Audit Committee Director Localization and Accounting Conservatism- Based on the C-Score Model

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Abstract: Under the constant upgrading of the modern economy, the use of big data to analyze accounting information has become the norm, and accounting conservatism as an important principle of accounting confirmation and measurement, the use of econometric model to study accounting conservatism has a certain practical significance. Therefore, based on the C-Score measurement model, this paper conducts A regression analysis on the relevant data of China's listed companies in Shanghai and Shenzhen A-share markets from 2007 to 2018, and finds that the localization of the chairman of the audit committee is positively correlated with the accounting conservatism of listed companies. The research of this paper is helpful to further deepen the understanding of accounting conservatism, and has a certain enlightenment effect on improving corporate governance.

Keywords: Chairman of audit Committee; localization; accounting conservatism

1 INTRODUCTION

From the theory of information asymmetry, the party with more information has an advantage in the market, while the party with the information disadvantage is at a disadvantage. There may also be information asymmetries between the Chairman of the Audit Committee and the management of the listed company, and the geographical distance will somehow deepen the asymmetry of this information. The quality and quantity of information obtained determines the degree of information asymmetry, and the chairman of the audit committee, which is closer to the company, has the advantage of information and can inhibit management information manipulation. As an important system in the corporate governance structure, the audit committee system can enrich and perfect the information asymmetry theory and the corporate governance theory, and make up for the deficiency of the theoretical scope of the effectiveness of the audit committee's role at the corporate governance level. Therefore, from the perspective of information asymmetry theory, this paper studies the impact of localization of the Audit Committee's chairman on accounting conservatism.

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2 THE LITERATURE REVIEW

The audit committee system plays an important role in corporate governance. The audit committee works primarily on the company's internal issues, while the Audit Committee has a supervisory role over the company's management and has been working to address issues arising from the company's internal governance. To study the effectiveness of audit committee operation plays an important role in improving accounting conservatism. The following is a list of domestic and foreign research literature on the relationship between audit committee and accounting conservatism. The research of Beasley[1] showed that the larger the size of audit committee is, the higher the quality of accounting information is. The two are significantly positively correlated. Klein[2] found that the higher the proportion of independent directors on the audit committee, the lower the level of earnings management in the company. Anderson[3] found that the more audit committee meetings there are, the more reliable financial reporting is. Krishnan and Visvanathan[4] discovered the accounting Profession by studying the relationship between members of the audit committee of the finance major and the accounting conservatism have a positive impact on accounting conservatism. Sultana[5] showed that the audit committee members of finance major and the number of audit committee meetings are significantly positively correlated with accounting conservatism. There is also a wealth of domestic literature on the relationship between the audit committee and accounting conservatism. Wang Xiongyuan, Guan Kao Lei Research found that the independence of the audit committee has a positive impact on the quality of information disclosure; the professionalism of the members of the audit committee is not significantly related to the quality of information disclosure, and the number of meetings of the audit committee has a negative correlation with the quality of information disclosure. Chen Shenglan and Wei Minghai showed that the protection of the board of directors for investors has a positive impact on improving the accounting conservatism of enterprises, and the independence of the board of directors is positively correlated with the accounting conservatism of enterprises. In addition, their research showed that the combination of the two positions of chairman and general manager has an impact on the conservatism of accounting information. Tang Yuejun found that the more active and independent audit committee is, the more positive it is to audit opinions. Xie Xiangbing study showed that the independence of the audit committee and the accounting professionalism of the members of the audit committee are significantly positively correlated with the conservatism of accounting information. Liu Lei found that the more independent the audit committee, the higher the quality of accounting information. Yu Nutao, Ge Huanzhi[6] through empirical research found that the role of major shareholder checks and balances will have a negative impact on information disclosure, and independent directors and audit committees through effective performance of their duties to improve the quality of information disclosure. The research of Yin Feng and Liao Jingping showed that the diligence, independence, legal experts and female members of the audit committee have a positive impact on the conservatism of accounting of listed companies. Zhou Guohua and Chen Xuefen showed that the higher the proportion of independent directors in China's audit committee, the larger the size of the audit committee, and the more reliable the financial report. The more audit committee meetings, the worse the reliability of financial report information. Deng Yingwen, Zhang Min[7] research found that the closer the customer and the local Securities Regulatory Commission geographical location, the greater the auditor's supervision, auditors will improve the level of work to reduce accounting risk, and thus enhance

the reliability of accounting information. This phenomenon is even more pronounced in smaller firms.

Based on the analysis of this paper, the following research hypotheses are proposed:

H1: Companies with a localized audit committee chairman have higher accounting conservatism than companies with a nonlocalized audit committee chairman.

H2: Compared with non-state-owned listed companies, state-owned listed companies with a localized audit committee chairman have higher accounting conservatism.

3 RESEARCH DESIGN AND SAMPLE SELECTION

3.1 Sample selection and source

The localization of the director of the audit committee is taken as the explanatory variable of the empirical study of this paper, the accounting conservatism is taken as explained variable of the empirical study of this paper, and the subjects of this paper are descriptively analyzed and the multiple regression analysis is carried out. The A-share listed companies in Shanghai and Shenzhen stock exchanges from 2007 to 2018 are selected as the research samples for empirical research. The samples are excluded as follows: (1) all listed companies in the financial insurance category; (2) listed companies with missing data from the chairman of the audit committee; (3) all listed companies in the ST and * ST categories; (4) newly listed companies in the current year, companies that have been delisted or suspended from the market; (5) companies whose financial data is missing. The company observations associated with the chairman of the Audit Committee are finally available. The relevant data for this article is derived from the CSMAR database, and the localized data of the chairman of the audit Committee are matched with the resumes of senior executives as explanatory variables in this paper. To remove the effect of extreme values, all continuous variables are treated up to and down 1% winsorize.

3.2 Model building and variable description

3.2.1 Measurement of accounting conservatism

In this paper, Khan and Watts (2009) improved the C-Score model based on Basu (1997) model to measure accounting conservatism. Basu (1997) measurement model is as follows:

$$EPS_{i,t} / P_{i,t} = \beta_0 + \beta_1 DR_{i,t} + \beta_2 R_{i,t} + \beta_3 DR_{i,t} * R_{i,t} + \varepsilon_{i,t} \quad (1)$$

The formula (1) is used to measure accounting conservatism.Among them $EPS_{i,t}$ is i company's earnings per share for the year t; $P_{i,t}$ is the closing price per share of i company at the end of April of t year; $R_{i,t}$ is i company's stock return for t year; $DR_{i,t}$ is a virtual variable, when i company's annual stock yield is less than 0, it is 1; otherwise, it is 0. The coefficient β_2 represents the timeliness of the accounting recognition of income, the timelyness of the

accountant's recognition of the loss is measured by (β_2+β_3), and The coefficient β_3 is the timeliness of accounting loss recognition relative to income recognition.

On the basis of the Basu model, Khan and Watts (2009) added asset-liability ratio (LEV), company size (SIZE), and market-to-account ratio (MB) as variables to this model, with G-Score indicating that the surplus would be sensitive to good news and C-Score representing the company's level of accounting conservatism.

$$G - Score = \beta_2 = \lambda_0 + \lambda_1 SIZE_{i,t} + \lambda_2 LEV_{i,t} + \lambda_3 MB_{i,t} \quad (2)$$

$$C - Score = \beta_3 = \mu_0 + \mu_1 SIZE_{i,t} + \mu_2 LEV_{i,t} + \mu_3 MB_{i,t} \quad (3)$$

The formula (2) and formula (3) are substituted in the Basu model, the coefficients are obtained, and the C-score model is reversed Khan and Watts Accounting Conservatism Metrics:

$$EPS_{i,t} / P_{i,t} = \beta_0 + \beta_1 DR_{i,t}$$
$$+(\lambda_0 + \lambda_1 SIZE_{i,t} + \lambda_2 LEV_{i,t} + \lambda_3 MB_{i,t}) R_{i,t}$$
$$+(\mu_0 + \mu_1 SIZE_{i,t} + \mu_2 LEV_{i,t} + \mu_3 MB_{i,t})\, DR_{i,t} * R_{i,t}$$
$$+\varepsilon_{i,t} \quad (4)$$

For the formula (4) yearly regression, the coefficient can be obtained and substituted into Formula (3) to calculate the accounting conservatism level C-score of the sample company in the current year.

3.2.2 Model building

In order to analyze the impact of localization of audit committee directors on accounting conservatism, the following model (5) is constructed for empirical analysis:

$$C - Score = \alpha_0 + \alpha_1 LCHAIR_{i,t} + \alpha_2 AO_{i,t} + \alpha_3 DUAL_{i,t} + \alpha_4 SIZE_{i,t} + \alpha_5 REC_{i,t} + \alpha_6 INVEN_{i,t} + \alpha_7 LEV_{i,t} + \alpha_8 BIG4_{i,t}$$
$$+\alpha_9 \sum IND_{i,t} + \alpha_{10} \sum YEAR_{i,t} + \varepsilon_{i,t} \quad (5)$$

The explanatory variable LCHAIR is the localization of the director of the audit committee, and the place where the director's daily work is located and the registered place of the listed company is 1; otherwise, it is 0.

Control variables are shown in table1. AO is audit opinion, dummy variable. If standard unqualified audit opinion is issued, it is set to 1, otherwise it is set to 0. DUAL is a virtual variable. If the chairman and general manager are the same, it is 1; otherwise, it is 0. SIZE is the size of the company, equal to the natural logarithm of the ending book value of total assets.

REC is the ratio of accounts receivable, equal to the ending book value of accounts receivable divided by the ending book value of total assets. INVEN is the inventory ratio, equal to the ending book value of inventory divided by the ending book value of total assets. LEV is financial leverage, equal to the ending book value of total liabilities divided by the ending book value of total assets. BIG4 is the four major international accounting firms, if the audit report is issued by the big four accounting firms, the value is 1; otherwise, the value is 0. IND and YEAR are industry dummy variables and annual dummy variables that control the influence of industry and annual factors.

TABLE 1 VARIABLE DEFINITION

The name of the variable	**symbol**	**The variable definition**
Accounting conservatism	C-SCORE	The accounting conservatism level is calculated based on the Khan and Watts(2009)model
Audit committee director’s localization	LCHAIR	Virtual variable, the place where the director's daily work is located and the registered place of the listed company is 1; otherwise, it is 0.
International big four	BIG4	Virtual variable, if the audit report is issued by the big four accounting firms, the value is 1; otherwise, the value is 0.
The type of audit report	AO	Virtual variable, If standard unqualified audit opinion is issued, it is set to 1, otherwise it is set to 0.
Accounts receivable ratio	REC	Equal to the ending book value of accounts receivable divided by the ending book value of total assets.
Two jobs in one	DUAL	Virtual variable, If the chairman and general manager are the same, it is 1; otherwise, it is 0.
Financial leverage	LEV	Equal to the ending book value of total liabilities divided by the ending book value of total assets.
The size of the company	SIZE	Equal to the natural logarithm of the ending book value of total assets.
Inventory ratio	INVEN	Equal to the ending book value of inventory divided by the ending book value of total assets.
Year	YEAR	The year virtual variable
Industry	IND	Industry Virtual Variable

4 EMPIRICAL RESULTS ANALYSIS

4.1 Descriptive statistics

TABLE 2 DESCRIPTIVE STATISTICS

	(1)	(2)	（3）	(4)	(5)	(6)
VARIABLES	**N**	**mean**	**median**	**sd**	**min**	**Max**
C-SCORE	14,888	-0.012	0.001	0.739	-5.871	3.218
LCHAIR	14,888	0.502	1	0.500	0	1
LEV	14,888	0.451	0.449	0.206	0.057	0.893
SIZE	14,888	22.140	21.999	1.239	19.80	25.83
REC	14,888	0.109	0.086	0.099	0	0.444
INVN	14,888	0.162	0.122	0.152	0	0.749
DUAL	14,888	0.229	0	0.420	0	1
TO	14,888	0.975	1	0.157	0	1
BIG4	14,888	0.054	0	0.226	0	1

As can be seen from Table 2, the mean of accounting conservatism (C-SCORE) is -0.012, the median is 0.001, and the mean is less than the median, which indicates C-SCORE is left-biased, which shows that most enterprises in China are conservatism and their stability level is higher than average. The minimum value is -5.871, the maximum value is 3.218, and the difference between the maximum and minimum value is large, indicating that there is a large difference in the level of accounting conservatism between companies, which may be related to the specific business situation of the company. The average company size (SIZE) is 22.14%, and the median is 21.999%, which shows that the gap between companies is not very large. The average asset-liability ratio (LEV) is 45.1%,and the median is 44.9%. The average receivables ratio (REC) is 10.9%. the average inventory ratio (INVEN) is 16.2%.

4.2 Empirical results

4.2.1 regression analysis

The test results of hypothesis 1 are shown in Table 3. Table 3 lists the results of regression analysis of audit committee director's localization and accounting conservatism. In this paper, accounting conservatism as a dependent variable, audit committee director localization as an argument for multiple regression, in table 3, the audit committee director's localization coefficient is 0.039, and significantly at the level of 1%, indicating that the localization of the audit committee director is positively related to the accounting conservatism, and the localization of the chairman of the audit committee is helpful to the improvement of the accounting conservatism. In terms of control variables, the Big4 significantly negative at 1%, possibly due to the fact that the chairman of audit committee localization is better able to perform his oversight duties, thereby weakening the impact of the BIG4 on accounting conservatism. This paper also finds through empirical research that there is a negative

correlation between company size (SIZE) and accounting conservatism (C-Score) at the level of 1%. The level of negative correlation indicates that the company size is larger and the company's accounting conservatism (C-SCORE) is lower. Financial leverage (LEV) is positively correlated with accounting conservatism at 1%, indicating the company's solvency is weak, and the company's accounting conservatism (C-SCORE) is higher.

TABLE 3 THE EMPIRICAL RESULTS OF THE AUDIT COMMITTEE DIRECTOR'S LOCALIZATION AND ACCOUNTING CONSERVATISM

The name of the variable	coefficient	t
Constant	2.602***	20.60
LCHAIR	0.039***	3.94
LEV	0.352***	11.11
SIZE	-0.138***	-25.71
REC	0.090	1.43
INVEN	-0.043	-0.92
DUAL	-0.019	-1.61
AO	-0.021	-0.67
BIG4	-0.070***	-3.02
IND	control	control
YEAR	control	control
N	14,888	14,888
Adj.R^2	0.108	0.108

Note： ***, ** and * represent significant at 1%, 5% and 10% levels respectively.

4.2.2 The group return of state-owned and non-state-owned listed companies

The test results of hypothesis 2 are shown in Table 4. In order to test the effect of audit committee director's localization on accounting conservatism under the nature of different property rights, the whole sample is divided into state-owned sub-samples and non-state-owned sub-samples, and the two sub-samples are diversified regression, and the results of regression analysis are shown in Table 4. In the sample of state-owned listed companies, the regression coefficient of audit committee director's localization was significantly positive. In the sample of non-state-owned listed companies, the regression coefficient of audit committee director's localization was not significant, which is consistent with the result of hypothesis 2. In state-owned enterprises, the regression coefficient of audit committee director's localization is 0.099, and it is significantly positively correlated at the level of 1%, which means that the impact of audit committee director's localization on accounting conservatism is mainly reflected in state-owned listed companies.

TABLE 4 GROUP REGRESSION AND T-TESTS UNDER DIFFERENT PROPERTY NATURES

The name of the variable	State-owned listed companies		Non-state-owned listed companies	
	coefficint	t	coefficient	t
Constant	3.186***	12.88	2.161***	18.62

LCHAIR	0.099***	4.85	0.009	1.13
LEV	0.309***	4.73	0.360***	13.00
SIZE	-0.174***	-16.30	-0.111***	-23.09
REC	0.076	0.53	0.057	1.15
INVEN	0.078	0.81	-0.139***	-3.48
DUAL	-0.063*	-1.84	-0.004	-0.40
AO	0.083	1.15	-0.061**	-2.47
BIG4	-0.116***	-2.91	-0.024	-1.01
IND	control	control	control	control
YEAR	control	control	control	control
N	6,647	6,647	8,241	8,241
Adj.R^2	0.115	0.115	0.144	0.144

Note： ***, ** and * represent significant at 1%, 5% and 10% levels respectively.

5 THE ROBUSTNESS TEST

5.1 Remeasurement of accounting conservatism

In order to verify the reliability of the above conclusions, this paper refers to the model of RayBall and Lakshmanan Shivakumar (2006) to measure corporate accounting conservatism. It is substituted into regression (1) for regression test. The regression results are shown in Table 5. It can be seen that the regression coefficient of localization of audit committee directors is 0.085, which is significantly positively correlated with accounting conservatism at the level of 1%, which is consistent with the previous research conclusion.

TABLE 5 ROBUSTNESS TEST

The name of the variable	coefficient	t
Constant	-0.484***	-3.45
LCHAIR	0.085***	6.88
LEV	0.012	0.28
SIZE	-0.004	-0.61
REC	-0.152***	-1.98
INVEN	-0.022	-0.36
DUAL	-0.011	-0.77
AO	0.050	1.02
BIG4	0.019	0.69
IND	control	control
YEAR	control	control
N	14,888	14,888
Adj.R^2	0.131	0.131

Note： ***, ** and * represent significant at 1%, 5% and 10% levels respectively.

6 CONCLUSIONS

Based on the relevant data of listed companies in Shanghai and Shenzhen from 2007 to 2018, this paper studies whether the daily work localization of the chairman of the audit committee of listed companies is consistent with the location of listed companies on the impact of accounting conservatism. The results show that the localization of the audit committee director is helpful to the improvement of the accounting conservatism of listed companies, and the effect is more obvious among state-owned listedcompanies. By analyzing the extent to which localization of audit committee directors plays a role in improving accounting conservatism, we can have a deeper understanding of the effectiveness of audit committee operation and help promote the standardized operation of audit committee system of listed companies. Improving accounting conservatism will help promote the capital market function to play a better role and create a better environment for market subjects. This paper combines accounting conservatism with the audit committee system of listed companies to help further understand the factors affecting accounting conservatism, and can promote the further improvement of capital market.

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