–386.

Chi, W., Hunag, Y., Liao, H., & Xie, H. (2009). Mandatory audit partner rotation, audit quality, and market perception: Evidence from Taiwan. *Contemporary Accounting Research*, *26*(2), 359–391.

Chow, C. W., & Rice, S. J. (1982). Qualified audit opinions and auditor switching. *The Accounting Review*, *57*(2), 326–335.

Claessens, S., Djankov, S. J., Fan, O. H., & Lang, L. H. (2002). Disentangling the incentive and entrenchment effects of large shareholdings. *The Journal of Finance*, *57*(6), 2741–2771.

Cohen, J., Krishnamoorthy, G., & Wright, A. (2004). The corporate governance mosaic and financial reporting quality. *Journal of Accounting Literature*, *23*, 87–152.

Craswell, A., Francis, J., & Taylor, S. (1995). Auditor brand name reputations and industry specializations. *Journal of Accounting and Economics*, *20*(3), 297–322.

DeAngelo, L. (1981). Auditor size and audit quality. *Journal of Accounting and Economics*, *3*(3), 183–199.

DeFond, M. (1992). The association between changes in client firm agency costs and auditor switching. *Auditing: A Journal of Practice and Theory*, *11*(1), 16–31.

DeFond, M. L., Raghunandan, K., & Subramanyam, K. R. (2002). Do non-audit service fees impair auditor independence? Evidence from going concern audit opinions. *Journal of Accounting Research*, *40*(4), 1247–1274.

Dey, A. (2008). Corporate governance and agency conflicts. *Journal of Accounting Research*, *46*(5), 1143–1181.

Elloumi, F., & Gueyié, J. P. (2001). Financially distress and corporate governance: An empirical analysis. *Corporate Governance*, *1*(1), 15–23.

Farber, D. B. (2005). Restoring trust after fraud: Does corporate governance? *The Accounting Review*, *80*(2), 539–561.

Ferguson, A., Francis, J. R., & Stokes, D. J. (2003). The effects of firm-wide and office-level industry expertise on audit pricing. *The Accounting Review*, *78*(2), 429–448.

Firth, M. (1980). A note on the impact of audit qualifications on lending and credit decisions. *Journal of Banking and Finance*, *4*(3), 257–267.

Firth, M., & Smith, A. (1992). Selection of auditor companies by companies in the new issue market. *Applied Economics*, *24*(2), 247–255.

Geiger, M. A., Raghunandan, K., & Rama, D. V. (1998). Costs associated with going concern modified audit opinions: An analysis of auditor changes, subsequent opinions, and client failures. *Advances in Accounting*, *16*, 117–139.

Geiger, M. A., & Rama, D. V. (2003). Audit fees, nonaudit fees, and auditor reporting on stressed companies. *Auditing: A Journal of Practice & Theory*, *22*(2), 53–69.

Ghosh, A., & Moon, D. (2005). Auditor tenure and perceptions of audit quality. *The Accounting Review*, *80*(2), 585–612.

Gordon, E. A., Henry, E., & Palia, D. (2004). Related party transactions and corporate governance. *Advances in Financial Economics*, *9*, 1–27.

Guillén, M. F. (2000). Business groups in emerging economics: A resource-based view. *Academy of Management Journal*, *43*(3), 362–380.

Gunduz, L., & Tatoglu, E. (2003). A comparison of the financial characteristics of group affiliated and independent companies in Turkey. *European Business Review*, *15*(1), 48–54.

Heninger, W. G. (2001). The association between auditor litigation and abnormal accruals. *The Accounting Review*, *76*(1), 111–126.

Hoffman, V. B., Joe, J. R., & Moser, D. V. (2003). The effect of constrained processing on auditors' judgments. *Accounting, Organizations & Society*, *28*(7/8), 699–714.

Hope, O.-K., & Langli, J. C. (2010). Auditor independence in a private firm and low litigation risk setting. *The Accounting Review*, *85*(2), 573–605.

Hubbard, R. D., & Pahlia, J. D. (1999). A reexamination of the conglomerate merger wave in the 1960s: An internal capital markets view. *The Journal of Finance*, *54*(3), 1131–1152.

Jenkins, N. T. (2002). *Auditor independence, audit committee effectiveness and earnings management*. Ph.D. dissertation proposal. Henry B. Tippie College of Business, The University of Iowa.

Jensen, M. C. (1993). The modern industrial revolution, exit, and the failure of internal control systems. *Journal of Finance*, *48*(3), 831–880.

Jian, M., & Wong, T. J. (2010). Propping through related party transactions. *Review of Accounting Studies*, *15*(1), 70–105.

Johnson, S., La Porta, F., Shleifer, A., & Vishny, R. (2000). Tunneling. *American Economic Review*, *90*, 22–27.

Jones, F. L. (1996). The information content of the auditor's going concern evaluation. *Journal of Accounting and Public Policy*, *15*(1), 1–27.

Kahle, K. M. (2000). Insider trading and the long-run performance of new security issues. *Journal of Corporate Finance*, *6*(1), 25–53.

Khanna, T., & Palepu, K. (2000a). Is group affiliation profitable in emerging markets? An analysis of diversified Indian business groups. *The Journal of Finance*, *55*(2), 867–891.

Khanna, T., & Palepu, K. (2000b). The future of business groups in emerging markets: Long run evidence from Chile. *Academy of Management Journal*, *43*(3), 268–285.

Khanna, T., & Rivikin, J. W. (2001). Estimating the performance effects of business groups in emerging markets. *Strategic Management Journal*, *22*(1), 45–74.

Khanna, T., & Yafeh, Y. (2005). Business groups and risk sharing around the world. *Journal of Business*, *78*(1), 301–340.

Kida, T. (1980). An investigation into auditors' continuity and related qualification judgments. *Journal of Accounting Research*, *18*(2), 506–523.

Krishnan, J., & Krishnan, J. (1997). Litigation risk and auditor resignations. *The Accounting Review*, *72*(4), 539–560.

La Porta, R., Lopez-de-Silanes, F., Shleifer, A., & Vishny, R. (1999). The quality of government. *Journal of Law, Economics and Organization*, *15*(1), 222–279.

La Porta, R., Lopez-de-Silanes, F., Shleifer, A., & Vishny, R. (1997). Legal determinants of external finance. *Journal of Finance*, *52*(July), 1131–1150.

La Porta, R., Lopez-de-Silanes, F., Shleifer, A., & Vishny, R. (1998). Law and finance. *Journal of Political Economy*, *106*, 1113–1155.

La Porta, R., Lopez-de-Silanes, F., Shleifer, A., & Vishny, R. (2000). Investor protection and corporate governance. *Journal of financial Economics*, *58*(1–2), 3–27.

Li, C. (2009). Does client importance affect auditor independence at the office level? Empirical evidence from going-concern opinions. *Contemporary Accounting Research*, *26*(1), 201–230.

McKeown, J. C., Mutchler, J. F., & Hopwood, W. (1991). Towards an explanation of auditor failure to modify the audit opinions of bankrupt companies. *Auditing: A Journal of Practice & Theory*, *10*(Suppl.), 1–13.

Mitchell, L. (2005). Structural holes, CEOs, and the missing link in corporate governance. *Brooklyn Law Review*, *70*, 1313–1368.

Mutchler, J. F. (1984). Auditors' perceptions of the going-concern opinion decision. *Auditing: A Journal of Practice & Theory*, *3*(2), 17–30.

Mutchler, J. F., Hopwood, W., & McKeown, J. M. (1997). The influence of contrary information and mitigating factors on audit opinion decisions on bankrupt companies. *Journal of Accounting Research*, *35*(2), 295–310.

Myers, J., Myers, L., & Omer, T. (2003). Exploring the term of the auditor-client relationship and the quality of earnings: A case for mandatory auditor rotation? *The Accounting Review*, *78*(3), 779–799.

Palmrose, Z. V. (1986). Audit fees and auditor size: Further evidence. *Journal of Accounting Research*, *24*(1), 97–110.

Palmrose, Z. V. (1987). Litigation and independent auditors: The role of business failures and management fraud. *Auditing: A Journal of Practice and Theory*, *6*(1), 90–103.

Palmrose, Z. V. (1988). An analysis of auditor litigation and audit service quality. *The Accounting Review*, *63*(1), 55–73.

Patton, A., & Baker, J. C. (1987). Why do not directors rock the boat? *Harvard Business Review*, *65*, 10–18.

Peng, W. Q., John Wei, K. C., & Yang, Z. (2011). Tunneling or propping: Evidence from connected transactions in China. *Journal of Corporate Finance*, *17*(2), 306–325.

Reynolds, J. K., & Francis, J. R. (2001). Does size matter? The influence of large clients on office-level auditor reporting decisions. *Journal of Accounting and Economics*, *30*(3), 375–400.

Ruder, D. S. (2002). Oversight hearing on accounting and investor protection issues raised by Enron and other public companies. Senate Committee on Banking, Housing, and Urban Affairs. 107th Cong., 2nd sess., 12 February. Retrieved from http://www.senate.gov/-banking/02-02hrg/021202/ruder.htm

Shu, S. Z. (2000). Auditor resignations: Clientele effects and legal liability. *Journal of Accounting and Economics*, *29*(2), 173–205.

Stein, J. C. (1997). Internal capital markets and the competition for corporate resources. *The Journal of Finance*, *52*(1), 111–133.

Stulz, R. (1990). Managerial discretion and optimal financing policies. *Journal of Financial Economics*, *26*(1), 3–27.

Teoh, S. H., & Wong, T. J. (1993). Perceived auditor quality and the earnings response coefficient. *The Accounting Review*, *68*(2), 346–366.

Weber, J., Willenborg, M., & Zhang, J. (2008). Does auditor reputation matter? The case of KPMG Germany and ComROAD AG. *Journal of Accounting Research*, *46*(4), 941–972.

Williamson, O. E. (1985). *The economic institution of capitalism*. New York, NY: The Free Press.

Yeh, Y. H., Lee, T. S., & Ko, C. E. (2002). Corporate governance and rating system. Taipei: Sunbright Publishing Co. (in Chinese).