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Research on Influencing Factors of Key Audit Matters Disclosure in China

Sun Longyuan

Lecturer, Department of Information Management College,
Beijing Information Science and Technology University, China

Zhang Yamin

Student, Information Management College,
Beijing Information Science and Technology University, China

Xing Chunyu

Vice Professor, Information Management College,
Beijing Information Science and Technology University, China

Abstract:

Taking companies listed in both A-shares market and H-shares market from 2016 to 2018 in China as samples, this paper uses literature and empirical research method to study the impact of the characteristics of key audit matters (namely, KAM) on disclosure from both auditors and audited companies. The results show that the number of key audit matters is more related to the characteristics of audited companies rather than auditors, indicating that the size, leverage, and IPO period of the audited companies generate a significant positive correlation with the number of disclosed key audit matters. At the same time, the profitability and net operating cash flow are obviously negative with the number. While for an accounting firm, there is only a significant correlation between the type of audit opinion, showing that the number of key audit matters disclosed with modified auditing opinion is less than those disclosed with unmodified opinion.

Based on this conclusion, this paper explores the relationship between types of key audit matters disclosed and the characteristics of firms and audited entities. The results show that the auditee level factors still have a greater impact on the type of key audit matters to make a contribution to the accounting standard construction in China.

Keywords: Key audit matters, disclosure, influencing factors, accounting firms, public companies

1. Introduction

Before 2017, accounting firms in China basically adopted the original standardized reporting format to issue audit reports for public firms. The unmodified audit reports are prepared in accordance with the consolidation format. There are only three types of modified audit reports:

- Reports with reservation opinion,
- Adverse opinions, and
- Disclaimer of opinion

These reports cannot fully realize the information transmission between the management of companies and report users. Therefore, some report users believe that the form of audit reports should be changed to improve the transparency of audit work to:

- Enhance the information content and decision usefulness of the audit report, and
- Safeguard the public interest

As a result, the Ministry of Finance issued over ten new audit reporting standards in December 2016, requiring companies listed in A+H share market and pure H share market put into practice from January 1, 2017, and those of other listed entities from January 1, 2018.

The standard of Key Audit Matters (namely, KAM) is in the seventh standard issued by the Ministry of finance. Based on Article 7 of the standards on key audit matters (namely, CSA1504), the so-called key audit matters refer to the matters that the certified public accountant (namely, CPA) is most likely to pay attention to in the process of undertaking service based on their own experience. Before selecting the matters, CPAs must first communicate with managers and select notable items from the communication. CSA1504 has improved the shortcomings of the original audit report. With the disclosure of KAM in audit reports, the sameness and lack of information of the original audit report, the information value and transparency of audit work had also been effectively increased. So we can say the disclosure of KAM has a significant impact and far-reaching significance for CPAs and accounting firms. However, it also put forward a lot of

challenges to the CPAs, such as selecting key audit items, adopting corresponding audit procedures, and writing audit reports.

As of April 30, 2019, CSA1504 has been implemented for three reporting years. Since it is the first implementation for audit work of financial statements of A+ H-share listed companies, there is still a period of time to test the effect of implementation. So we choose the number and character of key audit matters in the audit report of companies listed on A+H share market in China from 2016 to 2018 to study the influencing factors for disclosure of key audit matters from the perspectives of the accounting firm and audited companies. The purpose of us is to study influencing factors of key audit matters disclosure.

Nowadays, there are a lot of research on the influence and information content on accounting practice of key audit matters (Carver & Trinke, 2015), J/OL; Kachelmeier et al., 2014, J/OL; Brasel et al. 2015, p.1345-1362; Reid et al., 2015; J/OL, Zhang Ge, 2014, p.97-100; Tang Jianhua, 2015,p.60-66; Zhang Jixun et al., 2016,p.77-83.; Kai Jinghua, 2017,p.13-17), lacking empirical research on the disclosure influencing factors. Only a small part involves experimental studies (Han Dongmei & Zhang Jixun, 2017, pp. 70-76) and case studies (Zhang Jixun et al., 2016, pp. 77-83; Kai Jinghua and Shi Jingwen, 2019, p.70-76). Although there is a large number of Chinese research after 2018, most of them still focused on the consequences of reform and the impact of key audit matters on audit quality and investment return. There is an extreme lack of universal research on the influencing factors of disclosure of KAM, especially from the perspective of accounting firms. These gaps in existing studies provide opportunities and possibilities for us. Based on this situation, we aimed to study the effect of characteristics of accounting firms and practicing auditors on the disclosure of key audit matters, such as the size of accounting firms, the type of audit opinions, or the tenure of auditors, which may gain a marked effect on the disclosure.

The arrangement is as follows:

- The second part is the introduction of institutional background,
- The third part is a literature review and hypotheses,
- The fourth part is research design,
- The fifth part is empirical research,
- The sixth part is further research and robustness test, and
- The eighth part is the conclusion

2. Institutional Background

An audit report can show the value and result of the audit effort, which is also the bridge of communication between CPA and corresponding users of financial statements. Since Charles Snell firstly reported an independent audit report in 1721, the audit report has formed the characteristics of unified format, concise content, and clear opinions after nearly 300 years of evolution. However, with the development of the economy, the users of financial statements became more and more dissatisfied with the traditional audit report mode. They hope to obtain more useful information for decision-making through the audit report, so the reform of the audit report mode looms ahead.

After the financial and economic crisis in 2008, in order to improve the information content of audit reports and enhance the communication value, the Financial Reporting Council of the United Kingdom (FRC), the international audit and assurance standards board (IAASB), the Ministry of Finance of China and the public company accounting oversight board of the United States (PCAOB) issued standards of audit report in 2013, 2015, 2016 and 2017. The purpose of the revision is to change the mode of the audit report from standardized and single mode to standardized and personalized mode and significantly improve the form, elements, and content of the audit report.

In June 2013, FRC changed the framework of relevant standards for audit reports. Although the concept of 'key audit matters' was not clearly pointed out, material misstatement was required to be disclosed in those reports.

In January 2015, IAASB removed the original standard system and issued a new round of audit report standard framework, which is ISA701. Since it requires the audit report to disclose key audit matters, it becomes mandatory for listed companies to disclose key audit matters whether they are willing or not.

In December 2016, the Chinese Institute of Certified Public Accountants (CICPA) revised the original audit report system and officially promulgated a new audit report standard system. Among them, Document No. 1504 defines the CPA's responsibility for communicating key audit matters in the audit report and standardizes the scope of application, definition, determination, and disclosure of key audit matters, as well as communication with the management, audit working paper records, and other related contents. The document said financial statement audit of A + H shares and pure H shares listed companies shall be implemented from January 1, 2017, and other listed entities shall be implemented from January 1, 2018.

In May 2017, PCAOB also issued new auditing standards. Among them, auditors need to communicate with the Audit Committee on key audit matters, especially important and challenging matters. PCAOB also required the key audit matters to be promoted and implemented largely after the middle of 2019.

So we compare the requirements of FRC, IAASB, PCAOB, and CSA1504 on key audit matters with an international comparison of the audit report system.

Implementing Subject	IAASB	FRC	PCAOB	CSA1504
Is There Any Requirement for Opinion Section	Yes	No	No	yes
Requirements for Key Audit Matters	To be disclosed separately	No clear requirements	To be disclosed separately	No clear requirements
Whether Disclosure of Materiality and Audit Scope Is Required	No	Yes	No	No
Matters Related to Going Concern	Strengthen the expression of responsibility	Not required	Maintain the original mode	Emphasize the responsibilities of management and auditors
Other Information Segment-Related Matters	Add 'other information section' and explain other information in detail	Ask for additional information	No new elaboration of other information was made	A single column 'other information segment' describes the new information
The Basis for Forming Audit Opinions	No	No	Yes	Yes
Whether An Independence Declaration Required	Yes	Yes	Yes	Yes
Are Project Partners Required to Be Disclosed	Yes	Yes	Yes	Yes

Table 1: International Comparison of Audit Reporting System

As shown in table 1, the differences in auditing standards among IAASB, FRC, PCAOB, and CASB auditing standards are mainly reflected in the following six aspects:

- Firstly, while issuing audit opinions in the United Kingdom, the opinion paragraph is often put in the front position. However, the British auditing standards have not made a very clear provision
- Secondly, the standards of China, the United States, and the international level have clearly proposed the disclosure of key audit matters and the corresponding countermeasures. Although the United Kingdom does not explicitly mention them, it requires disclosure of the risks making a significant or significant impact on the financial statements
- Thirdly, the United Kingdom requires that the CPA must state the level of materiality and the scope of the audit in the audit report. However, China, the United States, and the international community do not require disclosure
- Fourthly, as for going concern, only the international auditing standards have clearly stated it
- Fifthly, both Chinese and international standards require that attention should be paid to other information, and it is clear that other items must be added. However, there is no clear provision in Britain and the United States
- Sixthly, China and the United States require disclosure of the formation basis of audit opinions, while the United Kingdom and the international have not made relevant requirements

3. Literature Review

The so-called key audit matters (hereinafter referred to as KAM) refer to the matters that may have a significant impact on the overall financial statements judged by CPAs based on their own experience in the process of undertaking audit service. Before selecting the items, the CPA must communicate with the management, select important matters causing their attention, and then select the most critical matters. The selection criteria are as follows:

- Firstly, areas with a high risk of material misstatement or special risks caused by fraud are identified with No. 1211 standard of the Chinese Institute of CPA
- Secondly, matters involving significant judgments of the management, including accounting estimates with a relatively large degree of uncertainty in the financial statements
- Thirdly, matters that can cause significant transactions to the audit in the current period

Research in western countries started earlier on the audit report format, mainly focusing on the impact on the users and auditors of financial statements. The purpose of these articles is to use the methods of archival research or experimental research to elaborate the disclosure of key audit matters or the change of audit report format on the audit information content or audit quality from the perspective of both users of financial statements and auditors.

For users of financial statements, some studies believe that KAM will improve the quality of audit reports. Hatherly (1998) found that the value of the audit report would be further increased if auditors issued the audit report more casually without a prescribed format. Doxey (2014) found that if there were more information in the audit report, the value and relevance of the audit report would be further increased.

However, other studies suggest that KAM will reduce the quality of financial statements. Christensen (2014) found that KAM would reduce the relevance, usefulness, and quality of investment decision-making of investors using standard audit reports, therefore reducing the quality of financial statements. Kachelmeier et al. (2014) further explained this reason through experimental research. They found that if the auditor issued KAM, investors would think that the auditor was absolved from the responsibility of searching and disclosing similar and related matters, increasing the opportunistic behavior of CPAs and making CPAs lazy in strictly carrying out the audit business. This effect is more obvious for some high-risk events involving management fraud. Consequently, the quality of financial statements has been reduced. Coincidentally, the experimental study carried out by Louis Philippe et al. (2014) has drawn a similar conclusion.

And then for auditors, first of all, relevant studies have focused on the relationship between KAM and the litigation risk of the auditor. Katz (2014) pointed out that if the auditor disclosed the information on key audit matters, the possibility of prosecution would significantly increase. However, Brasel et al. (2016), Carver and Trinke (2015), and Kachelmeier et al. (2014) all think that reporting key audit matters can decrease the litigation risk. Phillips (2015) takes public companies using ISA700 for a case study and found that under certain circumstances, additional information disclosure will reduce the risk of legal liability of auditors. Lennox et al. (2015) further believed that although KAM can help investors identify financial risks, investors could have obtained relevant information about financial risk through other ways before reporting the related information. So this kind of assistance is not that useful. Based on the balance theory in psychological research, Asbahr and Ruhnke (2017) found that if auditors have sorted out some matters in the audit report and explained corresponding measures, they are less inclined to adjust these matters to reduce the audit efficiency. Therefore, they believe reporting KAM is detrimental to audit quality.

Related research has also focused on the relationship between audit input and output in the disclosure of KAM. Reid et al. (2015) found that applying the new audit standards will increase the number of stock transactions of one company, making auditors put more labor and resources into the auditing service, thus increasing audit costs. In 2016, they also took the implementation of ISA 700 in the United Kingdom as the time node and found that the degree of earnings management of the company replacing the audit quality decreased significantly, while the earnings response coefficient increased higher.

Pranil and Chand (2017) respectively evaluated the impact of the change of audit report mode on the information content, audit quality, and audit cost from the perspective of different stakeholders. They believed that the information value of the audit report and transparency of audit work increased obviously with the disclosure of key audit matters in the audit report, which could achieve the original intention of audit reform. However, as time passed, the issuance of KAM gradually evolved into a fixed mode. The quality of audit reports may be lower, while the legal risk CPA faces will be higher. When mentioned to external supervision, Elizabeth et al. (2018) found that the disclosure of KAM makes the audit pay more attention to transparency and fairness. It is because the issuance will make it easier for users to supervise the implementation of auditor efforts, and the improvement of external supervision, in turn, will promote the improvement of audit quality.

So, generally speaking, western studies have not reached a unified conclusion on whether key audit matters will improve audit quality.

Research on key audit issues started comparatively late in China, mainly from three levels:

- Theoretical research,
- Experimental research, and
- Empirical research

Researchers in China first discuss the relationship between KAM and audit quality from the perspective of theoretical review. Zhang Ge (2014) found that communication between financial report users and audit practitioners on KAM can both strengthen users' cognition of audit business and help users make essential judgments. Tang Jianhua (2015) believed that the change of the disclosure method of the audit report will increase the information content of the audit report, thus improving audit quality and restoring the stakeholders' trust in the audit. In terms of the impact on audit practice, Zhang Jixun and Han Dongmei (2014) believed that the disclosure of KAM would improve the decision-making

relevance and usefulness of investors caring about the audit report to improve the quality of information disclosure of financial reports. Que Jinghua (2017) thinks that the main purpose of this kind of report adjustment is to serve the information users and increase the information content and communication value of audit reports. However, this study also found that KAM has changed the original standardization system and would inevitably bring a lot of changes and risks worthy of further attention from researchers. Li Xiaojuan and Zhai Luping (2017) respectively elaborated on the advantages and disadvantages of implementing the new audit reporting standards to different stakeholders to help them gain profit and avoid harm to achieve double-win results.

For experimental research, Zhang Jixun et al. (2016) used experimental research methods to study the relationship between KAM and the communication intention of auditors. The results show that the change of disclosure mode will enhance the communication vision of the management, governance, and auditors, especially when the relationship between the three parties is poor. Moreover, after comparing with international standards, Ran Mingdong and Xu Yaozhen (2017) used the data of different industries and disclosure contents of new audit reports in 2016 to do a descriptive analysis. At last, they found that overall results of audit reports in China are generally in line with the expectations, which can improve the information quality of financial reports. However, differences in information granularity of KAM, excessive standardization of disclosure contents, and inconsistent disclosure forms may also bring new problems. Based on psychological theory, Han Dongmei and Zhang Jixun (2018) used the method of creating a situation for experimental research, analyzed and tested the impact of the conclusions of KAM in the report on auditors' sense of responsibility, finding that auditors perceived greater audit responsibility in audit report with KAM under new standard audit report.

Liu Muhua and Dong Xiuqin (2018) conducted a vertical and horizontal comparison of the key audit matters disclosed in the audit reports of companies listed on A+H share market from 2016 to 2017, founding that the disclosure of key audit matters had strong continuity. Most of them focused on the recognition of sales revenue and impairment loss. Lu Jun and Zhang Jindan (2018) comprehensively analyze the information of KAM from the aspects of disclosure mode, quantity distribution, detailed classification, industry characteristics, and accounting firm characteristics. The results showed that disclosure of KAM will improve information transparency, especially for asset impairment. Similar articles are written by Wu Qiusheng and Du Zhengyuan (2018) and Wu Yong et al. (2018). Coincidentally, Kai Jinghua and Shi Jingwen (2019) used the method of questionnaire survey and actual interview to analyze the relationship between the report of KAM and audit quality from a deeper level and found that the report of key audit matters could indeed improve the audit quality. However, Zhang Jindan et al. (2019) found that disclosing key audit matters could not substantially impact the audit quality at the financial reporting level. It shows that the disclosure of KAM could only enhance the earnings response coefficient in the market but was not able to change the discretionary accruals of the companies. Their research marked that the disclosure of KAM leads the audit quality at the financial reporting level deviating from the audit quality at the market perception level, particularly in the observation of a shorter time window.

However, Wang Yan et al. (2018) used listed companies from 2015 to 2016 to explore the impact of KAM on communication quality in audit reports. The results show that the report of key audit matters helps improve the cumulative abnormal return (CAR), and this increase is more obvious for Big4 firms. In the same year, Yang mingzeng et al. (2018) used DID and a multiple regression model to take companies listed in A+H and other A-share markets disclosing KAM based on new audit standards for the first time from 2015 to 2016 as samples. They found that the audit quality of the company has significantly improved using new audit standards in previous years, and this increase is positively proportional to the number of key audit matters reported in the audit report. Similarly, Li Yanxi et al. (2019) believe that the number of KAM will have an impact on the company's earnings level. Guo Baochun and Guo Rong (2019) further prove that disclosure of KAM in companies with a low level of internal governance will significantly impact the improvement of audit quality. The research of Chen Lihong et al. (2019) also proves this point. He thinks that improvement is due to the incremental risk information provided by KAM, attracting investors' attention, enhancing the earnings uncertainty, and reducing the dependence on earnings in investors' decision-making, especially for specific types of KAM.

In recent years, there are also articles on the relationship between KAM and investors in China. Wang Muzhi and Li Dan (2019) took the stock price synchronization of the capital market as the index of *Unique Information of Companies*, using the construction of DID, and found that implementing the new audit report can reduce the stock price synchronization. Moreover, the decrease is affected by the synchronicity of stock price and the degree of detail of disclosure. When more non-industry common items are disclosed, and the content of disclosure is more detailed, the two show a more obvious negative correlation. Similarly, Zhang Jixun et al. (2019) have a conclusive evaluation of the effect of KAMs on the judgment of investors. They found that investment attractiveness is higher if the conclusion of KAM is reasonable, and this judgment is affected by the confidence of investors in KAM.

To sum up, the exploration of key audit matters is still in the initial stage in the world due to the unclear requirements for key audit matters. Moreover, the exploration of KAM in China mainly focuses on high-risk areas such as possible major misstatements and major audit estimates. However, research on factors of disclosing KAM is still on a small scale. Therefore, it is more necessary and meaningful to study them. Based on the previous research of audit firms such as Li Mingxi (2018), we take the A + H-share listed companies from 2016 to 2018 as samples to study the impact of disclosure of KAM in audit reports from the perspectives of an accounting firm and audited unit to fill the blank of previous studies and make contributions to previous studies.

4. Hypothesis

By combing the previous literature, we can see that the previous literature lacks research on the influencing factors of the disclosure of key audit matters. Therefore, we put forward the hypothesis of the factors affecting the disclosure of KAM from the perspective of the audited companies and the audit firm.

4.1. Accounting Firm

Firstly, we put forward the hypothesis on the accounting firm.

4.1.1. Size of Accounting Firms

Existing research has proved that if the accounting firm is large, its independence and audit quality will be higher than those of a small accounting firm (Zhu Hongjun and Wang Jun, 2004, p.114-123). However, in the audit market of China, the research of Chen Xinyuan and Xia Lijun (2006), Liu Minghui and Chang Li et al. (2003), and Guo Zhaorui (2011) show that if the audit business is undertaken by Big4, the quality of audit service is not that higher than that of domestic accounting firms. They believe that this is because Non-big4 firms are more suitable for the local system in China. However, due to the foreign research on KAM prior to Chinese research, provisions on key audit matters in China did not appear until 2016, so the international Big4 has more experience in dealing with key audit matters. Therefore, we put forward Hypothesis 1.

- H1: The number of companies audited by the Big4 will be issued with more key audit matters.

4.1.2. Auditor Tenure

Most existing articles believe that extending auditor tenure will improve audit efficiency and quality. From the perspective of quality, Cuganesan (1996) found that with the increase in audit tenure, CPAs can be more familiar with the audited unit, so they can improve their own professional ability to improve audit quality. Similarly, Yu Yumiao and Liu Yingfei (2003) conducted a study based on the learning curve effect and proved similar results. From the perspective of cost, Daniels and Booker (2011) analyzed the benefits of longer auditor tenure to the firm and found that if the audit tenure increases, the accounting firm will have a more stable income and expenditure to supplement the cost of undertaking business, thus improving the audit efficiency. Cui Jing et al. (2015) also believed that mandatory auditor change would lead to higher audit costs, unequal supply and demand, and lower audit quality. To sum up, most of the existing studies have identified that the extension of auditor tenure will improve audit quality. In contrast, the existing research shows that the improvement of audit quality and the issuance of KAM are mutually reinforcing (Lu Jun and Zhang Jindan, 2018, p.84-90; Wu Yong et al., 2018, p.46-51). Therefore, we propose Hypothesis 2.

- H2: Companies audited by auditors with longer tenure will be issued with more key audit matters.

4.1.3. Audit Opinion

Lennox (2000) believes that non-standard audit opinions issued by CPAs can increase the probability of risk aversion, and different audit opinions have different effects on report users. Bian Hong et al. (2008) show that audit opinions have obvious value, relevance, and the market response to modified audit opinions is greater than that of unmodified ones. Lv Xiankai and Wang Wei (2007) and other researchers think that it is the professional practice ability of CPAs that determines the audit opinion type. If CPA has sufficient professional practice ability, it will be easy to find out the problems and issue non-standard audit opinions. Based on this situation, we believe that as KAM is the only supplement of standard unqualified audit opinions, it cannot solve critical problems like a fraud. If the audited unit is issued with non-standard audit opinions, there must be serious problems that KAM cannot show and solve. Based on this, we propose hypothesis 3.

- H3: Companies with modified audit opinions are less likely to be issued with key audit issues.

4.1.4. Audit Fee

The existing research shows that there will be an interaction between audit quality and audit fees. The increase in audit fees means that auditors put in more effort, leading to higher audit quality. Simunic and Stein (1987) first came to a conclusion. At the same time, Krishnan et al. (2005), including the research of Zhang Limin and Guan Jinsong (2004) and Lei Guangyong and Liu Dan (2006), pointed out that higher audit fee means not only high cost but also high work passion of auditors, which will improve audit efficiency.

According to these articles, higher audit fees mean more audit investment, making CPAs discover more problems and leading to more key audit matters. So we propose Hypothesis 4.

- H4: Companies paying higher audit fees will be issued with more key audit matters.

4.1.5. Gender of CPA

Existing research shows that the quality of accounting information gained by female CPAs will be higher. Liu Xiaochun (2014) found that if the signing CPA is female, the discretionary accruals (DA) should be lower, and this effect is most significant when the two signed CPAs are both women. Arun et al. (2015) found that female independent director is more beneficial to improve the quality of supervision and management. Therefore, similar things happen to female CPAs. There are probably two explanations for the phenomenon that women are more cautious and conservative than men. On the one hand, the social responsibility of women makes them more inclined to avoid risks. On the other hand, men are expected to take more risks, while women's ideas of risk aversion are constantly strengthened. They are inclined to abide

by professional ethics and be able to resist the temptation of high income and work seriously. Based on this, we propose Hypothesis 5.

- H5: Companies audited by female CPAs will be issued with more key audit matters.

To sum up, on the level of accounting firms, we measure the impact of the characteristics of subjects accepting audit work on the number of key audit issues from the perspective of both the firm and the CPA by taking five factors, namely:

- The size of the firm,
- The type of audit opinion issued,
- The audit fees paid,
- The length of service, and
- The gender of CPAs

4.2. Audited Companies

Firstly, we put forward the hypothesis on the audited companies.

4.2.1. Size of Companies

Research by Simunic and Stein (1987) showed that there is a significant positive correlation between the size of companies and the choice of high-quality auditors. That is, the larger the size of clients is, the more complex their business operations are, and the more inclined the clients are to employ firms with higher audit quality. Wu Xi (2002) also found similar results. Li Minghui (2006) found that only size can significantly increase audit quality. Xie Fei (2009), Chen Lihong, and Zhang Longping (2014) have come to similar conclusions. For this reason, they all think that the increase in size will increase the difficulty of audits, thus increasing the demand for high-quality audit firms. Based on this, we conclude that the larger the company is, the more likely it is to employ high-quality auditors for audit, and the more KAM will be issued. So Hypothesis 6 is used.

- H6: Companies with larger size will be issued with more key audit matters.

4.2.2. Leverage of Companies

Eichenesher and shields (1986) and Smith and Bushman (2003) show that companies with higher financial leverage will encounter greater agency problems and are more likely to choose firms with higher audit quality. Moreover, the increase in leverage will increase the inherent risk of audit. If the financial statement of companies has a higher risk, the companies and auditors will be more likely to encounter litigation. It will increase the possibility of auditors investing more energy in undertaking audit business, thus improving the audit fee and audit quality (Simunic and Stein, 1987, p.187-199). Based on this, we infer that the companies with higher leverage are more likely to be involved in agency conflict and litigation. So auditors will invest more cost to audit and find more KAM; hence, we came to Hypothesis 7.

- H7: Companies with higher financial leverage will be issued with more key audit matters.

4.2.3. Profitability

The research of Simunic and Stein (1987) shows that companies with strong profitability are less likely to suffer losses and encounter bankruptcy crises. The decline in profitability will increase the possibility of clients suffering from bankruptcy, so we need high-quality audit service to guarantee the reality of the high possibility. The leading indicators to measure customer profitability are:

- The net interest rate of net assets (ROE),
- Gross profit rate, and
- The possibility of loss

Based on this, we hold that the poor profit situation of the companies will lead to stronger motivation to manipulate profit and higher litigation costs. To reduce litigation costs, the CPA will increase the input of audit to these companies with poor profitability to improve the audit quality to increase the ability to find the key audit matters. So we come to Hypothesis 8.

- H8: Companies with poor profitability are also issued with more key audit issues.

4.2.4. Actual Controller

Researches show that the choice of auditors is related to whether the senior managers and shareholders of the company are in government-related units. The probability is higher if state-owned enterprises employed CPAs ever worked in state-owned enterprises and owned working experience in similar companies (Huang Xinjian and Zhang Hui, 2011, p.46-54; Gong Qihui and Wu Liansheng, 2012, p.42-50). Due to strong agency conflicts in state-owned enterprises, it is easier to employ large-scale and high-quality audit firms (Zhang Qifeng, 2009, p.64-66). On the contrary, companies lacking state-owned backgrounds are not inclined to employ firms with higher audit quality because of inadequate supervision, serious speculation, and poor quality of financial statements (Zhang Qifeng and Zhang Ming, 2009, p.113-120). It is believed that the actual controller and the nature of ownership of the audited entity also have an impact on the issuance of key audit matters. The state-controlled enterprises are more likely to choose high-quality auditors because of the larger agency conflict, and the number of KAM issued will be more, so we came to Hypothesis 9.

- H9: State-owned enterprises might issue more key audit matters.

4.2.5. IPO Period

Companies that have been IPO for a long time tend to take the lead in the industry. Such enterprises tend to have stable business performance, better management mechanisms, perfect information disclosure systems, and higher-quality financial statements (Zhang Junsheng et al., 2017, p88-93+103). Based on this, we believe that enterprises with longer IPO years have stable operating performance and perfect management mechanisms. So the quality of financial statements is often higher. Auditors will also put in lots of effort, which will lead to an increase in the number of key audit matters issued. So we came to Hypothesis 10.

- H10: Companies with long IPO periods are also issued with more key audit issues.

4.2.6. Net Operating Cash Flow

The research of Huang Hao (2019) shows that good cash flow management reflects the higher management level of enterprises. It can also help the long-term and stable development of enterprises. Therefore, the development of enterprises needs to learn how to improve the level of cash flow management and capital utilization efficiency and control the risk of cash flow in the current increasingly complex market environment. The same is the research of Xu Bo (2018) and Wu Chunli (2018). Based on this, we believe that companies with better cash flow can reflect higher enterprise management levels, and the quality of financial statement information is also higher. Therefore, when the standard unqualified audit opinion is issued by the auditor, less KAM will be issued. Based on this, we propose Hypothesis 11.

- H11: Companies with more net operating cash flow are issued with more key audit matters.

To sum up, at the level of the auditee, we use six factors, namely, size, leverage, profitability, actual controller, IPO years, and net operating cash flow, to measure the impact of the characteristics of audited companies on the number of key audit matters disclosure.

The logic of this paper is as follows:

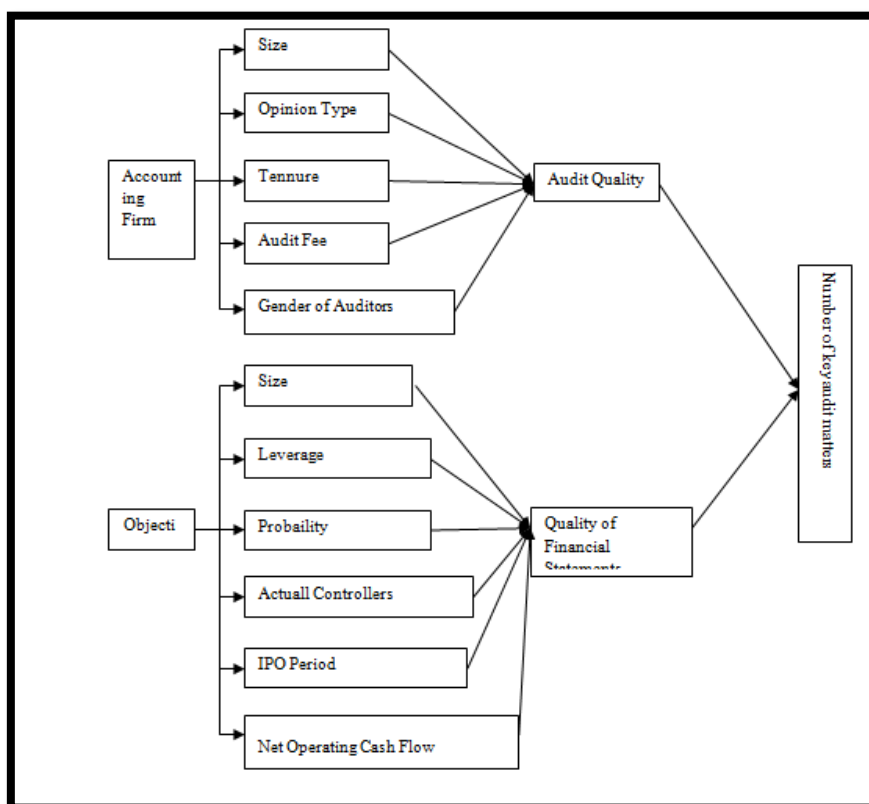


Figure 1: Diagram of Research Logic

5. Research Design

5.1. Samples Selection

We selected a total of 307 companies listed in both A-shares and H-shares market in China from 2016 to 2018 as the sample, obtaining 884 pieces of data while taking each key audit matter and each signed CPA as one piece. And then, we downloaded the financial data of the 307 listed companies from CSMAR and data of its actual controller from the Reset. After eliminating data with missing variables, 685 data were finally involved in the study. The results of the sample screening are shown in table 2.

Sifting Process	Data Volume
Original Sample	884
minus:	
Sample of missing audit tenure	128
Sample of missing key audit items	10
Sample of missing audit fees	10
Sample of missing gross profit margin	10
Sample of missing actual controller	13
Equals:	
Final remaining sample	685

Table 2: Samples Selection Process

According to the survey, the missing data of audit tenure cannot be supplemented manually, and so is other missing data. Therefore, we can only use 685 pieces of data for regression analysis.

5.2. Model Design and Variable Definition

Based on the research of Yang mingzeng et al. (2018) and Li Yanxi et al. (2019), we designed the model as follows, and the definition of variables is shown in table 2.

$$Kam_num = \alpha_0 + \alpha_1 * Big4 + \alpha_2 * Tennure + \alpha_3 * Opinion + \alpha_4 * Lnfee + \alpha_5 * Female + \alpha_6 * Size + \alpha_7 * Lev + \alpha_8 * ROE + \alpha_9 * GM + \alpha_{10} * Loss + \alpha_{11} * CN + \alpha_{12} * CFO + \alpha_{13} * Age + \Sigma Yeadum + \Sigma Indudum + \epsilon \tag{1}$$

Type	Name	Symbol	Notes	
Dependent Variable	Number of key audit matters	<i>Kam_num</i>	The number of key audit matters disclosed in the audit report of each company	
Independent Variable	Accounting Firms	Size of Accounting Firms	<i>Big4</i>	Whether companies employed a Big4 firm, if so, the value is 1; if not, the value is 0
		Practice Experience	<i>Tenure</i>	Years of an auditor working as a CPA
		Types of audit opinions	<i>Opinion</i>	Whether the audit opinion issued is an unmodified standard opinion, if so, the value is 0; if not, the value is 1
		Audit fee	<i>Lnfee</i>	The natural logarithm of audit fees paid by the company
		Auditor Gender	<i>Female</i>	If CPA is female, the value is 1; otherwise, the value is 0.
	Auditee characteristics	Size of companies	<i>Size</i>	Natural logarithm of total assets
		Leverage	<i>Lev</i>	Total liabilities/Total assets
		Profitability Index 1	<i>ROE</i>	Rate of return on net assets = net profit/equity of shareholders
		Profitability Index 2	<i>GM</i>	(Main Business Income - Main Business Cost)/Main Business Income *100%.
		Profitability Index 3	<i>Loss</i>	Net profit is positive 1 and negative 0
		The Nature of Actual Controller	<i>CN</i>	For state-owned companies, the value is 1; otherwise, the value is 0.
		Listing life of the company	<i>Age</i>	Years for IPO period in the maximum of A share and A+H share market
		Operating Cash Flow	<i>CFO</i>	Annual operating cash flow/the average total assets
Year	<i>Yeadum</i>	Year dummy variable		
Industry	<i>Indudum</i>	Industry dummy variable		

Table 3: Variable Definition

We mainly observe the coefficient α_1 to α_{13} to see whether it is significant. If significant, it shows that the factor associated with that coefficient can significantly impact the number of KAM, which can prove the relevant hypotheses, and if not significant, it shows that those factors have no significant impact, which cannot prove our hypotheses.

6. Empirical Study

6.1. Descriptive Analysis

6.1.1. Type Description

Firstly, the original sample without deleting the sample with missing data is used to make descriptive statistics on the types of key audit matters. There are 767 KAM in the original sample. We make descriptive statistics according to the types, industries, and firms in turn.

As shown in table 4, items of great significance are:

- Assets impairment,
- Financial assets-related matters,
- Income-related matters, and
- Accounts receivable-related matters

Among them, 102 items are assets impairment matters, accounting for 13.3% of the total number, showing that most companies listed on both A and H share markets have disclosed KAM related to assets impairment, which is also in line with previous studies.

A total of 79 items, accounting for 10.3% of the total number of items, are financial instruments-related matters, mainly including the confirmation, evaluation, and impairment of new financial instruments.

76 items each, accounting for 9.91% of the total number, are income confirmation-related matters and accounts receivable-related matters, accounts receivable confirmation, mergers, intangible assets, and disposal subsidiaries are also concerned.

It is worth mentioning that the decline in the ranking of goodwill also illustrates the gradual improvement of the goodwill system from the side.

Name of Key Audit Matters	Number	Frequency	Name of Key Audit Matters	Number	Frequency
Asset Impairment (excluding goodwill)	102	13.3	Depreciation and Amortization	11	1.43
Financial Instrument Related Items	79	10.3	Fair Value Related Items	9	1.17
Matters Related to Sales Revenue Recognition	76	9.91	Related Party Items	6	0.78
Receivability of Accounts Receivable	76	9.91	Information Technology System	6	0.78
Items Related to Enterprise Merger	72	9.39	Government Grants	5	0.65
Subsidiary of Intangible Assets and Disposal	68	8.87	Capitalized Expenditure	4	0.52
Goodwill Related Items	63	8.21	Pending Litigation	4	0.52
Net Realizable Value of Inventory	39	5.08	Structured Subject Merger	3	0.39
Contract Loss	34	4.43	Reserve	3	0.39
Loan-related Items	26	3.39	Deposit Related Items	2	0.26
Other Liabilities	26	3.39	Provision for bad Debts	2	0.26
Lease-Related Items	19	2.48	Bankruptcy Reorganization Items	1	0.13
Deferred Income Tax Items	16	2.09	Increase in business	1	0.13
Debt Investment related	14	1.83	Total	767	100

Table 4: Type Description of KAM

6.1.2. Industry Description

As shown in table 5, the industry codes are arranged according to standards published by the SEC in 2016. The industry with the largest number is the financial industry, which is coded as J67, with a total of 102 matters, followed by the number of monetary and financial service industries coded as J66, with a total of 95. They are both in the financial industry, mainly focused on asset impairment and matters related to financial instruments, including the merger of structured subjects. By reading the literature of the predecessors, we find that the financial industry is an emerging industry, and its particularity brings a higher level of concern for CPAs. In addition, the accounting standards for financial assets have changed greatly in the past two years, which will cause more attention to CPAs. The third is the special equipment manufacturing industry, coded as C35, with a total of 51 items, which involves many items such as fixed assets impairment, intangible assets amortization, and development capitalization expenditure. These are also matters with

obvious changes in standards, attracting the attention of CPAs. Finally, the fourth is the insurance industry, coded as J68, with a total of 44 items, which is subordinate to the financial industry disclosing similar items.

The following is a descriptive analysis of KAM disclosures from an industry perspective:

Industry Code	Number	Industry Code	Number
J67	102	B09	14
J66	95	C38	14
C35	51	C33	13
J68	44	C39	13
C36	42	K70	12
G55	33	C37	10
C34	30	F52	10
E48	30	C22	9
C27	28	C42	9
C30	25	D45	9
G56	25	C15	7
G54	21	D46	4
C31	19	G53	4
C32	17	C25	3
D44	17	R85	3
B11	15	C14	2
B06	14	C18	2
B07	14	Total	767

Table 5: Industry Distribution of KAM

6.1.3. Accounting Firm Distribution

Table 6 shows Ernst & Young's accounting firm issued 177 KAM, followed by PWC issuing 150 KAM. And then, Deloitte issued 99 key audit matters while KPMG issued 92 key audit matters. Big4 together issued 518 key audit matters, accounting for 67.53% of the total, monopolizing the issuance of KAM. However, among the domestic accounting firms, Xin Yong Zhonghe issued the largest number of key audit matters, with only 81 items, and Tianyuan issued only three items. This may be because the Chinese standards on KAM were issued relatively late, and the accounting firms own relatively less experience, meaning that the audit system and issuance of key audit matters in China need to be strengthened.

The following is an accounting firm distribution of the number of KAM in our sample.

Name of Accounting Firms	Number	Name of Accounting Firms	Number
Ernst & Young	177	Tianzhi	25
PWC	150	Dahua	12
Deloitte	99	Daxin	9
KPMG	92	Tianjian	9
Xin Yong Zhonghe	81	Zhitong	9
Lixin	51	Tianyuan	3
Ruihua	47	Total	767

Table 6: Number and Accounting Firm Distribution of Key Audit Matters

6.1.4. Description Analysis

The following descriptive analysis of all variables in the sample:

Variable	Obs	Mean	Std.Dev.	Min	Max
<i>Kam_number</i>	685	2.739	1.032	1	6
<i>Big4</i>	685	0.695	0.461	0	1
<i>Tenure</i>	685	15.47	7.239	1.047	25.00
<i>Opinion</i>	685	0.010	0.101	0	1
<i>Lnfee</i>	685	15.65	1.358	13.33	19.26
<i>Female</i>	685	0.403	0.491	0	1
<i>Size</i>	685	25.71	2.229	19.84	30.95
<i>Lev</i>	685	0.605	0.239	0.103	0.901
<i>ROE</i>	685	0.204	2.352	-0.595	43.60
<i>GM</i>	685	0.083	0.402	-1.600	1.251
<i>Loss</i>	685	0.048	0.214	0	1
<i>CN</i>	685	0.784	0.412	0	1
<i>Age</i>	685	14.64	7.148	0.874	28.94
<i>CFO</i>	685	0.037	0.102	-0.207	0.844

Table 7: Descriptive Analysis of Variables in Model I of Key Audit Matters

Table 7 shows that all variables are winsorized by 1%. For the dependent variable, the average value of the number of KAM issued by each company (*Kam_number*) is 2.739, the minimum value is 1, and the maximum value is 6, indicating that one A+H company has at least one key audit matter. In contrast, the company has about 3 key audit matters on average. We reviewed the company with 6 key audit matters and found that it is a company in a large-scale industry audited by Tianzhi firm. Although it issued six matters, no material misstatement was found.

For the independent variables, among the variables related to accounting firms:

- The average value of *Big4* representing the size of accounting firms is 0.695, which indicates that nearly 70% of the total accounting firms in the past three years hired by A+H listed companies are large-scale international Big4 firms,
- The average value of *Tenure* is 15.47, which indicates that the average cooperation period of auditors and companies is about 15.5 years, and the maximum value is 25, which indicates that the longest cooperation period can reach 25 years, showing that the auditors employed by the company are all experienced people, which is consistent with previous studies,
- The average value of *Opinion* is 0.1, which indicates that only 10% of the companies have issued non-standard audit opinions,
- The average value of *Lnfee* is 15.65, which is close to the maximum value of 19.26 and indicates that the audit fees paid by companies in the sample are generally higher, and
- The average value of *females* is 0.403, which indicates that the number of male auditors employed is slightly higher than those of females

Among the variables related to audited companies:

- The average value of the *Size* is 25.71, which is close to the maximum value of 30.95 and indicates that the sample companies are generally large-scale,
- The average value of *Lev* is 0.605, which indicates that the average liability ratio in the sample is about 60%. It may be because most of the enterprises in the sample are financial enterprises with high leverage. Among the indicators representing profitability, the average roe of *ROE* is 0.204, the average of *GM* is 0.083, and the average of *Loss* is 0.048, which is between the maximum and minimum and relatively normal,
- The average value of *CN* is 0.784, indicating that 78.4 percent of samples are state-owned;
- The average number of *Age* is 14.64, showing that the average A-share listing period of sample companies is about 14 years, and
- The average *CFO* representing the net operating cash flow is 0.037, indicating that companies in our sample have a good cash flow condition

So from the descriptive analysis, the companies with at least one key audit matter in the sample are generally larger in scale, slightly higher in leverage, and higher in profitability. Moreover, the accounting firms employed also have large-scale, experienced auditors. Most of them issued standard unmodified audit opinions to the audited units. Generally speaking, the sample situation is relatively normal with no abnormal phenomenon.

6.2. Regression Analysis

Then we use Model I mentioned above to verify the hypotheses through multiple linear regression.

	Panel-1	Panel-2
Variable	<i>Kam_number</i>	<i>Kam_number</i>
Variables of Accounting Firms		
<i>Big4</i>	-0.118 (-1.25)	-0.0940 (-0.99)
<i>Tennure</i>	0.001 (0.24)	-0.002 (-0.32)
<i>Opinion</i>	-0.639* (-1.89)	-0.710** (-2.05)
<i>Lnfee</i>	0.007 (0.15)	-0.028 (-0.64)
<i>Female</i>	-0.0230 (-0.32)	-0.0730 (-1.03)
Variables of Companies		
<i>Size</i>	0.097** (2.23)	0.164*** (4.58)
<i>Lev</i>	1.072*** (4.48)	1.050*** (4.64)
<i>ROE</i>	-0.036** (-2.46)	-0.034** (-2.24)
<i>GM</i>	-0.578*** (-5.72)	-0.443*** (-4.34)
<i>Loss</i>	-0.068 (-0.38)	-0.078 (-0.44)

	Panel-1	Panel-2
Variable	<i>Kam_number</i>	<i>Kam_number</i>
Variables of Companies		
<i>CN</i>	0.122 (1.28)	-0.003 (-0.03)
<i>Age</i>	0.015** (2.46)	0.005 (1.03)
<i>CFO</i>	-0.932** (-2.49)	-1.651*** (-4.40)
<i>Cons</i>	-1.186 (-1.62)	-35.45 (-0.39)
<i>Year*Indudum</i>		0.017 (0.37)
<i>Yeardum</i>	Controlled	
<i>Indudum</i>	Controlled	
N	659	685
Adj.R ²	31.49%	23.99%

Table 8: Multiple Linear Regression Table
t-statistics in Parentheses * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$

Before the multiple linear regression analysis, we first use Model I to carry out a univariate regression analysis. At the accounting firm level, *Kam_Number* is negatively correlated with *Opinion* and *Lnfee*. However, at the company level, *Kam_Number* is positively correlated with *Size* and *Lev* at 1% level but *CFO* negatively at 1% level.

Then we use multiple linear regression analysis, add industry and annual dummy variables in Panel-1 to control the industry and annual effect, and set the industry dummy variable in the Panel-2, setting manufacturing industry as 1 and non-manufacturing industry as 0. An annual dummy variable is used as a cross multiplier addition into Model I to control industry and annual effect.

As shown in table 8, when performing more accurate multiple linear regression: at the firm level, the variable *Kam_Number* is only significantly correlated with the other variable *Opinion*, which is significantly negative at the level between 5% and 10%, with the average coefficient of - 0.67 and the average T value of - 2.2. This shows that when an audited unit is issued with a modified audit opinion, the number of key audit matters will be significantly reduced, meaning that H3 was accepted. This result is consistent with the actual situation because KAM is only found in the unmodified audit opinion. However, the following variables have no significant relationship with *Kam_number*, meaning H1, H2, H4, and H5 were all rejected.

However, at the level of the auditees, firstly, *Size* is positively correlated with *Kam_number* at 5% level, which shows larger size will increase key audit matters, meaning that H6 is verified. And then, *Lev* is positively correlated with *Kam_number* at 1% level, showing that the more debt an audited entity has, the higher the financial risk is, which will increase key audit matters, meaning H7 is verified. Then, among the three variables representing profitability, *ROE* and *GM* are both negative at least 5% level, meaning that companies with fewer key audit matters usually have better profitability, and H8 is verified. *Age* is broadly positively correlated with *Kam_number*, indicating that the longer the company is listed, the more key audit matters are issued, so H10 is verified. Also, there is *CFO*, showing the higher the operating cash flow is, the more key audit matter is issued, and H11 is verified.

Only *CN* representing the actual controller is no significant correlation between the number of KAM and the nature of the actual controller. The hypothesis H9 of the actual controller has not been verified.

In summation, the number of key audit matters disclosed by the audited entity is more related to the characteristics of the audited companies rather than the accounting firm. The size, leverage profitability, IPO period, and net operating cash flow of the audited entity are all related to the number of key audit matters. It means that more key audit matters are significantly related to the larger size, the higher liability ratio, and the longer IPO period. Moreover, higher profitability and greater net operating cash flow are related to fewer numbers. However, for accounting firms, only types of audit opinions issued at the firm level are significantly related to the number of key audit matters. This shows that there are fewer key audit matters with non-standard and unqualified audit opinions. The analysis of the types of KAM will be mentioned in the next part of the study.

7. Further Study

Nowadays, only descriptive analysis is used to study the issue type of key audit matters (Ran Mingdong and Xu Yaozhen, 2017, p. 58-66; Han Dongmei and Zhang Jixun, 2017, p.70-76). However, there is no empirical analysis using large-scale data. Based on this, we combine five issued key audit matters with the highest frequency of occurrence in the sample, using probit regression to study the influence of the audit subject and object characteristics on the issuance type of key audit matters from the two levels of the audit firm and auditees.

We first defined the dummy variable from *Kam1* to *Kam5* as follows:

- *Kam1*: If the KAM is related to impairment-related matters (excluding goodwill), the value is 1; otherwise, the value is 0
- *Kam2*: if KAM is related to financial instrument, the value is 1; otherwise, the value is 0

- *Kam3*: if KAM is related to an income instrument, the value is 1; otherwise, the value is 0
 - *Kam4*: if KAM is related to the accounts receivable of other companies, the value is 1; otherwise, the value is 0
 - *Kam5*: if KAM is related to a merger business with other companies, the value is 1; otherwise, the value is 0
- Then, we substitute the variables *Kam1-Kam5* into model 1 to construct Model 2, 3, 4, 5 & 6 as follows:
- $Kam1 = \beta_0 + \beta_1 * Big4 + \beta_2 * Tennure + \beta_3 * Opinion + \beta_4 * Lnfee + \beta_5 * Female + \beta_6 * Size + \beta_7 * Lev + \beta_8 * ROE + \beta_9 * GM + \beta_{10} * Loss + \beta_{11} * CN + \beta_{12} * CFO + \beta_{13} * Age + \Sigma Yeadum + \Sigma Indudum + \epsilon$ (2)
 - $Kam2 = \gamma_0 + \gamma_1 * Big4 + \gamma_2 * Tennure + \gamma_3 * Opinion + \gamma_4 * Lnfee + \gamma_5 * Female + \gamma_6 * Size + \gamma_7 * Lev + \gamma_8 * ROE + \gamma_9 * GM + \gamma_{10} * Loss + \gamma_{11} * CN + \gamma_{12} * CFO + \gamma_{13} * Age + \Sigma Yeadum + \Sigma Indudum + \epsilon$ (3)
 - $Kam3 = \delta_0 + \delta_1 * Big4 + \delta_2 * Tennure + \delta_3 * Opinion + \delta_4 * Lnfee + \delta_5 * Female + \delta_6 * Size + \delta_7 * Lev + \delta_8 * ROE + \delta_9 * GM + \delta_{10} * Loss + \delta_{11} * CN + \delta_{12} * CFO + \delta_{13} * Age + \Sigma Yeadum + \Sigma Indudum + \epsilon$ (4)
 - $Kam4 = v_0 + v_1 * Big4 + v_2 * Tennure + v_3 * Opinion + v_4 * Lnfee + v_5 * Female + v_6 * Size + v_7 * Lev + v_8 * ROE + v_9 * GM + v_{10} * Loss + v_{11} * CN + v_{12} * CFO + v_{13} * Age + \Sigma Yeadum + \Sigma Indudum + \epsilon$ (5)
 - $Kam5 = \eta_0 + \eta_1 * Big4 + \eta_2 * Tennure + \eta_3 * Opinion + \eta_4 * Lnfee + \eta_5 * Female + \eta_6 * Size + \eta_7 * Lev + \eta_8 * ROE + \eta_9 * GM + \eta_{10} * Loss + \eta_{11} * CN + \eta_{12} * CFO + \eta_{13} * Age + \Sigma Yeadum + \Sigma Indudum + \epsilon$ (6)

Here, probit regression is used to test the model. The definition of variables is shown in table 2. The coefficients of variables in the main observation model are used to verify the conclusion of this paper. The results are shown in table 9.

	Kam1	Kam2	Kam3	Kam4	Kam5
	Impairment	Financial Instrument	Income Instrument	Accounts Receivable	Merges
Variables of Accounting Firm					
Big4	-0.183 (-1.25)	-0.329 (-1.24)	-0.181 (-0.98)	0.185 (1.01)	-0.081 (-0.37)
Tennure	0.002 (0.29)	-0.011 (-0.97)	0.005 (0.57)	0.004 (0.49)	-0.017 (-1.37)
Opinion	-0.308 (-0.52)	0.762 (1.00)	0.001 (0.001)	1.045** (2.07)	0.001 (0.001)
Lnfee	0.0310 (0.46)	-0.348*** (-3.28)	0.125 (1.35)	0.142 (1.63)	-0.306*** (-3.18)
Female	-0.088 (-0.79)	-0.077 (-0.45)	-0.099 (-0.71)	0.034 (0.25)	0.109 (0.69)
Variables of Auditees					
Size	-0.0380 (-0.69)	0.287** (2.33)	-0.109 (-1.56)	-0.203*** (-2.98)	0.156* (1.68)
Lev	0.508 (1.43)	3.001*** (2.58)	-0.573 (-1.39)	0.300 (0.70)	0.393 (0.58)
ROE	0.003 (0.13)	-5.323* (-1.73)	-0.0260 (-0.41)	-1.430 (-1.18)	1.221 (0.66)
GM	-0.163 (-1.03)	-0.01 (-0.07)	0.288 (1.36)	0.177 (0.83)	0.378 (1.52)
Loss	0.198 (0.75)	0.001 (0.001)	0.481* (1.67)	-0.691 (-1.36)	0.001 (0.001)
CN	-0.004 (-0.03)	-0.459** (-2.09)	-0.305* (-1.86)	-0.385** (-2.45)	0.004 (0.02)
Age	-0.002 (-0.29)	-0.056*** (-3.48)	-0.005 (-0.54)	-0.003 (-0.36)	-0.011 (-0.89)
CFO	-0.402 (-0.66)	-1.143 (-0.97)	-0.256 (-0.35)	-0.383 (-0.47)	-2.609** (-2.48)
Year and Indu	-0.113 (0.09)	0.010 (1.46)	0.129 (1.09)	0.0950 (1.45)	0.159 (1.45)
Cons	28.0 (1.61)	-24.03 (-0.10)	-259.3 (-1.45)	-189.3 (-1.08)	-321.5 (-1.46)
N	685	652	678	685	645
Pseudo. R ²	20.07%	19.07%	18.97%	20.07%	21.07%

Table 9: Further Analysis – Test of Type Issued of KAM
t-statistics in Parentheses * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$

Table 9 shows that only financial instruments, accounts receivable, and merger-related matters will be significantly affected by the influencing factors. The related items of accounts receivable will be slightly affected by the influencing factors, while the impairment events (excluding goodwill) will not be affected by the influencing factors.

The financial instrument-related matters are most affected by the influencing factors. In the financial instrument-related matters, the variables *Lnfee* and *Kam2* are significantly negatively correlated at the 1% level. The correlation

coefficient is -0.348, showing that the more audit fees charged by the accounting firm, the less likely it is to have KAM related to financial instruments. At the company level, *Size* and *Lev* are significantly positively correlated with *Kam2*, while the significance of *Size* is 5% and *Lev* is 1%, meaning that the larger scale and higher leverage ratio will lead the accounting firm to issue KAM related to financial instruments. However, *ROE* representing profitability is negatively correlated with *Kam2* at the level of 10%, and the correlation is not significant, which indicates that profitability is not related to financial instruments. At the same time, *CN* is significantly negatively correlated with *Kam2* at the level of 5%, and the correlation coefficient is -0.459, indicating that state-controlled enterprises are less likely to be issued with KAM related to financial instruments. It may be because of the fewer financial instruments used by state-controlled enterprises. At last, *Age* representing the listing year is also significantly correlated with *Kam2* at the level of 1%, indicating that the longer the listing year, the less likely it is for auditors to issue KAM related to financial instruments to these firms. We believe this is because enterprises with longer listing years have a better understanding of the financial market rules and are less likely to violate them.

Income-related matters (*Kam3*) are only affected by *Loss* representing whether the company is in loss or not, and *CN* represents the actual controller at the company level. The influence is weak, so we will not elaborate too much here. Among the items related to the confirmation of accounts receivable, *Opinion* is significantly positively correlated with *Kam4* at the level of 5%, with a coefficient of 1.045, indicating that if the audited entity is issued with a modified audit opinion, it is more likely to be accompanied by KAM related to accounts receivable. We further discover that the non-standard audit opinion of the company is caused by the fact that the accounts receivable are closely related to the income, and most of the income problems are caused by fraud. The fraud greatly impacts the credibility of the financial statements, which will directly lead to accounting firms issuing modified audit opinions. At the company level, *Kam4* is significantly negatively correlated with *Size* and *CN*, indicating that large-scale state-owned enterprises are less inclined to be issued with KAMs related to accounts receivable. We believe that this is because large-scale state-owned enterprises are subject to strict supervision and are not intended to use income and accounts receivable for fraud.

Among the key audit matters related to the merger, *Lnfee* and *Kam5* at the firm level are significantly negatively correlated, indicating that more audit fees paid by the audited entity will decrease key audit matters related to the merger. The reason may be that most key audit matters related to the merger are related to the consolidated financial statements, and firms paying more audit fees will be more likely to issue key audit matters related to the merger. Therefore, more adjustments will be added to reduce the issuance of related matters of the consolidated financial statements when auditors focus on the business of consolidated financial statements. *Size* is significantly positively correlated with *Kam5* at the level of 10%, and the significance is weak, while *CFO* is significantly negatively correlated with *Kam5* at the level of 5%. The results mean that more operating cash flow and stronger liquidity will improve the operating condition and decrease problems in financial statements, leading to decreasing key audit matters.

To sum up, factors that affect the issuing type of essential audit items are:

- Audit opinions,
- Audit fees of accounting firms and size,
- Leverage,
- ROE,
- Age,
- Net operating cash flow and
- The nature of the actual controller of companies

The company-level factors have a greater impact on the issuance type of key audit matters. In other words, the type and quantity of audit issues are dependent more on auditees than on accounting firms.

8. Robustness Test

8.1. Replacement of *Kam_Number*

We define the dummy variable *Kam6*. The definition is that when the number of KAM issued by a certain company is greater than the sample average of 2.73, *Kam6* is equal to 1; otherwise, it is taken as 0. Then we substitute *Kam6* into model (1) and construct Model 3.

$$Kam6 = \theta_0 + \theta_1 * Big4 + \theta_2 * Tennure + \theta_3 * Opinion + \theta_4 * Lnfee + \theta_5 * Female + \theta_6 * Size + \theta_7 * Lev + \theta_8 * ROE + \theta_9 * GM + \theta_{10} * Loss + \theta_{11} * CN + \theta_{12} * CFO + \theta_{13} * Age + \Sigma Yeadum + \Sigma Indudum + \epsilon \quad (7)$$

Then we use probit regression to test Model 7. The coefficients of the main influencing factors are observed to prove the robustness of the principal regression.

8.2. Principal Component Analysis of Profitability

We use principal component analysis (PCA) to analyze *ROE*, *Loss*, and *GM* and finally construct a new index indicator *Profit* to further prove the stable influence of profitability on the disclosure of key audit matters. The definition is as follows:

$$Profit = 0.71 * ROE + 0.70 * GM - 0.03 * Loss$$

Then we put the variable *Profit* into Model I and remove *ROE*, *GM*, and *Loss* to prove the impact of profitability on the number of key audit matters.

8.3. Control Autocorrelation and Heteroscedasticity

In this paper, robust and cluster tests are added to the original model to control heteroscedasticity and autocorrelation effects.

The results are shown in table 10.

	Replacement of Kam_number	Principal Component Analysis of Profitability	Control Autocorrelation and Heteroscedasticity
	Kam6	Kam_number	Kam_number
Big4	-0.139 (-0.96)	-0.125 (-1.31)	-0.0940 (-0.44)
Tennure	-0.003 (-0.43)	-0.001 (-0.26)	-0.002 (-0.37)
Opinion	-1.071 (-1.45)	-0.730** (-2.09)	-0.710*** (-4.40)
Lnfee	-0.001 (-0.01)	0.004 (0.08)	-0.028 (-0.26)
Female	-0.039 (-0.35)	-0.088 (-1.23)	-0.073 (-0.62)
Size	0.225*** (4.12)	0.119*** (3.52)	0.164* (1.81)
Lev	1.661*** (4.94)	1.081*** (4.78)	1.050*** (2.66)
Roe	-0.079 (-1.20)		-0.034*** (-4.16)
GM	-0.893*** (-4.88)		-0.443** (-2.42)
Loss	-0.516* (-1.94)		-0.0780 (-0.38)
Profit		-0.056*** (-2.62)	
CN	-0.345** (-2.38)	-0.046 (-0.51)	-0.003 (-0.02)
Age	0.004 (0.51)	0.007 (1.40)	0.005 (0.50)
CFO	-1.105** (-2.09)	-1.758*** (-4.66)	-1.651* (-1.69)
Year*Indu	-0.126* (-1.80)	0.0340 (0.76)	0.0170 (0.29)
cons	28.598* (1.76)	-70.31 (-0.77)	-35.45 (-0.30)
N	685	685	685
Adj.R ² /Pseudo.R ²	0.25	0.22	0.25

Table 10: Robustness Test
t-statistics in Parentheses * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$

As shown in table 10, the results at the company level are basically stable. After replacing *ROE*, *GM*, and *Loss* with *Profit*, the coefficient of *Kam_number* is also significantly positive, indicating that profitability has a relatively stable impact on the issuance of key audit matters. After controlling the autocorrelation and heteroscedasticity, the result is still the same. However, it is worth noting that after changing the dependent variable to *Kam6*, *CN* representing the nature of the actual controller is significantly negatively correlated with it at the level of 5%. It indicates that the number of key audit matters issued by state-owned holding enterprises is stronger, which is contrary to H9.

In addition, we also made the following robust assumptions:

- Changing the winsoring rate to 5%, 10% level,
 - Annual and industry tailing shrinking, and
 - Randomly deleting samples of 1%, 5%, and 10%
- However, the results remained unchanged.

9. Conclusion

Based on the sample of companies listed in both A and H markets from 2016 to 2018, we study the influence of the characteristics of accounting firms and audited units on the number of key audit matters. The results show that:

Firstly, among the five hypotheses put forward by the accounting firm, only H4 related to audit opinion has been verified, and none is the others. Among the six hypotheses from the perspective of the audited entity, H6, H7, H8, H10, and H11 have all been verified, and only the assumption of an actual controller of audited companies has not been verified. This shows that the number of key audit matters disclosed by the audited unit is mainly related to the characteristics of the auditees rather than the accounting firm.

Secondly, the scale, leverage, profitability, listing period, and net operating cash flow of audited companies will have an impact on the number of key audit matters. Larger scale, higher leverage, and longer listing period are related to more key audit matters, while higher profitability and greater net operating cash flow are correlated with fewer key audit matters.

Thirdly, only the type of audit opinion issued by the firm level is significantly related to the number of key audit matters, showing that the number of key audit matters of the company with non-standard unqualified audit opinion is less. Other factors, such as firm size, audit fees, auditor gender, and audit tenure, have nothing to do with the disclosure of key audit matters.

In further research, we study the relationship between the types of key audit matters and the characteristics of the accounting firm and the audited unit. The results show that the company-level factors have a greater impact on the types of key audit matters. That is, the type and quantity of key audit matters depend more on the audited unit level than on the accounting firm level. The factors influencing the type of key audit issues are:

- The size of the company,
- Liability ratio,
- The return on net assets,
- The listing period of A-share market,
- The net operating cash flow,
- The nature of the actual controller,
- The audit opinions and audit fees at the firm level

Moreover, the key audit events affected are:

- Financial instruments,
- Revenue recognition, and
- Accounts receivable-related matters

However, there are some limitations to our study.

- Firstly, due to the limitation of the sample of key audit matters, we cannot consider the endogenous problem that much
- Secondly, in addition to the factors listed in this paper, we need to pay attention to whether there are other factors affecting the disclosure of key audit matters
- Thirdly, there are too many influencing factors in this paper. The results may be more distinct if we use the PSM+Did event research method to conduct an in-depth study along with one of the influencing factors

To sum up, from the research conclusion of this paper, we can see that the characteristics of audited companies are the most critical factor in determining the number of key audit matters. Among the characteristics of the accounting firm, only the audit report opinions issued can play a certain role. Therefore, CPAs should pay more attention to the risk of material misstatement of the companies while performing business and screen out companies with higher risk through the selection of the client to reduce the risk of litigation. At the same time, in the process of practice, it is also necessary to pay more attention to the overall asset size, liabilities, profit-earning ability, and net cash flow of the audited companies in emerging industries such as the financial industry, real estate industry, etc. Only in this way can the reporting system of key audit matters be implemented and play its due role.

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