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# Does the Use of Honorific Appellations in Audit Reports Connote Higher Financial Misstatement Risk? Evidence from China

**Abstract:** From the sociolinguistic perspective, this study examines whether the honorific and actual-name appellations that Chinese auditors use to address clients in audit reports connote differential financial misstatement risk. Specifically, we hypothesize that auditors' use of honorifics signals their inferior social status relative to their clients, thereby leading to compromised auditor independence, lower audit quality, and higher financial misstatement risk. We find significantly greater financial misstatements, both in terms of likelihoods and magnitudes, for companies addressed by honorifics than for those addressed by actual names. Moreover, compared to auditors' consistent honorific usage, discretionary honorific usage has a stronger positive association with misstatements. We further show that the positive association between honorific usage and client misstatement risk weakens when the audit firm is a Top 10 accounting firm in China, is an industry specialist, is formed as a partnership, or resides in a more concentrated audit market. This study contributes to the sociolinguistics literature in accounting and provides evidence supporting the reform proposed by the International Auditing and Assurance Standards Board (IAASB) to enhance the usefulness of audit reporting.

**Keywords:** Honorific appellations; Financial misstatement risk; Audit reports; Sociolinguistics

**JEL Classification:** M41; M42; Z13

**Data Availability:** Data are available from sources indicated in the main text.

# **Does the Use of Honorific Appellations in Audit Reports Connote Higher Financial Misstatement Risk? Evidence from China**

## **1. INTRODUCTION**

Linguistic codes used in language are shaped by the socialization of individual consciousness and reflect social relationships (Schatzman and Strauss 1955; Ervin-Tripp 1969; Luckmann 1975). The usage of honorifics in Chinese audit reports manifests itself as an interesting linguistic phenomenon in accounting. Many auditors in China, like those in the U.S., normally address their client companies by actual names or use abbreviations (e.g., “your company”) in audit reports. However, some auditors in China voluntarily choose to address their clients by honorifics (e.g., “your esteemed company”) in audit reports, wherein “esteemed” expresses the respectful attitude of auditors toward client managers.

Drawing on sociolinguistic theories, we investigate the informativeness of honorific usage in audit reports. To the extent that financial statement users are most concerned about whether audit reports provide information for assessing financial reporting quality and distress risk, we focus on the linkage between honorific appellations and financial misstatement risk. According to sociolinguistic theories, using honorifics to address the other party not only directly conveys deference and respect, but also signifies relative social status difference (Brown and Gilman 1960). This phenomenon is particularly true in China, where Confucianism is ingrained as a cultural form (Gu 1990; Du 2015). Confucianism promotes a rigid social hierarchy as it emphasizes the seniority of people in higher social status and the submission of people in lower status. In China, such a rigid social hierarchy is well reflected by the frequent use of honorifics in formal business settings.

We argue that the tendency to use honorific appellations by some auditors reflects their perceived lower status relative to their clients, as well as their conscious or unconscious intention to be acquiescent to their clients. Impaired auditor independence hampers auditors' capability to detect and report clients' misstatements in their financial reports, thus leading to lower audit quality and higher risk of financial misstatements. Moreover, client management may exploit the compromised auditor independence by misstating their financial reports, thus further increasing misstatement risk. In addition, some auditors consistently address all clients with honorifics, while other auditors use honorifics in a discretionary way for some but not all clients. By selectively addressing their clients with honorifics, auditors likely exhibit a stronger proclivity of being acquiescent to their clients. Therefore, we expect that, compared to consistent honorific usage, discretionary honorific usage exhibits a stronger positive association with financial misstatement risk.

We use a sample of manually coded appellation data from audit reports of Chinese public firms between 2003 and 2012. During the sample period, there are two types of appellations in the audit reports: (1) honorifics with the phrase "your esteemed company" (in Chinese, "贵公司"), and (2) actual-name appellations (e.g., "XYZ company"). We proxy for financial misstatement risk by several measures, including the likelihood and magnitude of financial misstatements, the likelihood and magnitude of accounting overstatements, and the likelihood of enforcement actions taken by the China Securities Regulatory Commission (CSRC).

We conduct multivariate regression tests while controlling for other factors that affect financial misstatements, as identified in the prior literature, including characteristics of individual auditors, audit firms, and client companies. Our main test results reveal that the probability of financial misstatements is 1.31% higher for clients addressed by honorifics than

for clients addressed by actual-name appellations. Given that the average likelihood of financial misstatements for our sample firms is 7%, the increase in the likelihood of misstatements due to honorific usage is economically significant. Although both discretionary and consistent uses of honorifics are significantly positively associated with misstatement risk, the discretionary use of honorific appellations results in a higher likelihood as well as a greater magnitude of misstatements than the consistent use of honorifics. These results support our expectation.

Moreover, we perform a series of cross-sectional tests to examine whether the positive association between honorifics and misstatements varies with certain characteristics of audit firms that indirectly affect auditors' honorific usage and/or relative social status. Specifically, we argue that being a Top 10 audit firm, an audit firm with industry specialist status or a partnership organizational form, or a firm in a more concentrated local audit market, *ceteris paribus*, will attenuate the positive relation between auditors' honorific usage and client misstatement risk. The results confirm our expectation. In particular, we find that the positive relation between honorifics and misstatements weakens for clients that are audited by Top 10 audit firms, industry specialists, audit firms organized as a partnership, or audit firms located in a more concentrated audit market.

We address the endogeneity concern about the relation between honorifics and misstatements using three additional tests. First, to control for differences in auditor and client characteristics between usage of honorifics and actual-name appellation groups, we adopt the propensity-score matching (PSM) approach by first estimating the determinants of honorific usage, generating a paired sample of both honorific usage and actual-name appellations, and then performing the main analyses using the paired sample. Second, we adopt the change specification by computing year-over-year changes in both dependent and independent variables,

which uses a client company as its own control and therefore helps control for unknown time-invariant company-specific factors. Our main results continue to hold for the above two tests. Third, we utilize an exogenous regulation event in 2010 in which all audit firms were required to take the organizational form of limited-liability partnership, which means elevated audit liabilities for negligent audit partners and consequently a decreased effect of honorifics on auditor independence. As predicted, we find that the positive relation between honorifics and misstatements weakens after the regulation event. Collectively, these test results lend support to our conjecture that the use of honorifics in audit reports signals auditors' acquiescence to clients, resulting in clients being more prone to misstatements.

Finally, consistent with our main test results, we also find that the likelihood of issuing modified audit opinions (MAOs) decreases when auditors use honorifics in their audit reports.

This study contributes to academic literature and also has regulatory and practical implications. Most importantly, our study contributes to the growing sociolinguistics and auditing literature. Early auditing research that applies sociolinguistic theories focuses on investors' differentially perceived information from audit reports, using either experimental designs or qualitative analyses (Libby 1979; Belkaoui 1980; Olson and Wootton 1991). We are aware of only one Taiwan-based study (i.e., Duh et al. 2014) that exploits the subtle connotative meanings of various Chinese terms as contained in auditing standards, but the study does not explore the sociolinguistic roots of those auditing standards. We add to this line of research by providing the first archival evidence that auditors' honorific usage reflects their tendency to acquiesce to clients' demands, which leads to lower audit quality and higher risk of clients' misstatements.

Moreover, our findings suggest that even if the content of audit reports remains constant, certain linguistic features in audit reports may carry incremental information content about audit quality and the financial reporting quality of client companies. In this regard, our study has direct implications for the International Auditing and Assurance Standards Board (IAASB), which recently proposed regulatory reforms to improve the usefulness of audit reporting (see IAASB 2011, 2013). Finally, since we find that honorific usage in China is informative about audit quality and financial reporting quality, our study assists domestic and foreign investors in forming their own investment decisions.

Section 2 develops research hypotheses. Section 3 discusses sample selection, model specification, and variable measurement. Section 4 presents empirical results. Section 5 discusses additional analyses of potential endogeneity issues about honorifics and misstatements. Section 6 concludes.

## **2. HYPOTHESES DEVELOPMENT**

### **2.1 The Implications of Honorific Usage in Audit Reports**

Sociolinguistic theories assume that language conveys the socialization of individual consciousness as well as social relationships (Bernstein 1958; Luckmann 1975). Moreover, linguistic codes used in language play an important role as a mediator of the cognitive processes in defining the social environment (Schatzman and Strauss 1955; Ervin-Tripp 1969). Although the influence of social factors on audit reports is acknowledged in the prior literature (e.g., Kaplan 1987), only a limited number of accounting and auditing studies have applied sociolinguistic theories (e.g. Belkaoui 1980; Olson and Wootton 1991). For example, using an experimental design, Belkaoui (1980) introduces a sociolinguistic construct to explain the

perceptual differences of accounting concepts among accounting professionals. Olson and Wootton (1991) qualitatively analyze the terminology of standard audit reports throughout the history of auditing and identify the social, economic, and political factors crucial to changes in terminology, with particular emphasis on the periods leading to Statements on Auditing Standards (SAS) 58. Duh et al. (2014) exploit the connotations of various Chinese terms contained in auditing standards, but fail to link these terms to their sociolinguistic roots. Several studies on auditing and linguistics, including Libby (1979), Bailey (1981), Bailey et al. (1983), and Holt and Moizer (1990), all investigate users' perception of messages as communicated by audit reports, but these studies do not link the messages as contained in audit reports to sociolinguistic factors. To summarize, no prior archival auditing studies have systematically explored the sociolinguistic connotations of languages used in audit reports.

Specific to appellations, sociolinguistic theories suggest that the use of actual-name appellations represents a relationship of equal power between communicators (Brown and Gilman 1960; Brown and Levinson 1987). In contrast, the use of honorifics is determined by the relationship between communicators and signifies the relative power and ranking among communicators. Moreover, in the specific setting of China, Confucianism is "in the latent cultural traits of the mainland and overseas Chinese" (Lew 1979). Confucianism infuses strong connotations of social order and social ranking into honorific usage. As one of the important components of Confucianism, the politeness principle emphasizes that the party with lower social status should use honorifics to address a higher-status communicator. Thus, in China, the honorific form of address has a particularly strong connotation of social status and power (Scotton and Zhu 1983). Honorifics in both spoken and written Chinese languages usually place honorific appellations before the name of a person or a company. For example, when using



honorifics to address a company, a Chinese auditor may address the company as “your esteemed company” (in Chinese, “贵公司”). In China, auditors have discretions to use or not to use honorifics to address client companies in their auditor reports, which is different from the U.S. setting in which auditors unanimously use real-name appellations. Drawing from the sociolinguistic theory the concept that relative status and power of the communicators determines the use of honorific appellations, we argue that honorific appellations used in audit reports in China indicate an inferior social status and a lack of bargaining power by engagement audit partners vis-à-vis their clients.

Prior literature suggests that unequal social status between auditors and executives of client companies leads to lower auditor independence and consequently lower audit quality. Audit quality is defined as the joint probability that a given auditor will both detect a breach in the client’s accounting system and report the breach (e.g., DeAngelo 1981). Since social status enhances perceived ability and commands respect (D’Aveni 1990; Pollock et al. 2010), managers with higher relative status will be perceived to be more authoritative and are less likely to be questioned and challenged by engagement audit partners (Badolato et al. 2014). In other words, lower-status auditors may have less incentive to challenge managers’ misstatements (especially in the cases of overstatements), which jeopardizes lower-status auditors’ capability to detect and correct misstatements.

Prior auditing research has established that auditor independence is a cornerstone leading to higher audit quality (DeAngelo 1981; DeFond and Zhang 2014). Misstatements are the output measure of audit quality in that lower audit quality leads to higher frequency and magnitude of misstatements (e.g., Chin and Chi, 2009; DeFond and Zhang 2014). Recently, Koch and Salterio (2017) document that auditors who experience greater client affinity and explicit client pressure

(both indicating impaired auditor independence) make smaller adjustments to clients' aggressive accounting. Similarly, in the context of relative social status, Bennett and Hatfield (2013) present both survey and experimental evidence showing that auditors with lower social status than client management have disincentives to collect audit evidence that allows them to challenge accounting choices made by the clients. Their findings also imply that impaired auditor independence leads to lower audit quality. Moreover, the lower relative status of auditors directly enhances client managers' incentives for accounting manipulation because status commands authority and respect, and low status means lack of respect and authority (D'Aveni 1990; Pollock et al. 2010; Badolato et al. 2014). Meanwhile, early sociolinguistic studies suggest that auditors with lower social status are less willing to investigate potential problems and confront higher-status client managers about potential misstatements (D'Aveni 1990; Giordano 1983). Overall, prior research confirms that low-status auditors who are susceptible to social pressure from clients tend to show a lower degree of auditor independence, and to overlook client actions that could result in material misstatements (e.g., Lord and DeZoort 2001).

Combining the above streams of literature including sociolinguistic theories, the relative social status theory, the Chinese culture (i.e., Confucianism), and the audit-related literature, we argue that auditors' use of honorific appellations in audit reports would imply a lower social status of auditors and a compromise of auditor independence, which leads to lower audit quality and higher misstatement risk. Consequently, we expect that auditors' use of honorifics leads to a higher financial misstatement risk in the clients' accounting statements, as expressed in the following hypothesis:

*H1: Auditors' honorific appellations in audit reports are positively associated with future financial misstatement of client companies.*

## 2.2 Consistent and Discretionary Use of Honorific Appellations

Some engagement audit partners consistently use the honorific appellations in all audit reports, for which there are two possible explanations. First, these consistent users are of inferior social status relative to all of their client management, implying a statistically weakened linkage between honorific usage and client misstatement risk. Second, irrespective of their relative social status, these consistent users are simply well educated, so they are courteous to all clients. Admittedly, according to the latter explanation, the uniform usage of honorific appellations may not suggest a breach of auditor independence and could cast substantial doubt on the predicted linkage between honorific usage and client misstatement risk.<sup>1</sup> In contrast, some other engagement audit partners choose to address a selected group of their clients by honorific appellations, while addressing other clients by actual names. For these auditors, their discretionary honorific usage suggests that they possess inferior social status relative to only some of the client management. Furthermore, this discretionary use of honorifics may have a stronger connotation of compromised auditor independence, given that those engagement partners are acquiescent to only some of their clients. Therefore, we predict that the discretionary use of honorific appellations is more strongly associated with financial misstatement risk in clients' accounting statements. We formulate the second hypothesis as follows:

*H2: Compared to consistent usage of honorific appellations, auditors' discretionary honorific usage is more strongly associated with future financial misstatement of client companies.*

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<sup>1</sup> Although we are not able to identify which reason explains consistent honorific usage, we provide additional analyses of possible explanations of honorific usage in Section 5.1.

### 2.3 Cross-Sectional Predictions

Extending the main hypothesis about the relation between auditors' honorific usage and client companies' financial misstatement risk, we make the following cross-sectional predictions.

First, we predict that the hypothesized positive relation between auditors' honorific usage and client misstatement risk will be weaker if the client company is audited by a Top 10 audit firm (including international Big 4 and domestic Top 6 largest accounting firms). Top 10 accounting firms in China have strong quality control mechanisms in place, which alleviates the engagement auditors' tendency to succumb to pressure from higher-status client management. In addition, working at Top 10 audit firms carries additional prestige and authority for engagement audit partners, allowing them to be in a relatively strong bargaining position when dealing with client management.

Second, the hypothesized positive relation between auditors' honorific usage and client misstatement risk should be attenuated for auditors who are industry experts. To the extent that industry expertise suggests a leading market share for auditors in a local audit market, industry specialist auditors are in a relatively better bargaining position in their negotiations with client management. In addition, industry expertise commands professional authority for audit partners, which further mitigates the adverse effect caused by the relatively lower social status of engagement partners.

Third, the hypothesized positive relation between auditors' honorific usage and client misstatement risk should be attenuated for audit firms organized as partnerships. During our sample period, there were two organizational forms for audit firms in China: partnerships and limited-liability corporations. Auditors from partnership audit firms would be subject to higher liabilities related to audit failures than auditors from limited-liability corporations (Firth et al.

2012). Thus, mutual monitoring among audit partners is expected to be prevalent in partnership audit firms. Furthermore, when outsiders have difficulty in assessing service quality, profit sharing among audit partners allows partnership audit firms to provide higher quality audit services than corporations do (Levin and Tadelis 2005). Combined, these arguments suggest that the internal quality control mechanisms in partnership audit firms are stronger than in corporation audit firms, which mitigates the concern about compromised auditor independence.

Finally, the hypothesized positive relation between auditors' honorific usage and client misstatement risk should be attenuated for auditors residing in a highly concentrated audit market. Auditors residing in a concentrated local audit market possess greater market shares of local clients. Unlike their counterparts in a more competitive local audit market, these auditors are not as concerned about competing for more market share. As such, these auditors should have stronger bargaining power when dealing with their clients. The more concentrated audit market implicitly enhances auditors' social status relative to clients, thus weakening the potential positive relationship between honorific usage and client misstatement risk.

### **3. SAMPLE SELECTION AND RESEARCH DESIGNS**

#### **3.1 Sample Selection**

Starting in 2003, the Chinese Institute of Certified Public Accountants (CICPA) allows auditors' discretions to address their clients in audit reports with either honorific or actual-name appellations.<sup>2</sup> This rule change in 2003 allows us to examine the effect of honorific usage in audit opinions on client misstatement risk. We hand-collect the data on auditors' appellation to their clients from audit reports of all Chinese public firms from 2003 to 2012, starting with an initial sample of 17,173 firm-year observations. For each sample firm during the sample period,

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<sup>2</sup> Prior to 2003, the CICPA mandated that auditors use honorific appellations to address clients in all audit reports.

we also hand-collect misstatement data by checking whether the firm restates its accounting numbers over the next three years subsequent to its initial filing of annual reports. We merge the data of honorific appellation usage and client misstatements, and then we remove financial service firms from the sample and exclude firms with missing auditor-specific information and firm-specific accounting data. Furthermore, we exclude observations with missing stock market data. These sample selection procedures are listed in Table 1, and we end up with a final sample of 14,276 observations. We also winsorize each continuous variable at the top and bottom 1% of its distribution to remove the effect of outliers. In the following subsections, we discuss how we construct various test variables and how we collect the related data. The appendix provides detailed definitions of all variables used in the analyses.

### 3.2 Measures of Honorific Appellation Usage

We construct an indicator variable, *HONOR*, which equals one if a client company is addressed by its engagement auditors as “your esteemed company” in the audit report, and zero otherwise. The auditing standards in China also require that engagement partners sign the audit report (MOF 1995). There are normally two signing audit partners for each audit engagement, including a field partner (who is mainly in charge of field work) and a review partner (who is mainly responsible for review work). Utilizing field partners’ involvement in audit reports, we further differentiate the discretionary use of honorifics (*HONOR\_DIS*) from the consistent use of honorifics (*HONOR\_CON*). Specifically, we identify a field partner as a consistent user of honorifics if she/he uses honorifics to address all her/his clients over the sample period. In contrast, we define *HONOR\_DIS* as one when the field partner uses honorifics

to address some but not all of her/his clients, and zero otherwise.<sup>3</sup> As mentioned earlier, we take the view that discretionary honorific usage is a stronger signal of the inferior social status of engagement partners vis-à-vis the client managements.

### 3.3 Measures of Financial Misstatement Risk

We proxy for financial misstatement risk, i.e., the likelihood and magnitude of financial misstatements, using the following misstatement measures: the magnitude and the likelihood of financial misstatements, the magnitude and likelihood of accounting overstatements, and the likelihood of enforcement actions taken by the CSRC. Specifically, we denote the likelihood of misstatements, *MIS\_DUM*, as an indicator variable that equals one if a company's accounting report in year *t* is restated in the subsequent three years, and zero otherwise; and denote the likelihood of accounting overstatements, *OVER\_DUM*, as an indicator variable that equals one if a company's accounting report in year *t* is restated downward in the subsequent three years, and zero otherwise. We also signify the magnitude of misstatements and overstatements, by *MIS\_AMT* and *OVER\_AMT*, respectively. *MIS\_AMT* is the net misstated amount for a company's accounting report in year *t* scaled by total assets, and then multiplied by one hundred; *OVER\_AMT* is the overstated amount for a company's accounting report in year *t* scaled by total assets, and then multiplied by one hundred. Finally, the likelihood of enforcement actions, *ENFORCE*, is an indicator variable that equals one if a client company is subject to CSRC enforcement actions in the three years following year *t*'s accounting report due to earnings overstatements, assets overstatements, or misleading public disclosures, and zero otherwise.

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<sup>3</sup> Alternatively, we rely on the involvement of review partners to differentiate consistent from discretionary use of honorifics, and we obtain similar results (untabulated).

### 3.4 The Empirical Models

We test how the honorific usage in audit reports affects a client's financial misstatement risk using the following multivariate regression model:

$$MISSTATE_{it} = \alpha_0 + \alpha_1 HONOR_{it} + Client\ Company\ Characteristics_{it} + Client\ Importance_{it} + \varepsilon_{it} \quad (1)$$

The dependent variable  $MISSTATE_{it}$  refers to financial misstatement risk for firm  $i$  at year  $t$ , including five specific measures,  $MIS\_DUM_{it}$ ,  $MIS\_AMT_{it}$ ,  $OVER\_DUM_{it}$ ,  $OVER\_AMT_{it}$ , and  $ENFORCE$ , as described in Section 3.3. Our key variable of interest is  $HONOR_{it}$ , which is an indicator of honorific usage in the audit reports for firm  $i$  at year  $t$ . We further separate out the two types of honorific usage, consistent and discretionary honorific usage,  $HONOR\_DIS_{it}$  and  $HONOR\_CON_{it}$ , respectively.

Following Chin and Chi (2009) and Lennox and Pittman (2010), we control for the following company-specific characteristics that may affect client companies' misstatements, including profitability ( $ROA$ ), external financing ( $FINANCING$ ), client company size ( $SIZE$ ), financial leverage ( $LEV$ ), asset turnover ratio ( $TURNOVER$ ), client company age ( $AGE$ ), and a state-owned enterprise indicator ( $STATE$ ). We also include market-to-book ratio ( $MB$ ), price-to-earnings ratio ( $PE$ ), and standard deviation of stock returns ( $STD\_RET$ ). Following Chen et al. (2010), we control for client companies' *ex ante* earnings management incentives ( $EM$ ), including the incentives to avoid reporting a loss, to take a big-bath (Riedl 2004), and to meet the regulatory requirement for equity financing.<sup>4</sup> In addition, as prior literature emphasizes that economic importance of a specific client in the auditor's engagement portfolio might have affected audit quality (e.g., Reynolds and Francis 2001; Li 2009), we control for client importance at both the audit firm level and at the audit partner level ( $CI\_AUD\_FIRM$  and

<sup>4</sup> Specifically, the indicator variable  $EM$  equals one if: (1) companies report a small profit, i.e.,  $0 < ROA < 1\%$ , (2) loss-making companies report ROAs lower than the median value of the nonpositive ROAs of all of the listed firms, or (3) companies report ROEs that are marginally above the CSRC's rights offering requirement, i.e., 6% - 7%.



$CI\_AUDITOR$ ).  $CI\_AUD\_FIRM$  is measured as the natural logarithm of total assets of a client scaled by the sum of total assets (in natural logarithm form) of all clients audited by an audit firm in year  $t$ .  $CI\_AUDITOR$  is measured as the natural logarithm of total assets of a client scaled by the sum of total assets (in natural logarithm form) of all clients audited by an engagement auditor in year  $t$ . The appendix provides detailed definitions of all variables used in the analyses.

When  $MISSTATE_{it}$  refers to  $MIS\_AMT_{it}$  or  $OVER\_AMT_{it}$ , we estimate Eq. (1) by OLS regressions; when  $MISSTATE_{it}$  refers to  $MIS\_DUM_{it}$ ,  $OVER\_DUM_{it}$  or  $ENFORCE_{it}$ , we estimate Eq. (1) by logistic regressions. Hypothesis H1 predicts a positive coefficient on  $HONOR$ , and Hypothesis H2 predicts a statistically larger coefficient on  $HONOR\_DIS$  than on  $HONOR\_CON$ . When applicable, we calculate z-statistics based on standard errors adjusted for clustering at firm and year levels (Petersen 2009).

## 4. EMPIRICAL RESULTS

### 4.1 Descriptive Statistics

Table 2 presents the distribution of audit reports using honorifics and actual names by year and in total. Across the sample period, 36.31% of audit reports adopt honorific appellations whereas 63.69% of audit reports use actual names. Specifically, the proportion of actual-name appellations increases steadily between 2003 and 2009, and stays at around 66% in 2012. Among the honorific usage subsample, only 17.98% of them are considered discretionary honorific usage, while the remaining majority of the subsample (82.02%) is considered consistent honorific usage.<sup>5</sup>

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<sup>5</sup> As shown in Table 2, the use of discretionary honorifics dropped significantly in 2008, likely due to the fact that Chinese public firms started to adopt new accounting rules in 2007. To mitigate the concern about the exogenous effect of changing accounting standards, we separate our sample into two subsamples, i.e., before and after 2008, and rerun the main tests. Our inferences remain unchanged.

Table 3, Panel A presents the descriptive statistics about main variables used in the empirical analyses. The mean of financial misstatement indicator (*MIS\_DUM*) is 0.07, indicating that only 7% of the sample observations are subject to accounting restatements. *OVER\_DUM* is an indicator for accounting overstatements, and the variable is different from *MIS\_DUM* as the variable does not involve 312 observations of understatements from the sample. Its mean and median are 0.05 and 0, respectively, similar to the statistics for *MIS\_DUM*. In addition, the mean value of the magnitude of financial misstatements (*MIS\_AMT*) is 0.07, indicating that the average amount of misstatement accounts for 7% of total assets. The mean of *MAO* is 0.07, suggesting that only 7% of audit reports in the sample consist of modified audit opinions. We also observe that the mean of client importance at office level and individual auditor level, *CI\_AUD\_FIRM* and *CI\_AUDITOR*, are 0.03 and 0.31, respectively, which are comparable to the statistics reported by Chen et al. (2010). Finally, 31% of client companies in the sample are audited by Top 10 audit firms, while only 13% of client companies are audited by industry specialist auditors.

Table 3, Panel B reports Pearson and Spearman correlations of the main test variables. Specifically, the Pearson and Spearman correlations of honorific usage variables (including *HONOR*, *HONOR\_CON*, and *HONOR\_DIS*) with *MIS\_DUM* are positive and statistically significant at the 10% confidence level. The preliminary evidence from the bivariate correlations is consistent with our hypotheses. Given that *MIS\_DUM* and *OVER\_DUM* almost overlap with each other, the correlation between the two variables is 1.00. Both consistent and discretionary honorific usages (*HONOR\_CON* and *HONOR\_DIS*) are significantly positively associated with the honorific usage variable (*HONOR*), confirming their validity in measuring honorific usage from different aspects.

## 4.2 The Use of Honorifics and Misstatement Risk

Table 4 presents the logistic regression results of the effect of honorific usage on financial misstatement risk. The coefficient on *HONOR* is 0.106, which is positive and significant at the 1% level. This coefficient estimate means that, when an auditor uses honorifics to address a client company, the risk of misstatement increases by 1.31% (untabulated). Since the average likelihood of financial misstatements for our sample firms is 7% (see Table 3, Panel A), the increase in the likelihood of misstatements due to honorific usage is economically significant. The result confirms that, consistent with Hypothesis H1, auditors' use of honorific appellations does connote financial misstatement risk. Moreover, client importance variables measured at both audit firm and individual auditor levels, *CI\_AUD\_FIRM* and *CI\_AUDITOR*, are significantly positively associated with misstatement risk. This finding implies that the relation between honorific usage and misstatement is incremental and robust to the well-documented association between client importance and client misstatement risk. In addition, the results for other control variables are in line with prior studies.

We further classify honorific usage into discretionary honorific usage, *HONOR\_DIS*, and consistent honorific usage, *HONOR\_CON*, to investigate whether these two variables have differential relations with misstatement risk. As shown in the right-side columns of Table 4, both coefficients on *HONOR\_DIS* and *HONOR\_CON* are positive and highly significant. More importantly, the magnitude of the coefficient on *HONOR\_DIS* is significantly larger than that for *HONOR\_CON*. An F-statistic of 7.57 indicates that the coefficient estimates on *HONOR\_DIS* and *HONOR\_CON* are significantly different at the 1% level. The results corroborate Hypothesis

H2, suggesting that, compared to consistent honorific usage, auditors' discretionary honorific usage is more strongly associated with financial misstatement risk.

Next, we use the following alternative measures of financial misstatements to test the main hypotheses: (1) *OVER\_DUM*, an indicator for accounting overstatements only, (2) *MIS\_AMT*, the magnitude of financial misstatements, (3) *OVER\_AMT*, the magnitude of accounting overstatements, and (4) *ENFORCE*, an indicator for the CSRC enforcement. We use logistic regression models or OLS models to conduct empirical tests using these alternative misstatement measures. Table 5 presents the results. Panel A of Table 5 reports the results of the logistic regression using the overstatement indicator (*OVER\_DUM*) as the dependent variable. We observe that *HONOR*, *HONOR\_DIS*, and *HONOR\_CON* are significantly positively associated with the likelihood of accounting overstatements. Moreover, the coefficient difference between *HONOR\_DIS* and *HONOR\_CON* remains significant at the 5% level. Panels B and C report the OLS regression results using the magnitude of misstatements (*MIS\_AMT*) and the magnitude of overstatements (*OVER\_AMT*) as dependent variables, respectively. In both panels, the coefficients on all three honorific usage measures are significantly positive; more importantly, the coefficient estimate on *HONOR\_DIS* is larger than that on *HONOR\_CON*, and the difference is also significant at the 1% level. Panel D of Table 5 reports the logistic regression results of the likelihood of CSRC enforcement. Again, the coefficient estimates on *HONOR* and *HONOR\_DIS* are significantly positive, and the difference between *HONOR\_DIS* and *HONOR\_CON* is also statistically significant. In sum, the results in Table 5 using various misstatement measures consistently support both Hypotheses H1 and H2, and reaffirm our main conclusions from Table 4.

### 4.3 Cross-Sectional Test Results

In this section, we test to what extent the audit firm characteristics moderate the association between honorific usage and financial misstatements. We consider four types of audit firm characteristics: audit firm size, industry expertise of audit firms, organizational forms of audit firms, and local audit market competition faced by audit firms. We measure these audit firm characteristics as follows. First, we measure large audit firms, *TOP10*, as an indicator variable that equals one if a client company is audited by either international Big 4 or domestic Top 6 largest audit firms, and zero otherwise. Second, we measure industry expertise, *EXPERTISE*, as an indicator variable that equals one if the audit firm has the largest market share (in terms of audit fees) in each two-digit CSRC industry code, and zero otherwise. Third, we measure the organizational form of an audit firm, *ORG\_FORM*, as an indicator variable that equals one if the audit firm is formed as a limited or unlimited liability partnership, and zero if the audit firm is formed as a limited liability corporation. Finally, we measure local audit market concentration, *CONCENT*, as the sum of the squared market shares (in terms of audit fees) of all audit firms in the region in which the audit firm resides. To test the effects of these cross-sectional factors on the link between honorific usage and misstatements, we add these characteristic variables and their interactions with honorific usage variables to Eq. (1) with the misstatement indicator (*MIS\_DUM*) as the dependent variable. Our variables of interests are the interaction variables, and we expect that the coefficients on the interactions of *TOP10* (*EXPERTISE*, *ORG\_FORM*, or *CONCENT*) with all the three honorific usage variables to be negative.<sup>6</sup>

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<sup>6</sup> Untabulated descriptive statistics indicate that Top 10 audit firms, audit firms with industry expertise, partnership audit firms, or audit firms residing in a more concentrated audit market exhibit a significantly smaller financial misstatement risk.

Table 6 presents the cross-sectional test results. Panel A reports the interaction results related to Top 10 audit firms, *Top10*. The coefficients on the interactions of *Top10* with honorific usage variables—*HONOR*, *HONOR\_DIS* and *HONOR\_CON*—are significantly positive, and the *z*-statistics are significant at the 5% level or better. Meanwhile, all honorific usage variables remain significantly associated with misstatement risk. As expected, for clients of Top 10 audit firms, the positive relation between honorific usage and misstatement becomes weaker. The results support the notion that being employed by Top 10 audit firms enhances auditors' relative social status and bargaining power compared with those of client managers, and thus weakens the positive relation between honorific usage and misstatements.

Panel B reports the interaction results related to audit firms which are industry specialists (*EXPERTISE*). We find that the coefficients on the interactions of *EXPERTISE* with the honorific usage variables are significantly positive, and the *z*-statistics are significant at the 5% level, whereas the coefficients on all honorific usage variables *per se* remain significantly positive. The evidence is consistent with our expectation that the industry expertise of audit firms enhances auditors' relative status compared to that of client managers, and thus weakens the positive relationship between honorific usage and misstatements.<sup>7</sup>

Panel C reports the interaction results related to organization form of an audit firm (*ORG\_FORM*). We find that the coefficients on all the interactions of *ORG\_FORM* with the three types of honorific usage measures are significantly negative, in contrast to the significantly positive coefficients on the three types of honorific usage variables *per se*. These results support our expectation that the positive relation between auditors' honorific usage and client misstatement risk is attenuated for auditors from partnership audit firms.

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<sup>7</sup> One may argue that audit firms with industrial expertise are actually *Top10* audit firms, and thus findings in Panel B are actually attributable to *Top10* audit firms. To address this concern, we drop the observations for clients audited by industrial experts who are also *Top10* audit firms, and find that our results still hold following the exclusion.

Panel D reports the interaction results related to audit market concentration, *CONCENT*. We find that the coefficients on the interactions of *CONCENT* with honorific usage measures *HONOR* and *HORNOR\_DIS* are significantly negative, consistent with our expectation that a higher local audit market concentration weakens the association between honorific usage and misstatements.

## **5. ADDITIONAL TESTS OF ENDOGENEITY ISSUES AND OTHER ROBUSTNESS CHECKS**

Our primary analyses are in levels, which admittedly only document an association rather than a causal relation. We test for the causal relation between honorific usage and financial misstatement risk with the following three approaches: the propensity-score matching approach, the change specification, and a natural experiment utilizing an exogenous regulatory event.

### **5.1 Results with the Propensity-Score Matching (PSM) Approach**

While we have assumed in the hypothesis development section that relative social status between audit partners and client management would drive our main results, we have not explicitly tested this underlying assumption. An omitted-variable problem may ensue, in which an uncontrolled common factor likely affects both honorifics and misstatements. It also is possible that auditors' use of honorifics reflects their actual or potential economic dependence on clients. Higher economic dependence leads to auditors' succumbing to client's pressure, thereby jeopardizing audit independence and audit quality. We use the propensity-score matching (PSM) method to address this type of concern (see Stuart and Rubin 2007). The PSM analysis involves two stages which are detailed below.

In the first-stage PSM analysis, we run a probit model for honorific usage and include three sets of determinants of honorific usage. First, we include the field partner's gender (*GENDER\_AUD*). Second, following Bennett and Hatfield (2013) and Badolato et al. (2014), we include the variables that proxy for relative social status differences between audit partners and client management. Specifically, we include education background differences (*EDU\_DIF*), differences in financial and accounting expertise (*FEXP\_DIF*), and differences in professional reputation (*REP\_DIF*) between field partners and CEOs of client companies. In addition, we compute the difference of GDP per capita for the region where the audit firm is located and for the region where the client company is located (*GDP\_DIF*). In the above calculations, a positive value indicates that audit partners have higher social status than client management. Finally, we include client importance at the audit firm and the audit partner levels (*CI\_AUD\_FIRM* and *CI\_AUDITOR*).

Panel A of Table 7 reports the estimation results. We find that discretionary honorific usage is significantly linked to several variables for relative social status differences, including the difference in financial and accounting expertise, the difference in professional reputation, and the difference in regional GDP per capita. These results support our arguments made in Section 2.2 for Hypothesis H2. In other words, relative social status differences between field partners and client management are the main drivers of discretionary honorific usage. In contrast, consistent honorific usage mainly reflects the difference in educational background between the field partner and the client CEO. Importantly, client importance variables are not significant determinants for any of the three honorific usage variables, suggesting that honorific usage is not driven by the economic importance of clients. These first-stage results confirm that relative social status differences are significant drivers of discretionary honorific usage.



We then match, without replacement, an honorific usage observation with an actual-name appellation observation having the closest predicted probability from the probit regression. The matching procedure results in a subsample of 2,557 observations without honorifics that matches 2,557 observations with honorifics, arriving at a PSM sample of 5,114 firm-year observations.<sup>8</sup> In the second stage of the PSM analysis, we conduct the baseline analyses using the PSM sample. The results reported in Panel B of Table 7 lend further support to Hypotheses H1 and H2, and reconfirm our main finding by demonstrating that honorific usage is positively associated with misstatements, and that discretionary honorific usage has a more pronounced relation with financial misstatements than the consistent honorifics usage.<sup>9</sup>

## 5.2 Results with a Change Specification

To further explore the potential causal direction regarding the linkage between honorifics and misstatements, we adopt a change specification that uses a client company as its own control and therefore helps control for unknown time-invariant company-specific factors.<sup>10</sup> Specifically, we compute year-over-year changes for both dependent and independent variables and re-estimate Eq. (1) using these differenced variables. The dependent variable is  $\Delta MIS\_DUM$ , which is an indicator variable defined as follows: the variable equals two if the accounting report at year  $t$  is subsequently restated but the accounting report at year  $t-1$  is not subsequently restated; it equals one if (1) neither accounting report at year  $t$  or  $t-1$  is subsequently restated, or (2) both years' reports are subsequently restated; and it equals zero if the accounting report at year  $t-1$  is

<sup>8</sup> An untabulated t-test indicates no statistically significant difference in the mean propensity scores across the treatment and matched groups.

<sup>9</sup> In untabulated analyses, we separately obtain two propensity-score matched samples based on the estimated propensities of using discretionary and consistent honorifics, respectively. The results from these alternative matched samples are consistent with our main results.

<sup>10</sup> Furthermore, along the time series of each client company, any change in the form of appellations is due to audit partner rotation, and is thus considered to be exogenous.

subsequently restated but there is no restatement for the year  $t$  accounting report. The variable  $\Delta HONOR$  is defined as follows: it equals three if an honorific appellation is used at year  $t$  but an actual-name appellation is used at year  $t-1$ ; it equals two if honorific appellations are used at both years  $t$  and  $t-1$ ; it equals one if an honorific appellation is used at year  $t-1$  but an actual-name appellation is used at year  $t$ ; and it equals zero if actual-name appellations are used at both years  $t$  and  $t-1$ .

Using  $\Delta MIS\_DUM$  and  $\Delta HONOR$  as the dependent and independent variables, respectively, we run the ordered logistic regression, which is an extension to the logistic regression model by allowing the dependent variable to take more than two-category values. The results presented in Table 8 show that changes in auditors' honorific usage ( $\Delta HONOR$ ) remain significantly positively associated with changes in misstatements. The evidence from this change specification suggests that the causal direction runs from honorific usage to accounting quality rather than the other way around.

### 5.3 Results Utilizing an Exogenous Regulatory Event

Prior to 2010, most of our sample audit firms were formed as limited-liability corporations. In 2010, the Ministry of Finance promulgated that all large-size audit firms should be formed as limited-liability partnerships by the end of 2010, and medium-sized audit firms should make the same conversion by the end of 2011 (MOF 2010).<sup>11</sup> This exogenous regulatory shock means that audit partners face elevated audit liabilities for any audit negligence. To the extent that such an exogenous event causes auditors to change their acquiescent behaviors toward client management (and change the form of appellations), the test utilizing this

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<sup>11</sup> In practice, by the end of 2012, most audit firms switched their organizational form into limited-liability partnerships, in which only negligent audit partners are exposed to unlimited legal liabilities.

exogenous regulatory shock setting should be able to mitigate the potential endogeneity problem.<sup>12</sup> Specifically, we construct the variable *PARTNER*, which is an indicator variable that equals one when an audit firm has switched to limited-liability partnership in the event year, and zero for the year prior to the switch. We then add *PARTNER* and its interactions with honorific usage variables to Eq. (1).

Table 9 reports the logistic regression results for financial misstatements on honorific usage surrounding the exogenous event (i.e., in both the event year and one year prior to the event). In Column (1), the coefficient on *HONOR*×*PARTNER* is significantly negative, while the coefficient on *HONOR* remains significantly positive. Similarly, in Column (2), the coefficients on both *HONOR\_DIS*×*PARTNER* and *HONOR\_CON*×*PARTNER* are significantly negative, and the coefficients on *HONOR\_DIS* and *HONOR\_CON* are significantly positive. Thus, consistent with our expectation, mandatory switching to limited-liability partnerships mitigates the causal relation between honorific usage and financial misstatements.

#### 5.4 The Likelihood of Obtaining MAOs

Since audit opinions are key outputs from auditors and constitute a key measure of audit quality, we also investigate how the honorific usage affects the likelihood of auditor issuing MAOs. If honorific usage reflects compromised auditor independence, we would expect honorific usage to be negatively associated with the likelihood of issuing MAOs. We use the following logistic regression model:

$$P(MAO_{it} = 1) = \beta_0 + \beta_1 HONOR_{it} + \beta_2 MAO\_LAG_{it} + Client\ Company\ Characteristics_{it} + Client\ Importance_{it} + \varepsilon_{it} \quad (2)$$

<sup>12</sup> Wang et al. (2008) made an argument similar to ours.

In Eq. (2) above,  $MAO_{it}$  is an indicator that equals one if company  $i$  receives a modified audit opinion at year  $t$ , and zero otherwise. As in Eq. (1), our key variable of interest is  $HONOR_{it}$ , and we further differentiate the two types of honorific usage,  $HONOR\_DIS_{it}$  and  $HONOR\_CON_{it}$ . We control for the same set of control variables as used in Eq. (1). Moreover, following Chen et al. (2010), we add a lagged MAO indicator ( $MAO\_LAG$ ), quick ratio ( $QUICK$ ), and accounts receivable and inventory ratio ( $ARINV$ ) into Eq. (2). Hypothesis H1 predicts a negative coefficient on  $HONOR$ . Hypothesis H2 predicts that the coefficient on  $HONOR\_DIS$  is statistically larger than that on  $HONOR\_CON$ .

Table 10, Panel A presents the logistic regression results. Column (1) shows that the coefficient on  $HONOR$  is negative and significant at the 5% level. Moreover, Column (2) indicates that the coefficient on  $HONOR\_DIS$  is significantly negative, while the coefficient on  $HONOR\_CON$  is insignificant. In Panel B, we use  $OP$  as the dependent variable for Eq. (2), which is coded from 0 to 3 to represent clean opinions, unqualified opinions with explanatory notes, qualified opinions, and disclaimers/adverse opinions, respectively. The ordered logistic regression results reported in Panel B are similar to those in Panel A. Combined, the results from the MAO tests are indicative of a positive association between honorific usage and compromised auditor independence. Furthermore, the main driver of the positive association seems to come from discretionary honorific usage.

## 6. CONCLUSION

From the sociolinguistic perspective, this study investigates the financial reporting quality implication of auditors' usage of honorific appellations to address clients in a sample of Chinese audit reports. Sociolinguistic theories suggest that the use of honorific appellations

reflects the relative social status of the speaker relative to that of the addressee (Brown and Gilman 1960). Further, the prevalent Confucianism in the Chinese culture emphasizes the seniority of people in higher social status and the submission of people in lower status to people in higher status. We argue that honorifics used in the Chinese audit reports convey information about the lack of power of auditors over clients and their submission to clients, which leads to impaired auditor independence, lower audit quality, and higher client misstatement risk. We find that the use of honorifics is associated with a higher level of financial misstatement risk, i.e., the higher likelihood and magnitude of misstatements. Moreover, discretionary use of honorifics has a stronger effect on financial misstatements than the consistent use of honorifics. We further show that the positive association weakens when the audit firm is a Top 10 accounting firm in China, is an industry specialist, is organized as a partnership, or resides in a more concentrated audit market. Finally, our main results are robust to endogeneity issues as well as alternative measures of misstatement risk and honorific usage.

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### Appendix: Variable Definitions

Variable	Definition	Data Source
<b>Dependent variables</b>		
<i>MIS_DUM</i>	= An indicator variable that equals 1 if a company's accounting report in year <i>t</i> is restated in the subsequent three years, and 0 otherwise.	CSMAR/hand-collected
<i>OVER_DUM</i>	= An indicator variable that equals 1 if a company's accounting report in year <i>t</i> is restated downward in the subsequent three years, and 0 otherwise.	CSMAR/hand-collected
<i>MIS_AMT</i>	= The net misstated amount for a company's accounting report in year <i>t</i> scaled by total assets, and then multiplied by 100.	CSMAR/hand-collected
<i>OVER_AMT</i>	= The overstated amount for a company's accounting report in year <i>t</i> scaled by total assets, and then multiplied by 100.	CSMAR/hand-collected
<i>ENFORCE</i>	= An indicator variable that equals 1 if a company receives enforcement actions in the subsequent three years from the China Securities Regulatory Commission (CSRC) for year <i>t</i> 's accounting report due to earnings overstatements, assets overstatements, or misleading public disclosures, and 0 otherwise.	CSMAR
<i>MAO</i>	= An indicator variable that equals 1 if a company receives a modified audit opinion in year <i>t</i> , and 0 otherwise.	CSMAR
<i>OP</i>	= The audit opinion variable that is coded from 0 to 3 to represent clean opinions, unqualified opinions with explanatory notes, qualified opinions, and disclaimers/adverse opinions, respectively.	CSMAR
<b>Main independent variables</b>		
<i>HONOR</i>	= An indicator variable of honorific usage that equals 1 if an engagement partner uses honorifics to address a client company in the audit report at year <i>t</i> , and 0 otherwise.	CSMAR/hand-collected
<i>HONOR_DIS</i>	= An indicator variable of honorific usage that equals 1 if a field partner uses honorifics to address a client company in the audit report at year <i>t</i> , but the field partner does not use honorific appellations in all clients' audit reports, and 0 otherwise.	CSMAR/hand-collected
<i>HONOR_CON</i>	= An indicator variable of honorific usage that equals 1 if a field partner uses honorifics to address a client company in the audit report at year <i>t</i> and the field partner uses honorific appellations in all clients' audit reports, and 0 otherwise.	CSMAR/hand-collected
<b>Control variables</b>		
<i>CI_AUD_FIRM</i>	= Client importance at an audit firm level, measured as the natural logarithm of total assets of a client scaled by the sum of total assets (in natural logarithm form) of all clients audited by an	CSMAR

	audit firm in year $t$ .	
<i>CI_AUDITOR</i>	= Client importance at an individual auditor level, measured as the natural logarithm of total assets of a client scaled by the sum of total assets (in natural logarithm form) of all clients audited by an engagement auditor in year $t$ .	CSMAR
<i>ROA</i>	= Returns on total assets in year $t$ , measured as earnings before interest and tax divided by total assets.	CSMAR
<i>FINANCING</i>	= External financing, measured as the sum of common and preferred equity issuance and long-term debt, then scaled by average total assets.	CSMAR
<i>SIZE</i>	= Firm size, measured as the natural logarithm of total assets in year $t$ .	CSMAR
<i>LEV</i>	= Financial leverage, measured as total liabilities divided by total assets in year $t$ .	CSMAR
<i>TURNOVER</i>	= Asset turnover ratio, measured as total sales divided by total assets in year $t$ .	CSMAR
<i>EM</i>	= An indicator variable for clients' earnings management incentives, which equals 1 for any of the following criteria: (1) companies with a small profit ( $0 < ROA < 1\%$ ), (2) loss-making companies with a reported ROA that is lower than the median value of the non-positive ROAs of all of the listed firms, and (3) companies with ROEs that are marginally above the CSRC's rights offering requirement, i.e., $6\% - 7\%$ .	CSMAR
<i>MB</i>	= Market-to-book ratio, measured as the company's market value of equity divided by its book value of equity in year $t$ .	CSMAR
<i>PE</i>	= Price-to-earnings ratio, measured as the company's year-end closing price divided by earnings before interests and tax in year $t$ .	CSMAR
<i>STD_RET</i>	= Standard deviation of the company's market-adjusted stock return calculated using weekly return data over year $t$ .	CSMAR
<i>AGE</i>	= Natural log of 1 plus the number of years the company has been listed on the stock exchange.	CSMAR
<i>STATE</i>	= An indicator variable that equals 1 when the ultimate controlling shareholder of a listed firm is a (central or local) government agency or government-controlled state-owned enterprises, and 0 otherwise.	CSMAR
<b>Cross-sectional factors</b>		
<i>TOP10</i>	= An indicator variable that equals 1 if a company is audited by one of international Big 4 and domestic Top 6 largest accounting firms, and 0 otherwise.	Hand-collected from www.cicpa.org.cn
<i>EXPERTISE</i>	= An indicator variable for whether the audit firm is classified as an industry specialist, which equals 1 if the audit firm has the largest market share (in terms of audit fees) in each two-digit CSRC industry code, and 0 otherwise.	CSMAR

$ORG\_FORM$  = An indicator variable that equals 1 if an audit firm is formed as a limited or unlimited liability partnership, and 0 if the audit firm is a limited liability corporation. Hand-collected from audit reports

$CONCENT$  = Local audit market concentration ratio, measured as the sum of the squared market shares (in terms of audit fees) of all audit firms in the region where the audit firm resides. CSMAR

#### The first-stage variables used in the propensity-score matching (PSM) procedure

$EDU\_DIF$  = An indicator variable that equals 1 if  $EDU\_AUD - EDU\_CEO > 0$ , and 0 otherwise.  $EDU\_AUD$  is education background of the field partner, which equals 1 if the field partner holds a bachelor's degree or higher, and 0 otherwise.  $EDU\_CEO$  is education background of the client company's CEO, which equals 1 if the client CEO holds a bachelor's degree or higher, and 0 otherwise. hand-collected from CSMAR and www.cicpa.org.cn

$FEXP\_DIF$  = An indicator variable that equals 1 if  $FEXP\_AUD - FEXP\_CEO > 0$ , and 0 otherwise.  $FEXP\_AUD$  is financial and accounting expertise of the field partner, which equals 1 if the field partner obtained an undergraduate degree in accounting, auditing or finance, and 0 otherwise.  $FEXP\_CEO$  is financial and accounting expertise of the client company's CEO, which equals 1 if the client CEO holds professional designations in economics, finance, accounting or auditing, and 0 otherwise. hand-collected from CSMAR and www.cicpa.org.cn

$REP\_DIF$  = An indicator variable that equals 1 if  $REP\_AUD - REP\_CEO > 0$ , and 0 otherwise.  $REP\_AUD$  is the field partner's professional reputation, which equals 1 if the field partner works at one of international Big 4 audit firms, and 0 otherwise.  $REP\_CEO$  is the client CEO's professional reputation, which equals 1 if the client company is a state-owned enterprise, or is the largest firm among its industry peers in terms of total assets, and 0 otherwise. hand-collected from CSMAR and www.cicpa.org.cn

$GDP\_DIF$  = An indicator variable that equals 1 if  $GDP\_AUD - GDP\_CEO > 0$ , and 0 otherwise.  $GDP\_AUD$  is the GDP per capita for the region in which the audit firm resides;  $GDP\_CEO$  is the GDP per capita for the region in which the client company resides. China Statistical Yearbook

$GENDER\_AUD$  = Field partner's gender, which equals 1 if the field partner is female, and 0 otherwise. hand-collected from www.cicpa.org.cn

**Table 1: Sample Selection**

Initial observations	17,173
Excluding observations from financial service industries	(202)
Excluding observations with missing auditor-related information	(181)
Excluding observations with missing firm-specific accounting data	(950)
Excluding observations with missing stock market data	<u>(1,564)</u>
<i>Available firm-year observations</i>	<u>14,276</u>

**Table 2: Sample Distribution of Honorific and Actual-Name Appellations in Audit Reports**

Year	Yearly Audit Reports	Honorific Usage				Actual-Name Usage			
		Discretionary Usage		Consistent Usage		Subtotal	%		
		N	% among the Honorifics Subsample	N	% among the Honorifics Subsample				
2003	1,036	517	49.90	172	33.27	345	66.73	519	50.10
2004	1,104	549	49.73	118	21.49	431	78.51	555	50.27
2005	1,090	531	48.72	105	19.77	426	80.23	559	51.28
2006	1,157	424	36.65	122	28.77	302	71.23	733	63.35
2007	1,266	417	32.94	98	23.50	319	76.50	849	67.06
2008	1,348	419	31.08	70	16.71	349	83.29	929	68.92
2009	1,356	410	30.24	55	13.41	355	86.59	946	69.76
2010	1,784	566	31.73	71	12.54	495	87.46	1,218	68.27
2011	1,946	604	31.04	52	8.61	552	91.39	1,342	68.96
2012	2,189	746	34.08	69	9.25	677	90.75	1,443	65.92
Total	14,276	5,183	36.31	932	17.98	4,251	82.02	9,093	63.69

Table 3: Descriptive Statistics and Correlation Coefficient Matrix

## Panel A: Descriptive statistics

Variable	N	Mean	Std. Dev.	Min	Q1	Median	Q3	Max
<i>MIS_DUM</i>	14,276	0.07	0.26	0	0	0	0	1
<i>OVER_DUM</i>	13,964	0.05	0.22	0	0	0	0	1
<i>MIS_AMT</i>	14,276	0.07	1.57	-35.36	0	0	0	66.70
<i>OVER_AMT</i>	13,964	0.10	1.44	0	0	0	0	66.70
<i>ENFORCE</i>	14,276	0.13	0.33	0	0	0	0	1
<i>MAO</i>	14,276	0.07	0.25	0	0	0	0	1
<i>OP</i>	14,276	0.10	0.42	0	0	0	0	3
<i>HONOR</i>	14,276	0.36	0.48	0	0	0	1	1
<i>HONOR_DIS</i>	14,276	0.06	0.25	0	0	0	0	1
<i>HONOR_CON</i>	14,276	0.30	0.46	0	0	0	1	1
<i>CI_AUD_FIRM</i>	14,276	0.03	0.06	0.00	0.00	0.01	0.03	0.45
<i>CI_AUDITOR</i>	14,276	0.31	0.31	0.00	0.07	0.18	0.46	1.00
<i>ROA</i>	14,276	0.05	0.08	-0.34	0.03	0.05	0.08	0.28
<i>FINANCING</i>	14,276	0.02	0.09	-0.02	0.00	0.00	0.00	1.30
<i>SIZE</i>	14,276	21.49	1.18	18.74	20.69	21.36	22.14	26.04
<i>LEV</i>	14,276	0.49	0.26	0.05	0.32	0.49	0.64	1.80
<i>TURNOVER</i>	14,276	0.67	0.48	0.04	0.35	0.55	0.84	2.63
<i>EM</i>	14,276	0.24	0.43	0	0	0	0	1
<i>MB</i>	14,276	3.45	3.56	-5.65	1.65	2.53	4.16	23.95
<i>PE</i>	14,276	64.43	132.15	-157.30	16.71	31.21	61.37	929.80
<i>STD_RET</i>	14,276	0.06	0.03	0.02	0.04	0.06	0.08	0.33
<i>AGE</i>	14,276	9.05	5.16	1.00	5.00	9.00	13.00	23.00
<i>STATE</i>	14,276	0.56	0.50	0	0	1	1	1
<i>TOP10</i>	14,276	0.31	0.46	0	0	0	1	1
<i>EXPERTISE</i>	14,276	0.13	0.34	0	0	0	0	1
<i>ORG_FORM</i>	14,276	0.78	0.41	0	1	1	1	1
<i>CONCENT</i>	14,276	0.19	0.11	0.07	0.10	0.17	0.24	0.69

**Panel B: Pearson and Spearman correlation matrix**

Variable	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
(1) <i>MIS_DUM</i>	1.00	<b>1.00</b>	<b>0.96</b>	<b>0.97</b>	0.01	<b>0.02</b>	<b>0.02</b>	<b>0.02</b>
(2) <i>OVER_DUM</i>	<b>1.00</b>	1.00	<b>0.97</b>	<b>0.97</b>	0.01	<b>0.02</b>	<b>0.03</b>	<b>0.02</b>
(3) <i>MIS_AMT</i>	<b>0.96</b>	<b>0.97</b>	1.00	<b>1.00</b>	0.01	<b>0.02</b>	<b>0.03</b>	<b>0.02</b>
(4) <i>OVER_AMT</i>	<b>0.97</b>	<b>0.97</b>	<b>1.00</b>	1.00	0.01	<b>0.02</b>	<b>0.02</b>	<b>0.03</b>
(5) <i>ENFORCE</i>	0.01	0.01	0.01	0.01	1.00	-0.01	-0.01	-0.01
(6) <i>HONOR</i>	<b>0.02</b>	<b>0.02</b>	<b>0.02</b>	<b>0.02</b>	-0.01	1.00	<b>0.46</b>	<b>0.72</b>
(7) <i>HONOR_DIS</i>	<b>0.02</b>	<b>0.03</b>	<b>0.03</b>	<b>0.02</b>	-0.01	<b>0.46</b>	1.00	<b>-0.10</b>
(8) <i>HONOR_CON</i>	<b>0.02</b>	<b>0.02</b>	<b>0.02</b>	<b>0.03</b>	-0.01	<b>0.72</b>	<b>-0.10</b>	1.00

Table 3, Panel A reports descriptive statistics of all the variables used in this study. Panel B presents Pearson correlations (below the diagonal) and Spearman correlations (above the diagonal) of the main test variables used in the analyses. Correlation coefficients are highlighted in bold if they are significant at the 10% level or above, based on two-tailed tests. All variables are defined in the Appendix.

**Table 4: The Effect of Honorific Usage on Financial Misstatements**

Variable	Dependent variable: <i>MIS_DUM</i>			
	(1) Hypothesis H1		(2) Hypothesis H2	
	Coefficient	z-value	Coefficient	z-value
<i>HONOR</i>	0.106***	2.96		
<i>HONOR_DIS</i>			0.183***	3.70
<i>HONOR_CON</i>			0.080**	2.09
<i>CI_AUD_FIRM</i>	1.163***	8.03	1.170***	8.44
<i>CI_AUDITOR</i>	0.169*	1.77	0.168*	1.79
<i>ROA</i>	-1.370***	-5.01	-1.366***	-4.97
<i>FINANCING</i>	0.019	0.08	0.020	0.09
<i>SIZE</i>	-0.070**	-2.50	-0.068**	-2.49
<i>LEV</i>	0.325***	3.81	0.324***	3.79
<i>TURNOVER</i>	-0.101*	-1.93	-0.100*	-1.96
<i>EM</i>	0.027	1.01	0.026	0.96
<i>MB</i>	0.054	1.04	0.055	1.07
<i>PE</i>	0.005**	1.97	0.005**	2.00
<i>STD_RET</i>	0.247*	1.92	0.261*	1.89
<i>AGE</i>	0.000	0.01	0.000	0.02
<i>STATE</i>	0.113**	2.30	0.113**	2.33
<i>INTERCEPT</i>	-1.548***	-2.83	-1.578***	-2.94
Industry fixed effects		Yes		Yes
Year fixed effects		Yes		Yes
Audit firm fixed effects		Yes		Yes
Pseudo $R^2$		10.10%		10.56%
Obs.		14,276		14,276
Coefficient difference:				
<i>HONOR_DIS - HONOR_CON</i>				7.57***

\*\*\*, \*\* and \* represent the 1%, 5% and 10% levels of significance, respectively, for two-tailed tests. All reported z-statistics are based on standard errors adjusted for clustering at firm and year levels. This table reports logistic regression results of financial misstatements on honorific usage after controlling for a set of other determinants of financial misstatements. The dependent variable is *MIS\_DUM* in both regressions. All variables are defined in the Appendix.



**Table 5: The Effect of Honorific Usage on Alternative Measures of Financial Misstatements**

**Panel A: Regression results using the likelihood of accounting overstatements**

Variable	Dependent variable: <i>OVER DUM</i>			
	(1) Hypothesis H1		(2) Hypothesis H2	
	Coefficient	z-value	Coefficient	z-value
<i>HONOR</i>	0.150***	5.43		
<i>HONOR_DIS</i>			0.213***	3.68
<i>HONOR_CON</i>			0.128***	4.64
Control Variables	Yes		Yes	
Industry fixed effects	Yes		Yes	
Year fixed effects	Yes		Yes	
Audit firm fixed effects	Yes		Yes	
Pseudo $R^2$	10.52%		10.96%	
Obs.	13,964		13,964	
Coefficient difference: <i>HONOR_DIS - HONOR_CON</i>			5.43**	

**Panel B: Regression results using the magnitude of misstatements**

Variable	Dependent variable: <i>MIS AMT</i>			
	(1) Hypothesis H1		(2) Hypothesis H2	
	Coefficient	t-value	Coefficient	t-value
<i>HONOR</i>	0.011**	2.01		
<i>HONOR_DIS</i>			0.020**	2.04
<i>HONOR_CON</i>			0.008**	2.24
Control Variables	Yes		Yes	
Industry fixed effects	Yes		Yes	
Year fixed effects	Yes		Yes	
Audit firm fixed effects	Yes		Yes	
Adj. $R^2$	4.20%		4.66%	
Obs.	14,276		14,276	
Coefficient difference: <i>HONOR_DIS - HONOR_CON</i>			130.27***	

**Panel C: Regression results using the magnitude of accounting overstatements**

Variable	Dependent variable: <i>OVER AMT</i>			
	(1) Hypothesis H1		(2) Hypothesis H2	
	Coefficient	t-value	Coefficient	t-value
<i>HONOR</i>	0.010**	1.97		
<i>HONOR_DIS</i>			0.023**	2.36
<i>HONOR_CON</i>			0.007**	2.06
Control Variables	Yes		Yes	
Industry fixed effects	Yes		Yes	
Year fixed effects	Yes		Yes	
Audit firm fixed effects	Yes		Yes	
Adj. $R^2$	3.16%		3.45%	
Obs.	13,964		13,964	

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Coefficient difference: <i>HONOR_DIS - HONOR_CON</i>	46.01***
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**Panel D: Regression results using CSRC enforcement**

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Variable	Dependent variable: <i>ENFORCE</i>			
	(1) Hypothesis H1		(2) Hypothesis H2	
	Coefficient	z-value	Coefficient	z-value
<i>HONOR</i>	0.202**	2.09		
<i>HONOR_DIS</i>			0.241***	2.62
<i>HONOR_CON</i>			0.115	0.62
Control Variables	Yes		Yes	
Industry fixed effects	Yes		Yes	
Year fixed effects	Yes		Yes	
Audit firm fixed effects	Yes		Yes	
Pseudo $R^2$	13.08%		13.11%	
Obs.	14,276		14,276	

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Coefficient difference: <i>HONOR_DIS - HONOR_CON</i>	2.72*
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\*\*\*, \*\* and \* represent the 1%, 5% and 10% levels of significance, respectively, for two-tailed tests. Z-statistics and t-statistics in various panels are based on standard errors adjusted for clustering at firm and year levels.

This table reports logistic regression (for Panels A and D) and OLS regression (for Panels B and C) results of financial misstatements on honorific usage after controlling for a set of other determinants of financial misstatements. Four alternative measures of misstatements are used as dependent variables, including *OVER\_DUM*, *MIS\_AMT*, *OVER\_AMT*, and *ENFORCE*. All variables are defined in the Appendix.

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**Table 6: Cross-Sectional Analyses on the Association between Honorific Usage and Financial Misstatements**

<b>Panel A: Top 10 audit firms</b>				
Variable	Dependent variable: <i>MIS_DUM</i>			
	(1) Hypothesis H1		(2) Hypothesis H2	
	Coefficient	z-value	Coefficient	z-value
<i>HONOR</i>	0.216***	3.92		
<i>HONOR_DIS</i>			0.255***	4.34
<i>HONOR_CON</i>			0.197***	3.38
<i>TOP10</i>	-0.098	-0.28	-0.108	-0.29
<i>HONOR</i> × <i>TOP10</i>	-0.365***	-4.11		
<i>HONOR_DIS</i> × <i>TOP10</i>			-0.456**	-2.30
<i>HONOR_CON</i> × <i>TOP10</i>			-0.339***	-3.50
Control Variables	Yes		Yes	
Industry fixed effects		Yes		Yes
Year fixed effects		Yes		Yes
Audit firm fixed effects		Yes		Yes
Pseudo <i>R</i> <sup>2</sup>		10.17%		10.30%
Obs.		14,276		14,276
Coefficient difference: <i>HONOR_DIS</i> - <i>HONOR_CON</i>				5.15**

  

<b>Panel B: Industry expertise of audit firms</b>				
Variable	Dependent variable: <i>MIS_DUM</i>			
	(1) Hypothesis H1		(2) Hypothesis H2	
	Coefficient	z-value	Coefficient	z-value
<i>HONOR</i>	0.145***	3.81		
<i>HONOR_DIS</i>			0.251***	3.77
<i>HONOR_CON</i>			0.112***	2.67
<i>EXPERTISE</i>	-0.061**	-2.08	-0.063	-1.48
<i>HONOR</i> × <i>EXPERTISE</i>	-0.134**	-2.14		
<i>HONOR_DIS</i> × <i>EXPERTISE</i>			-0.170**	-1.98
<i>HONOR_CON</i> × <i>EXPERTISE</i>			-0.121**	-2.00
Control Variables	Yes		Yes	
Industry fixed effects		Yes		Yes
Year fixed effects		Yes		Yes
Audit firm fixed effects		Yes		Yes
Pseudo <i>R</i> <sup>2</sup>		10.20%		10.25%
Obs.		14,276		14,276
Coefficient difference: <i>HONOR_DIS</i> - <i>HONOR_CON</i>				10.37***

**Panel C: Organizational forms of audit firms**

Variable	Dependent variable: <i>MIS_DUM</i>			
	(1) Hypothesis H1		(2) Hypothesis H2	
	Coefficient	z-value	Coefficient	z-value
<i>HONOR</i>	0.319***	3.78		
<i>HONOR_DIS</i>			0.483***	3.77
<i>HONOR_CON</i>			0.338**	2.44
<i>ORG_FORM</i>	0.411***	4.40	0.495***	2.86
<i>HONOR</i> × <i>ORG_FORM</i>	-0.238**	-2.45		
<i>HONOR_DIS</i> × <i>ORG_FORM</i>			-0.326***	-4.05
<i>HONOR_CON</i> × <i>ORG_FORM</i>			-0.296*	-1.85
Control Variables	Yes		Yes	
Industry fixed effects	Yes		Yes	
Year fixed effects	Yes		Yes	
Audit firm fixed effects	Yes		Yes	
Pseudo $R^2$	10.41%		10.47%	
Obs.	14,276		14,276	
Coefficient difference: <i>HONOR_DIS</i> - <i>HONOR_CON</i>			3.47*	

**Panel D: Audit market concentration**

Variable	Dependent variable: <i>MIS_DUM</i>			
	(1) Hypothesis H1		(2) Hypothesis H2	
	Coefficient	z-value	Coefficient	z-value
<i>HONOR</i>	0.097***	2.70		
<i>HONOR_DIS</i>			0.146***	3.30
<i>HONOR_CON</i>			0.078**	2.26
<i>CONCENT</i>	-2.210***	-5.58	-2.206***	-5.60
<i>HONOR</i> × <i>CONCENT</i>	-0.314**	-2.30		
<i>HONOR_DIS</i> × <i>CONCENT</i>			-0.529***	-3.74
<i>HONOR_CON</i> × <i>CONCENT</i>			0.687	0.78
Control Variables	Yes		Yes	
Industry fixed effects	Yes		Yes	
Year fixed effects	Yes		Yes	
Audit firm fixed effects	Yes		Yes	
Pseudo $R^2$	10.81%		10.85%	
Obs.	14,276		14,276	
Coefficient difference: <i>HONOR_DIS</i> - <i>HONOR_CON</i>			10.45***	

\*\*\*, \*\* and \* represent the 1%, 5% and 10% levels of significance, respectively, for two-tailed tests. All reported z-statistics are based on standard errors adjusted for clustering at firm and year levels.

This table reports regression results of financial misstatements on honorific usage after controlling for a set of other determinants of financial misstatements. The dependent variable is *MIS\_DUM* in all regressions. Panels A, B, C, and D report results including cross-sectional factors such as auditor size, auditor expertise, organization forms of audit firms, and local audit market concentration, respectively. In Panel D, *CONCENT* is defined to be 1 if the actual value is above the sample median, and 0 if the actual value is below sample median. All variables are defined in the Appendix.

**Table 7: The Effect of Honorific Usage on Financial Misstatements with the Propensity-Score Matched (PSM) Sample**

**Panel A: First-stage probit regression results of propensity-score matching (PSM)**

Variable	(1) Dependent variable: <i>HONOR</i>		(2) Dependent variable: <i>HONOR DIS</i>		(3) Dependent variable: <i>HONOR CON</i>	
	Coefficient	z-value	Coefficient	z-value	Coefficient	z-value
<i>EDU_DIF</i>	-0.135**	-2.12	0.098	0.75	-0.185***	-3.16
<i>FEXP_DIF</i>	-0.081**	-2.05	-0.225**	-2.41	0.001	0.01
<i>REP_DIF</i>	0.547	1.42	-0.588**	-2.24	0.675	1.62
<i>GDP_DIF</i>	-0.178***	-2.88	-0.220***	-2.65	-0.105	-1.22
<i>CI_AUD_FIRM</i>	0.020	0.11	-0.090	-0.25	0.082	0.69
<i>CI_AUDITOR</i>	0.425	0.75	0.470	0.79	0.203	0.37
<i>GENDER_AUD</i>	-0.025	-0.57	-0.246***	-4.46	0.061	1.26
<i>INTERCEPT</i>	-3.133***	-2.89	9.245	0.01	-3.618***	-3.38
Industry fixed effects	Yes		Yes		Yes	
Year fixed effects	Yes		Yes		Yes	
Audit firm fixed effects	Yes		Yes		Yes	
Pseudo $R^2$	24.15%		5.96%		22.97%	
Obs.	14,276		14,276		14,276	

**Panel B: Second-stage regression results with the PSM sample**

Variable	Dependent variable: <i>MIS_DUM</i>			
	(1) Hypothesis H1		(2) Hypothesis H2	
	Coefficient	z-value	Coefficient	z-value
<i>HONOR</i>	0.155***	3.71		
<i>HONOR_DIS</i>			0.262***	3.47
<i>HONOR_CON</i>			0.121***	2.97
<i>CI_AUD_FIRM</i>	1.474***	4.45	1.472***	4.41
<i>CI_AUDITOR</i>	0.057	0.29	0.061	0.32
<i>ROA</i>	-1.974***	-6.40	-1.981***	-6.27
<i>FINANCING</i>	-0.229	-0.60	-0.225	-0.58
<i>SIZE</i>	-0.097***	-3.36	-0.096***	-3.35
<i>LEV</i>	0.290**	2.03	0.290**	2.01
<i>TURNOVER</i>	-0.100**	-2.44	-0.099**	-2.40
<i>EM</i>	-0.034	-0.45	-0.035	-0.45
<i>MB</i>	0.021	0.51	0.023	0.56
<i>PE</i>	0.007**	2.18	0.007**	2.22
<i>STD_RET</i>	-0.089	-0.19	-0.113	-0.24
<i>AGE</i>	-0.006	-0.90	-0.006	-0.91
<i>STATE</i>	0.003	0.85	0.003	0.83
<i>INTERCEPT</i>	-0.315	-0.63	-0.348	-0.71
Industry fixed effects		Yes		Yes
Year fixed effects		Yes		Yes
Audit firm fixed effects		Yes		Yes
Pseudo $R^2$		13.58%		13.60%

Obs.	6,364	6,364
Coefficient difference: <i>HONOR_DIS - HONOR_CON</i>		6.11**

\*\*\*, \*\* and \* represent the 1%, 5% and 10% levels of significance, respectively, for two-tailed tests. All reported z-statistics are based on standard errors adjusted for clustering at firm and year levels.

This table employs the propensity-score matching procedure to construct a matched sample. In the first stage (Panel A), the dependent variables are *HONOR*, *HONOR\_DIS* and *HONOR\_CON*, respectively. Panel A, Model (1) results in 5,114 firm-year observations, including 2,557 observations with honorifics in audit reports and 2,557 matched observations without honorifics in audit reports. In the second stage (Panel B) using the matched sample resulting from Panel A, Model (1), the dependent variable is *MIS\_DUM*. All variables are defined in the Appendix.

**Table 8: The Effect of Changes in Appellations on Changes in Financial Misstatements**

Variable	Dependent variable: $\Delta MIS\_DUM$	
	Coefficient	z-value
$\Delta HONOR$	0.094**	2.47
$\Delta CI\_AUD\_FIRM$	-0.214	-0.37
$\Delta CI\_AUDITOR$	-0.044	-0.51
$\Delta ROA$	0.000*	1.68
$\Delta FINANCING$	0.321	1.10
$\Delta SIZE$	0.215*	1.85
$\Delta LEV$	-0.214	-1.13
$\Delta TURNOVER$	-0.117	-0.85
$\Delta EM$	0.061	0.92
$\Delta MB$	0.018	0.99
$\Delta PE$	-0.006	-1.06
$\Delta STD\_RET$	-0.833	-0.54
$\Delta AGE$	-0.006***	-3.34
$\Delta STATE$	-0.124	-0.50
$CUT1$	-2.798***	-12.57
$CUT2$	3.109***	15.75
Industry fixed effects		Yes
Year fixed effects		Yes
Audit firm fixed effects		Yes
Pseudo $R^2$		1.10%
Obs.		11,905

\*\*\*, \*\* and \* represent the 1%, 5% and 10% levels of significance, respectively, for two-tailed tests. All reported z-statistics are based on standard errors adjusted for clustering at firm and year levels.

This table reports the ordered logistic regression results of changes in financial misstatements on changes in appellations after controlling for a set of other determinants of financial misstatements. The dependent variable is  $\Delta MIS\_DUM$ , which is an indicator variable defined as follows: the variable equals 2 if the accounting report at year  $t$  is subsequently restated but no restatement for the year  $t-1$  accounting report; it equals 1 if (1) neither years  $t$  or  $t-1$  accounting report is subsequently restated, or (2) both years' reports are restated; and it equals 0 if the accounting report at year  $t-1$  is subsequently restated but there is no restatement for the year  $t$  accounting report. The variable  $\Delta HONOR$  is defined as follows: the variable equals 3 if honorific appellation is used at year  $t$  but actual-name appellation is used in year  $t-1$ ; it equals 2 if honorific appellations are used in both years  $t$  and  $t-1$ ; it equals 1 if honorific appellation is used at year  $t-1$  but actual-name appellation is used in year  $t$ ; and it equals 0 if actual-name appellations are used in both years  $t$  and  $t-1$ . All other variables are taken in first-order difference.

**Table 9: The Effect of Honorific Usage on Financial Misstatements during an Exogenous Event**

Variable	Dependent variable: <i>MIS_DUM</i>			
	(1)		(2)	
	Coefficient	z-value	Coefficient	z-value
<i>HONOR</i>	1.081**	2.37		
<i>HONOR_DIS</i>			1.110***	4.04
<i>HONOR_CON</i>			1.013***	3.35
<i>PARTNER</i>	0.692	0.93	0.627	1.24
<i>HONOR</i> × <i>PARTNER</i>	-0.939**	-2.06		
<i>HONOR_DIS</i> × <i>PARTNER</i>			-0.799**	-2.31
<i>HONOR_CON</i> × <i>PARTNER</i>			-0.964***	-3.02
<i>CI_AUD_FIRM</i>	-1.675	-0.42	-1.528	-0.39
<i>CI_AUDITOR</i>	-1.244***	-2.82	-1.206	-1.52
<i>ROA</i>	-0.537	-0.80	-0.346	-0.22
<i>FINANCING</i>	0.314	0.38	0.246	0.25
<i>SIZE</i>	-0.019	-0.49	-0.018	-0.24
<i>LEV</i>	0.201	0.27	0.178	0.20
<i>TURNOVER</i>	-0.880***	-4.37	-0.872***	-3.34
<i>EM</i>	-0.078	-0.45	-0.043	-0.18
<i>MB</i>	-0.023	-0.22	-0.020	-0.23
<i>PE</i>	0.033	0.92	0.031	1.26
<i>STD_RET</i>	-0.536	-0.26	-0.372	-0.19
<i>AGE</i>	0.045	1.24	0.043*	1.91
<i>STATE</i>	-0.363*	-1.92	-0.360	-1.31
<i>INTERCEPT</i>	-1.971	-1.54	-2.441	-1.19
Industry fixed effects		Yes		Yes
Year fixed effects		Yes		Yes
Audit firm fixed effects		Yes		Yes
Pseudo $R^2$		21.34%		21.49%
Obs.		540		540

\*\*\*, \*\* and \* represent the 1%, 5% and 10% levels of significance, respectively, for two-tailed tests. All reported z-statistics are based on standard errors adjusted for clustering at firm and year levels.

This table reports the logistic regression results of financial misstatements on honorific usage during an exogenous organizational form switch event covering the year when the audit firm switched to an organizational form of limited liability partnership and the year prior to the switch. The dependent variable is *MIS\_DUM*. The variable *PARTNER* is an indicator variable that equals 1 for the year when the audit firm switched to an organizational form of limited liability partnership, and 0 for the year prior to the switch. All other variables are defined in the Appendix.



**Table 10: The Effect of Honorific Usage on Modified Audit Opinions**

**Panel A: Logistic regression results**

Variable	Dependent variable: <i>MAO</i>			
	(1) Hypothesis H1		(2) Hypothesis H2	
	Coefficient	z-value	Coefficient	z-value
<i>HONOR</i>	-0.184**	-2.14		
<i>HONOR_DIS</i>			-0.195***	-2.79
<i>HONOR_CON</i>			-0.181	-1.46
<i>CI_AUD_FIRM</i>	2.024**	2.02	2.024**	2.02
<i>CI_AUDITOR</i>	-0.039	-0.15	-0.041	-0.15
<i>ROA</i>	-11.426***	-14.56	-11.426***	-14.58
<i>FINANCING</i>	0.339***	4.51	0.338***	4.52
<i>SIZE</i>	-0.383***	-7.15	-0.383***	-7.01
<i>LEV</i>	2.427***	20.18	2.427***	20.81
<i>TURNOVER</i>	-0.306*	-1.92	-0.307*	-1.91
<i>EM</i>	0.319*	1.85	0.319*	1.85
<i>MB</i>	-0.032**	-2.49	-0.032***	-2.59
<i>PE</i>	-0.018	-0.90	-0.018	-0.90
<i>STD_RET</i>	-1.124	-1.49	-1.123	-1.48
<i>AGE</i>	0.030***	2.94	0.030***	2.89
<i>STATE</i>	-0.245	-1.48	-0.245	-1.48
<i>MAO_LAG</i>	3.134***	15.97	3.134***	15.75
<i>QUICK</i>	0.239***	3.85	0.239***	3.84
<i>ARINV</i>	-0.853**	-2.08	-0.853**	-2.11
<i>INTERCEPT</i>	8.502***	7.83	8.502***	7.83
Industry fixed effects		Yes		Yes
Year fixed effects		Yes		Yes
Audit firm fixed effects		Yes		Yes
Pseudo $R^2$		55.19%		55.41%
Obs.		12,178		12,178

**Panel B: Ordered logistic regression results**

Variable	Dependent variable: <i>OP</i>			
	(1) Hypothesis H1		(2) Hypothesis H2	
	Coefficient	z-value	Coefficient	z-value
<i>HONOR</i>	-0.186***	-4.49		
<i>HONOR_DIS</i>			-0.302***	-2.96
<i>HONOR_CON</i>			-0.152	-1.06
<i>CI_AUD_FIRM</i>	0.490	0.46	0.490	0.41
<i>CI_AUDITOR</i>	0.045	0.27	0.028	0.13
<i>ROA</i>	-8.869***	-8.01	-8.874***	-6.92
<i>FINANCING</i>	0.156	0.66	0.155	0.59
<i>SIZE</i>	-0.260***	-5.18	-0.258***	-3.76
<i>LEV</i>	1.142***	7.79	1.147***	7.52
<i>TURNOVER</i>	-0.177	-1.24	-0.179	-1.01
<i>EM</i>	0.540***	3.73	0.541***	4.06
<i>MB</i>	0.003	0.23	0.003	0.42
<i>PE</i>	-0.021	-1.18	-0.021	-1.23
<i>STD_RET</i>	-0.699	-1.11	-0.702	-1.27
<i>AGE</i>	0.051***	5.30	0.051***	4.69
<i>STATE</i>	-0.259*	-1.79	-0.261***	-2.98
<i>MAO_LAG</i>	1.542***	14.09	1.540***	10.19
<i>QUICK</i>	0.084	0.88	0.085	0.70
<i>ARINV</i>	-0.215	-0.54	-0.227	-0.59
<i>CUT1</i>	1.577**	2.31	1.634	1.49
<i>CUT2</i>	3.525***	5.30	3.582***	3.55
<i>CUT3</i>	5.248***	10.74	5.303***	5.49
Industry fixed effects		Yes		Yes
Year fixed effects		Yes		Yes
Audit firm fixed effects		Yes		Yes
Pseudo $R^2$		40.93%		41.14%
Obs.		12,178		12,178

\*\*\*, \*\* and \* represent the 1%, 5% and 10% levels of significance, respectively, for two-tailed tests. Z-statistics in Panel A are based on standard errors adjusted for clustering at firm and year levels, and z-statistics in Panel B are based on standard errors adjusted for firm-level clustering and Heteroskedasticity. This table reports the effect of honorific usage on the probability of clients receiving an MAO. *MAO\_LAG* is an indicator variable for the lagged value of *MAO*. *OP\_LAG* is the lagged value of *OP*. *QUICK* is the quick ratio, measured as the sum of cash, short-term investments, and accounts receivables, and then divided by current liabilities. *ARINV* is accounts receivables and inventory intensiveness, measured as the sum of accounts receivables and inventory, divided by total assets. In Panel A, the dependent variable is *MAO*; in Panel B, the dependent variable is *OP*. All other variables are defined in the Appendix.