

# Client Importance, Institutional Improvements, and Audit Quality in China: An Office and Individual Auditor Level Analysis

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**ABSTRACT:** This study examines how the legal and regulatory changes in China affect the relationship between client economic importance and audit quality. At the individual auditor level, we find that the propensity to issue modified audit opinions (MAOs) is *negatively* correlated with client importance from 1995 to 2000. However, from 2001 to 2004, when the institutional environment became more investor-friendly, the propensity to issue MAOs is *positively* associated with client importance. These findings are corroborated by an analysis of regulatory sanctions. Although client importance measured at the office level is also negatively related to the propensity for MAOs from 1995 to 2000 without controlling for the auditor-level client importance, this result is sensitive to model specification and sample composition. Our results suggest that (1) institutional improvements prompt auditors to prioritize the costs of compromising quality over the economic benefits gained from important clients; and (2) the impact of client importance on audit decisions appears to be different at the individual auditor and office levels.

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