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Audit Quality and Auditors' Party Membership: An Insightful Viewpoint into Financial Restatements

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Abstract

This study aims to explore the impact of communist culture as a variable in auditing research. We focus on auditors' party membership and how it empirically influences party culture in audit firms and, in turn, audit quality. Using financial restatements as a proxy variable for audit quality, our results indicate that auditors who are members of the party demonstrate higher audit quality. Our robustness test, using non-discretionary accruals as an alternative proxy for audit quality, consistently supports these findings. Additionally, we observe that the enhancing effect of party culture on audit quality is less significant for Big4 auditors and auditors with industry expertise, who already possess strong reputational constraints. Our findings suggest that party culture in audit firms, as an informal institution, can compensate for the deficiencies of formal institutions, particularly in areas where audit reputation mechanisms are relatively weak, thus significantly contributing to improving audit quality.

Keywords: BIG4, CPA, Party membership, Audit quality, Financial restatements.

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1. Introduction

Financial restatement is the act of a company revising previous accounting errors. Numerous studies have shown that financial restatements lead to negative economic consequences, such as increasing information asymmetry (Kravet and Shevlin, 2010; Graham et al., 2008), insider trading (Li and Yuan, 2006), and harming investor trust (Hribar and Jenkins, 2004). Therefore, financial restatements are considered indicative of low-quality corporate accounting information. As an external mechanism to ensure the effective implementation of accounting standards, external audits play a crucial role in constraining managerial opportunistic behavior and ultimately reducing financial restatements (Abbott et al., 2004; Agrawal and Chadha, 2005; Li and Lin, 2005; Lin et al., 2006; Raghunandan et al., 2003). Building on previous research, this paper further attempts to examine whether auditors with a Party background play a key role in curbing financial restatements.

The quality of an auditor's work depends not only on their skill level but also, to a large extent, on their audit independence. An auditor's personal reputation (Chi et al., 2012), professional integrity, and sense of ethics (Ma et al., 2018) enhance their independence, leading to high-quality audits. The ethical values of auditors align with the values of honesty, dedication, and protecting the interests of the broad masses (including small and medium investors) upheld by party members. Therefore, in response to the research by Bi et al. (2015) and Dai et al. (2017) on strengthening social culture and communist culture as informal institutions, clarifying the role of communist culture in audit work is undoubtedly of significant practical importance.

In recent years, there has been a significant amount of research on the party membership of executives or party organizations within enterprises. These studies recognize the positive impact of the party at the enterprise level, highlighting its role in improving corporate governance, curbing executive consumption, limiting executive compensation, protecting state-owned assets, safeguarding employees, protecting the environment, contributing to social donations, fulfilling social responsibilities, and ensuring the quality of information in the capital market. (Ma et al., 2012; Li and Zhang, 2018; Chen and Lu, 2014, Chen et al., 2014; Ma et al., 2013; Dong and Wei, 2018; Yu et al., 2019a, 2019b; Liang et al., 2010; Zhang and Jiang, 2019; Wu and Wang., 2018; Cheng et al., 2017).

However, the party membership of corporate executives can also be seen as a manifestation of political connections. The behavior of corporate executives may not be driven by self-imposed moral constraints and behavioral discipline as party members, but rather by benefits exchanged through political connections. Therefore, the economic outcomes associated with party membership among corporate executives may not necessarily stem from their higher moral constraints or greater identification with party values. Instead, these outcomes could be the result of benefit exchanges aimed at pursuing personal political advancement or seeking tax benefits, government subsidies, and government access. Corporate executives with party membership are more likely to establish political connections for their companies, and these studies cannot clearly distinguish whether the motivation is political connections or moral constraints. Compared to the research on corporate executives with party membership, our study focuses on auditors with party membership. Generally, party-member auditors are ordinary party members who are less likely to have close access to political power, making it easier to rule out the political connection's hypothesis.

Compared to previous research, our study also helps to mitigate the endogeneity problem caused by sample self-selection. A major issue in studying the party membership of corporate executives and internal party organizations within enterprises is that the samples of executives with party membership or enterprises with grassroots party organizations may only include those who have disclosed this information. Non-disclosure does not necessarily mean the absence of party membership or a party organization. In recent years, due to the political climate encouraging the establishment of party organizations within enterprises, establishing such organizations is considered politically correct. Most companies that have established party organizations are likely to disclose this information, and executives with party membership are also likely to disclose their status. However, such disclosures are still voluntary rather than mandatory, which can lead to sample selection and endogeneity problems. Although methods like Heckman correction and propensity score matching (PSM) can alleviate this issue to some extent, they do not completely eliminate it.

Our data on the party membership of auditors comes from publicly disclosed information by the Chinese Institute of Certified Public Accountants (CICPA). Although there are instances of incomplete information, the disclosure requirements significantly reduce the likelihood of undisclosed party membership. Therefore, the endogeneity problem arising from sample selection is relatively smaller in our study.

2. Literature and Hypotheses

2.1 Research on Party Membership and Party Organizations

China is a country where the party and government are unified, with the Communist Party as the sole ruling party, determining the country's major policies. At the micro level, the party's spirit is conveyed to all sectors of society through a vast number of grassroots party members and various party organizations (Chen and Lu, 2014). In the field of economic management, research on party membership and party organizations primarily focuses on the enterprise perspective, examining the party membership of corporate executives or internal party organizations within enterprises. Most of these studies have given positive evaluations of their economic consequences, asserting that party membership and party organizations can improve corporate governance, curb executive consumption (Chen and Lu, 2014), limit executive compensation (Ma et al., 2013), prevent the loss of state-owned assets (Chen and Lu, 2014), protect employee interests (Dong and Wei, 2018), enhance environmental protection and information disclosure (Yu et al., 2019a), promote social donations (Liang et al., 2010), fulfill general social responsibilities (Yu et al., 2019b; Zhang and Jiang, 2019), strengthen internal control and auditing (Wu and Wang, 2018; Cheng et al., 2017).

However, there are also a few studies that provide negative evaluations. For example, Ma et al. (2013) argue that party organizations in state-owned enterprises can lead to redundant employees; Wei (2013) suggests that party secretaries lack professionalism compared to other senior executives; and Chang and Wong (2004) found that the greater the power of the party committee relative to the managers, the worse the company's performance, indicating that the political costs of enterprises have a significant negative impact on their performance.

2.2 Internal Party Building Work and Integrity in Practice within the Firm

The above studies all focus on conveying the party's culture within enterprises through party members or party organizations, while neglecting the fact that party building also exists within audit firms. Although audit firms operate according to market principles, the Certified Public Accountant (CPA) is supervised by the Ministry of Finance and The Chinese Institute of Certified Public Accountants) (CICPA), and thus has strong administrative characteristics. In terms of party organization construction, the CPA industry 'combines the leadership advantages of the Ministry of Finance with the organizational advantages and management functions of the CPA Association to create a block-based industry party building management system, establishing a four-level party organization system at the national, provincial, municipal, and firm levels'. Therefore, party building work within the CPA industry is also very strong.

2.3 Party Membership of Auditors and Financial Restatements

A significant body of academic literature has highlighted the adverse economic consequences of financial restatements, such as evaluating market or analyst responses (Barniv and Cao, 2009; Akhigbe and Madura, 2008; Palmrose et al., 2004; Hribar and Jenkins, 2004; Griffin, 2003); the turnover rates or reputations of executives (Leone and Liu, 2010; Feldmann et al., 2009; Collins et al., 2009; Cheng and Farber, 2008; Hennes et al., 2008; Desai et al., 2006); and the likelihood of future litigation (Palmrose et al., 2004). These adverse consequences indicate poor quality of corporate accounting information. Therefore, many scholars consider financial statement restatements as one of the measures of accounting information quality (Chen et al., 2016; Chiu et al., 2012; Call et al., 2017; Zhao and Li, 2016; Dai et al., 2011; Ma and Zhang, 2012). Moreover, Blankley et al. (2012) indicate that restatements not only indicate the client's financial reporting failure but also represent the auditor's audit failure.

Furthermore, among numerous proxy variables for audit quality, financial restatements are directly observable by external parties. Therefore, many academic studies consider financial restatements as a proxy variable for low audit quality (Liu et al., 2009; Raghunandan et al., 2003; Guan et al., 2016). In summary, due to the representation of low audit quality by financial restatements and the integrity requirements of audit practice within audit firms' internal party building, this study proposes the following hypothesis:

H_1: Auditors who are members of the Communist Party can avoid financial restatements by client companies.

2.4 The Moderating Role of the Reputation Mechanism of the International Big4

Academic research from various perspectives, such as accounting conservatism (Liu and Zhou, 2007; Francis and Krishnan, 1999), information transparency (Wang and Chen, 2006), accruals earning (Qi et al., 2004; Wang et al., 2015; Becker et al., 1998; Francis and Krishnan, 1999), real earnings management (Guo and Huang, 2015), accounting information comparability (Yuan and Liu, 2019), financial statement restatements (Eshleman et al., 2014), and corporate social responsibility information disclosure (Huang et al., 2017), have confirmed the higher audit quality of the Big4 international firms. DeAngelo and Linda (1981) argue that larger firms face greater reputational costs if they engage in actions detrimental to audit independence. Therefore, Chi et al. (2012) consider the auditor's own reputation as a key factor in ensuring their independence.

The auditors from the Big4 international firms generally produce relatively high-quality audit outcomes, regardless of whether they are party members, due to their concern for reputation. Therefore, within the Big4, the role of integrity-focused party-building work is relatively limited. In contrast, in non-Big4 firms, where the role of reputation mechanisms is weaker, informal institutions such as party-building work can play a more significant role. Based on the above analysis, we propose the following hypothesis:

H_2: Compared to Big4, the inhibitory effect of auditor party membership on financial statement restatements is more pronounced within non-Big4 firms.

2.5 The Moderating Effect of Auditor Industry Expertise

A wealth of academic research (Fan et al., 2013; Cai and Xian, 2007; Liu et al., 2010; Chen and Ma, 2013; Ferguson et al., 2003; Francis et al., 2005; Francis and Yu, 2009; Reichelt and Wang, 2010; Choi, et al., 2010) demonstrates that auditors with industry expertise, stemming from their specialized investments in specific industries, specific scale groups, or companies with similar risk levels, as well as their well-established reputation in long-term professional practice, tend to have higher audit quality. From the perspective of audit client demand, appointing high-quality auditors is seen as a signal to enhance the quality of financial reporting, thereby reducing agency costs for client companies and increasing company value. Liu and Simunic (2005) argue that auditors, due to their efficient audits for clients, reap substantial rewards, winning more potential clients and receiving audit fee premiums. Meanwhile, auditors with industry expertise, trusted by most clients

within the industry due to their outstanding industry experience and good audit results, also face greater reputational costs if they fail in their audits.
Therefore, regardless of whether the auditors are party members or not, industry-specialist auditors driven by economic interests have a stronger motivation to maintain their good audit reputation. In comparison, for non-industry-specialist auditors, internal party-building activities and the evaluation and assessment of party members within the firm can impose significant constraints on party-member auditors in terms of both ideology and actions. Thus, we propose the following hypothesis:

H_3: Compared to industry-specialist auditors, the party membership of non-industry-specialist auditors has a more significant inhibitory effect on financial statement restatements.

3. Research Design

3.1 Sample and data

The research data in this study consists of annual data from A-share listed companies from 2005 to 2018. The auditor's party membership status is derived from the 'Individual Information Form of Chinese Certified Public Accountants' in the China Stock Market & Accounting Research Database (CSMAR), while financial restatement data is manually extracted from the restatement information in the CSMAR, excluding restatement data generated by policy changes. Other variables also originate from the CSMAR, with the auditor's individual characteristics data coming from the audit database and financial characteristics data of listed companies coming from annual reports, which are calculated accordingly. The initial dataset comprised 22,335 entries, after removing 4,500 entries with missing values and 32 entries of financial sector listed companies, resulting in 16,628 valid entries. All continuous variables underwent a 1% winsorization process.

3.2 Variables

Our dependent variable is financial restatements (RESTATE). Financial restatement data is sourced from the CSMAR Audit Database. If company i in year t issues a financial correction or supplementary explanation due to misreporting or omissions, the value is recorded as 1; otherwise, it's 0. In robustness tests, we use another dependent variable, earnings management (DA). Higher levels of earnings management often imply lower quality of accounting information and, consequently, lower audit quality. We employ the modified Jones model to calculate the absolute value of non-discretionary accruals as a measure of earnings management. Additionally, to differentiate between upward and downward earnings management, we introduce variables for positive earnings management (posDA) and negative earnings management (negDA). The absolute value of discretionary accruals is DA; if only positive values are retained and negative values are excluded, it's posDA; if only negative values are retained and positive values are excluded, it's negDA. When calculating negDA, we multiply negative non-discretionary accruals by "-1" to overcome the issue of inconsistent expected signs caused by the direction of negative earnings management. Our explanatory variable is auditor party membership (PARTY). Information on auditor party membership comes from the individual situation table of Chinese certified public accountants in the CSMAR Audit Database, which discloses whether auditors are members of the Communist Party of China (CPC). Since the audit of annual reports is generally conducted by two registered accountants if at least one of the two auditors is a CPC member, PARTY is recorded as 1; otherwise, it's 0.

3.3 Research Models

In order to test the three hypotheses, this article corresponds to the following three models:

$$RESTATE_{i,t} = \alpha_0 + \alpha_1 PARTY_{i,t} + \sum CONTROLS_{i,t} + \sum IND + \sum YEAR + \varepsilon_{i,t} \quad (1)$$

$$\begin{aligned} RESTATE_{i,t} = {} & \alpha_0 + \alpha_1 PARTY_{i,t} + \alpha_2 BIG4_{i,t} + \alpha_3 PARTY_{i,t} * BIG4_{i,t} \\ & + \sum CONTROLS_{i,t} + \sum IND + \sum YEAR + \varepsilon_{i,t} \end{aligned} \quad (2)$$

$$\begin{aligned} RESTATE_{i,t} = {} & \alpha_0 + \alpha_1 PARTY_{i,t} + \alpha_2 \mathrm{EXP}_{i,t} + \alpha_3 PARTY_{i,t} * EXP_{i,t} \\ & + \sum CONTROLS_{i,t} + \sum IND + \sum YEAR + \varepsilon_{i,t} \end{aligned} \quad (3)$$

Model (1) examines the impact of auditor party membership on financial restatements. As the influence on audit quality involves factors from both the audit firms and the audited client, following studies by Yang and Yang (2006), Dai et al. (2011), and Wu et al. (2017) on financial restatements, this study selects control variables including firm characteristics and auditor and firm attribute variables. The former includes SIZE (firm size), LEV (financial leverage), GROWTH (business growth), ROA (return on assets), SOE (state ownership enterprise), while the latter includes FEMALE (female auditor), DEGREE (auditor education level), and BIG4. In addition, we also control for IND (industry) and YEAR (year) dummy variables. Models (2) and Models (3) respectively examine the moderating effects brought by the Big4 and auditor industry expertise. To test Hypotheses 2 and 3, we set up the moderating variables BIG4 and EXP (auditor industry expertise). Following the studies of Chi (2011) and Zerni (2012), auditor industry expertise is defined as 'the ratio of an auditor's total clienSSSt revenue in a given year and industry to the total client revenue of all auditors in that industry for the same year.' In Model 2 (Model 3), we keep the original control variables of Model (1) unchanged and add the moderating variables BIG4 (EXP), and the interaction term PARTY*BIG4 (PARTY*EXP). We expect the coefficient of the interaction term PARTY*BIG4*

*(PARTY*EXP) to be significantly positive. All variables and their definitions are listed in Table 1 of the article.

Table 1: The variable names and definitions

Variable	Definition
RESTATE	Financial restatement: If company i issues a financial restatement or supplementary disclosure due to misreporting or omission in year t (excluding accounting policy changes), the value is 1; otherwise, it is 0
PARTY	If either the lead auditor or the deputy auditor is a member of the Communist Party, the value is 1; otherwise, it is 0.
BIG4	If the firm is one of the Big4 international firms, the value is 1; otherwise, it is 0.
EXP	The auditor's client's revenue in a given industry and year, divided by the total revenue of all listed companies in that industry for that year.
FEMALE	If either the lead auditor or the deputy auditor is female, the value is 1; otherwise, it is 0.
DEGREE	If either the lead auditor or the deputy auditor is female, the value is 1; otherwise, it is 0.
SIZE	If either the lead auditor or the deputy auditor is female, the value is 1; otherwise, it is 0
LEV	The year-end total liabilities divided by the year-end total assets.
GROWTH	The revenue for year t minus the revenue for year t-1, then divided by the revenue for year t-1.
ROA	Year-end net profit margin
SOE	If the company is a state-owned enterprise, the value is 1; otherwise, it is 0.

4. Empirical Results

4.1 Descriptive Statistics

Panel A of Table 2 presents descriptive statistics for the full sample. In Panel A, the mean value of PARTY is 0.403, indicating that in the annual audits of listed companies, 40% of the company-year samples involve at least one auditor who is a Communist Party member. The mean value of RESTATE is 0.24, indicating that 24% of listed companies have financial restatements. Additionally, 4% of the sample companies are audited by international Big4 firms, and 51% of the samples have at least one female auditor involved. The average educational level of auditors is approximately equivalent to a bachelor's degree. The sample companies have an average debt-to-asset ratio of 37%, an average annual return on assets of 3.3%, and 40% of the sample companies are state-owned enterprises (SOEs).

Panel B of Table 2 compares the samples of audits conducted by party-member auditors and non-party-member auditors. From Panel B, we see that the probability of financial restatements for reports audited by non-party-member auditors is 25%, which is significantly higher than the 23% probability for those audited by party-member auditors. This difference is significant at the 1% level, both in terms of mean difference tests and median difference tests.

Table 2: Descriptive statistics of the sample

Panel A. the descriptive statistics for the entire sample								
Variables	**N**	**mean**	**max**	**P25**	**P50**	**P75**	**min**	**sd**
RESTATE	16628	0.239	1	0	0	0	0	0.427
PARTY	16628	0.403	1	0	0	1	0	0.491
EXP	16628	0.0197	2	0.0009	0.00340	0.0113	-0.0748	0.0726
BIG4	16628	0.0399	1	0	0	0	0	0.196
FEMALE	16628	0.510	1	0	1	1	0	0.500
DEGREE	16628	2.037	4	1.500	2	2	1	0.628
SIZE	16628	21.74	25.21	20.93	21.63	22.39	19.25	1.151
LEV	16628	0.371	0.989	0.197	0.352	0.517	0.0107	0.217
GROWTH	16628	0.191	7.966	-0.0979	0.0605	0.228	-0.956	0.993
ROA	16628	0.0327	0.231	0.00780	0.0298	0.0606	-0.284	0.0659
SOE	16628	0.404	1	0	0	1	0	0.491

Panel B. the difference in mean and median between party-member auditors and non-party-member auditors						
Variables	non-party member mean	party member mean	T value (non-party member-party member)	non-party member P50	party member P50	Z value (non-party member-party member)
RESTATE	0.252	0.233	2.7447***	0	0	2.744***
EXP	0.0716	0.0742	-2.25**	0.0499	0.0537	-3.11**
BIG4	0.0390	0.0442	-1.65*	0	0	-1.653*
FEMALE	0.501	0.526	-3.144***	1	1	-3.144***
DEGREE	2.005	2.068	-6.67***	2	2	-11.96***
SIZE	21.76	21.76	0.24	21.65	21.63	0.39
LEV	0.371	0.362	2.49**	0.353	0.340	2.30**
GROWTH	0.191	0.197	-0.39	0.0586	0.0628	-1.75*
ROA	0.0341	0.0369	-2.85***	0.0301	0.0309	-1.54*
SOE	0.406	0.395	1.35	0	0	1.35

4.2 Multivariate Regression Analysis

Table 3 presents the results of the logit regression, with three columns corresponding to Models (1), (2), and (3), respectively. The first row reports the impact of auditor party membership on financial restatements. PARTY is significantly negatively correlated with RESTATE, indicating that auditors with party membership help reduce financial restatements in listed companies, consistent with the expected results of Hypothesis 1.

The second row reports the moderating effect of the reputation of the Big4 firms on the relationship between 'Party Member Auditor - Financial Restatements.' The coefficient of the interaction term PARTY*BIG4 is significant and positive, indicating that compared to non-Big4, the inhibitory effect of Party Member Auditors on financial restatements in listed companies is weakened in Big4. Within the Big4, since all auditors tend to uphold the audit reputation of the Big4, the impact of Party Member Auditor status on improving audit quality is less evident. In non-Big4, although there may not be the robust reputation mechanism of the Big4, internal party building efforts within the firms can serve as an informal alternative mechanism that positively influences audit quality. This alternative mechanism imposes constraints, at least on some auditors (Party Member Auditors), through practices such as party organizational education and party member evaluations, ultimately improving audit quality.

Table 3: Multivariate Regression Result

sVariables	Expected sign	Model(1)	Model(2)	Model(3)
		RESTATE	RESTATE	RESTATE
PARTY	**H1 (－)**	**-0.0881****	-0.0996***	-0.0944**
		(-2.3025)	(-2.5565)	(-1.8538)
BIG4		-0.3840***	-0.5326***	
		(-3.5086)	(-3.6341)	
PARTY×BIG4	**H2 (+)**		**0.335****	
			(1.5980)	
EXP				-1.5039**
				(-2.2948)
PARTY×EXP	**H3 (+)**			**1.083***
				(1.2812)
FEMALE		-0.00780	-0.00790	0.0454
		(-0.2098)	(-0.2115)	(0.9462)
DEGREE		0.0381	0.0389	0.0423
		(1.2765)	(1.3023)	(1.1068)
SIZE		0.0117	0.0120	-0.0487*
		(0.5915)	(0.6079)	(-1.9033)
LEV		-0.00810	-0.00630	0.0121
		(-0.0810)	(-0.0626)	(0.0944)
GROWTH		0.0218	0.0219	0.0481**
		(1.1519)	(1.1562)	(1.9976)
ROA		-2.7295***	-2.7284***	-1.8730***
		(-8.8756)	(-8.8717)	(-4.5035)
SOE		-0.2879***	-0.2903***	-0.2185***
		(-6.6431)	(-6.6919)	(-3.9716)
Intercept		-15.38	-15.39	0.215
		(-0.0217)	(-0.0217)	(0.3787)
IND/YEAR		YES	YES	YES
Observations		17546	17546	11642
LR Chi^2		2126	2129	988.9
Pseudo R^2		0.109	0.109	0.0846

The third row reports the moderating effect of auditor industry expertise on the relationship between 'Party Member Auditor - Financial Restatements.' The coefficient of the interaction term PARTY*EXP is significantly positive, indicating that compared to auditors without industry expertise, Party Member Auditors with industry expertise have a less pronounced inhibitory effect on financial restatements. Auditors with industry expertise have accumulated extensive experience in the industry, invested significant resources, conducted in-depth research on industry characteristics, and have earned a good reputation in the field of industry auditing. These auditors excel in both professional competence and reputation maintenance. Regardless of party membership, these auditors can achieve good audit results. Although the party building activities of the firm may not affect all auditors in the firm, they can enhance the abilities and ethical standards of some auditors, particularly Party Member Auditors. In terms of capability, the selection and absorption of Party Members themselves tend to favor those with better abilities or performance. The party organization activities of the firm are often integrated with business operations to enhance the business qualities of Party Members. In terms of ethics, party organization activities emphasize the ideological construction of Party Members. Practicing integrity is a focal point of the firm's party organization learning and is the embodiment of the party's ideology in practical actions. Therefore, within firms without industry expertise, there is a greater likelihood for differences in audit quality between Party Member Auditors and non-Party Member Auditors.

4.3 Propensity Score Matching Method

Our study above did not exclude the potential sample selection issues that may arise from auditor party membership. Many auditor party members joined the party during their university years, and academic performance and capability were important criteria for party membership selection. Students with relatively better academic performance are more likely to join international Big4 rather than domestic ones. Comparatively, the audit clients of international Big4 are generally larger in scale and have better performance. Therefore, auditor party members may be more likely to work for international Big4, leading to a higher probability of auditing clients with larger scale and better performance. Additionally, guided by party-building efforts, firms may require auditor party members to take on challenging assignments. Hence, auditor party members are more likely to encounter audit clients with higher audit risks, greater technical difficulties, and more challenging audit environments. In either case, the higher audit quality presented in our results may not necessarily be attributed to the ideological and moral education of firm party building or organizational constraints, but rather to the different client selection outcomes between auditor party members and non-party members.

To address endogeneity issues arising from sample selection, this study employs Propensity Score Matching (PSM) for further examination. The basic logic is that since the client types (firm size, firm performance, etc.) differ between the party-affiliated auditors and non-party-affiliated auditors, and different client types exhibit distinct audit quality, directly comparing the results between the two groups would lead to sample selection bias. Therefore, we identify subsets of samples from both party-affiliated and non-party-affiliated auditors where client types are very similar, and then proceed with the comparison. Specifically, in the first step, we select firm size (SIZE), leverage (LEV), growth rate (GROWTH), firm performance (ROA), whether audited by the BIG4, and whether a state-owned enterprise (SOE) as influencing factors for sample selection, and conduct a Logit regression on party affiliation (PARTY) to obtain propensity scores. In the second step, we match samples based on propensity scores using nearest neighbor matching within party-affiliated and non-party-affiliated auditor groups, and then regress the matched samples on the three hypothesis models. Table 4 presents the results of using the propensity score matching method, indicating that our conclusions remain robust after employing the PSM approach.

Table 4: The results of Propensity Score Matching (PSM)

Variables	Expected sign	Model(1)	Model(2)	Model(3)
		RESTATE	RESTATE	RESTATE
PARTY	**H1 (−)**	**-0.1001*****	**-0.1108*****	**-0.1588*****
		(-2.2930)	**(-2.4940)**	**(-2.5057)**
BIG4		-0.4315***	-0.5800***	
		(-3.4779)	(-3.3626)	
PARTY×BIG4	**H2 (+)**		**0.305***	
			(1.2892)	
EXP				-0.7318*
				(-1.7059)
PARTY×EXP	**H3 (+)**			**0.799***
				(1.3003)
Intercept		-3.885***	-3.8863***	-3.429***
		(-5.5088)	(-5.5110)	(-4.9491)
Controls		YES	YES	YES
IND/YEAR		YES	YES	YES
Observations		12,932	12,932	12,932
LR Chi^2		1,600	1,600	1,600
Pseudo R^2		0.109	0.109	0.108

5. Conclusion

We echo the research by Dai et al. (2017) on the influence of communist culture in the audit field and adopt the research perspective of auditor party membership to empirically examine the impact of firm party culture on audit quality. After using financial restatements as a proxy of audit quality, we find that auditors with party membership exhibit higher audit quality. In robustness tests, using non-discretionary accruals as a proxy for audit quality yielded consistent results. Furthermore, we find that auditors from the Big4 and those with industry expertise, due to their well-established reputation constraint mechanisms, may not show as significant improvement in audit quality from the influence of party culture. These combined findings suggest that firm party culture, as an informal institution, can compensate for deficiencies in formal institutions, particularly in areas where audit reputation constraint mechanisms are relatively weak, thereby playing an important role in enhancing audit quality.

Due to the possibility of party member auditors being selected by specific types of client companies, resulting in sample self-selection issues, we adopt the PSM method. After conducting a series of robust endogeneity tests, our results still hold. Differentiating itself from previous literature on the influence of communist culture in the economic domain, this paper's research perspective focuses on intermediary institutions in the capital market rather than on individual enterprises. Many previous studies have concentrated on intra-enterprise party organizations or the party membership of corporate executives, whereas our study is the first to observe the economic consequences of communist culture on corporate activities from the perspective of audit firms.

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