The Influence of Foreign Institutional Investors on Audit Fees: Evidence from Chinese Listed Firms

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Abstract: This study examines the influence of qualified foreign institutional investors (QFIIs) on investee companies' audit fees. We find that ownership by QFII-licensed investors is positively associated with audit fees. Besides, audit fees are higher in companies with QFIIs than in those without, and the demand for more extensive audits increases with the number of QFIIs. Notably, the demand for more extensive auditing procedures is mainly attributable to QFIIs from jurisdictions with strong governance institutions or is driven by QFIIs from jurisdictions that are geographically distant from China. Our cross-sectional analysis reveals that this positive influence is more prominent when investee companies exhibit severe earnings manipulation or a weak sense of social responsibility. Finally, our mediation analysis suggests that QFIIs can enhance firm value and that a portion of this effect is due to the increased audit effort driven by QFIIs.

Keywords: Qualified foreign institutional investors; Audit fees; Institutional quality; Shareholder protection; Geographical distance; Firm value

JEL classification codes: G23; G30; G34; M41; M42

EFM classification codes: 150; 180; 710

1 Introduction

Foreign institutional investors have played an increasingly critical role in business strategies and the integration of the global economy (Tee et al., 2017). According to the Global Financial Stability Report released by the International Monetary Fund (IMF) in 2015, a substantial percentage of assets managed by the world's top 500 fund managers is distributed globally.[1] Cross-border financial linkages driven by foreign institutional investors have facilitated international capital flows and efficient allocation of human capital resources. The increasing importance of foreign investors indicates that they now control a significant proportion of global resources and equity, particularly in developing countries (Ferreira et al., 2010; Tee et al., 2017). Prior research finds that foreign investors (i.e. investment banks, insurance firms, national pension fund associations) have generated numerous favourable effects for investee companies, including, for example, bringing advanced technological innovation (Luong et al., 2017), enhancing reporting transparency (Kang and Stulz, 1997; Jiang and Kim, 2004; He et al., 2013), achieving informational and functional efficiency of capital markets (Gul et al., 2010), and facilitating the spread of social norms (Dyck et al., 2019).

Since foreign institutional investors largely influence investee companies' management practice and social awareness, and among other factors, we begin to concentrate on the role of foreign investors in investee companies' audit process. Specifically, we aim to investigate foreign investors' demand on audit efforts from auditors (proxied by the fees charged by auditing firms). A pioneering study by Simunic (1980) documents that the amount paid in audit fees by the client company largely depends on the efforts of auditors, which in turn depend on auditors' assessment of the client firm's complexity and risk level. Over the past decades, practitioners and academic researchers have explored the influence of factors as possible

[1] For details, please see https://www.imf.org/en/publications/gfsr?page=2. The gradual opening up of emerging countries' securities markets to international investors is perceived as a vital manifestation of the increasing integration of international capital markets (Cao et al., 2017).

determinants of audit fees (Taylor and Simon, 1999; Gotti et al., 2012; Jha and Chen, 2015; Kim et al., 2015; Tee et al., 2017). Taylor and Simon (1999) find that the increased litigation pressures, external monitoring and regulation in turn increase the demand for more audit effort, hence exerting upward pressures on audit fees. These factors have a potential influence on the efforts of the auditor or the risk of litigation, both of which ultimately influence the fees charged by auditors. However, whether and – if so – how foreign investors may influence investees' audit fees and implications of foreign investors for audit markets has received little attention in prior literature.

China provides an ideal environment to investigate our research question. First, the Qualified Foreign Institutional Investor (QFII) Program by the China Securities Regulatory Commission (CSRC) has attracted many overseas investment entities and financial institutions from around the world to invest in the China A-share stock market since its launch in 2002.[2] Particularly, a large majority of these overseas investors originate from well-governed jurisdictions and advanced economies. This scheme grants foreign investors an opportunity to access the Chinese market, which significantly facilitates the market openness and the integration of economic resources. Moreover, these offshore investors are expected to play a critical part in improving corporate policies. For instance, as indicated in Huang and Zhu (2015), QFIIs have incentives to help increase the compensation to minority tradable shareholders and mitigate the agency problems of listed firms in China. Prior research documents that the foreign entities investing in developing economies, which are generally characterised by weak governance institutions and high information asymmetry, will enhance investees' corporate transparency and governance. As noted by Kim et al. (2019a), QFIIs help reduce Chinese listed companies' stock price crash risk via external monitoring. Li et al. (2021a)

[2] A-shares refer to firms that are incorporated in China and traded on the Shanghai and Shenzhen exchanges; they are quoted in local renminbi and entail foreign investment regulations.

argue that QFIIs from high-institutional-quality regions introduce their governance practices to their investee companies. Foreign investors often face heightened agency problems because they have limited access to information validation and executive team monitoring, mainly due to their unfamiliarity with local industry and the physical distance from investees. Prior studies have widely established that extensive and high-quality auditing services can mitigate the information asymmetry between corporate management teams and outside information users by allowing outsiders to verify the validity and enhance the readability of financial statements (Francis and Wilson, 1988; DeFond and Zhang, 2014). The need to facilitate external monitoring may drive the demand for additional audit services (Tee et al., 2017). Inspired by this strand of literature, we posit that once QFIIs have invested in overseas companies located in countries with inferior governance, such as China, they have strong motives to push the management to utilise additional audit services to facilitate external monitoring, overcome their information disadvantages, and protect investment stakes, hence driving up audit fees.

Second, although China has already achieved remarkable economic progress and become the largest emerging economy, its poor law enforcement and minority shareholder protection still raise severe concerns (Bai et al., 2004; Yuan et al., 2009). An Enterprise Risk Report by Deloitte reveals that under the current economic system in China, most listed companies' governance systems are under the leadership of the government and only serves the interests of the ultimate controlling shareholder rather than those of a broader group of stakeholders. It is not a firm's self-initiated behaviour, and it lacks internal motivation for achieving strategic goals and management improvement, thereby exhibiting lower audit quality, litigation risk, unexpected loss, and audit risk.[3] Thus, companies should focus on establishing an effective governance environment, identifying the area for value improvement in the processes, and pursuing higher-quality audit efforts. Analysing the extent to which foreign

[3] Please refer to https://www2.deloitte.com/cn/en/pages/risk/articles/enterprise-risk-9.html for details.

investors influence Chinese companies' auditing procedures may provide essential insights into mechanisms that induce changes in governance controls.

Third, given the increasingly crucial role of QFII-licensed entities in the Chinese market, they may have been provided with a higher latitude of action or a bigger 'say' in corporate activities. In addition, QFIIs are more financially sophisticated, with advanced management skills, in-depth investment knowledge, and a strong sense of investor protection and governance awareness (Gul et al., 2010; Jin et al., 2016; Li et al., 2021b). Thus, China and Chinese management teams, collectively characterised as a latecomer to the international markets, may attempt to rely on QFIIs to effectively implement governance practices and facilitate audit procedures since QFIIs, who have the ability and expertise, are more likely to play an important part in influencing advising duties and monitoring processes in China (Huang and Zhu, 2015).

Using a sample of 2,804 unique Chinese public corporations with 22,170 firm-year observations between 2005 and 2017, we provide overwhelming evidence that QFII ownership is positively connected with audit fees. Besides, we reveal that the audit fees for companies with QFIIs tend to be higher than for companies without, and that the more QFIIs there are, the higher the total fees that a company pays to its auditor. We then explore why QFIIs demand additional audit efforts in investee companies, hence driving up audit fees. First, the motive for QFIIs to induce the corporate management team to utilise more extensive audit services may be attributable to their home countries' high-quality corporate governance, and high-standard codes of conduct. The overwhelming majority of QFII-licensed entities in China are originating from well-governed jurisdictions, such as countries in Western Europe and the United States, where better governance practices, audit effort, and audit quality are seen as desirable (Firth et

al., 2012; Gong et al., 2013),[4] and they are more accustomed to higher-standard codes of conduct and better governance practice in their home countries. As a result, these overseas investors are highly likely to transplant their high standards of conduct and practice to the firms that they invest in, thus there is greater potential that they will require investee firms in inferior governance countries to use more audit services. Second, investing in a foreign market is accompanied by additional risk and investment uncertainty due to a lack of transparent and sufficient information for the fair evaluation of their prospective investees; when compared to local investors, overseas investors are naturally characterised by information disadvantages (Oh et al., 2011; Li et al., 2021b). As extensive audit efforts are considered as a vital monitoring mechanism that mitigates the degree of information asymmetry between managers and outside investors (Tee et al., 2017), once QFIIs have invested in overseas companies they have incentives to demand additional audits to address their concerns that arise from geographical distances. Our results suggest that this positive influence is mainly driven by QFIIs originating from regions with stronger governance institutions and QFIIs from geographically remote countries relative to China.

Next, we investigate the scope of the influence of QFIIs on the total fees paid to auditors. We first examine whether investees' earnings manipulation has an effect on the link between QFIIs and audit fees. As for companies with a high degree of earnings manipulation, foreign investors may demand more extensive audits, thereby driving up audit fees. We find that the positive influence of QFIIs is more prominent for investee companies that engage in a higher degree of accrual-based earnings manipulation than for those that engage in a lower degree of earnings manipulation. Second, we explore the influence of corporate social responsibility (CSR) on the said link since foreign investors may perceive that high-CSR-conscious

[4] Similarly, Jia et al. (2020) report that 95.83% of QFII-licensed investors in Chinese listed firms come from economies deemed as advanced by the IMF.

companies suffer less from ethical issues (Kim et al., 2012), litigation risk (Brooks et al., 2019), and information asymmetry (Liao et al., 2019), hence diminishing the need for extensive and diligent auditing. We find that the increase in audit fees associated with QFIIs is more salient in investees with low initial CSR consciousness than among those with high CSR.

To examine the robustness of our key findings and address potential endogeneity issues, we employ alternative measures for our key variables, control for additional governance variables, adopt alternative samples, and employ a firm fixed-effect model, propensity score matching (PSM) and the dynamic panel generalised method of moments (GMM) estimation. Finally, our path analysis indicates that QFIIs help improve shareholder value, and that a proportion of such enhancement occurs via the higher audit fees that a client pays to its auditor.

This study offers three strands of contributions to the extant literature. First, we provide new insights into the literature exploring the role of foreign investors. Previous research largely focuses on their influence on financial stability (Schuppli and Bohl, 2010), CSR (Dyck et al., 2019; Li et al., 2021b), internal control quality and shareholder protection (Huang and Zhu, 2015; Li et al., 2021a), and dividend policy (Cao et al., 2017). Our study highlights the role of foreign investors in influencing the demand for investee firms' auditing services in the Chinese market where governance and minority shareholder protection mechanisms are either weak or difficult to effectively enforce. Even though China differs from other emerging markets from some aspects, this article opens up avenues for future research – focusing on the everchanging changes in corporate governance practices in jurisdictions or countries, where monitoring mechanisms are relatively ineffective.

Second, this study adds to those on the determinants of audit pricing. For example, existing literature has well established that audit fees are influenced by litigation pressure and regulatory monitoring (Taylor and Simon, 1999), discretionary accruals and managerial incentives (Gul et al., 2003), directors' and officers' insurance (O'Sullivan, 2009), board

characteristics (Carcello et al., 2002; Johansen and Pettersson, 2013), CEO equity incentives (Kim et al., 2015), and social capital (Jha and Chen, 2015). We employ a panel data sample consisting of QFII-licensed investors originating from 23 countries and reveal that the positive influence is mainly driven by investors from jurisdictions with stronger governance institutions, or by investors from physically remote nations relative to China. This indicates that the national governance quality and geographical distance of QFII-licensed investors influence their distinctive governance behaviours and the demand for better monitoring in the investee firms. Simply put, we shed light on possible channels through which foreign institutional investors engage in monitoring investees worldwide and, hence, their governance practices regarding auditing travel around the world.

Third, we echo the call to explore the financial implications of audit work and foreign investors. Prior literature mainly focuses on the influence of audit work on firm value (Chan and Li, 2008; Asthana, 2014). Notably, we extend this strand of studies and empirically demonstrate that the increased audit effort driven by QFIIs is highly valued by the market, highlighting the key role of QFIIs in achieving broader economic and governance objectives.

This study is organised as follows. Section 2 reviews the institutional background and related literature, and develops hypotheses. Research design is described in Section 3. Section 4 discusses empirical results and robustness checks. Section 5 investigates the investors' valuation of firms with increased audit efforts driven by QFIIs. The final section draws conclusions.

2 Related studies and hypothesis development

2.1 Background

China partly opened its domestic capital market to international institutional investors by introducing a scheme for the distribution of investment quotas to QFIIs officially authorised by the CSRC in November 2002. This scheme aims to gradually develop the domestic capital

markets and allows QFII-licensed entities to buy and sell Chinese Yuan (CNY)-denominated A-shares listed on the Shanghai Stock Exchange (SSE) and Shenzhen Stock Exchange (SZSE). Since then, international investors in the domestic A-share market have risen dramatically with regard to foreign investment quotas and the number of QFII-licensed investors. For example, in July 2003, there was only one licensed investment entity with an initial investment quota of $800 million which was made by UBS AG (which obtained the first QFII license in China); however, in January 2019, this number increased to 308 QFII-licensed investors with a total quota of $300 billion.[5] Moreover, during the 2016–2018 period, the State Administration of Foreign Exchange (SAFE) carried out a major reform of the QFII system of foreign exchange management, including the abolition of restrictions on the proportion of foreign exchange remittances and the cancellation of related provisions on the lock-up duration, allowing foreign exchange hedging of securities owned by QFII-licensed investors, which further encourages foreign capital investments in China.

Once they have placed investments in overseas firms, these offshore investment entities have a strong motivation to monitor the investees so as to maximise the value of their investments (Kim et al., 2019b). For instance, as documented by Aggarwal et al. (2011), the higher the foreign institutional ownership, the more enhanced the internal corporate governance, such as setting up mechanisms to terminate poorly performing chief executive officers (CEOs). Recent years have seen significantly increased capital inflows and resources by QFII-licensed entities to emerging markets (Frenkel and Menkhoff, 2006; Zhang et al., 2017). As noted in Li et al. (2021a), QFII-licensed investors can help enhance the internal control quality in Chinese listed firms. Gul et al. (2010) provide evidence that stock price synchronicity is lower for companies that issue shares to both domestic and international

[5] See http://www.safe.gov.cn/en/2019/0118/1486.html and http://www.csrc.gov.cn/pub/newsite/gjb/sczr/qfiiylb/201906/t20190628_358352.html for details.

investors than for companies that issue shares solely to domestic investors, thus confirming the positive influence of the entrance of foreign institutional investors on the information environment. These studies broadly support the view that foreign investors are proactively involved in monitoring investees worldwide and, hence, they may impose their management styles and governance awareness on their investee firms. However, the influence of QFIIs, an increasingly important external monitoring mechanism, on companies' audit fees and procedures has received little attention in the literature. In this study, we fill this void by investigating whether and how QFII-licensed investors are linked to audit efforts.

2.2 QFIIs and their influence on audit fees

Grounded on the agency theory (Jensen and Meckling, 1976), potential opportunistic behaviours by a company's management team tend to drive severe conflicts of interests between outside investors and corporate insiders, which ultimately destroys firm value (Jensen and Meckling, 1976). Information asymmetry is perceived as a leading cause of the agency issue as the management tend to hide information from outside investors. Compared with domestic investors, foreign investors face severe information asymmetry as they are physically distant from the investee firms and unfamiliar with the local investment environments and regulations (Barmeyer and Mayrhofer, 2008; Oh et al., 2011; Li et al., 2021b). Severe information asymmetry prevents foreign investors from effectively monitoring the investee firms as it is difficult for them to understand, interpret, and validate the accounting and financial information. Hence, foreign investors may have a higher demand for procedures to mitigate the information asymmetry.

Prior research shows that extensive and high-quality auditing serves as an effective mechanism to mitigate the information asymmetry between corporate managers and outside investors and increase financial the integrity and readability of financial disclosure (Tee et al., 2017; Kim et al., 2019b). Therefore, an increasing strand of literature argues that foreign

institutional investors demand more extensive auditing and more transparent accounting information to prevent expropriation by corporate insiders and they could exert significant influence over investee companies' business strategies and governance practices. For example, both Ben-Nasr et al. (2015) and Huang and Zhu (2015) note that the openness of domestic capital markets to international investment institutions induces a greater demand for high-quality governance and increased corporate transparency. Kim et al. (2019b) report that companies with higher international institutional ownership are more likely to employ Big Four auditors, perceived to provide diligent auditing and extensive audit efforts, to mitigate the information asymmetry that these offshore investment entities face when investing overseas. Based on the aforementioned literature we postulate that, once foreign institutional investors have invested in overseas firms, they have strong incentives to compel the executive team to utilise more extensive and higher-quality audit services to reduce information asymmetry. Hence, from the demand-side perspective, foreign investors may demand increased audit efforts, which drives up audit fees.

From the supply-side perspective, however, it is possible that with an increase in foreign ownership, QFII-licensed investors may have incentives to actively monitor corporate activities (i.e. financial reporting processes and internal control) and mitigate the inherent risk of material misstatements (Lel, 2019). For example, Bradshaw et al. (2004) show that non-US companies with a higher degree of US ownership employ accounting methods consistent with the US Generally Accepted Accounting Principles (GAAP), suggesting that US investors (as foreign investors) actively engage in monitoring by requiring more transparent accounting information from investee companies. Accordingly, external auditors may charge less risk premium or reduce the level of substantive checking, because they perceive companies with the presence of foreign investors as having lower inherent risk and undergoing stronger scrutiny, eventually leading to lower audit fees.

Although the demand-side and supply-side perspectives may produce mixed findings, we argue that the demand for high-quality and more extensive audits is more conceptually and practically appealing because an international study by Kim et al. (2019b), who employ a larger sample consisting of 40 non-US countries, provides strong supporting evidence that foreign investors tend to compel investee firms to hire reputable auditing firms to mitigate their information asymmetry problems when placing their investments overseas. In line with Kim et al. (2019b), foreign investors have incentives to compel Chinese listed companies to utilise more extensive audit services due to China's inferior governance and weak shareholder protection, thereby driving up audit fees. The above argument leads to the following prediction:

H1: Foreign institutional ownership is positively related to investee companies' audit fees.

When studying the impact of QFII-licensed investors on audit fees, it is necessary to review these investors' institutional quality and backgrounds, which may influence their distinctive governance behaviours, preferences, and awareness. Institutional quality can largely explain the disparities in governance mechanisms across countries (La Porta et al., 2008; Del Bosco and Misani, 2016), and a high level of institutional quality drives the governance practices of individual firms (Del Bosco and Misani, 2016). For example, companies located in jurisdictions with higher institutional quality tend to have better governance systems to ensure that their directors on the board and executive members act in the best interests of all shareholders (Del Bosco and Misani, 2016). Besides, the Worldwide Governance Indicator by the World Bank shows that institutions in jurisdictions with higher national governance quality are more likely to (i) abide by the rules and laws of society, (ii) have better enforceability of contracts, investor protection, transparency, and accountability of the governance system and integrity, (iii) exhibit higher quality of policy formulation, implementation and credibility of an organisation's commitment to stakeholders, and (iv) effectively control for corruption issues and enhance the stringency of institutional conditions (Klun and Slabe-Erker, 2009; Del Bosco

and Misani, 2016). These country-level characteristics may significantly shape institutional investors' governance awareness and make them accustomed to a high standard of code of conduct and governance standards in home countries which, in turn, influences their governance practices in their investee companies.

Indeed, prior literature documents that institutional investors located in well-governed jurisdictions have stronger incentives and the ability to monitor their investees, when compared to those located in jurisdictions with inferior governance practices and weak enforcement (Aggarwal et al., 2011; Luong et al., 2017; Kim et al., 2019b). For instance, international institutional investors from jurisdictions with high governance quality can act as active monitors in investee firms, provide insurance for the corporate executive team against innovation failures, and promote knowledge spillovers, thereby playing a more effective role in influencing investees' innovation-related policies (Luong et al., 2017). As noted by Aggarwal et al. (2011), overseas investors from countries with a higher level of shareholder protection can significantly promote the governance efficacy of investee firms. Moreover, QFII-licensed investors who originate from regions with higher regulatory quality tend to transplant their socially responsible and environmentally friendly practices to investee companies, thereby driving up overall social awareness, particularly when the monitoring mechanisms of the investees' jurisdictions are weak (Li et al., 2021b).

The common theme of this strand of the literature is that foreign investors from high-quality governance markets are more active in developing a higher standard of governance practices in investee companies because they are more accustomed to high codes of conduct and governance norms in their home countries. However, foreign investors from countries with inferior governance systems may be less likely to influence investees to enhance their governance controls and practices (Kim et al., 2019b). In sum, we argue that QFII-licensed investment entities exhibit a greater demand for more extensive and higher-quality audit efforts

when they are originating from jurisdictions with more effective governance institutions. More formally:

H2: The positive influence of foreign institutional ownership on investee companies' audit fees is more salient when the ownership by QFII-licensed investors from jurisdictions with better governance quality is higher.

Further, geographical distance between the investor and the investee company will aggravate the information asymmetry problems. Institutional investors located close to the target companies can quickly obtain useful and valuable information about the targets via informal meetings or frequent visits with top management and staff (Baik et al., 2010). Conversely, foreign investors from countries that are distant from the investees' countries tend to suffer from more extremely information asymmetries relative to the case with investors from nations that are closer to target countries (Li et al., 2021b). The high degree of information asymmetry resulting from geographical distance is a core driving factor of major acquirers' governance practices in their investee companies (Kang and Kim, 2008). Notably, many studies reveal that extra, diligent, and high-quality auditing can serve as an information intermediary and protector of shareholder value (Clinch et al., 2012; Barroso et al., 2016; Tee et al., 2017; Kim et al., 2019b). Hence, we conjecture that QFIIs may pressure firm management to utilise more extensive and higher-quality audit services to facilitate more effective monitoring, particularly when QFIIs are from geographically remote countries relative to China, which in turn drives up audit fees. Thus,

H3: The positive influence of foreign institutional ownership on investee companies' audit fees is more pronounced when the ownership by QFIIs from physically remote jurisdictions relative to China is higher.

3 Research design

3.1 Data collection and sample construction

We start with all Chinese A-share companies listed on either the SSE or the SZSE between 2005 and 2017. Audit data (i.e. audit fees, auditor choice, name of the auditing firm, audit opinion, audit report issue date), financial variables and governance variables are taken from the China Stock Market and Accounting Research (CSMAR) database. The platform is widely used and cited by auditors, listed firms, and scholars in China (Huang and Zhu, 2015; Cao et al., 2017; Zhang et al., 2017; Wang et al., 2019). We follow McGuinness et al. (2017) and Yu and Zheng (2020) to extract the data on QFII-licensed investors' identities and ownership – i.e. foreign institutional shareholdings, names and headquarters of each investment entities – from the Wind-Financial Terminal and the State Administration of Foreign Exchange.[6] We then exclude firm-year observations in the financial sector (CSRC code: J66–J69), leading to a final sample of 22,170 firm-year observations for 2,804 firms during the sample period.

3.2 Empirical model and variable definitions

To test our hypotheses, we follow the empirical framework of prior studies on audit fees (Carcello et al., 2002; Johansen and Pettersson, 2013; Jha and Chen, 2015; Wang et al., 2019) and estimate the following ordinary least squares (OLS) regression:

$$AUDITFEE_{i,t} = \alpha + \beta_1 QFIIOWN_{i,t-1} + \beta_2 CONTROL_{i,t-1} + Year\ Fixed\ Effects + Industry\ Fixed\ Effects + \varepsilon_{i,t} \quad (1)$$

where *AUDITFEE* is measured as the natural logarithm of total audit fees for company *i* in year *t*. *QFIIOWN*, the explanatory variable of interest, is measured as the percentage of outstanding shares owned by QFII-licensed investors. We also employ *QFIIDUMMY* which is a categorical variable assigned a value of one if a company has at least one QFII-licensed investor, and zero

[6] See https://www.wind.com.cn/ and https://www.safe.gov.cn/guangdong/2019/0107/1293.html for details.

otherwise. Moreover, *QFIINUM*, computed as the natural logarithm of the total number of QFII-licensed investors of a company, is introduced as an alternative key independent variable in our baseline model. Given our hypothesis, we expect β_1 to be significantly positive.

We refer to prior studies (Hay et al., 2006; Jha and Chen, 2015; Wang et al., 2019; Bryan and Mason, 2020; Ge and Kim, 2020; Lobanova et al., 2020) and control for a set of variables (*CONTROL*) known to influence audit fees. The company size (*SIZE*) is measured by the natural logarithm of the book value of total assets. As noted by Pratt and Stice (1994), accounts receivable and inventory require subjective judgement in determining their values and, accordingly, are difficult and risky to audit. To reduce the probability of audit failure and related risk, auditors may need to pay more efforts to improve audit quality, thereby driving up audit fees (Carcello et al., 2002). Thus, we use *RECEIVABLE*, which is computed as the accounts receivable scaled by the book value of total assets, as well as *INVENTORY*, computed as the ratio of inventory to total assets, as proxies for corporate complexity. Next, we employ four variables to capture business risk: (i) total liabilities divided by total assets (*LEVERAGE*); (ii) a loss indicator variable (*LOSS*); (iii) the ratio of net income to total assets (*ROA*), and (iv) the current ratio of current assets to current liabilities (*CRATIO*). A firm's growth potential is captured by *Q*, computed as the book value of total assets minus the book value of equity plus the market value of equity, all scaled by the book value of total assets. We also follow Ge and Kim (2020) to account for the effect of earnings quality, and therefore include the volatility of operating cash flows scaled by the book value of total assets (*CFO_VOLATILITY*), as well as the volatility of pre-tax earnings divided by the book value of total assets (*EBT_VOLATILITY*) in the previous five years in our model specification. *SOE* is included in our model specification; it is a categorical variable set to one if the ultimate controlling owner of a firm is the state or state-owned, and zero otherwise.

Carcello et al. (2002) document that board independence and the number of board meetings are both positively associated with audit fees because independent and diligent boards generally demand higher audit quality beyond normal standards, thereby driving up the fees charged by auditing firms. Hence, we control for *INDEPENDENCE*, measured as the proportion of independent directors sitting on the board, and *MEETING*, computed as the natural logarithm of the total number of board meetings held each year. Bryan and Mason (2020) find that board size is positively associated with audit fees. Thus, we control for *BOARDSIZE*, measured as the natural logarithm of the total number of directors in the boardroom. *ANALYST*, defined as the natural logarithm of one plus the total number of financial analysts following a firm (Lim and Monroe, 2020), is included to control for external monitoring. Finally, based on prior studies' findings (Jha and Chen, 2015; Wang et al., 2019; Ge and Kim, 2020), we control for several auditor-specific attributes: *BIG4*, *OPINION*, and *AUDITLAG*. *BIG4* is a categorical variable set to one if a client-company is audited by a Big Four auditor in a given fiscal year; otherwise, it is assigned a value of zero.[7] *OPINION* is a categorical variable assigned a value of one if a client-company receives an audit opinion that is neither an unqualified opinion nor an unqualified opinion with additional language, and zero otherwise. *AUDITLAG* is computed as the natural logarithm of the number of days between the fiscal year-end date and the audit report issue date. We include industry and year fixed effects. Standard errors are clustered by firm and year (Petersen, 2009; Thompson, 2011). The variable construction and data sources are displayed in Appendix A.

[7] The Big Four accounting organisations are PricewaterhouseCoopers, Ernst & Young, Deloitte, and KPMG.

4 Empirical results and discussions

4.1 Univariate results

Panel A of Table 1 displays the annual distribution of our sample. It shows that our sample size gradually increases, from 1,046 observations in 2005 to 2,584 observations in 2017. Notably, the percentage of companies with QFII-licensed investors increased to about 9.83% (254/2,584) in 2017, up from 2.68% (28/1,046) in 2005, suggesting that the QFII programme initiated by the Chinese regulatory authority has significantly facilitated foreign institutional investment in the domestic capital market. As shown in Panel B, the CSRC industries with larger representation are Manufacturing (58.290%), Wholesale and Retail Trade (6.698%), Real Estate (6.229%), and Information Transmission, Software and Information (5.922%).

[Table 1 inserted here]

Table 2 displays descriptive statistics of all variables in our regression analysis. First, *AUDITFEE* (in the form of natural logarithm), a proxy for audit effort, varies from 9.210 to 18.198, with a mean (median) value of 13.592 (13.459), suggesting that more than half of our sample firms have audit fees lower than the average level. These statistics are largely comparable to those documented in prior research investigating auditor remuneration in China such as Gong et al. (2016) and Wang et al. (2019). Next, *QFIIDUMMY* has a mean of 0.087, meaning that 8.7% of our sample firms have at least one QFII-licensed investor. In terms of some other variables, the means of the firm size (*SIZE*), leverage ratio (*LEVERAGE*), and profitability ratio (*ROA*) are 21.849, 0.471, and 0.032, respectively. Of our sample firms, 10.9% report a loss (*LOSS*), 49.6% of our sample firms are state-owned companies (*SOE*), and 36.7% of the board directors are independent (*INDEPENDENCE*). These summary statistics are comparable with those in prior studies (Gong et al., 2016; Ma et al., 2019; Wang et al., 2019; Li et al., 2021a; Li et al., 2021b).

[Table 2 inserted here]

Table 3 shows that the correlation coefficients between pairs of *QFIIOWN* and *AUDITFEE* (0.0612), *QFIIDUMMY* and *AUDITFEE* (0.1290), and *QFIINUM* and *AUDITFEE* (0.1364) are all positive and significant. This lends initial support to our central hypothesis. In addition, the low correlations between the explanatory variables suggest that multicollinearity may not drive our results.

[Table 3 inserted here]

4.2 Regression results and discussions

4.2.1 Effect of foreign institutional investors on audit fees

To empirically examine the link between QFII-licensed investors and audit fees, we specify equation (1) and display the results in Table 4. Model 1 presents the results of the baseline OLS regression; *QFIIOWN* attracts a positive and statistically significant coefficient (0.0149 with *t*-stat = 4.5172), indicating that ownership by QFII-licensed investors is positively associated with audit fees due to additional audit efforts demanded by foreign investors. For example, auditors may pay particular attention to reporting completeness, valuation and allocation, classification and understandability, cut-off testing, and rights and obligations testing, among others. This finding is also economically significant. A one-standard-deviation (0.873) increase in foreign ownership, denoted by *QFIIOWN*, translates into, approximately, a 1.301-percentage point (0.0149×0.873) increase in *AUDITFEE*.[8] This evidence is supportive of H1. Similarly, the estimate on *QFIIDUMMY* is significantly positive in column 2, implying

[8] The coefficient on *QFIIOWN* is 0.0149 in Model 1 of Table 4, and the standard deviation of *QFIIOWN* is 0.873, as shown in Table 2; this is calculated as 0.0149×0.873=0.0130077 (1.301%). Notably, the above result is mainly attributable to the fact that in our panel data regression analysis, approximately 8.7% of the sample firms are with the presence of QFIIs (thus with QFII ownership greater than zero) while the rest of the sample firms are with QFII ownership of zero. Therefore, it may appear to be a 'modest' improvement. We then re-run Eq. (1) based on firm-year observations with the presence of QFIIs, and we find that the coefficient on *QFIIOWN* is 0.0143 (with *t*-stat = 3.31). The standard deviation of *QFIIOWN* (when *QFIIDUMMY*=1) is 2.310, as shown in Table 2. Economically, a one-standard-deviation (2.310) increase in foreign ownership, denoted by *QFIIOWN*, will translate into about 3.303% (0.0143×2.310) increase in *AUDITFEE*, again indicating a significant improvement. These results are available upon request.

that audit fees tend to be higher for companies with QFIIs than for companies without.[9] In column 3, we find a significantly positive coefficient on *QFIINUM*, reaffirming the positive link between foreign investors and audit fees. As for the effects of control variables, *SIZE*, *RECEIVABLE*, *Q*, *EBT_VOLATILITY*, *INDEPENDENCE*, *MEETING*, *BOARDSIZE*, *BIG4*,[10] *OPINION*, and *AUDITLAG* are positively associated with auditor remuneration, while *LEVERAGE*, *ROA*, *CRATIO*, *SOE*, and *ANALYST* are negatively related to audit fees.

[Table 4 inserted here]

4.2.2 Role of governance quality of QFIIs' countries of domicile

In this section, we examine why QFII-licensed investors would demand high-quality audit efforts, hence leading to higher audit fees. We first conjecture that QFII-licensed investors transplant their strong corporate governance motivation and high standards of codes of conduct to the firms in which they invest; foreign investors, who have such governance awareness driven by the institutional quality, may demand that the corporate executive team uses more extensive audit services, particularly when investees are located in jurisdictions with inferior governance and weak minority shareholder protection. As such, we follow Del Bosco and Misani (2016) and Li et al. (2021b) to employ the Worldwide Governance Indicator (WGI) scores from the World Bank as a proxy for institutional quality, and compute the median WGI score for each year.[11] Next, we create two continuous variables. *QFII_HIGHWGI_OWN* is

[9] We have tested the parallel trends assumption by matching 'each QFII observation' to 'an observation without QFIIs' within the same year, the same industry, and the nearest firm size. After matching, we find that *AUDITFEE* for firms with the presence of QFIIs in the year prior to QFII involvement is 13.7742 and that for firms without QFII involvement is 13.7235. The difference between these mean values is not statistically significant, which is evidenced by a p-value of 0.1250, indicating that the parallel trends condition is likely to be met.

[10] In unreported analysis, even if the *BIG4* is lagged by one year, our key finding still holds. This means that even if the Chinese firm has appointed a Big Four auditor in a fiscal year (to signal its high audit quality), the influence of one-year lagged QFIIs on audit fees remains positive and statistically significant. This result is available upon request.

[11] WGI includes six dimensions: voice and accountability, political stability and absence of violence, government effectiveness, regulatory quality, the rule of law, and control of corruption. Consistent with Del Bosco and Misani (2016), we averaged the six indicators (using equal weights) to build a WGI index as a comprehensive institutional quality measure. WGI ranges from -2.5 to 2.5, with higher WGI scores corresponding to stronger governance institutions. Please refer to https://info.worldbank.org/governance/wgi/Home/Documents for details.

measured as the sum of the percentage of outstanding shares held by QFII-licensed entities originating from regions or countries with a high degree of institutional quality (with a WGI score equal to or above the median level of WGI in a given fiscal year). In the same vein, *QFII_LOWWGI_OWN* is defined as the sum of the percentage of outstanding shares held by QFII-licensed entities domiciled in jurisdictions or countries with relatively low institutional quality (with a WGI index score below the median WGI).

We substitute *QFII_HIGHWGI_OWN* and *QFII_LOWWGI_OWN* for *QFIIOWN* in Eq. (1) and report the estimates in column 1 of Table 5. Notably, the estimated coefficient on *QFII_HIGHWGI_OWN* is positive and highly significant (0.0177 with *t*-stat = 2.7483), while that on *QFII_LOWWGI_OWN* is less significant (0.0112 with *t*-stat = 1.6632). We can see that *QFII_HIGHWGI_OWN* attracts a slightly larger coefficient than *QFII_LOWWGI_OWN* in terms of the magnitude, suggesting that compared to QFII-licensed investors from jurisdictions with low institutional quality ratings, investors from well-governed countries may demand more extensive auditing procedures, consistent with their motives.

[Table 5 inserted here]

Next, we follow Porta et al. (2008) and Spamann (2010) to use the anti-director rights index score as a proxy for a country's shareholder protection level and governance quality. Specifically, we create two variables – namely, *QFII_HIGHSP_OWN* and *QFII_LOWSP_OWN* – to capture the influence of QFII-licensed investors from high shareholder protection jurisdictions and investors from relatively weak shareholder protection jurisdictions on audit fees. The former one is measured as the sum of the percentage of outstanding shares held by QFII-licensed investors from countries with a higher level of shareholder protection (with an anti-director rights index score equal to or above the median level). The latter is measured as the sum of the percentage of outstanding shares held by QFIIs

from countries with weaker shareholder protection (with an anti-director rights index score below the median level).

We modify our main variable of interest from *QFIIOWN* to *QFII_HIGHSP_OWN* and *QFII_LOWSP_OWN* in Eq. (1) and re-run the equation. In column 2, the estimate on *QFII_HIGHSP_OWN* is highly significant (0.0154 with *t*-stat = 2.9118), while that on *QFII_LOWSP_OWN* is less significant (0.0139 with *t*-stat = 1.8028). This evidence implies that the positive influence of QFIIs on auditor remuneration may be mainly driven by QFIIs from jurisdictions with better shareholder protection, consistent with Aggarwal et al. (2011) who find that foreign investors play a critical role in promoting governance changes in economies with weak shareholder protection. In summary, the results presented in columns 1 and 2 of Table 5 conform with H2.

4.2.3 Role of geographical distance between QFIIs' countries of domicile and China

We further explore why foreign institutional investors have incentives to push the executive team to utilise additional auditing services. We follow Li et al. (2021b) and measure the level of information asymmetry by employing the physical distance between QFII-licensed investors' countries of domicile and China as a proxy for such investment uncertainty. Specifically, we classify QFII-licensed investors into those from geographically distant jurisdictions (with geographic distance equal to or greater than the sample median geographic distance between QFIIs' countries of domicile and China) and those from geographically proximate nations (with geographic distance below the median geographic distance). Next, we create two variables to capture the magnitude of QFIIs' influence. *QFII_DISTANT_OWN* is measured as the sum of the percentage of outstanding shares held by QFIIs from geographically distant countries. *QFII_CLOSE_OWN* is measured as the sum of the percentage of outstanding shares held by QFIIs from geographically close countries.

We substitute *QFII_DISTANT_OWN* and *QFII_CLOSE_OWN* for *QFIIOWN* in Eq. (1) and re-run the model specification. In column 3 of Table 5, we observe that the coefficient on *QFII_DISTANT_OWN* is positive and statistically significant at the 1% level, while that on *QFII_CLOSE_OWN* is insignificant. From this, we can confirm that QFIIs from geographically remote countries tend to demand additional audit efforts (thereby higher audit fees) to mitigate the risk and investment uncertainty driven by the physical distance from the investee companies in China. Notably, this result may be driven by foreign investors from North America or European countries because, in an unreported analysis, we empirically reveal that the coefficients of QFIIs from these regions are both significantly positive compared to that of QFIIs from geographically close regions. Also, our data reveal that approximately 15.83% of the QFIIs locate in North America and 52.09% are situated in European countries (i.e. 17.62% from the UK, 10.24% from Switzerland, and 8.11% from France). These results indicate that our finding is not solely driven by QFIIs from either North America or any single country from Europe. Thus, H3 is supported. Overall, our evidence indicates that monitoring by QFII-licensed investors appears to be an underlying mechanism through which these investors could enhance investees' audit quality.

4.3 Additional analysis: roles of earnings quality and CSR

4.3.1 Role of investee firms' discretionary accruals in the link between QFIIs and audit fees

Next, we investigate the scope of the influence of QFIIs on audit fees by looking into the role of an investee company's initial earnings management. Prior studies on earnings management mainly use measures of discretionary accruals as surrogates for financial reporting quality and earnings manipulation (Jones, 1991; DeFond and Subramanyam, 1998; Kothari et al., 2005; Kim et al., 2012). Companies that aggressively use discretionary accruals to manage earnings are more likely to diminish the extensiveness of the external audit and exhibit lower audit quality (Chen et al., 2011), implying that a company's initial earnings

quality may affect the scope of the stakeholders' monitoring role in corporate activities. The overwhelming evidence from previous studies suggests that companies with severe earnings management issues are associated with severe agency problems and poor governance (Richardson, 2000; Rezaee and Tuo, 2019), and are thus perceived to be riskier. Consequently, investors require them to use high-quality audit services because of their high inherent risks (Tee et al., 2017). Following this line of reasoning, we posit that for investee companies aggressively engaging in earnings manipulation, QFIIs may face more severe investment uncertainty driven by earnings manipulation, which gives them strong incentives to require more extensive auditing procedures in the post-investment period, which drives up audit fees.

To validate our conjecture, in this sub-section we empirically test whether investee companies' discretionary accounting accruals may play a part in the relation between QFII ownership and audit fees. We follow Kim et al. (2012) to augment the modified Jones model by including the one-year-lagged return on assets as an explanatory variable. We use the residuals from the annual cross-sectional industry regression model as our estimates of a firm's discretionary accruals. We then follow Kousenidis et al. (2013) and partition our sample firms into two groups that correspond to firms with high and low levels of earnings manipulation, respectively. Specifically, first, we calculate the median of the absolute value of discretionary accounting accruals for each year and industry. Next, we sort a firm into a high (low) discretionary accrual group which is characterised by a higher (lower) level of earnings manipulation if the firm's absolute value of accounting discretionary is equal to or above (below) the median. We re-run our baseline model separately for each subgroup and test the difference in the estimated coefficient on *QFIIOWN* across subgroups; and display the regression results in columns 1 and 2 of Table 6. Notably, the estimate on *QFIIOWN* in column 1 is significantly positive (0.0281 with *t*-stat = 3.9331), while that on *QFIIOWN* in column 2

is insignificant.[12] Consistent with our prediction, when investee companies exhibit relatively poor accounting quality, QFIIs have greater incentives to demand more audit effort, resulting in higher audit fees; however, in companies with better accounting quality, QFIIs have no significant influence on the demand for additional audit procedures.

[Table 6 inserted here]

4.3.2 Role of investee firms' CSR in the link between QFIIs and audit fees

Relatedly, CSR has attracted extensive attention from academics and policymakers in understanding companies' motivation for engaging in ethically and socially responsible activities, with a particular strand in the CSR literature focusing on information environment enhancement. Indeed, CSR plays a critical role in reducing information asymmetry among stakeholders and therefore enhances earning capacity and corporate integrity (Tian et al., 2011). Based on Chinese data, Ye and Zhang (2011) note that companies with better CSR records exhibit a lower level of cost of debt because the improvement in a company's CSR reduces business risks and information asymmetry by generating positive moral and social capital as well as building public trust among a wide range of stakeholder groups. This responsibility and foresight can, to a large extent, lead to a reduction in audit risks and audit scope, hence decreasing audit fees (Wang et al., 2019). Companies that actively engage in CSR practices are less likely to undertake activities prone to external censure, so litigation risk from investors may, therefore, decrease (Brooks et al., 2019). Li et al. (2021b) find a significant disparity in the adoption of CSR and ethical activities in Chinese companies; for example, the social conduct performance varies considerably, and some may exhibit extremely high initial CSR, while others are characterised by extremely low CSR. This could largely affect the scope of the motive of QFIIs regarding inducing the management to employ more extensive audit procedures to eliminate their investment concerns. However, a different view may emerge. The

[12] The difference between the subgroups is statistically significant (p-value = 0.0576).

agency theory argues that CSR involvement may reflect poor incentives among top executives that could impede prospective investment opportunities (Bhandari and Javakhadze, 2017). CSR activities may also be used for personal interests and reputation building at the expense of shareholder wealth (Krüger, 2015). Meanwhile, a large volume of empirical evidence regarding Chinese firms' CSR engagement also supports its positive implications for financial activities (Tian et al., 2011; Du et al., 2019; Li et al., 2021b), thus mitigating QFIIs' concerns in terms of their investee companies' litigation risk and business environments.

Based on the above, we argue that foreign investors have less potential to require additional audit work and related due diligence services in companies with higher CSR scores since they may perceive socially responsible firms as having lower operating uncertainty and risk, but they may demand more extensive audit effort in low CSR companies which may exhibit a high litigation risk, hence driving up audit fees.

To test our conjecture, we collect CSR scores of Chinese listed firms from the Hexun website,[13] and then divide our sample into two groups that correspond to companies with high social responsibility and companies with low social responsibility, based on our sample median CSR score of each year, respectively. Next, we re-estimate our baseline model for each subgroup and display these results in columns 3 and 4 of Table 6. We find that *QFIIOWN* attracts a positive and highly significant coefficient in the low CSR group (column 4), while that *QFIIOWN* attracts an insignificant coefficient in the high CSR group (column 3). In line with our prediction, the evidence implies that QFIIs tend to compel the management team to

[13] The Hexun platform, which is a leading rating agency, provides numeric scores of Chinese listed companies' socially responsible and environmentally sustainable activities. This website has been increasingly used as a main data resource by studies in international journals (Huang et al., 2017; Deng et al., 2019; Shahab et al., 2019). Companies are totally scored from 0 to 100, with higher values corresponding to better CSR. CSR activities are categorised as shareholder protection, employee contributions, suppliers' and customers' rights, environments, and society. By default, the weights of shareholder protection, employee contributions, suppliers' and customers' rights, environments, and society are 30%, 15%, 15%, 20% and 20%, respectively, but the weights of the consumption, service, and manufacturing sectors may vary. For details, please refer to http://stockdata.stock.hexun.com/zrbg/Plate.aspx?date=2017-12-31.

utilise more extensive audit effort in local firms with relatively lower initial CSR, thereby resulting in higher audit fees.

4.4 Robustness

In this section, we adopt several robustness checks to test the validity of our main finding. For brevity, we mainly report the results based on our baseline model.

4.4.1 Role of the auditor choice

When QFII-licensed investors invest overseas, they face a higher degree of asymmetric information because it is costly and/or difficult to fully interpret and verify the financial conditions of their investees located in foreign markets (Kim et al., 2019b). The case could be even worse when investees are located in emerging markets where shareholder protection is weak (Li et al., 2021b). Since prior studies have clearly established that high-quality auditing firms play a critical part in reducing the information asymmetry (Becker et al., 1998; Ball et al., 2012) and mitigating the investment uncertainty associated with the liability of foreignness (Kim et al., 2019b),[14] we posit that QFIIs have strong incentives to demand better quality auditing services; for example, requiring the top management to appoint one of the Big Four auditing firms to verify the validity of accounting information and financial statements, and enhance the readability of financial disclosure. We, therefore, test the influence of QFIIs on the probability of appointing a Big Four auditor by specifying a probit model, where *BIG4*, an alternative dependent variable, indicates whether a firm is audited by a Big Four auditing firm in a fiscal year. *CONTROL* is an array of factors (i.e. *SIZE*, *RECEIVABLE*, *INVENTORY*, *LEVERAGE*, *LOSS*, *ROA*, *CRATIO*, *Q*, *CFO_VOLATILITY*, *EBT_VOLATILITY*, *SOE*, *INDEPENDENCE*, *BOARDSIZE*, and *ANALYST*) known to influence the auditor choice.

[14] More specifically, high-quality auditors are associated with more informative voluntary disclosure policies (Ball et al., 2012; DeFond and Zhang, 2014), greater credibility of earnings news (Teoh and Wong, 1993), and better financial reporting quality (Becker et al., 1998).

The result is displayed in column 1 of Table 7. The estimate on *QFIIOWN* is significantly positive (0.0549 with *z*-stat = 4.5978), implying that companies with higher QFII ownership are more likely to appoint a Big Four auditing firm, which has specialised resources and litigation concerns.[15] Thus, our key finding still holds when *BIG4* is employed as an alternative explained variable.

[Table 7 inserted here]

Furthermore, to mitigate the concern that our key finding (the increased audit fees/effort) is solely driven by Big Four involvements rather than by QFIIs, we sort our sample into two groups: one is with Big Four auditors and the other is without Big Four auditors. In the sub-sample with Big Four auditors only, we regress *AUDITFEE* on *QFIIOWN* and the same set of *CONTROL* employed in our baseline model and present the result in column 2 of Table 7, while in the sub-sample with non-Big Four auditors, we repeat the above regression and display the result in column 3. Interestingly, we find that the coefficient on *QFIIOWN* is positive and statistically significant in both groups. Although *QFIIOWN* attracts a larger coefficient (0.0166 with *t*-stat = 1.9159) in the sub-sample firms with Big Four involvements while the magnitude of the coefficient on *QFIIOWN* in the sub-sample with non-Big Four auditors is slightly smaller (0.0140 with *t*-stat = 4.1271), the estimates are not systematically different from each other based on our seemingly unrelated test. Hence, our key finding is mainly driven by QFIIs who have strong motives to push the management team to use more extensive audit services rather than solely attributable to Big Four auditor appointments that automatically drive prices up.

4.4.2 Additional control variables

We additionally control for several factors known to influence a firm's audit fees. Prior studies document that discretionary accruals, such as bad debt expenses, inventory

[15] The positive effect of foreign institutional investors on *BIG4* still exists even if we substitute *QFIINUM* or *QFIIDUMMY* for the key independent variable, and results are presented in Appendix B. Our findings still hold when we use two-year lagged, three-year lagged, …, or eight-year lagged *QFIIOWN*, further providing supportive evidence that QFIIs lead to Big Four auditor choice. These results are available upon request.

obsolescence, and warranty expenses, may be manipulated by firm management to offset poor business outcomes (DeAngelo, 1988; DeAngelo et al., 1994; Gul et al., 2003), hence exhibiting severe information asymmetry, higher likelihood of fraudulent financial reporting, and higher litigation risk. Venkataraman et al. (2008) argue that higher discretionary accruals are generally accompanied by a higher degree of inherent risk as assessed by the external auditing firms. The higher the degree of inherent risk within a firm, the more extensive auditing procedures (thus higher audit fees) are needed to compensate for the detection risk and the examination work to achieve a given level of audit risk. As such, we follow prior studies (Kothari et al., 2005; Kim et al., 2012) and employ the estimated residuals from the annual cross-sectional industry model as a proxy of a firm's discretionary accounting accruals.

We follow Kothari et al. (2005) and Kim et al. (2012) and then augment the modified Jones model by including the one-year-lagged *ROA* as an independent variable to control for the influence of firm profitability on measured discretionary accruals. We use the absolute value of discretionary accruals (*ABS_DA*) from the above cross-sectional industry model as a proxy for earnings quality because earnings management can involve either income-increasing or income-decreasing accruals (Kim et al., 2012; Ma et al., 2019; Xu et al., 2019). Higher values of *ABS_DA* indicate poorer earnings quality. Next, we add *ABS_DA* as an additional control variable to Eq. (1) and re-run the regression. The result presented in column 4 of Table 7 still shows a significantly positive coefficient on *QFIIOWN* (0.0148 with *t*-stat = 4.4444), providing additional support to our central hypothesis.

Drawing on agency theory and the demand perspective, Zaman et al. (2011) argue that larger and independent audit committees tend to demand more extensive auditing services, which increases the amount of fees for audit effort that a client-company pays to its audit firm. Hence, we augment Eq. (1) by including the size (*AUDITCOMM_SIZE*) and the independence (*AUDITCOMM_INDEP*) of the audit committee as control variables. Specifically,

AUDITCOMM_SIZE is measured as the natural logarithm of the total number of audit committee members; *AUDITCOMM_INDEP* is defined as the percentage of independent directors on the audit committee. The positive and statistically significant coefficient on *QFIIOWN* in column 5 of Table 7 indicates that, after controlling for *AUDITCOMM_SIZE* and *AUDITCOMM_INDEP*, our key finding continues to hold.

4.4.3 Excluding companies in the manufacturing sector

We further examine the industry distribution of QFII-clustering firms using the CSRC classification. As shown in Table 1, we find that firms operating in the manufacturing (CSRC code C) industry dominate our sample, accounting for approximately 58.29% (12,923 out of 22,170) of the firm-year observations. Notably, QFII-licensed investors are mainly clustered in this industry; for example, among 12,923 firm-year observations in the manufacturing sector, 1,178 observations have at least one QFII-licensed investor. Our findings are similar to the summaries reported by Liu et al. (2014) and Li et al. (2021b), which show that QFII-licensed investors are keen to invest in the manufacturing industry. Hence, this 'industry clustering effect' may drive our result. It is important to identify whether it is the QFII-licensed investors that exert a positive influence on audit effort, or whether it is the manufacturing industry itself that QFIIs concentrate on that exerts this positive effect. To rule out such a concern, we remove manufacturing firms in our regression analysis as a robustness check. The result presented in column 6 of Table 7 shows that *QFIIOWN* attracts a significantly positive coefficient, meaning that the 'industry clustering effect' does not drive our result.

4.4.4 Different time frames

Since 2014, the Chinese regulatory authorities have enacted several reforms to relax the QFII selection criteria to attract more foreign investments to the domestic Chinese market. For example, the 2014 Shanghai Hong-Kong Connection (SHKC) programme has relaxed the trading restrictions for foreign investors, and the CSRC has announced simplified rules that

removed the relevant criteria of assets under management and years of experience for QFIIs after 2019. Given such an increased number of QFIIs entering the Chinese market after 2014, it would be interesting to see whether this particular timeline may have a potential influence on the positive link between QFIIs and audit fees. To verify our conjecture, we partition our sample around 2014 as a cut-off point and report the results in columns 7 and 8 of Table 7.

In both periods, *QFIIOWN* attracts a positive and statistically significant coefficient. Although its magnitude is slightly greater in the earlier period 2005–2013 (coefficient = 0.0159) than that in the later period 2014–2017 (coefficient = 0.0106), the seemingly unrelated test shows no systematic difference between these two groups. This test further warrants us to draw a conclusion that the increased audit work is driven by QFIIs in general, not attributable to a specific timeline, strengthening our key finding.

4.4.5 Change analysis

Although year fixed effects and the one-year lagged QFII ownership could, to a certain extent, make some causal statements in our study, examining the influence of changes in QFII ownership on audit fees could further take away the concern that our key finding is associated with Granger causality (Granger, 1969). We thus regress *AUDITFEE* on the change in QFII ownership (*CHANGE_IN_QFIIOWN*) and the same set of control variables employed in Eq. (1) and display the regression result in column 9 of Table 7. Notably, *CHANGE_IN_QFIIOWN* attracts a positive and statistically significant coefficient, warranting our key finding.

4.4.6 Firm fixed-effect model

Next, since our findings are likely to be driven by omitted time-invariant firm-level factors, we employ a firm fixed-effect model. The result displayed in column 10 of Table 7 shows that the coefficient on *QFIIOWN* is positive and statistically significant at the usual significance level, thereby supporting H1.

4.4.7 Endogeneity issues

Our analysis so far supports a positive link between foreign investors and audit fees. The possible endogenous link between foreign investors and the demand for more extensive audit effort may, however, drive severe endogeneity issues in our study. First, the unobservable heterogeneity may bias our results. Such heterogeneity appears when there are unobservable firm-level characteristics that influence both QFIIs and driving factors of audit fees. Second, reverse causality is a source of endogeneity. Institutional investors may tend to invest in overseas companies that are willing to pay a higher audit fee because this implies additional audit effort has been performed in terms of a company's financial statements (Tee et al., 2017). Rigorous and extensive auditing procedures increase the integrity of accounting and financial statements of these firms (Kim et al., 2003), conveying a signal regarding a transparent business environment to the outside investors. Third, the dynamic link between the dependent variable and the independent variable may result in endogeneity issues in our empirical setting. In this section, we carry out the PSM analysis and the dynamic GMM approach to address these concerns.

PSM method

Here, we conduct the PSM method to address the potential concerns that firms with the existence of QFIIs are fundamentally different from those without. More specifically, we first run a probit model to estimate the probability of the presence of QFIIs using the full sample and calculate the propensity score for each observation. With replacement, we match a *QFII firm* to a *non-QFII firm* using the nearest neighbour matching technique based on an array of variables employed in Eq. (1): *SIZE*, *RECEIVABLE*, *INVENTORY*, *LEVERAGE*, *LOSS*, *ROA*, *CRATIO*, *Q*, *CFO_VOLATILITY*, *EBT_VOLATILITY*, *SOE*, *INDEPENDENCE*, *MEETING*, *BOARDSIZE*, *ANALYST*, *BIG4*, *OPINION*, and *AUDITLAG*. During the matching procedure, we set a caliper distance at 0.001. After matching, we follow Armstrong et al. (2010) and carry

out a covariate balance test to ensure the validity of our matching criteria in the treatment firms and control firms. Finally, we re-run Eq. (1) based on the PSM sample to examine the validity of our main finding.

The results are displayed in Table 8. Specifically, the result of the covariate balance between the treatment and control samples is presented in Panel A. We find that the observable firm characteristics of the control sample are largely similar to those of the treatment sample after matching. That is, the differences of mean values of the matching criteria between the treatment group and the control group are insignificant among 17 out of 18 control variables, implying a well-balanced sample. The regression result of the matched sample is displayed in Panel B. Notably, the estimate on *QFIIOWN* in column 1 is 0.0185 with a *t*-value of 2.4537, reaffirming H1.[16]

[Table 8 inserted here]

In order to further address the concern related to the potential imbalance among covariates between sample firms with the presence of QFIIs and those without, we follow Ma et al. (2019) to employ an entropy balancing approach, a reweighting technique that incorporates covariate balance into the weight function when carrying out the matching procedure. We use this method to balance the first three moments of the control variables – the mean, variance, and skewness – and then re-run the regression. The empirical results are displayed in Appendix C. Specifically, Panels A and B show descriptive statistics for control variables for the treatment sample versus the control sample derived before and after the application of the entropy balancing approach, respectively. Panel C reports the regression results of the entropy balancing. Notably, *QFIIOWN* continues to attract a positive and highly significant coefficient, again confirming the positive influence of QFIIs on audit fees.

[16] We have also conducted the PSM method with the 'no replacement' technique and our key finding is not affected. This result is available upon request.

Dynamic GMM estimation

The dynamic nature of our variables, according to which the current values of the independent variables are a function of past values of the explained variable, may drive endogeneity issues in our empirical setting. Following Kim et al. (2015), we include the one-year-lagged total audit fees (*AUDITFEE*) as an independent variable in Eq. (1) to implement the dynamic GMM estimation. We employ the Arellano–Bond system GMM method, which includes a procedure of two models. One is the dynamic regression that is transformed into a first-differenced mode. The other is the dynamic regression that is transformed into a level form (Arellano and Bover, 1995; Blundell and Bond, 1998).[17]

The result from the dynamic panel system GMM approach presented in column 1 of Table 9 shows that *QFIIOWN* attracts a significantly positive estimate (0.0061, with *z*-stat = 2.0611). To assess whether the instruments are exogenous, we adopt the Hansen test and find a p-value of 0.120 for the difference-in-Hansen examination of exogeneity, which validates the use of our instruments. The evidence displayed in this table indicates the positive link between foreign ownership and audit fees still exists when employing the dynamic panel-data estimation.

[Table 9 inserted here]

5 Does the market value the increased audit effort driven by QFII-licensed investors?

Our analysis thus far has documented that QFII ownership is positively connected with the fees for audit work that a client company pays to its auditor. Prior research suggests that the market highly values the extensive auditing procedures because investors generally refer to additional audit efforts as an insurance tool against litigation and information risk and managerial incentive problems (Caramanis and Lennox, 2008; Mao and Yu, 2015), potentially

[17] First-differencing the dynamic regression helps address the concern that unobserved heterogeneity and omitted factors may have an influence on audit fees. The system of equations is estimated via GMM using lagged values of the endogenous variables as instruments. The lagged levels are employed as instruments for the differenced equation, and lagged differences are used as instruments for the level equation in the Arellano–Bond system GMM procedure.

enhancing firm value (Asthana, 2014). We, therefore, argue that market participants may highly value firms with increased audit fees driven by QFIIs.

To verify our conjecture, we follow the procedures in Huang et al. (2016) and Cook et al. (2019) to carry out a mediation (path) analysis. We employ the Tobin's *Q* and the market-to-book (*MTB*) ratio as proxies for firm value, which is the examined outcome variable. QFII ownership is the treatment variable, while the audit fee is the mediator. Figure 1 demonstrates the intuition behind the mediation analysis and shows a causal diagram of the mediating effect. First, Path A corresponds to the effect of QFII ownership on the mediator–audit fees, and Path B illustrates the effect of the mediator on firm value. Second, Path C corresponds to the direct effect of QFII ownership on firm value. Finally, Path ABC represents the total effect of QFII ownership on firm value, thus incorporating both direct and indirect effects.

[Insert Figure 1 here]

The results of the mediation analysis are reported in Table 10. In line with our findings in Table 4, columns 1 and 3 of this table show that the treatment (*QFIIOWN*) is significantly related to the mediator (*AUDITFEE*), which is evidenced by the significantly positive coefficient on *QFIIOWN*. When the effect of the mediator is considered in columns 2 and 4, the treatment (*QFIIOWN*) is positively associated with *Q* and *MTB*, indicating that a higher percentage of outstanding shares held by QFIIs increases firm value. Notably, the mediating effect reveals that the influence of QFII ownership on firm value is weakened when the mediator is included in the model.[18] The result of the mediation test (Baron and Kenny, 1986) presented in Panel B of Table 10 indicates that the total effect of *QFIIOWN* on *Q* is 0.0236 (with *z*-stat = 2.6675), and its mediating effect (i.e. the indirect effect that operates through audit fees) is 0.0027 (with *z*-stat = 4.1411), both highly significant, thus accounting for a certain

[18] For example, in column 2 of Table 10 where the dependent variable is *Q*, the coefficient on *AUDITFEE* is 0.1752 and statistically significant at the 1% level, while that on *QFIIOWN* is 0.0209 and its significance reduces from the 1% level in column 1 to the 10% level in column 2 which additionally controls for *AUDITFEE*.

part (11.44%) of the overall improvement in *Q*. Similarly, the result that employs *MTB* as a performance proxy is consistent with the one that uses *Q* as an outcome variable. That is, approximately 8.95% of the total effect of QFII ownership on firm value operates indirectly through the impact on audit fees. These statistics suggest that the effect of QFII-licensed investors on firm value is partially achieved through the increased audit fees. Our empirical evidence supports our conjecture that the increased audit efforts (proxied by audit fees) driven up by QFII-licensed investors are highly valued by investors. Collectively, our mediation analysis reveals that QFIIs improve future firm value, and that a portion of this influence occurs via the higher audit fees that a client company pays to its auditor.

[Table 10 inserted here]

6 Conclusions

In this study, we explore the impact of QFIIs on auditing procedures within the Chinese context. We find that these offshore owners demand more audit efforts to reduce the high degree of information asymmetry they face in overseas markets, hence driving up audit fees. Our findings highlight the monitoring role of QFII-licensed entities, and we find that the demand for more extensive and high-quality auditing procedures is mainly driven by QFIIs from jurisdictions with strong governance institutions or is driven by QFIIs from geographically remote countries relative to China.

Our cross-sectional analysis further reveals that the positive link between QFIIs and audit fees is more salient in firms with severe earnings management (or lower initial CSR ratings) than in firms with a lower degree of earnings manipulation (or higher CSR). In addition to achieving good governance objectives, we shed light on the economic implications of audit efforts and foreign ownership – that is, the increased audit efforts driven by QFIIs are highly valued by the market. However, this study is still subject to some limitations. Future studies could explore the effects of foreign investors on other governance or information environment

issues such as analyst forecasting accuracy and forecasting dispersion. Besides, we restrict our analysis to the listed firms on China's A-share market. The China Interbank Bond Market Direct scheme was launched in 2016, providing international financial institutions access to a wide variety of fixed income instruments in the Chinese bond market. Thus, it may be imperative that future studies examine the relationships between QFIIs and fixed income issues.

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Appendix A: Variable definitions and data sources

Dependent variable	
AUDITFEE	Natural logarithm of total audit fees for a company in a given fiscal year. Source: CSMAR (https://cn.gtadata.com/).
BIG4	A categorical variable assigned a value of one if the client-company is audited by a Big Four auditor in a given fiscal year, and zero otherwise. The Big Four accounting organisations are PricewaterhouseCoopers, Ernst & Young, Deloitte, and KPMG. Source: Annual reports of Chinese listed firms and CSMAR.
Key independent variables	
QFIIOWN	The percentage of outstanding shares owned by QFIIs in a given fiscal year. Source: Wind-Financial Terminal (https://www.wind.com.cn/en/wft.html).
QFIIDUMMY	A categorical variable assigned a value of one if a Chinese listed company has QFII-licensed investment entities in a fiscal year, and zero otherwise. Source: Wind-Financial Terminal.
QFIINUM	Natural logarithm of the total number of QFII-licensed investors of a company in a given fiscal year. Source: Wind-Financial Terminal.
QFII_HIGHWGI_OWN	The sum of the percentage of outstanding shares held by QFII-licensed investors originating from countries or regions with high institutional quality (with a Worldwide Governance Indicator score equal to or above the median level of sample countries in a given fiscal year). Source: Wind-Financial Terminal and Worldwide Governance Indicator (WGI) of World Bank.
QFII_LOWWGI_OWN	The sum of the percentage of outstanding shares held by QFII-licensed investors from countries or regions with low institutional quality (with a WGI index score below the median WGI). Source: Wind-Financial Terminal and Worldwide Governance Indicator (WGI) scores from World Bank.
QFII_HIGHSP_OWN	The sum of the percentage of outstanding shares held by QFII-licensed investors from countries or regions with a higher level of shareholder protection (with an anti-director rights score equal to or above the median level). Source: Wind-Financial Terminal and anti-director rights score from Porta et al. (2008) and Spamann (2010).
QFII_LOWSP_OWN	The sum of the percentage of outstanding shares held by QFII-licensed investors domiciled in countries with weaker shareholder protection (with an anti-director rights index score below the median level). Source: Wind-Financial Terminal and anti-director rights score from Porta et al. (2008) and Spamann (2010).
QFII_DISTANT_OWN	The sum of the percentage of outstanding shares held by QFII-licensed investors originating from countries that are geographically distant from China (with geographical distance equal to or above the median physical distance between the QFII-licensed investors' countries of domicile and China). Source: Wind-Financial Terminal, the State Administration of Foreign Exchange, and Research and Expertise on World Economy (http://www.cepii.fr).
QFII_CLOSE_OWN	The sum of the percentage of outstanding shares held by QFII-licensed investors originating from countries that are closer to China in terms of geographical distance (with physical distance below the median physical distance between the QFIIs' countries of domicile and China). Source: Wind-Financial Terminal, the State Administration of Foreign Exchange, and Research Expertise on World Economy (http://www.cepii.fr).
Control variables and variables in additional analysis	
SIZE	Book value of total assets (in the form of natural logarithm). Source: CSMAR.
RECEIVABLE	Accounts receivable scaled by the book value of total assets. Source: CSMAR.
INVENTORY	Ratio of inventory over the book value of total assets. Source: CSMAR.
LEVERAGE	Book value of total liabilities divided by the book value of total assets. Source: CSMAR.
LOSS	A categorical variable assigned a value of one if the company in the previous year end reported negative net income, and zero otherwise. Source: CSMAR.
ROA	Net profit over the book value of total assets. Source: CSMAR.
CRATIO	Current assets divided by current liabilities. Source: CSMAR.
Q	Book value of total assets minus the book value of equity plus the market value of equity, all divided by the book value of total assets. Source: CSMAR.
MTB	Market-to-book ratio of a firm. Source: CSMAR.
CFO_VOLATILITY	Volatility of operating cash flows divided by the book value of total assets in the previous five years. Source: CSMAR.
EBT_VOLATILITY	Volatility of pre-tax earnings divided by the book value of total assets in the previous five years. Source: CSMAR.
SOE	A categorical variable that is set to one if the ultimate controlling owner of a company is the state or state-owned; otherwise, it is equal to zero. Source: Annual reports of Chinese listed firms and CSMAR.
INDEPENDENCE	The proportion of independent directors sitting on board. Source: CSMAR.

MEETING	The total number of board meetings held each year (in the form of natural logarithm). Source: CSMAR.
BOARDSIZE	The total number of directors on board (in the form of natural logarithm). Source: CSMAR.
ANALYST	One plus the total number of financial analysts following a company (in the form of natural logarithm). Source: CSMAR.
OPINION	A categorical variable set to one if an audit opinion a company received is neither an unqualified opinion nor an unqualified opinion with additional language; it is assigned a value of zero otherwise. Source: CSMAR.
AUDITLAG	The number of days between the fiscal year-end date and the audit report issue date (in the form of natural logarithm). Source: CSMAR.
ABS_DA	The absolute value of discretionary accounting accruals from the cross-sectional industry model in Kothari et al. (2005) and Kim et al. (2012). Source: CSMAR.
AUDITCOMM_SIZE	The total number of members in the audit committee (in the form of natural logarithm). Source: CSMAR.
AUDITCOMM_INDEP	The proportion of independent directors sitting on the audit committee. Source: CSMAR.

Appendix B: Alternative measures of QFIIs and auditor choice

Dependent variable = BIG4		
	(1)	(2)
QFIINUM	0.2863***	
	(6.0922)	
QFIIDUMMY		0.2525***
		(5.9184)
SIZE	0.5891***	0.5908***
	(30.0536)	(30.1654)
RECEIVABLE	0.5979***	0.5913***
	(3.1805)	(3.1421)
INVENTORY	-0.8193***	-0.8202***
	(-5.3991)	(-5.3852)
LEVERAGE	-1.3680***	-1.3751***
	(-9.4774)	(-9.5115)
LOSS	0.1357*	0.1374*
	(1.9047)	(1.9266)
ROA	0.7077	0.7334
	(1.4037)	(1.4505)
CRATIO	-0.0801***	-0.0803***
	(-4.2005)	(-4.2191)
Q	0.1115***	0.1119***
	(5.8744)	(5.8970)
CFO_VOLATILITY	-0.4678	-0.4626
	(-0.9943)	(-0.9831)
EBT_VOLATILITY	-0.0367	-0.0283
	(-0.1230)	(-0.0950)
SOE	0.0432	0.0424
	(1.1989)	(1.1747)
INDEPENDENCE	0.3445	0.3578
	(1.1682)	(1.2149)
BOARDSIZE	0.2612***	0.2640***
	(2.8545)	(2.8874)
ANALYST	-0.0414**	-0.0414**
	(-2.2303)	(-2.2290)
_CONSTANT	-15.2098***	-15.2523***
	(-25.6299)	(-25.7303)
Year Fixed Effects	Included	Included
Industry Fixed Effects	Included	Included
Number of Observations	22,650	22,650
Pseudo R^2	26.4%	26.4%
Wald chi^2	1829.81	1815.37

Notes: The results of the probit regression on the effects of the number of QFII-licensed investors (*QFIINUM*) and the presence of QFII-licensed investors (*QFIIDUMMY*) on Big Four auditor choice (*BIG4*) are presented in this table. Z-statistics, which are computed with robust standard errors, are displayed in parentheses. In both regressions, standard errors are clustered by year and by firm. The 10%, 5%, and 1% significance levels are denoted by ***, **, and * (two-tailed), respectively.

Appendix C: Entropy balancing approach

Panel A: Before entropy balancing (without weighting)

Matching criteria	QFIIDUMMY = 1			QFIIDUMMY = 0		
	Mean	Variance	Skewness	Mean	Variance	Skewness
SIZE	22.5100	2.0740	0.8498	21.7900	1.6790	0.5083
RECEIVABLE	0.0919	0.0083	1.4660	0.1099	0.0104	1.2810
INVENTORY	0.1485	0.0183	1.8110	0.1632	0.0230	1.7870
LEVERAGE	0.4560	0.0400	0.1014	0.4725	0.0526	0.4317
LOSS	0.0593	0.0559	3.7300	0.1134	0.1006	2.4380
ROA	0.0547	0.0032	-0.9323	0.0298	0.0049	-2.4700
CRATIO	1.9890	4.6800	3.9940	2.1610	5.8910	3.5250
Q	2.4600	1.4540	2.5990	2.5720	2.0820	2.7450
CFO_VOLATILITY	0.0515	0.0015	2.2460	0.0580	0.0021	2.1980
EBT_VOLATILITY	0.0353	0.0034	8.0970	0.0471	0.0080	5.9740
SOE	0.6137	0.2372	-0.4672	0.4850	0.2498	0.0602
INDEPENDENCE	0.3669	0.0027	1.5890	0.3667	0.0028	1.1760
MEETING	2.2640	0.1187	0.4472	2.2810	0.1184	0.3054
BOARDSIZE	2.3120	0.0362	0.0554	2.2780	0.0334	-0.1375
ANALYST	2.1250	1.1150	-0.5796	1.3140	1.2690	0.2841
BIG4	0.1624	0.1361	1.8310	0.0555	0.0524	3.8850
OPINION	0.0109	0.0108	9.4070	0.0546	0.0516	3.9200
AUDITLAG	4.4750	0.0674	-1.4940	4.4950	0.0824	-2.1530

Panel B: After entropy balancing (with weighting)

Matching criteria	QFIIDUMMY = 1			QFIIDUMMY = 0		
	Mean	Variance	Skewness	Mean	Variance	Skewness
SIZE	22.5100	2.0740	0.8498	22.5100	2.2560	0.7839
RECEIVABLE	0.0919	0.0083	1.4660	0.0919	0.0085	1.5210
INVENTORY	0.1485	0.0183	1.8110	0.1485	0.0188	1.8240
LEVERAGE	0.4560	0.0400	0.1014	0.4561	0.0404	0.0858
LOSS	0.0593	0.0559	3.7300	0.0597	0.0561	3.7180
ROA	0.0547	0.0032	-0.9323	0.0546	0.0031	-0.2585
CRATIO	1.9890	4.6800	3.9940	1.9880	4.2160	3.7730
Q	2.4600	1.4540	2.5990	2.4610	1.5470	2.7770
CFO_VOLATILITY	0.0515	0.0015	2.2460	0.0515	0.0015	2.1790
EBT_VOLATILITY	0.0353	0.0034	8.0970	0.0355	0.0029	8.6140
SOE	0.6137	0.2372	-0.4672	0.6136	0.2371	-0.4666
INDEPENDENCE	0.3669	0.0027	1.5890	0.3669	0.0032	1.2390
MEETING	2.2640	0.1187	0.4472	2.2640	0.1242	0.3855
BOARDSIZE	2.3120	0.0362	0.0554	2.3120	0.0354	0.0312
ANALYST	2.1250	1.1150	-0.5796	2.1230	1.1640	-0.5438
BIG4	0.1624	0.1361	1.8310	0.1623	0.1360	1.8320
OPINION	0.0109	0.0108	9.4070	0.0115	0.0114	9.1610
AUDITLAG	4.4750	0.0674	-1.4940	4.4750	0.0776	-2.5890

Panel C: Regression results of entropy balancing

Dependent variable =	AUDITFEE
	(1)
QFIIOWN	0.0122***
	(3.7474)
SIZE	0.4825***
	(52.5448)
RECEIVABLE	0.3903***
	(5.5809)
INVENTORY	0.2871***
	(5.0042)
LEVERAGE	-0.3108***
	(-5.8903)
LOSS	0.0177
	(0.5443)
ROA	-0.5415***
	(-3.2070)
CRATIO	-0.0143***

	(-3.7114)
Q	0.0513***
	(7.6498)
CFO_VOLATILITY	-0.1354
	(-0.7590)
EBT_VOLATILITY	0.5642***
	(4.9514)
SOE	-0.1462***
	(-10.7930)
INDEPENDENCE	0.4471***
	(3.5214)
MEETING	0.1331***
	(7.5884)
BOARDSIZE	0.1194***
	(3.0804)
ANALYST	-0.0363***
	(-5.2515)
BIG4	0.7409***
	(31.6707)
OPINION	0.0208
	(0.4470)
AUDITLAG	0.0986***
	(4.8586)
_CONSTANT	1.7939***
	(7.7070)
Year Fixed Effects	Included
Industry Fixed Effects	Included
Number of Observations	22,170
R2	76.9%

Notes: This table displays the entropy balancing results. Panels A and B report descriptive statistics (i.e. mean, variance and skewness) for control variables for the treatment sample (*QFIIDUMMY*=1) versus the control sample (*QFIIDUMMY*=0) derived before and after the application of the entropy balancing approach, respectively. Panel C presents the regression results of the entropy balancing method. All variables are defined in the Appendix to the paper. The regression includes industry and year fixed effects; *t*-statistics are based on robust standard errors to heteroskedasticity. ***, **, * denote significance at the 1%, 5%, and 10% levels, respectively.

Figure 1 Paths among QFII ownership, audit fees, and the client company's firm value

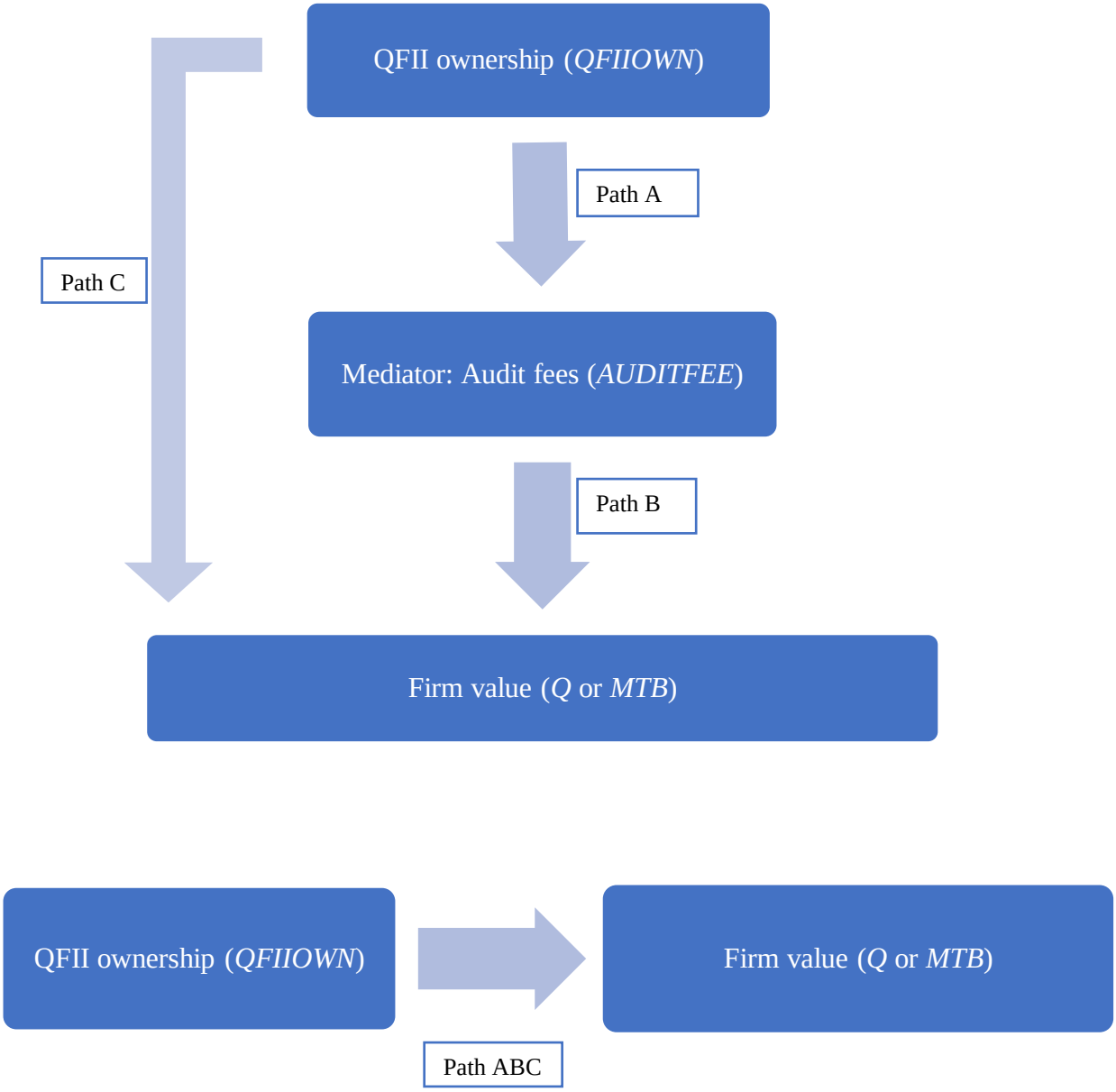

Table 1 Sample distribution

Panel A Full sample distribution by year

Year	QFIIDUMMY = 1	QFIIDUMMY = 0	No. of Obs.	Per_cent
2005	28	1,018	1,046	4.718
2006	101	962	1,063	4.795
2007	143	843	986	4.447
2008	107	962	1,069	4.822
2009	100	1,162	1,262	5.692
2010	166	1,222	1,388	6.261
2011	172	1,333	1,505	6.788
2012	123	1,857	1,980	8.931
2013	142	2,094	2,236	10.086
2014	191	2,158	2,349	10.595
2015	226	2,081	2,307	10.406
2016	168	2,227	2,395	10.803
2017	254	2,330	2,584	11.655
Total	1,921	20,249	22,170	100

Panel B Full sample distribution by industry

Industry classification	QFIIDUMMY = 1	QFIIDUMMY = 0	No. of Obs.	Percent
A: Agriculture, Forestry, Animal Husbandry, and Fishery	26	319	345	1.556
B: Mining	68	609	677	3.054
C: Manufacturing	1,178	11,745	12,923	58.290
D: Production and Supply of Electric Power, Heat Power, Gas and Water	69	940	1,009	4.551
E: Construction	50	534	584	2.634
F: Wholesale and Retail Trade	108	1,377	1,485	6.698
G: Transport, Storage, and Postal Services	156	724	880	3.969
H: Accommodation and Catering Service	13	94	107	0.483
I: Information Transmission, Software, and Information Technology Services	68	1,245	1,313	5.922
K: Real Estate	81	1,300	1,381	6.229
L: Leasing and Business Services	20	312	332	1.498
M: Scientific Research and Technical Services	7	144	151	0.681
N: Water Conservancy, Environment and Public Facilities Management	37	271	308	1.389
P: Education	0	48	48	0.217
Q: Health and Social Work	6	78	84	0.379
R: Culture, Sports and Entertainment	27	277	304	1.371
S: Miscellaneous	7	232	239	1.078
Total	1,921	20,249	22,170	100

Notes: This table describes our sample distribution by year and by industry. The investigation period is 2005-2017. The annual distribution of the sample is presented in Panel A. The sample by industry is tabulated in Panel B. Industry classifications and descriptions are from the CSRC website (http://www.csrc.gov.cn/pub/csrc_en/).

Table 2 Descriptive statistics

	No. of Obs.	Mean	SD	Min	Q1	Median	Q3	Max
AUDITFEE	22,170	13.592	0.762	9.210	13.122	13.459	13.960	18.198
QFIIOWN (QFIIDUMMY=1)	1,921	1.949	2.310	0.011	0.575	1.200	2.370	27.297
QFIIOWN	22,170	0.169	0.873	0.000	0.000	0.000	0.000	27.297
QFIIDUMMY	22,170	0.087	0.281	0.000	0.000	0.000	0.000	1.000
QFIINUM	22,170	0.072	0.248	0.000	0.000	0.000	0.000	2.079
QFII_HIGHWGI_OWN	22,170	0.088	0.605	0.000	0.000	0.000	0.000	17.828
QFII_LOWWGI_OWN	22,170	0.081	0.501	0.000	0.000	0.000	0.000	12.222
QFII_HIGHSP_OWN	22,170	0.110	0.670	0.000	0.000	0.000	0.000	22.767
QFII_LOWSP_OWN	22,170	0.059	0.435	0.000	0.000	0.000	0.000	12.972
QFII_DISTANT_OWN	22,170	0.125	0.723	0.000	0.000	0.000	0.000	23.840
QFII_CLOSE_OWN	22,170	0.044	0.367	0.000	0.000	0.000	0.000	17.701
SIZE	22,170	21.849	1.325	11.348	20.956	21.708	22.575	28.509
RECEIVABLE	22,170	0.108	0.101	0.000	0.027	0.082	0.161	0.489
INVENTORY	22,170	0.162	0.150	0.000	0.062	0.124	0.207	0.722
LEVERAGE	22,170	0.471	0.227	0.053	0.301	0.471	0.628	1.299
LOSS	22,170	0.109	0.311	0.000	0.000	0.000	0.000	1.000
ROA	22,170	0.032	0.069	-0.413	0.011	0.033	0.062	0.205
CRATIO	22,170	2.146	2.406	0.194	0.972	1.418	2.268	16.123
Q	22,170	2.562	1.424	1.236	1.751	2.089	2.810	9.443
MTB	22,046	4.511	4.022	-1.780	2.501	3.501	5.072	28.923
CFO_VOLATILITY	22,170	0.057	0.045	0.004	0.028	0.045	0.072	0.284
EBT_VOLATILITY	22,170	0.046	0.087	0.001	0.013	0.024	0.046	0.761
SOE	22,170	0.496	0.500	0.000	0.000	0.000	1.000	1.000
INDEPENDENCE	22,170	0.367	0.053	0.000	0.333	0.333	0.400	0.571
MEETING	22,170	2.279	0.344	0.693	2.079	2.303	2.485	4.060
BOARDSIZE	22,170	2.281	0.184	1.386	2.197	2.303	2.303	2.996
ANALYST	22,170	1.385	1.144	0.000	0.000	1.386	2.398	4.190
BIG4	22,170	0.065	0.246	0.000	0.000	0.000	0.000	1.000
OPINION	22,170	0.051	0.220	0.000	0.000	0.000	0.000	1.000
AUDITLAG	22,170	4.493	0.285	0.000	4.394	4.511	4.710	6.732
ABS_DA	19,834	0.059	0.078	0.000	0.018	0.040	0.075	2.444
AUDITCOMM_SIZE	11,871	0.284	0.583	0.000	0.000	0.000	0.000	2.079
AUDITCOMM_INDEP	11,871	0.127	0.268	0.000	0.000	0.000	0.000	1.000

Note: To eliminate the influence of outliers on our results, we winsorise all continuous variables at the 1st and 99th percentiles of their respective distributions.

Table 3 Pearson correlations

	Full sample	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
(1)	AUDITFEE	1.0000										
(2)	QFIIOWN	0.0612*	1.0000									
(3)	QFIIDUMMY	0.1290*	0.6279*	1.0000								
(4)	QFIINUM	0.1364*	0.7449*	0.9455*	1.0000							
(5)	SIZE	0.7502*	0.0661*	0.1538*	0.1585*	1.0000						
(6)	RECEIVABLE	-0.0994*	-0.0333*	-0.0500*	-0.0533*	-0.1888*	1.0000					
(7)	INVENTORY	0.0226*	-0.0161*	-0.0275*	-0.0242*	0.1102*	-0.0903*	1.0000				
(8)	LEVERAGE	0.1851*	-0.0249*	-0.0205*	-0.0200*	0.2590*	0.0046	0.2626*	1.0000			
(9)	LOSS	-0.0573*	-0.0454*	-0.0489*	-0.0494*	-0.1321*	0.0162*	-0.0279*	0.2625*	1.0000		
(10)	ROA	0.0658*	0.0902*	0.1015*	0.1042*	0.1282*	-0.0498*	-0.0374*	-0.4280*	-0.6633*	1.0000	
(11)	CRATIO	-0.1713*	-0.0158*	-0.0202*	-0.0225*	-0.2228*	0.0129*	-0.0800*	-0.6079*	-0.1249*	0.2154*	1.0000
(12)	Q	-0.1202*	-0.0271*	-0.0220*	-0.0260*	-0.3720*	0.0341*	-0.0773*	0.0094	0.1251*	-0.0462*	0.0541*
(13)	CFO_VOLATILITY	-0.0935*	-0.0224*	-0.0404*	-0.0399*	-0.1491*	-0.0551*	0.2493*	0.1693*	0.0776*	-0.0806*	-0.0356*
(14)	EBT_VOLATILITY	-0.1018*	-0.0271*	-0.0381*	-0.0373*	-0.2637*	-0.0093	-0.0393*	0.2361*	0.2256*	-0.2528*	-0.0515*
(15)	SOE	0.1141*	0.0373*	0.0725*	0.0728*	0.2665*	-0.1581*	0.0057	0.2349*	0.0399*	-0.0732*	-0.2400*
(16)	INDEPENDENCE	0.0923*	-0.0086	0.0010	0.0036	0.0440*	0.0104	0.0148*	-0.0287*	-0.0066	0.0011	0.0483*
(17)	MEETING	0.2283*	-0.0123*	-0.0133*	-0.0166*	0.2081*	-0.0087	0.1009*	0.1288*	-0.0201*	-0.0143*	-0.0672*
(18)	BOARDSIZE	0.1295*	0.0501*	0.0525*	0.0562*	0.2335*	-0.0834*	-0.0368*	0.1176*	-0.0205*	0.0316*	-0.1315*
(19)	ANALYST	0.3460*	0.1429*	0.1994*	0.1961*	0.4325*	-0.0335*	-0.0572*	-0.1607*	-0.2448*	0.3874*	0.1031*
(20)	BIG4	0.4546*	0.0873*	0.1223*	0.1360*	0.3360*	-0.0744*	-0.0217*	0.0528*	-0.0354*	0.0588*	-0.0776*
(21)	OPINION	-0.0793*	-0.0378*	-0.0560*	-0.0529*	-0.1735*	0.0504*	-0.0538*	0.2412*	0.2879*	-0.3253*	-0.0881*
(22)	AUDITLAG	0.1169*	-0.0225*	-0.0195*	-0.0216*	0.0819*	0.0451*	-0.0214*	0.0008	0.0311*	-0.0522*	-0.0019
		(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)	(20)	(21)	(22)
(12)	Q	1.0000										
(13)	CFO_VOLATILITY	0.1541*	1.0000									
(14)	EBT_VOLATILITY	0.3357*	0.3977*	1.0000								
(15)	SOE	-0.1604*	-0.0521*	-0.0624*	1.0000							
(16)	INDEPENDENCE	0.0851*	0.0159*	0.0233*	-0.1034*	1.0000						
(17)	MEETING	0.0094	0.0364*	-0.0142*	-0.1119*	0.0742*	1.0000					
(18)	BOARDSIZE	-0.1677*	-0.0857*	-0.0891*	0.2751*	-0.4322*	-0.0605*	1.0000				
(19)	ANALYST	-0.0280*	-0.1312*	-0.1741*	-0.0752*	0.0525*	0.1454*	0.0918*	1.0000			
(20)	BIG4	-0.0869*	-0.0594*	-0.0475*	0.1243*	0.0233*	0.0298*	0.1108*	0.1577*	1.0000		
(21)	OPINION	0.1823*	0.1138*	0.2894*	-0.0267*	-0.0230*	-0.0132*	-0.0176*	-0.1906*	-0.0283*	1.0000	
(22)	AUDITLAG	0.0112*	-0.0251*	-0.0085	-0.0594*	0.0248*	0.0327*	-0.0138*	-0.0020	-0.0120*	0.1001*	1.0000

Notes: Pearson correlation coefficients between variables from the main regression analysis are displayed in this table. The symbol * denotes significance level of at least 0.1.

Table 4 Foreign institutional investors and audit fees

Dependent variable = AUDITFEE	Prediction	Baseline		
		(1)	(2)	(3)
QFIIOWN	+	0.0149***		
		(4.5172)		
QFIIDUMMY	+		0.0208*	
			(1.8550)	
QFIINUM	+			0.0327**
				(2.5209)
SIZE	+	0.4137***	0.4133***	0.4131***
		(80.1946)	(79.9454)	(79.8712)
RECEIVABLE	+	0.2216***	0.2187***	0.2195***
		(6.9614)	(6.8691)	(6.8944)
INVENTORY	+	-0.0145	-0.0136	-0.0138
		(-0.5739)	(-0.5398)	(-0.5458)
LEVERAGE	?	-0.1024***	-0.1028***	-0.1022***
		(-4.6113)	(-4.6271)	(-4.5983)
LOSS	+	0.0188	0.0192	0.0189
		(1.4120)	(1.4390)	(1.4184)
ROA	-	-0.1746**	-0.1685**	-0.1705**
		(-2.3833)	(-2.3004)	(-2.3276)
CRATIO	-	-0.0128***	-0.0129***	-0.0129***
		(-8.7478)	(-8.7938)	(-8.7777)
Q	+	0.0621***	0.0620***	0.0620***
		(20.6375)	(20.6049)	(20.5878)
CFO_VOLATILITY	+	-0.0227	-0.0219	-0.0219
		(-0.3106)	(-0.3001)	(-0.2993)
EBT_VOLATILITY	+	0.5223***	0.5224***	0.5216***
		(10.9260)	(10.9281)	(10.9145)
SOE	+	-0.0660***	-0.0662***	-0.0663***
		(-10.0747)	(-10.0943)	(-10.1099)
INDEPENDENCE	+	0.2707***	0.2732***	0.2724***
		(4.1990)	(4.2386)	(4.2271)
MEETING	+	0.1115***	0.1118***	0.1120***
		(11.8590)	(11.8877)	(11.9119)
BOARDSIZE	?	0.0567***	0.0577***	0.0577***
		(2.9085)	(2.9542)	(2.9531)
ANALYST	-	-0.0192***	-0.0183***	-0.0185***
		(-5.4754)	(-5.2223)	(-5.3007)
BIG4	+	0.7418***	0.7432***	0.7422***
		(41.2362)	(41.2714)	(41.1854)
OPINION	+	0.0475***	0.0474***	0.0474***
		(3.1532)	(3.1456)	(3.1420)
AUDITLAG	+	0.0682***	0.0683***	0.0685***
		(7.1064)	(7.1216)	(7.1340)
_CONSTANT	?	3.4778***	3.4817***	3.4856***
		(28.8624)	(28.8563)	(28.8863)
Year Fixed Effects		Included	Included	Included
Industry Fixed Effects		Included	Included	Included
Number of Observations		22,170	22,170	22,170
Adjusted R^2		68.3%	68.3%	68.3%

Notes: This table presents the regression results of the influence of QFII-licensed investors on audit fees for the full sample. The dependent variable in all model specifications is the natural logarithm of the total audit fees of a firm (*AUDITFEE*). In column (1), the explanatory variable of interest is *QFIIOWN*, which is measured as the percentage of outstanding shares owned by QFII-licensed investors. In column (2), *QFIIDUMMY* is a categorical variable assigned a value of one if a company has at least one QFII-licensed investor in a fiscal year and zero otherwise. In column (3), *QFIINUM* is measured as the natural logarithm of the total number of QFII-licensed investors of a company. All independent variables are lagged by one year, except for *LOSS*, *CFO_VOLATILITY*, *EBT_VOLATILITY*, *BIG4*, *OPINION*, and *AUDITLAG*. *T*-statistics, which are computed with robust standard errors, are displayed in parentheses. In all models, standard errors are clustered by year and firm. The 10%, 5%, and 1% significance levels are denoted by ***, **, and * (two-tailed), respectively.

Table 5 Channels through which foreign institutional investors influence audit fees

Dependent variable = AUDITFEE	Institutional quality	Shareholder protection	Geographical distance
	(1)	(2)	(3)
QFII_HIGHWGI_OWN	0.0177***		
	(2.7483)		
QFII_LOWWGI_OWN	0.0112*		
	(1.6632)		
QFII_HIGHSP_OWN		0.0154***	
		(2.9118)	
QFII_LOWSP_OWN		0.0139*	
		(1.8028)	
QFII_DISTANT_OWN			0.0187***
			(3.3512)
QFII_CLOSE_OWN			0.0033
			(0.4066)
SIZE	0.4136***	0.4137***	0.4137***
	(33.5407)	(33.5472)	(33.5453)
RECEIVABLE	0.2214***	0.2216***	0.2217***
	(3.3082)	(3.3122)	(3.3136)
INVENTORY	-0.0145	-0.0145	-0.0148
	(-0.2627)	(-0.2626)	(-0.2671)
LEVERAGE	-0.1023**	-0.1024**	-0.1024**
	(-2.2930)	(-2.2951)	(-2.2942)
LOSS	0.0188	0.0188	0.0188
	(1.1090)	(1.1115)	(1.1127)
ROA	-0.1745*	-0.1744*	-0.1747*
	(-1.6479)	(-1.6462)	(-1.6499)
CRATIO	-0.0128***	-0.0128***	-0.0128***
	(-4.7487)	(-4.7495)	(-4.7423)
Q	0.0621***	0.0621***	0.0620***
	(11.9263)	(11.9302)	(11.9149)
CFO_VOLATILITY	-0.0226	-0.0225	-0.0227
	(-0.1717)	(-0.1716)	(-0.1728)
EBT_VOLATILITY	0.5224***	0.5223***	0.5225***
	(6.8168)	(6.8164)	(6.8183)
SOE	-0.0660***	-0.0660***	-0.0661***
	(-4.1876)	(-4.1917)	(-4.1940)
INDEPENDENCE	0.2707**	0.2706**	0.2716**
	(2.1220)	(2.1211)	(2.1286)
MEETING	0.1115***	0.1114***	0.1113***
	(6.5031)	(6.5015)	(6.4956)
BOARDSIZE	0.0568	0.0568	0.0564
	(1.3452)	(1.3446)	(1.3375)
ANALYST	-0.0191***	-0.0192***	-0.0191***
	(-2.9760)	(-2.9844)	(-2.9789)
BIG4	0.7420***	0.7418***	0.7419***
	(16.7286)	(16.7217)	(16.7244)
OPINION	0.0475**	0.0475**	0.0477**
	(2.0160)	(2.0187)	(2.0252)
AUDITLAG	0.0682***	0.0681***	0.0679***
	(4.7691)	(4.7675)	(4.7513)
_CONSTANT	3.4791***	3.4778***	3.4801***
	(12.9402)	(12.9325)	(12.9459)
Year Fixed Effects	Included	Included	Included
Industry Fixed Effects	Included	Included	Included
Number of Observations	22,170	22,170	22,170
Adjusted R^2	68.3%	68.3%	68.3%

Notes: This table displays the regression results of possible channels through which foreign institutional investors influence investee firms' audit fees. The result of the effect of the institutional quality of QFII-licensed investors' countries of domicile on investees' audit fees is presented in column (1). *QFII_HIGHWGI_OWN* is measured as the sum of the percentage of outstanding shares held by QFII-licensed investors originating from countries or regions with high institutional quality (with a WGI score equal to or above the median level of sample countries in a given fiscal year). *QFII_LOWWGI_OWN* is measured as the sum of the percentage of outstanding shares held by QFII-licensed investors that are coming from countries with low institutional quality (with a WGI index score below the median WGI). Column (2) reports the result of the effect of the shareholder protection level of QFIIs' countries of domicile on audit fees. *QFII_HIGHSP_OWN* is measured as the sum of

the percentage of outstanding shares held by QFII-licensed investors from countries or regions with a higher degree of shareholder protection (with an anti-director rights index score equal to or above the median level). *QFII_LOWSP_OWN* is measured as the sum of the percentage of outstanding shares held by QFII-licensed investors from countries with weaker shareholder protection (with an anti-director rights index score below the median level). Column (3) presents the result of the influence of the geographical distance between QFIIs' countries of domicile and China on investees' audit fees. *QFII_DISTANT_OWN* is measured as the sum of the percentage of outstanding shares held by QFII-licensed investors from countries that are geographically distant from China. *QFII_CLOSE_OWN* is measured as the sum of the percentage of outstanding shares held by QFII-licensed investors from countries that are closer to China in terms of geographic distance. All independent variables are lagged by one year, except for *LOSS*, *CFO_VOLATILITY*, *EBT_VOLATILITY*, *BIG4*, *OPINION*, and *AUDITLAG*. *T*-statistics, which are computed with robust standard errors, are displayed in parentheses. The 10%, 5%, and 1% significance levels are denoted by ***, **, and * (two-tailed), respectively.

Table 6 Cross-sectional analysis: roles of investees' initial discretionary accruals and CSR

Dependent variable = AUDITFEE	High discretionary accruals	Low discretionary accruals	High CSR	Low CSR
	(1)	(2)	(3)	(4)
QFIIOWN	0.0281***	0.0086	0.0010	0.0199**
	(3.9331)	(1.1615)	(0.1534)	(2.1530)
SIZE	0.4158***	0.4499***	0.4491***	0.3831***
	(57.2755)	(59.5408)	(46.4399)	(40.8827)
RECEIVABLE	0.2280***	0.2741***	0.2511***	0.1686***
	(4.9275)	(5.6428)	(3.6136)	(3.4403)
INVENTORY	0.0249	0.1014**	0.0032	-0.0225
	(0.6764)	(2.3727)	(0.0545)	(-0.5840)
LEVERAGE	-0.1965***	-0.2733***	-0.2622***	-0.0185
	(-5.2788)	(-7.3285)	(-4.7816)	(-0.5602)
LOSS	0.0393*	0.0170	0.0569	0.0141
	(1.9348)	(0.7942)	(1.4678)	(0.7349)
ROA	-0.1905	-0.2352*	-0.6722***	-0.2088*
	(-1.5513)	(-1.7083)	(-3.4263)	(-1.7798)
CRATIO	-0.0133***	-0.0173***	-0.0182***	-0.0061***
	(-5.4464)	(-8.8549)	(-6.8904)	(-2.7922)
Q	0.0510***	0.0502***	0.0572***	0.0626***
	(11.8103)	(10.0684)	(9.4861)	(12.7168)
CFO_VOLATILITY	-0.1169	-0.3463***	-0.3167**	0.1918*
	(-1.1431)	(-2.6625)	(-2.1170)	(1.7509)
EBT_VOLATILITY	0.4097***	0.4920***	0.4004***	0.4323***
	(4.6546)	(4.1801)	(2.8834)	(6.6694)
SOE	-0.0640***	-0.0793***	-0.0738***	-0.0488***
	(-6.5730)	(-8.1174)	(-5.3294)	(-4.7058)
INDEPENDENCE	0.0323	0.3938***	0.1901	0.2394**
	(0.3560)	(4.0315)	(1.4876)	(2.3495)
MEETING	0.1261***	0.0871***	0.1046***	0.1082***
	(9.3173)	(6.1572)	(5.7781)	(7.0607)
BOARDSIZE	-0.0002	0.0664**	0.0330	0.0310
	(-0.0075)	(2.2672)	(0.8106)	(0.9495)
ANALYST	-0.0196***	-0.0262***	-0.0341***	-0.0209***
	(-3.9358)	(-5.1744)	(-5.0302)	(-3.7237)
BIG4	0.7319***	0.7341***	0.6970***	0.7167***
	(28.9841)	(27.2857)	(24.0993)	(18.5362)
OPINION	-0.0090	0.0321	0.0220	0.0415**
	(-0.3713)	(1.1753)	(0.4248)	(2.0187)
AUDITLAG	0.0672***	0.0812***	0.0656***	0.0594***
	(4.4429)	(5.6665)	(2.9311)	(4.0711)
_CONSTANT	3.7192***	2.7112***	3.0598***	4.2391***
	(21.7162)	(15.4840)	(13.2149)	(19.6005)
Year Fixed Effects	Included	Included	Included	Included
Industry Fixed Effects	Included	Included	Included	Included
Number of Observations	9,853	9,981	6,142	7,873
Adjusted R^2	68.0%	70.8%	69.7%	59.0%
Difference in β1 (high-low)	0.0195		-0.0189	
Chi^2 Test Statistic High versus low group (p-value)	3.60* (0.0576)		2.838* (0.0921)	

Notes: This table displays the results of the cross-sectional analysis. The result of the subsample with high discretionary accounting accruals is displayed in column (1), and the result of the subsample with low discretionary accounting accruals is presented in column (2). Column (3) reports the result of the subsample with high CSR, and column (4) presents the result of the subsample with low CSR. *T*-statistics, which are computed with robust standard errors clustered by firm and year, are displayed in parentheses. The 10%, 5%, and 1% significance levels are denoted by ***, **, and * (two-tailed), respectively.

Table 7 Robustness checks

Dependent variable =	BIG4	AUDITFEE	AUDITFEE	AUDITFEE	AUDITFEE	AUDITFEE	AUDITFEE	AUDITFEE	AUDITFEE	AUDITFEE
	Probit model	BIG4 group	Non-BIG4 group	Accrual quality	Audit committee effectiveness	Excluding manufacturing firms	2005-2013	2014-2017	Change analysis	Firm fixed effects
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
QFIIOWN	0.0549***	0.0166*	0.0140***	0.0148***	0.0107*	0.0099*	0.0159***	0.0106*		0.0059*
	(4.5978)	(1.9159)	(4.1271)	(4.4444)	(1.9154)	(1.6574)	(4.2032)	(1.7389)		(1.9234)
CHANGE_IN_QFIIOWN									0.0074*	
									(1.6714)	
ABS_DA				0.3519***						
				(5.5877)						
AUDITCOMM_SIZE					-0.0196					
					(-0.8875)					
AUDITCOMM_INDEP					0.1961***					
					(4.0956)					
SIZE	0.5958***	0.5904***	0.3770***	0.4347***	0.4180***	0.4438***	0.4102***	0.4193***	0.4429***	0.2752***
	(30.5251)	(32.0246)	(72.9832)	(82.6991)	(65.9826)	(74.2246)	(55.2126)	(60.5507)	(28.9328)	(23.0522)
RECEIVABLE	0.5911***	0.7132***	0.1691***	0.2579***	0.1918***	0.3870***	0.2750***	0.1732***	0.0156	0.0471
	(3.1438)	(3.5741)	(5.4095)	(7.7088)	(4.6890)	(7.3272)	(6.1537)	(3.7951)	(0.1214)	(0.7155)
INVENTORY	-0.8324***	0.5620***	-0.0520**	0.0537*	0.0286	-0.0821**	-0.0412	0.0478	0.3287***	-0.1114**
	(-5.4468)	(3.5910)	(-2.1486)	(1.9257)	(0.7742)	(-2.2898)	(-1.2829)	(1.1432)	(3.0318)	(-2.4116)
LEVERAGE	-1.3975***	-0.3008**	-0.0570***	-0.2359***	-0.1382***	-0.1156***	-0.0548*	-0.1498***	-0.3079***	0.0238
	(-9.6526)	(-2.1143)	(-2.6415)	(-8.9876)	(-4.4812)	(-3.5605)	(-1.9255)	(-4.2747)	(-3.4152)	(0.6717)
LOSS	0.1446**	0.0670	0.0184	0.0256*	0.0021	0.0239	0.0295	-0.0012	-0.0530	0.0028
	(2.0356)	(0.8874)	(1.3886)	(1.7385)	(0.1186)	(1.1486)	(1.6165)	(-0.0643)	(-0.8485)	(0.2783)
ROA	0.7432	-0.7101	-0.0718	-0.2459***	-0.4178***	-0.2837***	-0.0104	-0.4733***	-0.5456*	-0.0697
	(1.4665)	(-1.5439)	(-0.9939)	(-2.6826)	(-3.9065)	(-2.7836)	(-0.1101)	(-4.0965)	(-1.7142)	(-1.0264)
CRATIO	-0.0814***	-0.0034	-0.0146***	-0.0154***	-0.0148***	-0.0103***	-0.0084***	-0.0172***	-0.0200***	-0.0029
	(-4.2499)	(-0.2569)	(-10.1172)	(-10.1218)	(-8.1135)	(-3.8533)	(-4.2213)	(-7.8913)	(-3.2435)	(-1.5432)
Q	0.1133***	0.0839***	0.0528***	0.0499***	0.0626***	0.0944***	0.0665***	0.0583***	0.0544***	0.0310***
	(5.9962)	(4.0010)	(18.1353)	(15.3645)	(17.0088)	(21.0194)	(14.0193)	(14.7674)	(4.0575)	(8.9483)
CFO_VOLATILITY	-0.4931	-0.2536	-0.0036	-0.2816***	-0.1824*	0.0237	0.0082	-0.1444	-0.3550	0.1233
	(-1.0462)	(-0.4794)	(-0.0501)	(-3.4077)	(-1.7789)	(0.2208)	(0.0869)	(-1.2367)	(-0.9992)	(1.2204)
EBT_VOLATILITY	-0.0165	1.0383*	0.4531***	0.4468***	0.6080***	0.4769***	0.4570***	0.6322***	0.4809*	0.2088***
	(-0.0555)	(1.7355)	(9.8629)	(6.1800)	(7.7692)	(8.2138)	(7.9353)	(7.2868)	(1.7700)	(3.4005)
SOE	0.0498	-0.1407***	-0.0566***	-0.0702***	-0.0759***	-0.0427***	-0.0511***	-0.0888***	-0.1503***	-0.0252
	(1.3855)	(-3.6584)	(-8.6473)	(-10.1998)	(-8.0948)	(-3.8299)	(-6.1175)	(-8.4253)	(-5.8458)	(-1.0665)
INDEPENDENCE	0.3309	0.3210	0.1739***	0.2195***	0.1666*	0.3044***	0.3412***	0.1306	0.5648**	0.0389
	(1.1260)	(1.0777)	(2.7511)	(3.2968)	(1.9201)	(3.0172)	(3.8838)	(1.3576)	(2.3256)	(0.4897)
MEETING		0.1915***	0.1068***	0.1047***	0.1169***	0.0821***	0.0965***	0.1201***	0.1556***	0.0632***
		(4.7327)	(11.4003)	(10.7303)	(9.4789)	(5.7582)	(7.4461)	(8.7401)	(4.7637)	(6.2309)
BOARDSIZE	0.2470***	-0.1706*	0.0843***	0.0308	0.0040	0.0948***	0.0727***	0.0086	0.1589**	0.0547*
	(2.6943)	(-1.8037)	(4.4156)	(1.5161)	(0.1380)	(3.2551)	(2.9570)	(0.2674)	(2.2370)	(1.7189)
ANALYST	-0.0363**	-0.0370*	-0.0162***	-0.0222***	-0.0215***	-0.0124**	-0.0148***	-0.0267***	-0.0270**	0.0128***
	(-1.9614)	(-1.8288)	(-4.6692)	(-6.2996)	(-4.9106)	(-2.1986)	(-2.9459)	(-5.4419)	(-2.0110)	(3.0361)

BIG4				0.7328***	0.6362***	0.7052***	0.8233***	0.6240***	0.7699***	0.3191***
				(39.5969)	(26.8189)	(36.9136)	(34.0531)	(23.8632)	(18.0503)	(6.7395)
OPINION		0.0485	0.0485***	0.0099	0.0511**	0.0094	0.0435**	0.0545**	0.0414	-0.0073
		(0.4189)	(3.2595)	(0.5456)	(2.4764)	(0.4126)	(2.2073)	(2.3839)	(0.5565)	(-0.4189)
AUDITLAG		0.1530**	0.0693***	0.0734***	0.0657***	0.0481***	0.0714***	0.0581***	0.1525***	0.0421***
		(1.9951)	(7.4058)	(7.1154)	(4.6480)	(2.8660)	(5.9659)	(3.6607)	(3.8416)	(4.6554)
_CONSTANT	-15.3030***	0.3896	4.2289***	3.1770***	3.8597***	2.7978***	3.4415***	3.9299***	2.4404***	6.6769***
	(-25.8961)	(0.7004)	(35.0978)	(25.9056)	(24.9676)	(17.9096)	(20.4541)	(22.7763)	(6.1187)	(26.8193)
Year Fixed Effects	Included	Included	Included	Included	Included	Included	Included	Included	Included	Included
Firm Fixed Effects	Excluded	Excluded	Excluded	Excluded	Excluded	Excluded	Excluded	Excluded	Excluded	Included
Industry Fixed Effects	Included	Included	Included	Included	Included	Included	Included	Included	Included	Excluded
Number of Observations	22,650	1,435	20,735	19,834	11,871	9,247	12,535	9,635	1,710	22,170
Adjusted/Pseudo R2	26.3%	74.3%	59.0%	69.5%	65.7%	71.8%	66.5%	64.0%	77.0%	65.0%

Notes: This table displays the robustness checks. Column (1) presents the regression result with *BIG4* being an alternative dependent variable. Column (2) presents the regression result of the sub-sample that only includes firms audited by one of the Big Four auditors. Column (3) displays the regression result of the sub-sample that only includes firms audited by non-Big Four auditors. Column (4) accounts for the effect of accrual quality. *ABS_DA* is measured as the absolute value of the estimated discretionary accruals. Column (5) controls for the characteristics of the audit committee. *AUDITCOMM_SIZE* is measured as the natural logarithm of the total number of members on the audit committee. *AUDITCOMM_INDEP* is measured as the proportion of independent directors sitting on the audit committee. Column (6) reports the result of a sub-sample excluding manufacturing firms. We partition our sample around 2014 as a cut-off point and report the results in columns (7) and (8). Column (9) displays the result of the influence of changes in *QFIIOWN* on *AUDITFEE*. Column (10) presents the result of a firm fixed-effect model. T-statistics (or Z-statistics), which are computed with robust standard errors clustered by firm and year, are displayed in parentheses. The 10%, 5%, and 1% significance levels are denoted by ***, **, and * (two-tailed), respectively.

Table 8 PSM analysis

Panel A Covariate balance for pairs of treatment and control firms after matching

Matching criteria	Treated (mean)	Control (mean)	Difference	T-test
	No. of Obs. = 1,808	No. of Obs. = 18,236	Treated - Control	p-value
SIZE	22.3500	22.3530	-0.0030	0.950
RECEIVABLE	0.0922	0.0862	0.0060	0.042
INVENTORY	0.1503	0.1493	0.0010	0.835
LEVERAGE	0.4542	0.4552	-0.0010	0.874
LOSS	0.0581	0.0553	0.0028	0.719
ROA	0.0535	0.0529	0.0006	0.747
CRATIO	2.0165	1.9681	0.0484	0.503
Q	2.3818	2.3703	0.0115	0.781
CFO_VOLATILITY	0.0526	0.0535	-0.0009	0.524
EBT_VOLATILITY	0.0342	0.0367	-0.0025	0.179
SOE	0.6322	0.6350	-0.0028	0.863
INDEPENDENCE	0.3646	0.3643	0.0003	0.907
MEETING	2.2473	2.2558	-0.0085	0.462
BOARDSIZE	2.3202	2.3194	0.0008	0.900
ANALYST	1.9775	1.9713	0.0062	0.868
BIG4	0.1527	0.1449	0.0078	0.513
OPINION	0.0144	0.0144	0.0000	1.000
AUDITLAG	4.4490	4.4507	-0.0017	0.857

Panel B Regression analysis based on the PSM sample

Dependent variable = AUDITFEE	PSM sample
	(1)
QFIIOWN	0.0185**
	(2.4537)
SIZE	0.4162***
	(20.7051)
RECEIVABLE	0.1260
	(0.8635)
INVENTORY	0.1461
	(1.0693)
LEVERAGE	-0.1519
	(-1.5867)
LOSS	0.0345
	(0.6001)
ROA	0.1154
	(0.3495)
CRATIO	-0.0087
	(-1.5199)
Q	0.0896***
	(4.4123)
CFO_VOLATILITY	-0.3834
	(-1.0658)
EBT_VOLATILITY	0.2243
	(1.2037)
SOE	-0.1006***
	(-3.4033)
INDEPENDENCE	0.3778
	(1.2871)
MEETING	0.0716*
	(1.7312)
BOARDSIZE	0.1108
	(1.2996)
ANALYST	-0.0202
	(-1.1074)
BIG4	0.7244***
	(13.4813)
OPINION	0.0171
	(0.2382)
AUDITLAG	0.1222***
	(2.8688)

_CONSTANT	3.4350***
	(6.7022)
Year Fixed Effects	Included
Industry Fixed Effects	Included
Number of Observations	20,044
Adjusted R^2	66.3%

Notes: This table reports the results of the PSM analysis. Panel A reports the result of the covariate balance test. Panel B reports the regression result of the propensity-score-matched sample. All control variables are lagged by one year, except for *LOSS*, *CFO_VOLATILITY*, *EBT_VOLATILITY*, *BIG4*, *OPINION*, and *AUDITLAG*. *T*-statistics, computed with robust standard errors clustered by firm and year, are displayed in parentheses. The 10%, 5%, and 1% significance levels are denoted by ***, **, and * (two-tailed), respectively.

Table 9 Dynamic GMM estimation

Dependent variable = AUDITFEE	Dynamic panel-data estimation
	System GMM
	(1)
QFIIOWN	0.0061**
	(2.0611)
LAG_AUDITFEE	0.5859***
	(24.4591)
SIZE	0.1427***
	(11.8937)
RECEIVABLE	-0.0488
	(-0.7796)
INVENTORY	-0.1183**
	(-2.3656)
LEVERAGE	0.0485
	(1.5011)
LOSS	0.0048
	(0.1422)
ROA	0.0560
	(0.4655)
CRATIO	-0.0050**
	(-2.3856)
Q	0.0167***
	(4.7161)
CFO_VOLATILITY	0.1833
	(1.4796)
EBT_VOLATILITY	0.1389**
	(2.3688)
SOE	-0.0486**
	(-2.3717)
INDEPENDENCE	0.1106
	(1.2268)
MEETING	0.0564***
	(6.0661)
BOARDSIZE	0.0169
	(0.4315)
ANALYST	0.0128***
	(3.1977)
BIG4	0.2269***
	(5.3753)
OPINION	-0.0147
	(-0.4869)
AUDITLAG	0.0195
	(0.6477)
_CONSTANT	1.8990***
	(6.9782)
Year Fixed Effects	Included
Industry Fixed Effects	Included
Difference-in-Hansen tests of exogeneity for the instruments	p-value = 0.120
Wald Chi^2	24932.61
Number of Observations	21,303
Number of Groups	2,799

Notes: This table displays the result from the dynamic GMM approach. We treat *QFIIOWN*, *LAG_AUDITFEE*, *SIZE*, *RECEIVABLE*, *INVENTORY*, *LEVERAGE*, *LOSS*, *ROA*, *CRATIO*, *Q*, *CFO_VOLATILITY*, *EBT_VOLATILITY*, *SOE*, *INDEPENDENCE*, *MEETING*, *BOARDSIZE*, *ANALYST*, *BIG4*, *OPINION*, and *AUDITLAG* as endogenous variables. Levels of these variables lagged twice are used as instruments in the first-differenced equation, and first-differences of these same variables lagged once as additional instruments in the level equation. The difference-in-Hansen test of exogeneity of instrument subsets is displayed at the bottom of this table. Standard errors of all variables in the regression are asymptotically robust to heteroscedasticity. *Z*-statistics are reported in parentheses. The 10%, 5%, and 1% significance levels are denoted by ***, **, and * (two-tailed), respectively.

Table 10 Mediating effect of audit fees on the link between foreign ownership and firm value

Panel A Regression analysis regarding the mediating effect

Dependent variable =	AUDITFEE	Q	AUDITFEE	MTB
	(1)	(2)	(3)	(4)
QFIIOWN	0.0156***	0.0209*	0.0156***	0.0661*
	(4.5352)	(2.3626)	(4.5352)	(2.3708)
AUDITFEE		0.1752***		0.4173***
		(10.1517)		(7.6759)
SIZE	0.3714***	-0.6147***	0.3714***	-1.1396***
	(106.6124)	(-55.9414)	(106.6124)	(-32.9186)
RECEIVABLE	0.1548***	-0.6816***	0.1548***	-1.5023***
	(4.7954)	(-8.2341)	(4.7954)	(-5.7603)
INVENTORY	-0.0545*	-0.0866	-0.0545*	0.0668
	(-2.1195)	(-1.3142)	(-2.1195)	(0.3215)
LEVERAGE	-0.0037	0.9939***	-0.0037	7.5512***
	(-0.1759)	(18.5209)	(-0.1759)	(44.6617)
LOSS	0.0489***	0.3587***	0.0489***	1.4937***
	(3.8165)	(10.9153)	(3.8165)	(14.4271)
ROA	0.0569	2.1618***	0.0569	7.7902***
	(0.8729)	(12.9430)	(0.8729)	(14.8035)
CRATIO	-0.0121***	0.0238***	-0.0121***	0.0968***
	(-7.5755)	(5.7766)	(-7.5755)	(7.4671)
CFO_VOLATILITY	0.0483	0.3408	0.0483	2.4237***
	(0.6457)	(1.7769)	(0.6457)	(4.0110)
EBT_VOLATILITY	0.7145***	2.0756***	0.7145***	-1.1604***
	(17.4681)	(19.6694)	(17.4681)	(-3.4901)
SOE	-0.0557***	0.0862***	-0.0557***	0.2798***
	(-8.1173)	(4.8963)	(-8.1173)	(5.0443)
INDEPENDENCE	0.3491***	0.9482***	0.3491***	1.9339***
	(5.5616)	(5.8922)	(5.5616)	(3.8142)
MEETING	0.1111***	-0.1362***	0.1111***	0.0203
	(11.9565)	(-5.7011)	(11.9565)	(0.2702)
BOARDSIZE	0.0633***	-0.0604	0.0633***	0.4199**
	(3.2910)	(-1.2260)	(3.2910)	(2.7050)
ANALYST	-0.0057	0.1584***	-0.0057	-0.0074
	(-1.6721)	(18.2334)	(-1.6721)	(-0.2719)
BIG4	0.7679***	0.2355***	0.7679***	0.3371**
	(59.6030)	(6.6209)	(59.6030)	(3.0078)
OPINION	0.0691***	0.9606***	0.0691***	1.1873***
	(4.5654)	(24.7653)	(4.5654)	(9.7150)
AUDITLAG	0.0713***	-0.1459***	0.0713***	-0.2891***
	(6.6561)	(-5.3142)	(6.6561)	(-3.3412)
_CONSTANT	4.3553***	12.3261***	4.3553***	16.5883***
	(45.0136)	(47.5828)	(45.0136)	(20.3243)
Year Fixed Effects	Included	Included	Included	Included
Industry Fixed Effects	Included	Included	Included	Included
Number of Observations	22,046	22,046	22,046	22,046
Structural equation model	Maximum likelihood estimation		Maximum likelihood estimation	

Panel B Details on the path analysis

Effects of QFII ownership on firm value	Firm value measures			
	Q		MTB	
	Coefficient	p-value	Coefficient	p-value
Total effect	0.0236	0.008	0.0726	0.009
Direct effect	0.0209	0.018	0.0661	0.018
Indirect effect	0.0027	0.000	0.0065	0.000
% total effect mediated	11.44%	-	8.95%	-
QFIIOWN » AUDITFEE	0.0156	0.000	0.0156	0.000
AUDITFEE » Firm value	0.1752	0.000	0.4173	0.000

Notes: This table displays the results of the mediating effect of audit fees on the link between QFII ownership and firm value. Columns (1) and (3) estimate the effect of QFII ownership on audit fees for the samples with observable Tobin's *Q* and *MTB* ratio, respectively. The dependent variable is Tobin's *Q* in column (2) and *MTB* in column (4). All independent variables are lagged by one year, except for *AUDITFEE*, *LOSS*, *CFO_VOLATILITY*, *EBT_VOLATILITY*, *BIG4*, *OPINION*, and *AUDITLAG*.

Standard errors of the mediation of effect (and the associated *Z*-statistic) are calculated using the observed information matrix (OIM) (Sobel, 1982). The 10%, 5%, and 1% significance levels are denoted by ***, **, and * (two-tailed), respectively.