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THE IMPACTS OF CHARACTERISTICS OF HOMETOWN CONNECTEDNESS BETWEEN AUDITORS AND EXECUTIVES ON AUDIT QUALITY: EVIDENCE FROM CHINA

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ABSTRACT

Quality audit depends on the qualified audit team. Hometown connectedness affects audit quality among executives and auditors. Higher auditor-executive hometown connectivity degrades audit quality more. The present study aimed to analyse and test the influence of the strength and density of auditors-managers hometown connectedness on audit quality. Panel data research methods were employed here. The data is analyzed using the Regression model, including the Logit regression model and OLS regression model, Pearson correlation coefficients, χ2 grouping test and Heckman two-step regression, by using 3674 observations of the Chinese Stock markets from 2008 to 2020 and from the perspective of sociology and economics that were reserved over 15 different industries and the auditor-manager hometown connectivity involved 25 different provinces. The present study reveals that the auditors-manager's hometown connectedness has a negative effect on audit quality. The influence degree increases along with the strength of the auditors-manager's hometown connectedness. Secondly, the influence degree increases along with the density of auditors-managers hometown connectedness. Finally, some suggestions related to audit quality supervision are put forward. The above findings are still valid after controlling for potential endogenous problems. The research on the relationship between auditors-managers' hometown connectedness and audit quality is extended and deepened. The present study's findings apply to auditors and executives in that a bias-free relationship is essential to carry out an influence-free audit process. Audit organizations and business organizations can benefit from this research.

INTRODUCTION

For developing countries, efforts to improve capital markets' efficiency constitute the capital market regulators' primary responsibility (Ayadi & Williams, 2023). As an important part of the capital market, the independent audit services provided by accounting firms have an important impact on improving the effectiveness of the capital market (Alotaibi & Alnesafi, 2023). In other words, high-quality audit services are an important part of the efficient capital market. Therefore, it is of great significance for developing countries to further explore the influencing factors of audit quality to improve the efficiency of the capital market (Saifudin & Januarti, 2023).

As the core topic of audit practice and research, audit quality has been paid much attention to its influencing factors (DeFond & Zhang, 2014). Audit quality is the combined probability that auditors find and report errors in the accounting reporting process of an enterprise. The ability to detect errors depends on the accountant's professional competence, and the ability to report the discovered errors mainly depends on the auditor's independence (DeAngelo, 1981; Kang, Kim, & Lee, 2023). As the largest developing country in the world, China's capital market has the typical characteristics of the capital market of developing countries. At the same time, China is a society of acquaintances (Chang, 2023), and personal

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relationships will significantly affect auditors' independence. A large number of studies have proved that hometown connectedness (hometown relationship) constitutes the most important component of personal relationships (Wang, Wu, You, Zhu, & Zhang, 2023). Therefore, the research objective of this paper is to explore the impact of auditors-managers' hometown connectedness on audit quality based on the Chinese context. Research on this issue will help understand the generating principle of audit quality more deeply and provide useful policy references for developing countries to improve audit quality and capital market efficiency.

There needs to be research on how auditors-managers' hometown connectedness affects audit quality. Only a few studies have explored the impact of CEO-director's hometown connectedness on firm risk (Lu & Hu, 2014) and investment efficiency (Hu, 2023). However, these studies only focus on the economic consequences of the CEO-director's hometown connectedness and do not further explore the economic consequences of two important personal relationship characteristics (relationship strength and density). The difference with other personal relationships is that other personal relationships (such as alumni relationships) are difficult to measure the strength of the relationship. In China, hometown connectedness can be embodied at three levels, i.e., province, city and county. At the same time, it provides a good measure for measuring the strength of auditors-managers' hometown connectedness. Meanwhile, in the group of auditors and executives, the number of people with hometown connectedness can be used to measure hometown relationship density. Based on this, this paper intends to use the above methods to measure the strength and density of auditors-managers hometown connectedness, and further explore the impact of the strength and density of auditors-managers' hometown connectedness on the audit quality.

Therefore, based on the data of Shanghai and Shenzhen A-share listed companies from 2008 to 2020, this paper explores and tests the impact of two main characteristics (strength and density) of auditors-managers hometown connectedness on audit quality. The data is analyzed using the Regression model, including the Logit regression model and OLS regression model, Pearson correlation coefficients, $\chi 2$ grouping test and Heckman two-step regression. The possible contributions are as follows: (1) The antecedents of audit quality were explored to strength and density of auditors-managers hometown connectedness, and the related studies on audit quality were expanded and deepened, which enriched the connotation of audit quality governance; (2) The direct method is used to measure strength and density of the auditors-managers hometown connectedness, which reduces the noise of indicator measurement and improves the depth of indicator quantification, and enriches the relevant literatures on the measurement of hometown connectedness; (3) Using the data of listed companies in China for empirical analysis, it provides new theoretical references and empirical evidence for audit supervision departments to formulate policies related to improving audit independence.

The subsequent sections of the article are scheduled as follows: Section 2.0 presents a comprehensive review of the relevant prior research pertaining to our chosen issue. The data sources and techniques are presented in Section 3.0. The empirical findings are reported and analyzed in Section 4.0. Section 5.0 illustrates the discussion of the present study. Section 6.0 presents the concluding remarks with implications, limitations and future study directions.

LITERATURE REVIEW

Audit quality is heavily influenced by the personal characteristics of accountants and executives (Gul, Wu, & Yang, 2013; Kang et al., 2023; Knechel, Krishnan, Pevzner, Shefchik, & Velury, 2013; Li, Qi, Tian, & Zhang, 2016; Nelson, 2009; H. Yuan & Han, 2012), such as tenure, gender, client importance, audit experience, industry expertise, education, work history, partnership status, political party affiliation, and alumni relationships (Alissa, Capkun, Jeanjean, & Suca, 2014; Carey & Simnett, 2006; Chen, Sun, & Wu, 2010; Chen, Zhang, & Yan, 2016; Guan & Lui, 2016; Gul et al., 2013; Ittonen, Vähämaa, & Vähämaa, 2013; Liu, Guo, & Tang, 2015; Wang, Wang, Yu, Zhao, & Zhang, 2016; Yuan & Han, 2012). In recent years, the academic circle has conducted a heated discussion on the impact of the personal relationship (also known as social relationship) between auditors and corporate managers on audit quality (Du, 2017; Granovetter, 1985), which can be roughly divided into two categories: first, the impact of private relationship on audit quality in a general sense (Liu et al., 2015; Xie & Yan, 2013). The second is the influence of different types of personal relationship on audit quality, such as political relationship, peer relationship, former colleague relationship, alumni relationship, and dialect relationship the shortcoming of the first type of research is that the measurement of the core variable, personal relationship contains some noise. For example, some scholars use the phenomenon that auditing-firm changes but auditors do not change to measure the existence of auditors-managers super-instrumental personal relationship (Liu, Zhou, Fu, & Xiao, 2010; Xie & Yan, 2013). However, the above situation may also be due to the fact that the client enterprise has invested specific assets in the auditors (such as the efforts made to get familiar with the auditors' work mode), so it is unwilling to replace the auditors (so as to avoid making specific asset investment again); The shortcoming of the second type of research is that it ignores the impact of the differences in the characteristics of the auditors-managers personal relationship. Previous studies on peer relationships, former colleagues and alumni relationships have focused only on the economic consequences of the existence of personal relationships (Cai, Xie, & Ma, 2015; Guan, Su, Wu, & Yang, 2016; Wu, Wang, & Lu, 2015). A small number of studies have focused on the impact of CEO hometown identity on corporate audit costs, but existing studies have paid more attention to the impact of the existence of CEO-managers' hometown relationship, while ignoring the impact of major characteristics of social relationships such as strength and density of the hometown relationship (Lv, Zhang, & Zhang, 2022; Yuan, Xu, Chen, Liu, & Liu, 2018). To sum up, both types of studies focus too much on the impact of the existence of personal relationships on audit quality, while relatively ignoring the impact of strength and density of personal relationships, which is not conducive to accurately grasp the panorama of the impact of personal relationships, especially hometown relationships, on audit quality.

From a macro perspective, audit quality is the quality of audit services or products traded in the audit market. It

results from the tripartite power game between firms' quality demand, auditors' quality supply and regulatory agencies' quality supervision (DeFond & Zhang, 2014; Xu, 2010). From the micro level, audit quality is the joint probability that auditors find and report errors in the accounting reporting process of customer enterprise (Kang et al., 2023). The ability to detect errors depends primarily on the professional competence of the auditors, and the ability to report errors that are detected depends primarily on the independence of the auditors (DeAngelo, 1981; Putri & Setiany, 2023).

Auditors' professional competence mainly includes information acquisition ability and information processing ability (Bhattacharjee, Moreno, & Riley, 2012; Sampepolan, Herawaty, & Caeshara, 2023). The former mainly depends on the auditors' study and practice experience and is unaffected by personal relationships. Because the pattern of personal relationships determines the pattern of interpersonal information communication and trust, information acquisition ability is affected by personal relationships (Dai, Xiao, & Pan, 2016; Mahlangu & Moosa, 2023). According to some former studies, although auditors who have hometown connectedness with managers can theoretically obtain more additional information, therefore have a greater probability of finding errors in financial reports. However, due to the higher costs and lower output of obtaining and processing additional information, auditors have no strong incentives to obtain additional information to improve audit quality (Chegrinets, 2021; Kornish & Levine, 2004). In addition, it is difficult for auditors to become core members of the manager's network regardless of whether they are from the same hometown. Managers will not provide opposing information in corporate financial reports, so the increment of audit quality caused by auditors obtaining additional information is also very limited (Deng, Kim, & Ye, 2023). Therefore, the impact of auditors-managers hometown connectedness on audit quality is mainly reflected in the impact on audit independence (Bamber & Iyer, 2007; Yuan et al., 2018).

Auditors' hometown connectedness reflects the auditors' personal identity (Akerlof & Kranton, 2000; Dunakhir, Afiah, Idris, & Idrus, 2023) and reflects the auditor's personal sense of belonging to their hometown people (Hammitt, Backlund, & Bixler, 2006; Jiang, Qian, & Yonker, 2019; Yonker, 2017). The identification with the native people and the sense of belonging to the hometown will greatly influence the auditors' decision-making behavior (Coval & Moskowitz, 1999). Some scholars have studied and found that hometown connectedness damages audit independence through cultural identity mechanism, interest binding mechanism and reputation constraint mechanism, and further damages audit quality. The concrete manifestation is the phenomenon of auditors' failure to report errors in financial reports (Yuan et al., 2018). In fact, this phenomenon can also be explained by the fraud triangle theory (Albrecht, Albrecht, & Albrecht, 2008; Yusnaini, 2023). First of all, from the perspective of pressure, auditors conniving or even helping enterprises cover up mistakes can be exchanged for financial or emotional returns given by managers, thus helping to relieve their own economic and emotional pressure (Brozovsky & Richardson, 1998). Secondly, the degree of specialization in audit business is high, and the errors in financial reports can easily be concealed, so auditors have opportunities to commit fraud without being discovered or getting away with punishment (Bhattacharjee et al., 2012; Petrov & Stocken, 2022). Finally, helping managers with hometown connectedness pull through difficult times can easily become an important excuse to be accepted or be highly spoken to by everyone from the same hometown.

Former studies have shown significant differences in the economic consequences of strong and weak relationships (Sundararajan & Yeh, 2022; Yao, Zhang, & XI, 2008). In China, there are multiple levels of criteria for the definition of the relationship between the same province, the same prefecture-level city and the same county, and the different levels of the relationship mean different strengths of hometown connectedness. It is generally believed that the lower the level, the stronger the hometown connectedness. The reason is that the lower the level, the narrower the geographical scope, the higher the consistency of ethics, codes of conduct and customs between auditors and managers, and the stronger the emotional alliance (Hwang, 1987; Kim & Fernandez, 2023; Xin & Pearce, 1996). At the same time, the frequency and probability of economic and social exchange between auditors and managers and their respective nepotism will be higher so that the interest alliance will be more solid (Baiman, Evans Iii, & Nagarajan, 1991; Kornish & Levine, 2004). In other words, the higher the strength of the hometown connectedness, the more obvious the effect of the cultural identity mechanism, interest binding mechanism and reputation constraint mechanism of the hometown connectedness, and the more significant damage of the hometown connectedness to the audit quality. Based on this, the following hypothesis is proposed.

***H_1**: The higher the strength of the auditors-manager's hometown connectedness, the more significant the damages of auditors-manager hometown connectedness to audit quality.*

In the group composed of auditors and managers, the number of people from the same hometown reflects the density of auditors-managers hometown connectedness (Cohen, Gaynor, Krishnamoorthy, & Wright, 2022; Peng & Luo, 2000; Yao et al., 2008). So the greater the density of the auditors-managers hometown connectedness, the higher the proportion of people who form emotional alliance and interest alliance through hometown connectedness (Suleiman & Yahaya, 2023), therefore the higher the probability of forming a consensus in the audit quality decision, and the greater the damage to the audit quality. Based on this, the following hypothesis is proposed.

H_2: There is a negative correlation between the density of auditors-managers' hometown connectedness and audit quality.

MATERIALS AND METHODS

Sample and Data

In order to avoid the impact of the new China accounting standards in 2007 on the quality of financial reporting caused by firms unfamiliar with the new accounting standards in 2007, and considering the availability of data, this study takes all the

A-share listed companies in Shanghai and Shenzhen stock market from 2008 to 2020 as the initial sample and is screened as follows: (1) Considering the double audit problem of listed companies in many stock markets, AB/AH/ABH companies are excluded; (2) Excluding companies in the financial, insurance and securities industries; (3) Remove samples with missing information about the domicile of the managers or auditors; (4) Remove samples with other missing information; (5) In order to eliminate the interference of former colleague relationship between auditors and managers, samples which managers having worked in the same accounting firms with auditors were excluded. Finally, total 3674 observables in 15 industries were reserved, and the auditor-manager hometown connectedness involved 25 provinces.

The key data in this paper is the hometown (including native place or birthplace) information of managers and auditors (if the native place information is missing, the birthplace information will be replaced; When the native place is inconsistent with the birthplace, the native place information shall prevail), at present, the above information is not within the scope of mandatory disclosure. Hence, managers' (referring to the board chairman, CEO, and CFO) hometown information comes from the following channels: The first is to identify the background information of the management in the RESI database; the second is to manually collect it from an internet based on keywords such as unit name + personal name + native place/birthplace/hometown; the third is to obtain it by personal relations (mainly referring to firms with familiar managers). The auditor's hometown information is from the following channels: The first is by personal relationship (mainly referring to accounting firms with familiar auditors); the second is through the use of telephone, email, field visits and other forms of research (because only the information of the hometown is not high privacy and easy to reply, the overall response rate of the survey is relatively high). The third is manually collecting it from the internet based on the same keywords as above). The managers' personal work-related background information comes from the firm's annual report, other personal information of accountants comes from the AIMNQS (Accounting Industry Management Network Query System), and other data comes from CSMAR.

Regression Model and Variable Description

In order to test the impact of auditors-managers hometown connectedness on audit quality, this paper constructs the following regression model:

$$AQ = \alpha + \beta Hometown + \gamma Controls + \varepsilon \qquad (1)$$

Considering that audit quality (AQ) is difficult to measure directly and there are many alternative indicators, this article adopts two indicators with high effectiveness, i.e. non-standard audit opinion (MAO) and the absolute value of discretionary accruals (ABDACC). When the dependent variable is MAO (dummy variable), binary Logit regression is used, and when the dependent variable is ABDACC, OLS regression is used (Guan et al., 2016; Yuan et al., 2018). Specifically, when the auditor issues an audit report with a negative audit opinion, an inability to express audit opinion, a qualified audit opinion, or an unqualified audit opinion with an emphasis on the matter, the MAO is 1; otherwise, it is 0. ABDACC is the absolute value of discretionary accruals (DACC); DACC is calculated based on the residual term of the modified cross-section Jones model that controls the return on total assets (ROA) for the current year (Kothari, Leone, & Wasley, 2005; Liu et al., 2015).

In model (1), Hometown represents the auditors-managers hometown connectedness. When examining the influence of the strength of hometown connectedness (homestrength) on audit quality (H1), according to the relationship level, auditors and managers may be in the same county, the same city, the same province, and not in the same province (the relationship strength changes from strong to weak), the values of homestrength are 3, 2, 1 and 0 respectively.

When examining the impact of town-mate relationship density on audit quality (H2), Provdensity, Citydensity, and *Coundensity* represent the densities of hometown connectedness at the province, city, and county levels, respectively. Essentially, they are continuous variable measures of the auditors-manager's hometown connectedness. The values of Provincedensity, Citydensity, and Countydensity range from 1 to 5, which means that there are 5 people, including 2 auditors and 3 managers (in practice, there are 3 accountants, but such sample is not in this study), it valued 1 when there is no auditors-managers hometown connectedness, only two auditors in the same hometown or only two or three managers in the same hometown. When the board chairman and CEO are the same people, although there are actually only 4 people, they are still considered as 5 people (5 positions); when there are two sets of hometown connectedness, such as 4 people from two different hometowns, this study still considers them as one hometown to calculate the variable value.

There are three types of factors that have been found to affect audit quality in former research: firstly, macro and external factors (regional marketization level, regulatory intensity, product market competition, and analyst coverage); The second factor is the relationship between the accounting firm and the client firm(importance of the accounting firm, accounting firm-client firm hometown connectedness, the importance of client firm, the size of client firm, leverage, equity concentration, the nature of controlling shareholder, board size, managers' shareholding ratio); The third factor is the relationship between auditors and managers (accounting tenure, accounting audit experience) (Chen et al., 2010; Yanling Guan & Lui, 2016; Luo, Li, & Lin, 2016; Samudhram, Stewart, Wickramanayake, & Sinnakkannu, 2014; Wang, Wong, & Xia, 2008; Xiao, 2006; Xing & Chen, 2013). When the dependent variable is MAO, current ratio, accounts receivable, inventory, and return on equity are additionally controlled (Guan & Lui, 2016; Guan et al., 2016; Gul et al., 2013). Variable symbols and descriptions are shown in table 1.

To eliminate the interference of outliers, the continuous variables in the model were winsorized at the level of 1%. To alleviate the issues of autocorrelation and cross-sectional correlation in time series, a robust estimation method was used to double cluster adjust the standard error (Petersen, 2009).

Table 1. Variable Description

Variable Type	Variable Name	Variable Symbol	Variable Description
Dependent Variables	Non-standard audit opinion	*MAO*	audit report with a non-standard unqualified opinion is 1; otherwise, it is 0
	Absolute value of discretionary accruals	*ABDACC*	The calculation procedure is described above
Independent Variables	Strength of hometown connectedness	*Homestrength*	If any two auditors' and managers' hometown is the same county, same city, same province, it is 3, 2, and 1, respectively; otherwise, it is 0
	Density of province connectedness	*Provdensity*	The number of people (referring to auditors and managers) whose hometown is the same province
	Density of city connectedness	*City density*	The number of people (referring to auditors and managers) whose hometown is the same city
	Density of county connectedness	*Coundensity*	The number of people (referring to auditors and managers) whose hometown is the same county
Controls: Macro and external factors	Regional marketization degree	*Market*	The comprehensive index of China's regional marketization degree is filled with the principle of similarity for missing data (Wang, Hu, & Fan, 2021)
	Supervision intensity	*REGU*	The natural logarithm of the average distance between the client firm and the three regulatory agencies, i.e. CSRC, Shanghai Stock Exchange and Shenzhen Stock Exchange. The larger the value, the farther the listed company is from the regulatory agencies, the lower the regulatory intensity（Luo et al., 2016）
	Product market competition	*Compete*	It is measured using the Herfindahl-Hirschman index (HHI); the smaller the value, the fiercer the competition.
	Analyst coverage	*Analyst*	The natural logarithm is taken by adding 1 to the number of analyst coverage (Lang, Lins, & Miller, 2003)
Controls: Firm-level factors	Accounting firm importance	*Audition*	The larger the accounting firm, the more important it is. It is 1 for Big4, otherwise it is 0
	accounting firm-client firm hometown connectedness		Confirm It is 1 when the accounting firm and client firm are registered in the same province; otherwise, it is 0
	Firm importance	*Firmimp*	The natural logarithm of the total assets of the client firm accounts for the proportion of the natural logarithm of the total assets of all the accounting firm's clients in the year; the greater the value, the more important the client firm.
	Firm size	*Firm size*	The natural logarithm of the total assets of the clent firm, the greater the value, the more important the firm
	Financial leverage	*Lev*	Total asset-liability ratio
	Ownership concentration	*FShare*	The stock proportion of the largest shareholder
	The nature of controlling shareholder	*State*	Dummy variable: It is 1 for state-owned controlling shareholders; otherwise, 0
	Board size	*Board size*	Total number of directors
	management ownership ratio	*MShare*	The sum of the shareholding ratio of directors and top management team
	Current ratio	*CR*	Current assets divided by current liabilities
	Accounts receivable ratio	*AR*	Accounts receivable divided by total assets
	Inventory ratio	*INV*	Inventory divided by total assets
	Return on equity	*ROE*	Net profit divided by the average shareholder equity at the beginning and end of the year.
Controls: individual factors	CPA's tenure	*CPAtenu*	The natural logarithm of the sum of the tenures (years) of the two auditors
	CPA's audit experience	*CPAexper*	The natural logarithm of the sum of the years of practice of the two auditors

RESULTS

Demographic Profile

Table 2 shows the Pearson correlation coefficients between the main variables (due to space limitations, the correlation coefficients between the control variables were not reported in this article). The Pearson correlation coefficient indicates that, firstly, there is a negative correlation between hometown connectedness strength (Homestrength) and hometown connectedness density (Provdensity, Citydensity, Countensity) and audit quality (Mao), and the greater the strength and density of hometown connectedness, the higher the degree of damage to audit quality. H_1 and H_2 are supported; secondly, there is a significant positive correlation between the density of province-, city-, and county-connectedness. There is also a significant positive correlation between the strength and the density of hometown connectedness, and the correlation

coefficient is large. This indicates that all independent variables cannot be included in the regression model at the same time; otherwise, it will cause multicollinearity problems.

Table 2. Pearson correlation coefficients between main variables

	MAO	Homestrength	Provdensity	City density	Coundensity
MAO	1				
Homestrength	-0.3469**	1			
Provdensity	-0.0390*	0.3233*	1		
Citydensity	-0.1655**	0.4020***	0.5034***	1	
Coundensity	-0.2233***	0.3975**	0.5705**	0.6842*	1

Note: ***, **, * respectively indicate significant (double-tailed) at the 1%, 5%, and 10% levels, the same as below.

Statistical Analysis and Results

The regression results with strength of hometown connectedness as an independent variable (see Table 3) indicate that when the dependent variable is MAO, the strength of auditors-managers hometown connectedness (Homestrength) is negatively correlated with MAO at the 5% level. Further marginal effect analysis results show that under the same conditions, the probability of the home-connectedness group obtaining non-standard audit opinion is about 4 percentage points lower than that of the non-province-connectedness group (3.96%, unreported). Considering that the probability of the non-province-connectedness group obtaining non-standard audit opinion is 7.37% (unreported), the impact of the strength of auditors-managers' hometown connectedness on auditors' audit opinion decision-making is significant in economic terms. When the dependent variable is ABDACC, the strength of auditors-managers' hometown connectedness is positively correlated with ABDACC at the 5% levels too, indicating that client firms audited by hometown-connected auditors have higher discretionary accruals. The above results indicate that the strength of auditors-managers hometown connectedness reduces the probability of client firms obtaining non-standard audit opinions and increases the absolute value of discretionary accruals, indicating that the strength of auditors-managers hometown connectedness damages audit quality; H1 is supported.

Table 3. Regression results with a strength of hometown connectedness as an independent variable

Independent Variables	MAO	ABDACC
Homestrength	-0.218** （-2.342）	0.029** （2.513）
Market	0.036*	-0.02**
REGU	-0.035	-0.018
Compete	-2.790	0.450
Analyst	0.077**	-0.007**
Audition	2.728***	-0.697**
Confirm	-1.187*	0.611*
Firmimp	0.62	0.006
Firm size	-0.005	0.047
Lev	0.317***	-0.008***
FShare	0.213	0.118
State	-0.355***	0.037***
Boardsize	-0.253**	0.012*
MShare	-13.606***	1.457**
CR	-0.329	
AR	0.557**	
INV	-1.159	
ROE	-0.787**	
CPAtenu	-0.130*	0.074*
CPAexper	0.079**	-0.091*
intercept	7.354***	-2.029***
industry	controlled	controlled
year	controlled	controlled
Adjusted R^2	18.33%	54.23%
Observable	3674	3674

Note: (1) It is Logit regression when the dependent variable is MAO and OLS regression when the dependent variable is ABDACC, the same as below. (2)The regression results of the control variables have yet to be reported, the same as below.

Table 4. Regression results with a density of hometown connectedness as an independent variable

Variables	*MAO*			*ABDACC*		
Intercept	3.853*** （3.750）	3.624*** （5.108）	3.710***（6.875）	-3.316*** （-7.376）	-3.327*** （-8.135）	-3.402*** （-8.863）
Provdensity	-0.114* （-1.812）			0.194** （2.340）		
City density		-0.127*** （-3.449）			0.249*** （6.104）	
Coundensity			-0.153*** （-4.207）			0.266*** （6.785）

Controls	controlled	controlled	controlled	controlled	controlled	controlled
Industry	controlled	controlled	controlled	controlled	controlled	controlled
Year	controlled	controlled	controlled	controlled	controlled	controlled
Adjusted R^2	15.31%	17.68%	17.92%	45.04%	46.11%	46.44%
Observable	3674	3674	3674	3674	3674	3674

Endogenous Issues

The regression results of panel A in Table 5 indicate that the influence direction of IMR1 is the same as that of auditors-managers hometown connectedness and is significant, indicating the existence of a certain degree of self-selection effects. After controlling for the self-selection effect, the direction and significance level of the influence of the strength of hometown connectedness on audit quality remains unchanged, indicating that the degree of damage to audit quality by hometown connectedness increases with the strength of auditors-managers hometown connnectedness, and H1 is supported.

The regression results of Panel B in Table 5 indicate that after controlling for the self-selection effect, the direction of the impact of the density of hometown relationships on audit quality remains unchanged. Although the regression coefficients' absolute value and significance level have changed, they are still significant. After controlling for the self-selection effect mentioned above, a negative correlation exists between the density of hometown connectedness and audit quality, and H2 is supported. As the density of hometown connectedness increases, the absolute value and significance level of the regression coefficient of hometown connectedness show a roughly increasing trend. This indicates that the degree of damage to audit quality by hometown connectedness increases with the density of auditors-managers hometown connectedness, and H1 is further supported.

Table 5. Heckman's two-step regression results

	MAO			**ABDACC**		
Panel A： Two-step regression in which strength of hometown connectedness is an independent variable						
Homestrength	-0.174*（-1.929）			0.023**（2.475）		
IMR1	-1.984**			0.217*		
Panel B： Two-step regression in which density of hometown connectedness is an independent variable						
Provdensiyt	-0.101*（-1.877）			0.172*（1. 935）		
City density		-0.119**（-2.321）			0.227**（2.458）	
Coundensity			-0.140**（-2.467）			0.241***（4.313）
IMR2	-0.896	-1.102*	-1.120**	0.094*	0.105*	0.118**
Controls	controlled	controlled	controlled	controlled	controlled	controlled
industry	controlled	controlled	controlled	controlled	controlled	controlled
year	controlled	controlled	controlled	controlled	controlled	controlled
Observable	3674	3674	3674	3674	3674	3674

Note: The regression results of Heckman's first step and the regression results between the intercept term and the control variable were not reported.

Robustness Testing

Test 1 Testing of alternative variables. Specifically, it includes two variables: the substitute variable for the audit opinion, which replaces the dummy variable MAO in model (1) with the multivariate ranking variable AO. When the audit opinion is a standard unqualified opinion with an emphasized matter segment, a qualified opinion that cannot be expressed, or a negative opinion, AO values 0-4, respectively. The higher the audit quality is higher, the greater the value. Based on this, a multivariate ordered Logit regression is performed; the second is the alternative variable for discretionary accruals. Some studies suggest that Abnormal Working Capital Accruals (AWCA) can more effectively reflect corporate accounting fraud and misstatement behaviour than Total Manipulatable Accrued Profits (ABDACC) (Dechow, Ge, Larson, & Sloan, 2011; Jones, Krishnan, & Melendrez, 2008). Therefore, this article uses the absolute value of AWCA (ABAWCA) as an alternative indicator of audit quality, and AWCA measures the residual term obtained by industry and annual regression estimation using the following model (Guan & Lui, 2016; McNichols & Stubben, 2015).

$$\frac{\Delta WC_t}{ATA_t} = \alpha_0 + \beta_1 \frac{CFO_{t-1}}{ATA_t} + \beta_2 \frac{CFO_t}{ATA_t} + \beta_3 \frac{CFO_{t+1}}{ATA_t} + \beta_4 \frac{\Delta SALE_t}{ATA_t} + \beta_5 \frac{PPE_t}{ATA_t} + \varepsilon_t \qquad (2)$$

Among them ΔWC is the increase in working capital, that is, operating profit minus net cash flow from operating activities; ATA is the average of total assets at the beginning and end of the year; CFO is the net cash flow generated from operating activities, $\Delta SALE$ is the value added to operating income, and PPE is the net value of fixed assets. The purpose of dividing each variable ATA_t is to alleviate the heteroscedasticity problem and then regress on this basis.

Test 2 Inspection of alternative methods. The sample in this article is imbalanced panel data, with a relatively scattered annual and industry distribution. The results of the F-test and Hausman test reject the original hypothesis at the 5% level, indicating that the estimation method for fixed effects of imbalanced panels can be used while controlling for fixed effects of enterprises and annual fixed effects (double fixed effects model), which helps to alleviate endogeneity issues

and improve the reliability of regression results.

When the independent variable is the strength of hometown connectedness (homestrength), the robustness test results (see Table 6) indicate that although the regression coefficient values and significance levels of hometown connectedness change after using alternative variables and alternative regression methods, the sign of the regression coefficient and whether it has significance remain unchanged, thus keeping the basic conclusion of the previous text unchanged, i.e. the existence of hometown connectedness reduces audit quality, H1 is supported. After using alternative variables and methods for regression, the model's overall fit changed slightly, but the change was not significant.

Table 6. Regression results of alternative variables and alternative methods

Panel A: Regression with alternative dependent variable		
Variables	*AO*	*ABWACC*
Homestrength	-0.288*（-1.893）	0.049**（2.543）
Adjusted R^2	17.38%	15.24%
Observable	3674	3674
Panel B: Regression with double fixed effects model		
Variables	*MAO*	*ABDACC*
Homestrength	-0.231**（-2.565）	0.020**（2.159）
Adjusted R^2	18.12%	47.80%
Observable	3674	3674

Note: It is multivariate ordered Logit regression when the dependent variable is AO. It is OLS regression when the dependent variable is ABAWCA.

DISCUSSIONS

From the perspective of industries, the sample population (a total of 3674 observations) is distributed in 15 industries, with industry representativeness. The manufacturing industry accounts for a relatively large proportion (57.89%). From the perspective of changing trends, the observables of provincial-level, city-level, and county-level hometown connectedness are 916, 197, and 36, respectively, accounting for 24.93%, 5.36%, and 1.01% of the total sample, and maintaining a growth trend. Possible reasons are as follows: firstly, since 2010, large and medium-sized accounting firms have gradually shifted to special general partnerships, and the increasing legal responsibility and risk of signing accountants have led to a decrease in their willingness to provide audit opinions to meet the demands of client firms. Thus, client firms have a stronger motivation to hire local auditors to obtain the required audit opinion managers. Secondly, the rapid development of communication technology has facilitated the expansion of personal social networks, thereby increasing the probability of collaboration between local auditors and managers. From the perspective of regional distribution, among the sample population, economically developed regions have a relatively large proportion of samples; in the sample, auditors and managers in the same hometown, economically and educationally developed regions and populous provinces (cities) account for a relatively high proportion. From the perspective of control variables, most variables are significant and similar to the correlation analysis results between variables (not reported), indicating that the selection of control variables is reasonable. When the dependent variables are MAO and ABDACC, the adjusted R^2 exceeds 15% and 52%, respectively, indicating that the regression model has high explanatory power. However, the sample size (40 companies per year) in the county-connectedness group is relatively small, affecting the explanatory power of the regression results to some extent.

The regression results with a density of hometown connectedness as an independent variable (shown in Table 4) show that when the dependent variable is MAO, the density of province-, city-, and county-connectedness is negatively correlated with the probability of client firms obtaining non-standard audit opinion at 10%, 1%, and 1% levels, respectively. When the dependent variable is ABDACC, the density of province-, city-, and county-connectedness is positively correlated with the absolute value of discretionary accruals at 5%, 1%, and 1% levels, respectively, The higher the density of hometown connectedness, the higher the probability of auditors and managers forming interest alliance and emotional alliance, which has a greater negative impact on audit independence and ultimately leads to a decrease in audit quality, and H2 is supported. From the differences in auditors-managers' hometown connectedness at different levels, it can be seen that city-level hometown connectedness has a more significant negative impact on audit quality than province-level hometown connectedness (with a higher absolute value and significance level of the regression coefficient). County-level hometown connectedness has a more significant negative impact on audit quality than city-level hometown connectedness (with a higher absolute value and significance level of the regression coefficient). H1 is further supported.

There may be some self-selection effects in hometown connectedness, mainly including: (1) compared to non-hometown-connectedness auditors, the probability of managers collaborating with hometown-connectedness auditors to obtain standard unqualified audit opinion is higher and collaborating costs are lower. Therefore, client firms with lower financial report quality are more likely to hire hometown connectedness auditors to obtain standard unqualified audit opinions. (2) Hometown connectedness may reflect the tendency of client firms to choose local auditing firms, and there is a higher probability of auditors-managers' hometown connectedness between local client firms and local auditing firms; (3) Audit fees may also affect the choice of local auditors, as the higher the audit fees, the greater the cost savings brought by cooperation between hometown-connected managers and auditors. This article uses Heckman's two-step method to control the above self-selection effects (Heckman, 1979): the first step is the selection equation, with the dependent variable being the dummy variable of hometown connectedness. The independent variables include audit quality, local auditor (Local, which is 1 for the local client firm, otherwise 0), and audit fees (Fee, which is the natural logarithm of the audit fees) in order to obtain the inverse Mills ratio (IMR). The second step is to add IMR as the control variable in the previous regression

equation to overcome self-selection effects.

When the independent variable is the density of hometown relationships (Provdensity, Citydensity, Countensity), the unreported robustness test results indicate that in most cases, the regression coefficient sign of density of hometown connectedness remains unchanged and has statistical significance. Moreover, as the strength of hometown relationships increases, the significance level and coefficient value of the regression coefficient also show an increasing trend, indicating that the basic conclusion is consistent with the previous text; on the one hand, there is a negative correlation between the density of hometown connectedness and audit quality, and H2 is supported; On the other hand, the higher the strength of hometown connectedness, the greater the impact of the strength of hometown connectedness on audit quality, and H1 is further supported.

CONCLUSIONS

This study draws the following conclusions: firstly, the higher the strength of auditors-managers hometown connectedness, the more significant the degree of damages to audit quality caused by the hometown connectedness. Secondly, the higher the density of hometown connectedness, the more significant the degree of damage to audit quality caused by hometown connectedness.

Theoretical Implications

The phenomenon of hometown connectedness people forming alliances in the current Chinese business community has become increasingly common, and the impact of managers' hometown connectedness on corporate governance and corporate decision-making is increasingly being valued by the academic community (Hu, Song, & Wang, 2017). However, the economic consequences of auditors-managers' hometown connectedness, especially the impact on audit quality, remain relatively blank. Based on social exchange theory and data from A-share listed companies in China's Shanghai and Shenzhen stock markets, this study conducts theoretical and empirical analysis on the impact of the strength and density of hometown connectedness on audit quality to fill the blank point.

Managerial Implications

Independence is the soul of auditing (Christensen, Glover, Omer, & Shelley, 2016); currently, relevant laws such as the Independent Audit Standards and the Certified Public Accountants Law in China do not restrict auditors from conducting independent auditing services for hometown-connected-client firms (Wu & Li, 2018). This study found that auditors-managers' hometown connectedness, as an informal system, negatively impacts audit independence and quality. Hometown-connected auditors have become legally independent and essentially non-independent "grey auditors". This study believes that audit regulatory authorities can strengthen the supervision of grey auditors from the following two aspects: firstly, to improve the transparency of personal information disclosure for auditors and managers, and to suggest, encourage, or even force listed companies to disclose information such as the birthplace and native place of auditors and managers (detailed to the county level), graduation institutions, and names of previously employed units, in order to supervise opportunistic behaviours caused by auditors' or managers' private relationship in the independent audit process. Secondly, based on factors such as the strength and density of auditors-managers' hometown connectedness, accurately screen and focus on supervising hometown-connected client firms, especially those with high strength and density of auditors-managers hometown connectedness.

Limitations and Scope of Future Study

Limited by the data of personal hometown information, the managers in this study only refer to the board chairman, CEO, and CFO. In fact, other directors and senior executives may also influence audit decisions. With the increasingly full disclosure of managers' information and the means of obtaining information continuing to upgrade, in future research, the scope of managers can be further expanded, which will help to improve the effectiveness of the research further.

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