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Article

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Controller changes and auditor changes

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ABSTRACT

Using listed companies in China's A-share market from 1997 to 2009, this paper investigates the relationship between controller changes (including changes in controlling shareholders, directors and CEOs) and auditor changes. The empirical evidence indicates that controller changes are positively related to auditor changes and that auditor changes are more likely if there are extensive controller changes. For companies in which both the controlling shareholder and the auditor change, if the successor controlling shareholder is controlled by an other-province government, the auditor is more likely to be replaced and the successor auditor is more likely to be a smaller auditor from the same province as the new controlling shareholder.

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1. Introduction

Auditor changes (or auditor switches)¹ and opinion shopping have been the subject of considerable concern from investors, regulators and researchers. The extant research has identified several reasons for companies to change auditors, including the desire to decrease audit fees, improve the credibility of annual reports, improve audit quality, lower agency costs, obtain a more favorable audit opinion, etc. (Firth, 1999). Of these, opinion shopping, whereby management replaces the incumbent auditor with one who will accept more aggressive

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¹ Generally, auditor changes involve the replacement, through dismissal or resignation, of the accounting firm (not the CPA) that audits the financial statements of a company. We are not concerned with involuntary auditor changes, such as changes caused by accounting firm dissolution.



Table 1
The probability of controlling shareholder change, chairman change and CEO change.

	Controlling shareholder change (%)	Chairman change (%)	CEO change (%)	Any change (%)
Sample with auditor changes ($n = 1169$)	20.7	32.5	36.5	52.3
Sample without auditor changes ($n = 13,238$)	5.9	18.6	23.4	34.6
Difference	14.8***	13.9***	13.1***	17.7***

*** Indicates significance at the 1% level.

Table 2
Average ROA and the probabilities of receiving a qualified opinion, controller change and auditor change.

Average ROA	≤ -0.15	$(-0.15, -0.05]$	$(-0.05, 0.05]$	> 0.05	All
The probability of receiving a qualified opinion in the previous year (%)	60.5	30.1	16.5	5.5	11.3
The probability of controlling shareholder change in this year (%)	17.4	14.2	8.9	5.5	7.1
The probability of main business change in this year (%)	3.9	3.1	1.8	1.1	1.5
The probability of chairman change in this year (%)	40.7	32.5	25.1	16.3	19.7
The probability of CEO change in this year (%)	44.3	36.6	28.8	21.5	24.6
The probability of auditor change in this year (%)	20.1	11.9	9.7	6.7	8.1
Sample size	772	741	2069	10,703	14,285

accounting numbers, has received the most attention. However, most of the relevant research has found that management attempts to engage in opinion shopping are unsuccessful. In this study's sample, companies that change (do not change) their auditors after receiving a qualified opinion have a 64.1% (64.0%) probability of receiving a qualified opinion.

If a company cannot obtain a more favorable opinion, why does it change its auditor after receiving a qualified opinion? Table 2 shows that companies receiving qualified opinions usually have poor performance and are more likely to experience a controlling shareholder change, chairman of the board change and CEO change. It is possible that the companies change their auditor either because the controller changes or because the firm is performing poorly. In Beattie and Fearnley's (1995) survey, 14% of the respondents cite "merger/takeover with/by another company" as the reason for a change in auditor and they also find that a change (or consideration of a change) of auditor is associated with changes in top management. Anderson et al. (1993) identify corporate takeovers as events that generate auditor choice decisions, the acquiring company (the acquirer) has to choose whether to retain the new subsidiary's (the acquiree's) incumbent auditor or switch to its own auditor. Firth (1999) finds that of the 175 takeovers which took place in the UK from 1976 to 1992 (in which all of the acquirers and acquirees were publicly listed companies), 141 switched the auditor of the subsidiary to that of the acquirer and 34 retained the incumbent auditor of the subsidiary for at least 2 years following the takeover. These auditor changes were based on the perceived cost savings and efficiency benefits derived from the use of one auditing firm rather than two.

The transfer of controlling rights in China's capital market offers a unique opportunity to investigate the relationship between controller changes and auditor changes. First, most of the acquirers are non-listed companies. Second, most of the acquirers and acquirees are not in the same or a similar industry. Third, most of the sellers of controlling shares are state controlled, whereas the acquirers are mixed – some are controlled by individuals, some by the central government, some by local governments and some by other province governments (provinces other than that of the companies themselves). It is the identity (individual, central government, local government, other-province government) of the acquirer, not the similarity of activities (main business) of the acquirer and the acquiree (as investigated by Firth, 1999), that determines whether or not the acquiree's auditor is changed.

Using 14,407 observations of listed companies on China's capital market from 1997 to 2009, this paper finds that auditor changes are positively related to controller changes (including controlling shareholder changes, chairman of the board changes and CEO changes). This positive relationship is more pronounced

when there are more extensive controller changes, such as when both the controlling shareholder and the chairman (or CEO) change or if the predecessor and the successor controlling shareholders are not controlled by the same government or if the successor chairman or CEO is from outside the company. I also find that for companies in which the controlling shareholder and auditor change, if the successor controlling shareholder is controlled by an other-province government, the auditor is more likely to be replaced and the successor auditor is more likely to be a smaller auditor from the same province as the new controlling shareholder.

This paper makes the following contributions: (1) the findings suggest that auditor changes are influenced more by controller changes (especially controlling shareholder change) than by qualified opinions; (2) it subdivides the types of controlling shareholder changes, the identities of the successor controlling shareholders and the origins of the successor chairman and CEO; and (3) it investigates how the successor controlling shareholder chooses an auditor for the acquiree.

Zhang et al. (2010) investigate the effects of controlling shareholder changes and management changes on auditor changes and find that management changes, rather than controlling shareholder changes, result in auditor changes. Their findings differ from those reported here, which show that controlling shareholder changes result in auditor changes. However, I question the data used by Zhang et al. (2010). In their 7997 sample observations in the 2001–2007 period, the percentage of auditor change is 25.45%, which seems beyond belief. For example, Wen and Ding (2007) report 8.2% auditor change in their 4444 sample observations in the 2001–2004 period and Wu and Zhu (2010) report 12% auditor change in their 10,510 sample observations in the 2000–2008 period and this 12% already includes mandatory auditor changes. In the sample used in this paper, 8.1% of companies changed their auditor, and the figure is 8.7% for the 2001–2007 period. This is close to that of Wen and Ding (2007) and Wu and Zhu (2010). I conjecture that Zhang et al.'s (2010) auditor change sample firms include mandatory auditor changes, auditor mergers and auditor name changes.

2. Literature review and theoretical analysis

2.1. Auditor changes and opinion shopping

A large volume of literature has reported evidence indicating that companies are more likely to change their auditors after receiving qualified opinions (Chow and Rice, 1982; Krishnan and Stephen, 1995; Li et al., 2001; Geng and Yang, 2001; Li and Wu, 2002a). Krishnan (1994) finds that auditor changes are triggered by auditors' use of conservative judgments for some clients. However, most of the related literature finds that companies that change auditors do not seem to receive "improved" opinions in the year following the change (Chow and Rice, 1982; Krishnan, 1994), suggesting that opinion shopping is generally futile. Chen and Zhang (2004), Wu and Tan (2005) and Wang (2006) find similar evidence in China. Krishnan et al. (1996) even find that auditors are more likely to issue qualified opinions to switchers. One exception is Lennox (2000), who finds that companies successfully engaged in opinion shopping in the UK.

China's reinforced regulations may prevent companies from successfully engaging in opinion shopping. Since 2002, the Chinese Institute of Certified Public Accountants (CICPAs) has introduced several measures relating to auditor changes, aimed at ensuring the independence of the successor auditor and preventing auditors from issuing improper opinions.² The CICPA issued an "Urgent notice on further carrying out the auditing of listed companies' annual reports of 2001," requiring auditors who were dismissed in the process of auditing listed companies' 2001 annual reports to report the events to the CICPA in writing by the end of April. This notice illustrates the CICPA's concern over auditor changes, which may be triggered by the intention to opinion shop (Li and Wu, 2002b). On June 25th, 2002, the CICPA issued "The guiding opinions of CPA professional ethics," which clearly states that before accepting auditing work, the successor auditor should inquire with the predecessor auditor the reason for the auditor change and pay attention to the probable divergence between the auditor and management. One may conjecture that a rational and smart management would not change auditor merely for receiving a qualified opinion (Li and Wu, 2004).

² One example is "ZonHeng International (600862)." See Li and Wu (2002b).

2.2. Controller changes and auditor changes

In China, few qualified opinions are actually triggered by disagreements between the auditor and the firm's management, as most qualified opinions are either going-concern opinions or merely emphasize some important or abnormal events. Most of the companies that receive qualified opinions are falling into financial distress, have made losses in the past few years and have extremely high leverage. Some of them have had considerable sums of money misappropriated by their controlling shareholders. These companies have a high probability of bankruptcy and the probability of auditor resignation is relatively high. [Schwartz and Menon \(1985\)](#), [Geng and Yang \(2001\)](#) and [Li and Wu \(2002a\)](#) find that auditors are more likely to resign if clients are in financial distress. However, companies that are in financial distress are also more likely to go through controlling shareholder changes and management changes. [Table 2](#) shows that poor performing companies are more likely to receive qualified opinions and also experience controller changes (including controlling shareholder changes, chairman changes and CEO changes) and auditor changes. Thus, the reason for auditor changes may not be qualified opinions, but poor performance or controller changes.

In China, the majority of listed companies have controlling shareholders who hold large proportions of outstanding shares and enjoy substantial control rights, including the right to choose the auditor. [Liu et al. \(2010\)](#) points out that since the establishment of the stock markets in the early 1990s, the right to choose the auditor has been controlled by controlling shareholders and management. [Zhang and Zhang \(2007\)](#) note that in the currently implemented auditor–client relationship, it is the agent of the company who chooses the auditor. Therefore, a change in the controller (the controlling shareholder, the chairman of the board or the CEO) may result in a change of auditor.

[Beattie and Fearnley \(1995\)](#), [Anderson et al. \(1993\)](#) and [Firth \(1999\)](#) note that acquiring companies change the acquiree's incumbent auditor. [Anderson et al. \(1993\)](#) and [Firth \(1999\)](#) focus on the similarity of the acquirer's and the acquiree's main business activities. The replacement of the acquiree's auditor by the acquirer's auditor is based on the perceived cost savings and efficiency benefits of using one auditing firm rather than two. These cost savings and efficiency benefits are more significant if the acquirer and the acquiree are in the same or a similar industry.

Transferring controlling rights in China's capital market is a quite different process from that in developed capital markets. First, most acquirers are non-listed companies. Second, most acquirers and acquirees are not in the same or a similar industry. Third, most sellers of controlling shares are stated-controlled and the acquirers are mixed – some are controlled by individuals, some by the central government, some by local governments and some by other-province governments (provinces other than that of the companies themselves). It is the identity (individual, central government, local government, other-province government) of the acquirer, not the similarity of activities (main business) of the acquirer and the acquiree (as investigated by [Firth, 1999](#)), that determines whether or not the acquiree's auditor is changed.

2.3. Choice of auditors

In markets in which companies require high quality audit services, companies select appropriate auditors to mitigate specific conditions, such as information asymmetry and agency problems. [Pittman and Fortin \(2004\)](#) find that retaining a Big Six auditor, which can reduce debt-monitoring costs by enhancing the credibility of financial statements, enables young firms to lower their borrowing costs. Choosing a Big Six auditor also affects firms' interest rates less over time and particularly benefits firms with short private histories that initially experience worse information problems. Using a broad sample from eight East Asian economies, [Fan and Wong \(2005\)](#) document that firms with agency problems embedded in their ownership structures are more likely to employ Big Five auditors. [Lennox \(2005\)](#) finds that the association between management ownership and audit firm size is significantly negative within low and high regions of management ownership. Using a unique dataset of 176 privatizations from 32 countries, [Guedhami et al. \(2009\)](#) find that privatized firms worldwide are less (more) likely to appoint a Big Four auditor with the extent of state (foreign) ownership. The basis of these studies is that it is the company (not the controller) that chooses the auditor that fits the company best.

In China's capital market, there is no evidence that companies need high quality audit services. Liu et al. (2002) points out that in the process of meeting the requirements of the regulatory authority in China, auditing is a by-product of imitating international routines and is not necessarily needed by the capital markets. Audit quality is not a variable in the cost-benefit functions of listed companies. Companies just need a clean opinion and it does not matter which auditor conducts the audit. In this case, the controller may choose the auditor from his own perspective.

Wang et al. (2008) find that compared with non-state-owned firms, Chinese state-owned enterprises controlled by province, city and county governments (local SOEs) are more likely to hire small auditors from the same region (small local auditors).

3. Empirical analysis

3.1. Sample

The sample includes listed companies in China's A-share market in the 1997–2009 period. This long period provides a large sample size to subdivide the sample by controlling shareholder change, the identities of successor controlling shareholders and the origins of the successor chairman and CEO. The sample starts from 1997 because controlling shareholder changes were rare before then. Every company in every year is a sample company, but I exclude the year when the company was first listed on the stock market because it was not listed in the previous year. I exclude companies whose predecessor auditors were disbanded or were banned by the regulatory authority from auditing listed companies. If two accounting firms merged, and these two accounting firms' clients employed the newly established accounting firm, I treat it as no auditor change. There are 14,407 sample observations with an auditor change rate of 8.1%.

Of these 14,407 sample observations, 1022 (7.1%) changed their controlling shareholder, 2839 (19.7%) changed their chairman of the board and 3526 (24.5%) changed their CEO. Controlling shareholder change refers to a change in the biggest shareholder³ or the ultimate controller of the company. All related parties are regarded as one shareholder. If shares are transferred from a father (mother) to a son (daughter) or between shareholders controlled by the same individual, it is regarded as no transfer. Instances where the shareholder becomes the biggest shareholder by buying shares in the secondary market, there are generally several big shareholders or the biggest shareholder changes frequently and does not completely control the company are also regarded as no transfer. Management buy-outs (MBOs) are regarded as no transfer because the company was controlled by the management both before and after the MBO. There are eight methods for changing the controlling shareholder: (1) the predecessor and the successor biggest shareholders agree on the sale of the shares. If the government controls the shares, the change date is the day on which the agreed sale is eventually authorized by the government. If the government does not control the shares, the change date is the day on which the agreement is signed. (2) The biggest shareholder itself is sold out. The change date is the same as for method (1). (3) The listed company offers shares to the buyer, who then becomes the biggest shareholder. The change date is the day on which the China Securities Regulatory Commission (CSRC) approves the share offer plan. (4) Joint venture – the predecessor biggest shareholder contributes the shares to a corporation, which is then not controlled by the biggest shareholder itself, or the acquirer invests in the predecessor biggest shareholder and then controls it. The change date is the day on which the investment agreement is signed. (5) The change date is the jurisdiction day if the shares are transferred by jurisdiction. (6) Shares are not sold between the predecessor and successor biggest shareholders. The change date is the same as for method (1). (7) Shares are transferred within the same state-controlled group. The change date is the day on which the agreement is signed. (8) Free transfer between two state-controlled entities. The change date is the day on which the free transfer is eventually authorized by the government. In Table 8, I exclude the last two methods of controlling shareholder change as they are not commonly used and I obtain similar results (see Table 8).

³ If the annual reports state that the biggest shareholder does not control the company, I do not treat it as the controlling shareholder. For example, The South Securities Co. was once the biggest shareholder of Harbin Pharmaceutical Group (600644), but the company's annual report identifies the controlling shareholder as Harbin Pharmaceutical Co., not South Securities Co.

3.2. Descriptive statistics

Table 1 shows that for the sample with auditor changes, the probabilities of a controlling shareholder change, chairman change and CEO change are 20.7%, 32.5% and 36.5% respectively, which are significantly higher than for the sample without auditor changes. For the sample with auditor changes, the probability of one of the three types of controller change (controlling shareholder change, chairman change and CEO change) is 52.3%, which is higher than the sample without auditor changes. The difference of 17.7% indicates that controller changes account for 17.7% of auditor changes.

In Table 2, the sample observations are divided into four sub-samples according to average ROA (average return on assets in the sample year and 1 year before) while excluding 122 sample companies in the finance industry. Table 2 shows that lower ROA is associated with higher probabilities of receiving a qualified opinion, controlling shareholder change, main business change, chairman change, CEO change and auditor change. Poor performing companies are more likely to manipulate earnings and have higher audit risk, thus the auditors are more likely to resign. Shu (2000) finds that auditors are more likely to resign from high-risk clients. Companies that receive a qualified opinion in the previous year are more likely to disagree with auditors, thus the auditors are more likely to resign. A change in the main business means that the new controlling shareholder injects business into the company that results in the company's main business changing. In the case of a main business change, the cost of an auditor change is not high because the predecessor auditor is not familiar with the new business.

3.3. Controller changes and auditor changes

Table 3 shows the probability of auditor change for the sample with (without) a controlling shareholder change, chairman change and CEO change in each year. It shows that the probability of auditor change is 16.8% higher for the sample with a controlling shareholder change than for the sample without. The difference between the samples with and without a chairman change (or CEO change) is also significant. The difference between the samples with and without a controlling shareholder change is much larger than that between the samples with and without a chairman change (or CEO change), which indicates that compared to a chairman change and CEO change, a controlling shareholder change has a stronger effect on auditor change.

In Table 4, the sample is divided into eight sub-samples according to whether or not the controlling shareholder, chairman and CEO change. It shows that the probability of auditor change increases with more controller changes (controlling shareholder, chairman and CEO). The difference between the two sub-samples in

Table 3
The probability of auditor change (%): subsample by year.

Year	97	98	99	00	01	02	03	04	05	06	07	08	09	All	Difference
Sample with controlling shareholder change	11.4	16.2	17.8	22.0	18.3	24.8	25.3	25.0	20.0	27.7	26.8	30.0	29.6	23.7	16.8***
Sample without controlling shareholder change	2.9	5.4	5.5	7.0	6.8	6.5	5.5	7.0	9.0	8.6	8.2	7.2	6.3	6.9	
Sample with chairman change	4.8	13.2	10.9	11.4	10.6	14.4	11.3	13.2	14.8	15.9	15.3	14.6	16.5	13.4	6.6***
Sample without chairman change	3.3	4.5	5.1	7.5	6.9	6.3	5.7	6.7	8.2	9.0	8.3	7.2	5.8	6.8	
Sample with CEO change	4.7	9.1	9.5	12.6	9.4	13.5	11.0	12.3	15.7	11.2	15.1	9.6	15.8	12.1	5.3***
Sample without CEO change	3.2	5.5	5.3	6.4	7.2	6.2	5.5	6.5	7.6	10.0	7.8	8.1	5.3	6.8	
All	3.6	6.4	6.6	8.4	7.8	8.3	6.9	7.9	9.5	10.3	9.5	8.4	7.5	8.1	
Sample size	478	683	804	891	875	1090	1186	1256	1337	1316	1372	1525	1594	14,407	

*** Indicates significance at the 1% level.

Table 4
The probability of auditor change (%): subsample by controller change.

Controlling shareholder	No change	Change	No change	Change	No change	Change	No change	Change
Chairman	No change	No change	No change	No change	Change	Change	Change	Change
CEO	No change	No change	Change	Change	No change	No change	Change	Change
Sample size	9220	371	1860	117	1124	166	1181	368
The probability of auditor change (%)	6.1	16.2	7.8	21.4	8.0	20.5	11.3	33.4
Difference	10.1***		13.6***		12.5***		22.1***	

*** Indicates significance at the 1% level.

each of the four groups is whether or not the controlling shareholder changes. It shows that in each of these four groups, the probability of auditor change for companies with a controlling shareholder change is much higher than that for companies without a controlling shareholder change. If we compare the probabilities of auditor change between sub-samples with and without a chairman change (or CEO change), we also find a difference, but the difference is not as large as that between sub-samples with and without a controlling shareholder change. This means that compared to a chairman change and a CEO change, a controlling shareholder change has a greater effect on auditor change.

3.4. The method of controlling shareholder change and the probability of auditor change

In Table 5, the sample is divided into eight sub-samples according to the method of controlling shareholder change. I define the first five methods as TYPE I and the last three methods as TYPE II. The controlling shareholder change is more extensive in TYPE I than in TYPE II. The probabilities of auditor change are different between TYPE I and TYPE II, indicating that the auditor is more likely to be replaced if there are more extensive controlling shareholder changes.

Table 5
The method of controlling shareholder change and the probability of auditor change.

The method of controlling shareholder change	<i>N</i>	Probability of auditor change (%)
Agreed sale of shares between the predecessor and successor biggest shareholders	476	26.5
The biggest shareholder is sold out	74	23.0
The listed company offers shares to the buyer	26	57.7
Joint venture	26	30.8
Shares are transferred by jurisdiction	99	28.3
Shares are sold not between the predecessor and successor biggest shareholders	40	15.0
Shares are transferred within the same state-controlled group	76	18.4
Free transfer between two state-controlled entities	205	13.7
TYPE I	701	27.7
TYPE II	321	15.0
Difference		12.7***
No controlling shareholder change	13,385	6.9

*** Indicates significance at 1%.

I also find that for companies with a main business change following controlling shareholder change, the probability of auditor change is 41.7%. For companies with a controlling shareholder change but no main business change, the probability of auditor change is 20.5%. The difference is highly significant (the p -value is 0.000).

3.5. The origins of the successor chairman and CEO and the probability of auditor change

The origin of the successor chairman and CEO implies the extent of controller change. For example, if the successor chairman is promoted from inside (usually from the position of vice-chairman or CEO), the controller change is not as severe as when the chairman is from outside.

Panel A of Table 6 shows that the probabilities of the successor chairman and CEO coming from outside are highest for a TYPE I controlling shareholder change and lowest for companies without a controlling shareholder change. Panel B of Table 6 shows that the auditor is more likely to be replaced if the successor chairman (or CEO) comes from outside.

3.6. Auditor change regressions

A logistic regression model is used to test the effects of a controlling shareholder change, main business change, chairman change and CEO change on auditor change. The dependent variable $AuditorChange = 1$ if the auditor changes, and 0 otherwise. The explanatory variables are defined as follows:

- $Holderchange = 1$ if the controlling shareholder changes, otherwise 0.
- $Businesschange = 1$ if the main business changes, otherwise 0.
- $Chairmanchange = 1$ if the chairman changes, otherwise 0.
- $CEOchange = 1$ if the CEO changes, otherwise 0.
- $Nonclean = 1$ if the company received a qualified opinion, otherwise 0.
- $ROA =$ average return on assets in the sample year and 1 year before; ROA is winsorized at 1% to mitigate the influence of outliers.

Table 6
The origins of the successor chairman and CEO and the probability of auditor change.

		TYPE I controlling shareholder change	TYPE II controlling shareholder change	No change in controlling shareholder
<i>Panel A: The probability of the successor chairman and CEO coming from outside</i>				
The probability of the successor chairman coming from outside (%)		83.8	64.2	45.5
The probability of the successor CEO coming from outside (%)		71.1	58.2	39.5
	All	TYPE I controlling shareholder change	TYPE II controlling shareholder change	No change in controlling shareholder
<i>Panel B: The probability of auditor change (%)</i>				
The successor chairman comes from outside	17.0	34.0	22.8	10.9
The successor chairman comes from inside	9.4	21.7	12.8	8.7
Difference	7.6***	12.3**	10.0	2.2*
The successor CEO comes from outside	15.1	34.9	24.6	10.1
The successor CEO comes from inside	9.8	29.5	12.2	8.6
Difference	5.3***	5.4	12.4	1.5

*** Indicate significance at 1% levels.

** Indicate significance at 5% levels.

* Indicate significance at the 10% levels.

- *Merged* = 1 if the predecessor auditor is an acquired audit firm whose audit revenue is less than one-third of the acquirer audit firm; otherwise 0.

Merged equals 1 in 209 of the sample companies. A small audit firm being acquired by a big audit firm may result in auditor changes. For example, in the year following Ernst & Young's acquisition of the audit firm DaHua, 30 of DaHua's 46 client companies went through auditor change and 11 companies changed auditors in the year of the merger (Chen et al., 2010; Wang and Chen, 2004).

Table 7 presents the regression results. The coefficients for *Holderchange*, *Businesschange*, *Chairmanchange*, *CEOchange*, *Nonclean* and *Merged* are all significantly positive, indicating that a controlling shareholder change, main business change, chairman change, CEO change, qualified opinion and auditor firm being acquired all contribute to auditor change. The coefficient for *Holderchange* is much larger than that for *Chairmanchange* and *CEOchange*, indicating that controlling shareholder change has a stronger effect on auditor change. The Pseudo R^2 in regressions (1)–(3) show that controller changes have strong explanatory power for auditor change. I exclude one explanatory variable in each of the regressions from (4) to (10) and the Pseudo R^2 in regression (4) is the smallest, indicating that controlling shareholder change is the most powerful explanation for auditor change.

Table 8 presents robustness tests for the auditor change regressions. The first column, "Exclude sample," means that observations in which the controlling shareholder changes and shares are transferred within the same state-controlled group or there is a free transfer between two state-controlled entities are excluded. These two types of controlling shareholder change are not commonly referred to as controlling rights transfers. The regression results are similar to those in Table 7. I also divide the sample into three periods: 1997–2000, 2001–2006 and 2007–2009, because the institutional environment changed over these sample periods. In 2001, there was the YinGuangXia affair. In 2007, the new accounting standards and auditing standards began to be implemented. The regression results are similar to those in Table 7.

I do not control for auditor resignations, as companies usually do not report the reason for auditor changes. However, I can say that the probability of auditor resignation is slim for companies with positive ROA and companies that receive clean opinions, because these companies have relatively low audit risk. Therefore, I divide the sample into four sub-samples according to the variables *Nonclean* and *ROA*. For the sub-sample with *Nonclean* = 0 and *ROA* \geq 0, the regression results are similar to those in Table 7, indicating that the main findings in Table 7 are robust. For the sub-sample with *Nonclean* = 0 and *ROA* < 0, the

Table 7
Auditor change regressions.

<i>AuditorChange</i>	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
<i>Holderchange</i>		1.13*** (0.000)	0.99*** (0.000)		1.07*** (0.000)	1.06*** (0.000)	1.01*** (0.000)	1.04*** (0.000)	1.01*** (0.000)	1.01*** (0.000)
<i>Businesschange</i>		0.61*** (0.000)	0.51*** (0.004)	1.09*** (0.000)		0.53*** (0.003)	0.54*** (0.002)	0.64*** (0.000)	0.50*** (0.004)	0.47*** (0.004)
<i>Chairmanchange</i>		0.38*** (0.000)	0.29*** (0.000)	0.42*** (0.000)	0.30*** (0.000)		0.38*** (0.000)	0.32*** (0.000)	0.28*** (0.000)	0.31*** (0.000)
<i>CEOchange</i>		0.34*** (0.000)	0.27*** (0.000)	0.31*** (0.000)	0.28*** (0.000)	0.36*** (0.000)		0.28*** (0.000)	0.27*** (0.000)	0.30*** (0.000)
<i>Nonclean</i>	0.97*** (0.000)		0.77*** (0.000)	0.83*** (0.000)	0.80*** (0.000)	0.79*** (0.000)	0.78*** (0.000)		0.76*** (0.000)	0.96*** (0.000)
<i>Merged</i>	1.57*** (0.000)		1.55*** (0.000)	1.58*** (0.000)	1.55*** (0.000)	1.55*** (0.000)	1.55*** (0.000)	1.52*** (0.000)		1.57*** (0.000)
<i>ROA</i>	-1.15*** (0.000)		-0.90*** (0.000)	-0.97*** (0.000)	-0.87*** (0.000)	-0.95*** (0.000)	-0.94*** (0.000)	-1.60*** (0.000)	-0.90*** (0.000)	
<i>Cons.</i>	-3.21*** (0.000)	-3.64*** (0.000)	-3.51*** (0.000)	-3.41*** (0.000)	-3.54*** (0.000)	-3.47*** (0.000)	-3.45*** (0.000)	-3.35*** (0.000)	-3.51*** (0.000)	-3.69*** (0.000)
Year dummies	Control	Control	Control	Control	Control	Control	Control	Control	Control	Control
Pseudo R^2	0.0473	0.0474	0.0750	0.0628	0.0740	0.0733	0.0734	0.0659	0.0668	0.0733
<i>N</i>	14,285	14,285	14,285	14,285	14,285	14,285	14,285	14,285	14,285	14,285

*** Indicates significance at 1%. 122 companies in the finance industry are excluded.

Table 8
Robustness tests for auditor change regressions.

<i>AuditorChange</i>	Exclude sample	1997–2000	2001–2006	2007–2009	Nonclean = 0		Nonclean = 1	
					ROA \geq 0	ROA < 0	ROA \geq 0	ROA < 0
<i>Holderchange</i>	1.08*** (0.000)	0.92*** (0.000)	0.97*** (0.000)	1.11*** (0.000)	1.02*** (0.000)	0.98*** (0.000)	0.95*** (0.001)	1.01*** (0.000)
<i>Businesschange</i>	0.43** (0.018)	0.49 (0.267)	0.49* (0.063)	0.56** (0.050)	0.99*** (0.000)	0.83* (0.095)	0.14 (0.743)	-0.03 (0.939)
<i>Chairmanchange</i>	0.27*** (0.001)	0.24 (0.196)	0.26** (0.017)	0.38*** (0.007)	0.35*** (0.000)	0.38* (0.083)	0.09 (0.712)	0.02 (0.919)
<i>CEOchange</i>	0.27*** (0.000)	0.31* (0.075)	0.24** (0.020)	0.29** (0.034)	0.28*** (0.003)	0.53** (0.013)	0.17 (0.477)	0.12 (0.535)
<i>Nonclean</i>	0.79*** (0.000)	0.63*** (0.002)	0.88*** (0.000)	0.68*** (0.000)				
<i>Merged</i>	1.65*** (0.000)	1.73*** (0.000)	1.84*** (0.000)	1.21*** (0.000)	1.47*** (0.000)	1.89*** (0.000)	2.60** (0.023)	1.74*** (0.004)
<i>ROA</i>	-0.87*** (0.000)	-0.78 (0.154)	-0.84*** (0.001)	-1.02*** (0.001)	-0.75* (0.089)	-1.80** (0.011)	-1.01 (0.279)	-0.76** (0.049)
<i>Cons.</i>	-3.43*** (0.000)	-3.49*** (0.000)	-2.92*** (0.000)	-2.60*** (0.000)	-3.56*** (0.000)	-3.29*** (0.000)	-2.50*** (0.001)	-19.3*** (0.000)
Year dummy	Control	Control	Control	Control	Control	Control	Control	Control
Pseudo R ²	0.0755	0.0721	0.0777	0.0706	0.0431	0.0933	0.0690	0.0591
N	14,006	2850	7009	4426	11,348	1320	778	839

*** Indicate significance at 1% levels.

** Indicate significance at 5% levels.

* Indicate significance at 10% levels.

Table 9
Auditor change regressions according to the method of controller change.

<i>AuditorChange</i>	
<i>Holderchange1</i>	1.03*** (0.000)
<i>Holderchange2</i>	0.69*** (0.000)
<i>Businesschange</i>	0.41** (0.021)
<i>Chairmanchange1</i>	0.43*** (0.000)
<i>Chairmanchange2</i>	0.09 (0.426)
<i>CEOchange1</i>	0.31*** (0.001)
<i>CEOchange2</i>	0.23** (0.012)
<i>Nonclean</i>	0.76*** (0.000)
<i>Merged</i>	1.57*** (0.000)
<i>ROA</i>	-0.88*** (0.000)
<i>Cons.</i>	-3.50*** (0.000)
Year dummy	control
Pseudo R ²	0.0766
<i>N</i>	14,285

* Indicate significance at 10% levels.

*** Indicate significance at 1% levels.

** Indicate significance at 5% levels.

Table 10
The effects of the identity of the successor controlling shareholder on auditor change.

Identity of the successor controlling shareholder	<i>N</i>	The probability of auditor change (%)	<i>Scalechange</i>			
			<i>N</i>	1/4	Median	3/4
Local government	328	14.6	28	0.71	1.44	2.47
Other-province government	70	41.4	21	0.30	0.67	1.02
Local private	148	23.0	23	0.73	1.19	1.74
Other-province private	278	26.6	48	0.64	0.97	1.89
Central government and university	198	28.8	43	1.00	2.75	4.13

coefficients for *Businesschange* and *Chairmanchange* are positive, though only marginally significant. This may be due to the small sample size. For the sub-sample with *Nonclean* = 1, the coefficients for *Businesschange*, *Chairmanchange* and *CEOchange* are insignificant. Maybe there are more complicated reasons for these companies changing auditors. For all sub-samples, the coefficient for *Holderchange* is large and significantly positive and, once again, this means that compared to chairman and CEO changes, controlling shareholder changes have a stronger effect on auditor changes.

In Table 9, *Holderchange1* = 1 for companies with a TYPE I controlling shareholder change. *Holderchange2* = 1 for companies with a TYPE II controlling shareholder change. *Chairmanchange1* = 1 for companies with chairman change and the successor chairman comes from outside. *Chairmanchange2* = 1 for companies with chairman change and the successor chairman comes from inside. *CEOchange1* = 1 for companies with CEO change and the successor CEO comes from outside. *CEOchange2* = 1 for companies with CEO change and the successor CEO comes from inside.

The coefficients for *Holderchange1* and *Holderchange2* are significantly positive, and the coefficient for *Holderchange1* is larger than that for *Holderchange2*, indicating that compared to a TYPE II controlling shareholder change, a TYPE I controlling shareholder change has a stronger effect on auditor change. The coefficient for *Chairmanchange1* is significantly positive and the coefficient for *Chairmanchange2* is insignificant, indicating that a successor from outside affects auditor change, whereas a successor from inside does not. This may be because an inside successor would have held a previous top management position (usually vice-chairman or CEO) and thus would already have been acquainted with the incumbent auditor. The coefficients for *CEOchange1* and *CEOchange2* are significantly positive, indicating that CEO change affects auditor change, no matter where the successor comes from.

Table 11
Regression on the effects of the identity of the successor controlling shareholder on auditor change.

<i>Scalechange</i>	(1)	(2)
<i>Other-province-state</i>	−0.963* (0.073)	−1.058* (0.054)
<i>Central</i>	0.972** (0.018)	0.966** (0.024)
<i>Buyper</i>		−3.862 (0.475)
<i>Buyper</i> ²		7.087 (0.264)
<i>Sellerper</i>		1.756 (0.384)
<i>Leverchange</i>		−0.087 (0.615)
<i>Cons.</i>		2.048* (0.086)
Year dummy		Control
Adj. <i>R</i> ²	0.056	0.115
<i>N</i>	163	163

*** Indicate significance at 1% levels.

** Indicate significance at 5% levels.

* Indicate significance at 10% levels.

3.7. How does the successor controlling shareholder choose an auditor?

In Table 10, I divide the sample companies with controlling shareholder changes into five sub-samples according to the identities of the successor controlling shareholders. “Local” (“Other-province”) means that the ultimate controller is located in (out of) the province of the sample company, but isn’t the central government. Table 10 shows that other-province (local) governments are more (less) likely to change auditors. Of those companies with local governments as the successor controlling shareholder, 88% were already controlled by local governments before the controlling shareholder change. There are 39 companies with local governments as the successor controlling shareholder that were not previously controlled by local governments. The probability of auditor change of these 39 companies is 20.5%. If both the controlling shareholder and the auditor change, how does the successor controlling shareholder choose a new auditor? The variable *Scalechange* is the revenue of the successor auditor/revenue of the predecessor auditor. The sample period for “*Scalechange*” is 2002–2009 because revenue data is unavailable before 2002. Table 10 shows that controlling shareholders controlled by central governments and universities are more likely to choose larger auditors and controlling shareholders controlled by other-province governments are more likely to choose smaller auditors.

Table 11 is the regression of the effects of the identity of the successor controlling shareholder on auditor change. The dependent variable *Scalechange* is the revenue of the successor auditor/revenue of the predecessor auditor. The explanatory variables are as follows.

Other-province-state = 1 if the successor controlling shareholder is controlled by an other-province government, and 0 otherwise. *Central* = 1 if the successor controlling shareholder is controlled by the central government or a university, and 0 otherwise. *Buyper* is the percentage of the outstanding shares controlled by the controlling shareholder. *Sellerper* is the percentage of shares retained by the predecessor controlling shareholder. *Leverchange* is the ratio of the year-end leverage to the leverage of the previous year. *Scalechange* and *Leverchange* are winsorized at 2% to mitigate the influence of outliers. Table 11 shows that the coefficient for *Other-province-state* is significantly negative and the coefficient for *Central* is significantly positive, indicating that controlling shareholders controlled by central governments and universities are more likely to choose larger auditors, whereas those controlled by other-province governments are more likely to choose smaller auditors.

In Table 12, the sample includes those companies with auditor changes and controlling shareholder changes in which the predecessor and successor controlling shareholders are not from the same province, but excludes companies in which the predecessor auditor and the successor controlling shareholder are from the same province. It also excludes companies in which the successor controlling shareholder is an individual or not from mainland China. Table 12 shows that compared to companies acquired by other-province private acquirers, companies acquired by other-province government controlled acquirers are more likely to choose auditors located in the province of the acquirers. Taken together, Tables 10–12 show that if the successor controlling

Table 12

The probability of the successor auditor being from the same province as the successor controlling shareholder.

Identity of the successor controlling shareholder	<i>N</i>	The probability of the successor auditor being from the same province as the successor controlling shareholder (%)
Other-province government	31	45.2
Other-province private	64	25.0
Difference		20.2**

shareholder is controlled by an other-province government, the auditor is more likely to be replaced and the successor auditor is more likely to be a smaller auditor from the same province as the new controlling shareholder.

4. Conclusion

Auditor change and auditor choice have received considerable attention because they may affect auditor quality. The literature on auditor change has mainly focused on qualified opinions and the literature on auditor choice has generally examined the influence of company factors, such as information asymmetry and agency costs, on auditor choice. This study hypothesizes that the controller, including the controlling shareholder, chairman and the CEO, affects the choice of auditor. The results show that auditor changes are influenced by changes in the controlling shareholder, the main business, the chairman and the CEO, and the auditor is more likely to change with more extensive changes in the controller. If the successor controlling shareholder is controlled by an other-province government, the auditor is more likely to be replaced and the successor auditor is more likely to be a smaller auditor from the same province as the new controlling shareholder.

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