Accounting vs. Politics:
Effects of China-US Audit Cooperation on China Concept Stocks

Shijie Wang

abstract

Since 1993, Chinese companies have been entering the US capital market, making it a crucial platform for them to go public and raise funds. However, inconsistent accounting policies between China and the US have led to the delisting of some Chinese concept stocks (CCS) listed in the US. Nevertheless, the recent accounting review cooperation agreement between the China Securities Regulatory Commission and the US PCAOB has changed the future of CCS in the US. This paper aims to quantify the economic value of the bilateral collaboration using the Audit Supervision Cooperation Agreement signed by China and the US on August 26, 2022, as a natural experiment. Our study shows that in the three months after the agreement, CCS with political ties and accounting issues with the Chinese government experienced returns of 4.63% and 1.13%, respectively. We employed a robustness test strategy, including parallel trend tests, experimental and control groups based on interference in VIE architecture, and subanalysis samples and placebo tests. Moreover, aside from stock returns, the trading volume and price volatility of companies with political links have also been positively affected. Our study concludes that the political friendship between China and the US has a significant impact on the economic development of both countries and the world economy.

1. Introduction

The US stock market is widely recognized as one of the world's most developed capital markets, and Chinese companies have benefited from listing in the US. By bypassing China's strict regulatory policies, companies can enjoy lower financing costs, a wider source of funds, and increased visibility and reputation (U. Mittoo, 1992; J. Fanto, R. Karmel, 1997; Lins, Ket). However, the US capital market places greater emphasis on corporate disclosure to ensure that investors invest their money in promising companies (Cantale, 1996; Fuerst, 1998; Moel, 1999). To comply with US regulations, companies must pay compliance costs.

China and the United States have been discussing cross-border audit regulation since 2007, and the issue became an important part of strategic and economic coordination negotiations four years later. China's attitude towards this issue is closely related to its economic development strategy with the United States. In 2012, the frequent financial fraud of CCS, coupled with short sellers' accusations of accounting fraud, increased the attention of American investors and regulators. However, negotiations between the two sides did not progress smoothly. Since the SEC implemented the Foreign Corporate Accountability Act in 2021, the negotiations have become more intense. Finally, on August 26, 2022, the two sides reached an agreement on cross-border accounting review collaboration. Although there are still differences in understanding, the two sides have basically agreed on the review issue. The Chinese side believes that the US side can investigate the accounting papers and audit institutions of specific CCS under the conditions of negotiation. The US side believes that the investigation does not require the approval of the Chinese side and can be carried out at will.

This paper conducts a natural experiment around the Audit Supervision Cooperation Agreement signed by the China Securities Regulatory Commission and the SEC on August 26, 2022. We selected all CCS that could obtain data to quantify the impact of this event on these stocks and which kinds of CCS were affected. We adopted a two-difference method to study the changes in the returns of CCS with accounting problems and political links with the Chinese government after the event.

Our findings indicate that three months after the signing of the agreement, CCS with political relations and accounting problems received cumulative abnormal returns of 4.63% and 1.13%, respectively. This reflects that when PCAOB signs a cooperation agreement with China Securities Regulatory Commission, it fosters a positive market expectation of accounting information, which is reflected in the stock market and drives back the value that was lowered due to the poor quality of accounting information.

However, we suggest that the signing of the cooperation agreement may signal more political easing than accounting compliance. Hence, American investors may be more concerned about political tensions between China and the US than the accounting of Chinese stocks.Because there are implicit differences between CCS that have political ties with the Chinese government or have accounting problems and the general type of enterprises, the effect may originate from other characteristics of the enterprises or amplify the effects influenced by the policy, thus adding endogeneity to our model. Therefore, to mitigate this potential problem, we introduce an interactive fixed effect of industry, market value, and week in the DID model, which can eliminate the impact of each external trait.

[①] Next, we distinguish the companies that had accounting problems but were not shorted by professional short sellers and were actually shorted, taking the companies that were not shorted within the limited range as the control group. The regression results indicate that actual short behavior further reduces investors' expectations of CCS, and the return after the event is 5.28%.

Moreover, CCS with political connections had significantly higher returns than those with accounting problems, reaching 18.76%. This conclusion was robust by subsample regression and placebo tests. The article concludes that this event can attract more Chinese enterprises to the American capital market, and CCS will get more attention from American investors.

Furthermore, the liquidity of CCS with political connections has significantly improved compared to those without. However, there may still be accounting CCS that have not fundamentally improved, and the positive feedback effect of this event is lower

[①]Most of the institutions in the sample are famous for doing aerial concept stocks, Muddy Waters Research, Citron Research, Glaucus Research, from 2012 to 2-20,20, the short-term successful short ratio of 30%, long-term successful short ratio of 65%.

than that of the political link companies.

Overall, the study suggests that Chinese companies still favor the US capital market despite the past attempts to delist or transfer to Hong Kong capital. The findings of this research can provide insights for investors and policymakers in the context of China-US relations and capital markets.

Our research demonstrates that investors evaluate the value of overseas listed companies within a particular context - more so based on the political relationship between countries than from a strictly traditional perspective. This creates possibilities for enhancing theoretical systems beyond the accounting fundamentals and reliability of financial reports. Existing literature presents several reasons for investors' attitudes towards foreign-listed companies, including the challenge facing these firms to attract US institutional investors rather than local (French and Poterba, 1991). Such preferences are also indicated by individual investors, including households (Karolyi and Stulz, 2003; Chan et al., 2005), attributed to behavioral finance. Obstacles in investing overseas include blocked international capital flows, information asymmetry, and behavioral preferences (Black, 1974; Cooper and Kaplanis, 1994; Jeske, 2001). Transparency in accounting disclosures plays a significant role in the investment preference of institutional investors, with high transparency corresponding to more reliable valuation (Subrahmanyan and Titman, 1999), reduced agent problems (Easterbrook, 1984), and American institutional investors being more attracted to foreign companies with high-quality accounting disclosure (Lundholm et al., 2014).

Studies suggest that cross-border issues, as well as political relations, and business management challenges can influence investor preferences towards local enterprises, particularly those speaking the same language and adhering to similar accounting standards (Grinblatt and Keloharju, 2002; Bradshaw et al., 2004; Covrig et al., 2007; Leuz et al., 2009; DeFond et al., 2011). Bae et al. (2008) found that two countries with good accounting cooperation resulted in a reduction of information asymmetry, facilitating cross-border investment. The literature currently focuses more on the political factors in the host country and their impact on the investment decisions of investors, especially regarding the political risk associated with investing in a particular country. However, there is no systematic explanation of how the political relationship between two countries affects stock prices, nor about how representatives of the two social camps in the international community impact stock prices.

In addition, there is a link between this paper and the policy events issued by PCAOB. The impact of such events can improve accounting operations and enhance investors' confidence of enterprises. PCAOB audit generally improves the quality of internal audit of accounting institutions and companies inspected by PCAOB tend to provide high quality and reliable financial reporting. Studies have shown that PCAOB-reviewed foreign companies are easily distinguished in the capital markets and have higher information transparency, leading institutional investors to buy more equity。

The construction of an accounting system is deeply rooted in political economy and reflects the ideology of the ruling class in society (Cooper, 1995; Goddard, 2005; Yee, 2009). Both China and the United States have different political forms which are reflected in their accounting policies of review and supervision. The US tends to control more information and carry out strict domestic and transnational reviews to ensure a fair environment and stable market order, whereas China tends to protect the accounting information of local enterprises and does not easily interfere in the accounting information of other countries. China even has the will to partially deviate from the international accounting system due to its view of confidential accounting paper information as one of the elements of national security development. The passage suggests that these differences in political philosophy are shown through the many differences between the two countries' accounting systems. While the US considers sound accounting information essential for a healthy market, China sees confidential accounting information crucial for national security. The failure of the two countries to reach accounting cooperation over the years is tied to their different political ideas and subtle political relations. Research conducted by Roberts (1990) and Ramalho (2007) suggests that companies with political connections tend to have higher value. They often receive preferential treatment from the government in terms of regulatory policies, particularly in human societies (Zhang Jianjun and Zhang Zhixue, 2005). However, inter-state relations can also influence the performance of listed companies in significant ways. For instance, events such as the Cuban Missile crisis and the Kennedy assassination have been shown to increase implied volatility in US stocks (Bloom, 2009). The outbreak of the trade war between China and the US had similar implications on market indexes for both countries, which experienced sharp declines at key points before gradually recovering after easing (Yan Peng et al., 2022). In light of these developments, China Economic Net has emphasized that retaining the listing of CCS in the US would benefit investors, listed companies, and both nations. This collaboration is seen as a significant step in cross-border regulation between the two countries, especially for "conservative" China.

Therefore, it is reasonable to assume that good political relations between China and the United States will translate into greater value, particularly when the countries hold divergent development concepts. Our article will highlight the role of this collaboration in improving political relations between China and the United States.

2. Background

2.1 Chinese Concepts Stocks

China concept stocks are Chinese enterprises listed for financing in overseas capital markets whose operations and income come from China. The majority of these stocks are currently listed in the United States, the United Kingdom, and other countries.

Financial Fraud and Accounting Problems. One long-standing issue with China concept stocks is the problem of financial fraud and a lack of accounting information. Upon conducting an audit, the PCAOB found that Chinese accounting firms have poor audit quality, exacerbating this problem. In May 2023, the watchdog released an inspection report on KPMG and PWC, two Hong Kong-based firms operating in mainland China. The report noted defects in all four audits accepted by KPMG, with three out of the four audits containing insufficient evidence concerning financial statements and internal controls of financial reporting audits. Similarly, PWC's audits were flawed in revenue and related accounts, significant accounts, and major transactions. Furthermore, the PCAOB discovered that both companies had failed to comply with institutional standards or rules. In specific instances, PWC was discovered to be noncompliant in maintaining independence. "Any defect is unacceptable," stated PCAOB President Erica Williams in a press release. "Still, it is not surprising to find such a high rate of defects in jurisdictions first examined."

The hotbeds of financial fraud and insufficient accounting information for CCS include several factors. First, China's audit papers have not been allowed to be disclosed to the United States for a long time in order to protect national information security①. This regulatory barrier has led to the situation of "different accounting reports of the same company" for CCS. Additionally, there is a lack of communication and coordination in supervision between China and the United States, which may result in insufficient comprehensive and accurate information disclosure of CCS overseas, causing doubts among investors. Differences in domestic and foreign management systems and document requirements may further contribute to inadequate information disclosure. For example, at the end of 2018, the China Securities Regulatory Commission (CSRC) and the US Public Corporate Accounting Regulatory Commission issued a joint statement on the important role of audit quality and regulatory access to audit and other international information, discussing the current challenges in accessing information for US-listed companies with significant operations in China. The statement highlighted that the SEC and PCAOB still encounter difficulty in obtaining audit papers for Chinese stocks. As evidence of this problem, the PCAOB website lists a detailed list of listed companies experiencing audit obstacles and their audit institutions, many of which are Chinese concept stock companies.

The Chinese government has always placed great importance on national security, creating several challenges for Chinese companies looking to share data and accounting information overseas. Chinese law prohibits foreign regulatory bodies from undertaking investigations or gathering evidence within its borders. As a result, when seeking access to accounting papers of Chinese companies listed abroad, overseas regulators must negotiate with their Chinese counterparts. However, these negotiations often face hurdles. For instance, Luckin Coffee, involved in an accounting scandal, is registered in Cayman and listed in the US, and the Securities and Exchange Commission (SEC) requires access to its financial records. Yet, the China Securities Regulatory Commission (CSRC) believes that Luckin's business entity belongs to China, making it a domestic enterprise, which limits the level of disclosure expected by the SEC.In 2012, the SEC sued five accounting firms tasked with auditing Longtop, and was unsuccessful in accessing the audit papers of external auditor Deloitte Shanghai. Such divergence in

① Submit two kinds of accounting reports to the United States and China. At the end of 2018, the US Securities and Regulatory Commission and the US Public Corporate Accounting Regulatory Commission issued the Statement on the Important Role of Audit Quality and Regulatory Access to Audit and Other International Information —— Discussion on the Challenges of Current Access to Information for US Listed Companies with a large number of business in China.

accounting policies within the internal and external markets frequently complicates cooperation between the CSRC and US accounting regulators. While China has introduced new regulations such as the New Securities Law in 2019 and the Opinions on Strictly Cracking down on Illegal Securities Activities in accordance with the Law in 2020, aimed at enhancing supervision and responding to risks related to CCS, their impact so far has been limited.①

Second, the VIE structure adopted by CCS is extremely opaque and complex. This structure is used to facilitate overseas listing, avoid regulation, and save taxes, which reduces the identification degree of investors.②For instance, Luckin Coffee was registered in the Cayman Islands, issued securities registered by overseas regulators, and listed on the NASDAQ Stock Market. The lack of disclosure regarding original materials such as audit papers for local operating entities in China has been a significant issue in US capital markets. In February 2021, the State Administration for Market Regulation (SAMR) issued a new platform economic guide that formally incorporated the VIE into China's anti-monopoly law. Still, this law has not had any significant impact on the VIE structure behavior of CCS, and there have been no new actions. However, it remains a possibility that the VIE structure could be identified as an illegal structure at any time. Therefore, it is difficult for the United States to track down fraud compensation when VIE China concept stocks are delisted. As a result, the VIE listing structure adopted by CCS has become a common point of discussion between the United States and China.

Third, the packaging and exaggeration of investment banks and accounting firms in the Chinese concept stock market have led to an aggravated distortion of accounting information. This has impacted American investors who often judge a company's valuation by comparing it with similar companies. During roadshows, companies may engage in stunts such as calling themselves the "China's Facebook" to attract investors. However, American investors may fail to understand the actual business structure and profit model of these companies, which can lead to manipulation of stock prices. Additionally, the listing path from OTCBB to NASDAQ is also a concern as regulators may question the accounting information due to intermediaries' involvement in the packaging process.

CCS that have been involved in fraud are more likely to be made short. The probability of being punished by the China Security Regulatory Commission is positively correlated with the probability of short selling. Short sellers can identify companies that engage in serious earnings management and distorted accounting practices and sell them short. As a result, the emergence of short selling mechanisms has significantly

① The new securities law has been discussed and approved by the Standing Committee of the National People's Congress of China. The specific content can refer to the following website. Securities Law of the People's Republic of China (2019) (sc.gov.cn)

②VIE architecture is actually for listed companies overseas, in the Cayman islands or the British Virgin Islands set up a parallel offshore company, with the offshore company as the future listed or financing subject, the equity structure reflects the real equity structure of listed companies, and the domestic proposed listed company itself does not necessarily reflect the equity structure.

reduced the degree of earnings management in margin trading target companies.

It is concerning to hear about the allegations of financial fraud and corporate governance issues against Chinese stocks. The process for addressing such allegations seems to involve several important nodes, including a short agency report, a sharp drop in share prices, potential legal action by shareholders, settlement or judgment compensation, company suspension or delisting, SEC prosecution, and fines. It is notable that Muddy Waters' report in 2010 initiated major institutions to short CCS, resulting in price declines and even suspensions or delistings. It appears that the US capital market is now less interested in CCS, and the SEC's policy towards them is becoming stricter. Table 1 is a review of the short selling events of CCS in recent years.

Table 1:Companies that have been shorted and subsequent events

Year	Stock code	Short institution	The end
2010	ONP	Muddy Waters	change one's name
	RINO	Muddy Waters	quit from market
2011	CCME	Citron	quit from market
	DGw	Muddy Waters	Be delisted
	UTA	Glaucus	quit from market
	GURE	Glaucus	stock price collapsed
	SPRD	Muddy Waters	Mistake in troubled waters, privatization of the company
	FMCN	Muddy Waters	Withdraw from the market and return to the A-share market
	CMED	Glaucus	go bankrupt
	FSIN	Muddy Waters	privatization
2013	QIHU	Anonymous Analytics	Withdraw from the market and return to the A-share market
	EDU	Muddy Waters	Successfully sniper muddy water
	SFUN	Glaucus	stock price collapsed
	JOY	Anonymous Analytics	quit from market
	NQ	Muddy Waters	quit from market
2017	CIFS	Muddy Waters	stock price collapsed
2018	TAL	Muddy Waters	Successfully sniper muddy water
	MFC	Muddy Waters	Share price has no effect
	PDD	Blue Orca	Successfully attacked short-selling institutions
	UXIN	J capital	stock price collapsed
	GSX	Grizzly Research	Share price has no effect
	LK	Muddy Waters	stock price fell by 80%
	lQ	Wolfpack Research	stock price fluctuated violently
	TAL	Self-destructing	After-hours plunge

2.2 PCAOB

PCAOB is a non-profit private organization that supervises auditors of public companies to produce informative, fair and independent audit reports to protect the interests of investors and enhance the public interest. It was founded under the Sarbanes Oxley Act in 2002 and is regulated by the US Securities and Futures Commission. Its primary function is auditing corporate accounting accounts with the authority to maintain investor confidence in the company's disclosure of financial data.

Compared to the China Securities Regulatory Commission and the Ministry of Finance, PCAOB has a different status as a department under the US Securities and Futures Commission. As of 2021, it has established cooperation mechanisms with regulatory agencies in over 50 countries and regions worldwide. However, only a few areas will not accept the PCAOB inspection of its audit papers, and companies from mainland China and Hong Kong account for nearly 90% of these cases.

The turning point between China and the United States occurred in 2021 when the SEC issued the Foreign Company Holding Responsibility Act, which led to the pre-delisting list of CCS. Companies on the list will be forced to delist if they fail to submit the accounting reports required by the SEC within three years. This resulted in China making concessions in 2022, leading to the signing of an agreement on cross-border accounting regulatory cooperation by the CSRC and PCAOB on August 26,2022①②.

The agreement allows the Chinese side to cooperate with investigations of accounting firms if permitted by law, while the US side cannot enter the country separately. The agreement can promote the improvement of accounting quality of CCS, boosting the confidence of American investors, and easing the trend of institutional investors' shareholding in CCS significantly. The previous decline in stock value due to defective accounting information portions could now recover.

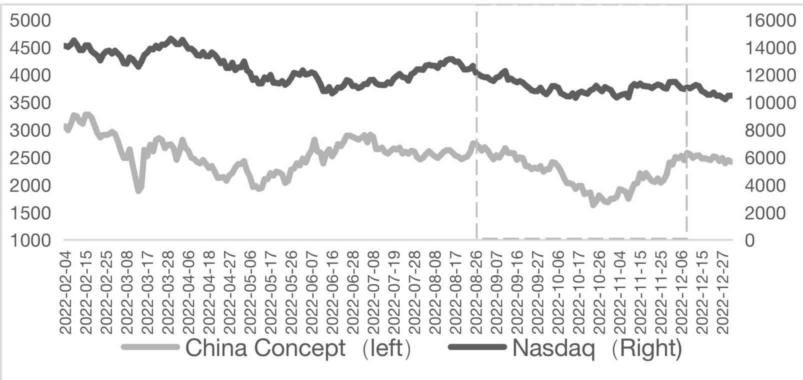


Figure 1:he Nasdaq index and the China-concept stock market index③

The review of cooperation between China and the United States reflects an easing of political tensions and an acknowledgement of each other's accounting policies. Furthermore, there is no fundamental contradiction between these two countries regarding the development of CCS. In the past, transferring Chinese stocks from US

① [China-us regulators sign cooperation agreement to promote cross-border audit supervision cooperation in accordance with law-Xinhuanet (News.cn)]

②The audit paper has a detailed record of the company's revenue activities in various regions, and it also includes the company's associated suppliers, customers, and their patented technologies.

③ This chart shows the comparison of the Chinese stock index and the Nasdaq Market index.

capital markets to other markets has been slow, such as moving to Hong Kong. However, it is expected that more Chinese companies will return or travel to the US stock market. Notably, in the first quarter of 2023, a total of 18 Chinese stocks (13 IPOs and five backdoor SPACs) are preparing to list in major capital markets, with approximately 86 in the works. Currently, 65 Chinese stocks have updated their prospectus with the Securities and Futures Commission (SEC), 14 are preparing for backdoor SPAC listing, and seven are seeking to become listed companies on NASDAQ or upgrade their transfer board to NASDAQ. This number of anticipated listings is in stark contrast to the 29 Chinese companies that were listed by SEC in all of 2022.

In recent years, the overall value index of CCS has trended lower than the NASDAQ index due to unstable political relations between China and the United States and the financial issues faced by some CCS. However, from September to November 2022, the Public Company Accounting Oversight Board (PCAOB), with assistance from Chinese regulators, conducted on-site inspections of some audit sector issuers. The preliminary work was mostly completed in November, and the reaction from the Chinese stock market index indicated that it rebounded during that month, suggesting positive expectations for Chinese stocks.

2.3 The Policy Shock: China and the United States have reached an accounting review agreement

The focus of this academic article is the Audit Supervision Cooperation Agreement that has been signed between the China Securities Regulatory Commission and PCAOB on August 26, 2022. This agreement builds upon the foundation established by the 2013 memorandum of understanding on law enforcement cooperation and the 2016 memorandum of cooperation on pilot inspection. The main objective of this cooperation agreement is to establish specific arrangements for both parties to carry out daily inspection and law enforcement investigations on the collaboration between relevant accounting firms. It also outlines important matters such as the purpose, scope, form of cooperation, information use, and specific data protection.

Some of the key contents covered in the cooperation agreement are as follows: Firstly, the principle of reciprocity has been agreed upon. Both parties are bound equally by the terms specified in the agreement. As per their statutory duties, both China and the United States have the right to conduct inspections and investigations of relevant firms within each other's jurisdictions. The requested party will provide full assistance to the extent permitted by law. Secondly, the scope of cooperation has been defined. This includes assisting the other party in the inspection and investigation of relevant firms. Additionally, the scope of Chinese assistance covers some Hong Kong firms that provide audit services for CCS and whose audit papers are deposited in the mainland. Thirdly, the way of collaboration has been specified. The two sides will communicate and coordinate in advance on the plan of inspection and investigation activities. Moreover, the US side shall obtain audit papers and other relevant documents through the Chinese regulatory authorities, while conducting interviews and inquiries with relevant personnel of the accounting firm, with the participation and assistance of the Chinese side.

This incident marks an end to the dispute between the two sides over the years, responding to the fundamental issue of cross-border accounting supervision. Additionally, PCAOB has sent personnel to carry out substantive reviews and provide review opinions. Considering multiple events that occurred in China and the United States during the same period, we will be using other events for robustness analysis..

3. Sample, variables and methodology

3.1 Data and Variable Construction

Our study utilized data exclusively from the WRDS and Wind databases. Our sample consisted of all U.S.-listed Chinese shares, excluding delisted stocks, during the three-month period both before and after the PCAOB collaboration practice on August 26, 2022 (May 31, 2022, to November 25, 2022). The regression analysis included 233 stocks with 23,581 observed values, using a time window of [-90 days, +90 days]. We applied two-tailed t-tests at the 1% level for all variables, and we refer readers to Table 2 for detailed variable definitions.

3.2 Main variables

Our study examined cumulative abnormal return and stock liquidity as outcome variables. Cumulative abnormal returns were measured in two ways: first, by calculating the difference between the daily stock return and SP500 return and then cumulatively adding these differences; and second, by computing abnormal returns using the CAPM, FAMA 3-factor, and FAMA 4-factor models and cumulatively summing these results. Stock liquidity was assessed using three different metrics.

The explanatory variables Treat * Post, a dummy variable indicating whether the company has ever been shorted (ever short = 1, no = 0) and Post is a dummy variable indicating whether the observations fall on or after August 26, 2022 (time = 1, no = 0).

Given the potential impact of political connections on government procurement bidding, we also included a virtual variable called Political Connect. Specifically, we assigned a value of 1 to Political Connect when a company had cooperative relationships with key government institutions or general institutions in procurement activities. If a company had only one or no collaboration on record, we assigned a value of 0[①].

Table 2: variable-definition

type	variable	meaning

① Government procurement is a kind of government intervention between market transactions and direct government support, supporting enterprises in meeting social needs (DouC, 2019). When the government talks, it will certainly make contact with officials, and they will often provide the government at a lower price than the market. Therefore, the purchasing enterprises will form a contact with the government.

type	variable	meaning
dependent variable	CAR_{capm}	Cumulative abnormal returns estimated with respect to the CAPM model using a 252-day window with a minimum observation requirement of 126 days
	CAR_{FF3}	Cumulative abnormal returns estimated with respect to the Fama -French three-factor model using a 252-day window with a minimum observation requirement of 126 days
	CAR_{FF4}	Cumulative abnormal returns estimated with respect to the Fama -French four -factor model using a 252-day window with a minimum observation requirement of 126 days
	ES	Daily dollar-weighted effective spread
	HLS	Daily high and low stock spreads
	VOL	Stock daily real earnings and expected earnings difference volatility
argument	Treat①	The dummy variable of whether the company was ever shorted, ever short =1, no 0
	Post	Whether the dummy variable after 2022-8-26 event, time after 2022-8-26 event =1, no is 0
	T reat*Post	Treat and post, of the cross term
	Political connect*Post	Political connect and Post, for the cross term. Political connect② is the dummy variable of whether the company has a political connection with the Chinese government, if the company has more than once commodity procurement relationship with the Chinese government, then Political connect=1, otherwise 0.
controlled variable	Ted	The difference between the three-month T-bill and the LIBOR rate
	VIX	CBOE Volatility Index
	Size	Log (market value)
	inst	Percentage of company shares held by large securities institutions
	Leverage	Debt is divided by the total assets
	ROE	Net profit divided by share capital stock
	BM	Book value is divided by the market value

3.3 Empirical model: DID Estimation

In this paper, the date of the event study is taken on August 26,2022, and the sample period is six months from May 31,2022 to November 25,2022. Here are the underlying models of this paper:

①Have been short see Table1 for the data of companies.
② Companies with political connections are listed in Table 1 of the appendix.

$$CAR_{it}=\alpha Treat_i \times Post_t + c_i + w_t \times d_i \times l_i + \gamma x_{it} + \mu_{it} \quad (1)$$

$$CAR_{it}=\alpha Political\ connect_i \times Post_t + c_i + w_t \times d_i \times l_i + \gamma x_{it} + \mu_{it} \quad (2)$$

where $\mathrm{CAR_{it}}$ means the dependent variables are calculated based on the three basic models, which are capm, Fama-3 and Fama-4. After model regression, the abnormal return rate of stocks under the current model is obtained according to the constant term, and the cumulative abnormal return rate of stocks of each company is calculated. If the company has been shorted by a professional institution, $\mathrm{Treat_i}$ is 1, and 0 otherwise. If the company has political ties with the Chinese government, $\mathrm{Political\ connect_i}$ is 1, and 0 otherwise. If the current event occurs after the study event, $\mathrm{Post_t}$ is 1. $\mathrm{w_t \times d_i \times l_i}$ means three-dimensional fixed effect of company size fixed effect, weekly fixed effect and industry fixed effect, which can absorb other influencing factors at the individual level of the company and at different times. Since time and company level effects have been controlled, $\mathrm{Treat_i}$、$\mathrm{Post_t}$ can be omitted. $\mathrm{x_{it}}$ means the firm-level control variables including ted spread, VIX index, and book market value ratio and leverage ratio etc.

4. Empirical Result

4.1. Descriptive statistics

The table 3 provides summary data of key variables, including CAR calculated in three ways, namely CAR-CAPM, CAR-FF 3, and CAR-FF 4. CAR-CAPM-politics represents the data of companies with political links on the basis of CAR-CAPM, and CAR-CAPM-short is the data that had been shorted by professional institutions. ES, HL, VOL independent variables, TED, VIX control variables, and other company-level control variables are also included.

There are relatively few large Chinese concept companies listed in the United States, and most of the companies are small and medium-sized companies with market capitalization, most of which are listed by reverse acquisitions. Hot stocks are even more scarce.

Table 3:Summary Statistics①

	N	Mean	STD	P10	P25	Median	P75	P90
CAR - CAPM	23577	0.55	38.01	-47.61	-16.74	4.19	22.25	40.85
CAR-CAPM-Politics	4974	8.70	30.65	-31.05	-7.20	10.20	28.12	44.54

① The market value data is processed by ln logarithmic data in millions of dollars before processing. The CAR and subsequent CAR data units are percentage (%), including instOwn are also percentage (%).

CAR-CAPM-Short Time	1984	9.76	23.21	-16.81	-2.87	7.09	22.27	42.43
CAR - FF3	23577	-8.74	38.05	-58.61	-27.99	-3.23	12.25	30.65
CAR-FF3-Politics	4974	-3.48	31.48	-46.91	-21.97	0.06	16.19	34.29
CAR-FF3-Short Time	1984	-1.51	24.04	-33.92	-13.81	1.69	10.44	26.10
CAR - FF4	23577	-8.33	37.54	-57.24	-26.92	-2.91	12.27	30.38
CAR-FF4-Politics	4974	-2.50	31.56	-45.46	-20.79	0.87	17.21	35.01
CAR-FF4-Short	1984	-1.46	23.64	-32.62	-15.00	1.22	10.32	27.26
ES	26579	1.23	0.57	0.59	0.75	1.32	1.52	2.06
HL	26579	0.52	1.62	0.03	0.06	0.14	0.39	1.28
VOL	26579	5.93	2.55	3.72	4.32	5.57	6.67	8.24
TED	26579	0.30	0.11	0.17	0.23	0.29	0.37	0.46
VIX	26579	26.05	3.59	21.29	23.73	25.86	28.55	31.37
Size	26579	5.76	2.71	2.51	3.55	5.50	7.45	9.78
bm	26579	1.63	3.26	0.04	0.15	0.63	1.83	3.37
Leverage	26579	0.41	0.30	0.11	0.19	0.35	0.56	0.78
ROE (Annual)	26579	-0.23	0.90	-0.79	-0.22	-0.04	0.04	0.12
InstOwn	26579	12.60	16.83	0.15	0.50	3.65	19.77	42.60

In Table 4, we present a comparison of the key characteristics between Chinese concept stock companies that have been shorted and those that have not. These characteristics include the logarithm of market value (log size), book-to-market value ratio (BM), leverage ratio (Leverage), and institutional shareholding ratio (Inst). The final column indicates the differences in these variables. Notably, significant differences exist in the market value and institutional shareholding ratio of the companies.

Specifically, the market value of shorted companies (logarithmic scale) is approximately 3.32 units higher, and the institutional shareholding ratio is 17% greater. This suggests that certain companies may possess characteristics that attract investors to artificially inflate their market value through potential financial fraud, and institutions may also be deceived by their financial illusion.

Furthermore, our analysis reveals that larger companies are more likely to be targeted for shorting, while companies with a higher book-to-market value ratio exhibit a negative correlation with shorting. Companies with a high book value and low book-to-market value ratio are less prone to engaging in accounting exaggerations. On the other hand, companies with a higher return on equity (ROE) ratio are more likely to inflate their earnings. Notably, companies with political ties demonstrate an increased likelihood of being shorted, which aligns with previous speculation regarding the influence of political connections on US investors' expectations of Chinese stocks.

Table 4:Comparing companies that are short and those that are not short

Variables	Treat(shorted)	Control(not shorted)	Difference p value	T	Difference

Size	8.82	5.50	0.000	57.07	3.32
bm	1.00	1.69	0.000	−9.31	−0.69
Leverage	0.51	0.41	0.000	14.7	0.10
ROE (Annual)	0.00	−0.25	0.000	12.42	0.25
Inst Own (%)	28.44	11.21	0.000	46.87	17.21

To investigate the impact of control variables on companies being shorted, we used the variable indicating whether a company has ever been shorted as the dependent variable. The results of the OLS regression are presented in Table 5. The analysis reveals that only company size partially explains the likelihood of being shorted in the cross-section, accounting for approximately 11% of the observed variation, and the estimated coefficient is statistically significant.

While other factors such as book capitalization ratio, leverage, and political attributes are also associated with the likelihood of being shorted, their explanatory power is relatively weaker compared to market capitalization. Hence, it can be concluded that the scale characteristics of listed CCS (Concept Stock Companies) are likely to play a major role in determining the likelihood of being shorted in the future. As a result, we include market value as a fixed effect in our cross-sectional analysis.

Table 5 The factors that determine the company's short selling

Dependent: Treat	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Ln(Size)	3.17***						-10.29***
	(55.97)						(55.97)
BM		−0.03***					0.03***
		(−4.34)					(48.01)
Leverage			9.42***				3.97***
			(17.54)				(14.25)
ROE				2.23***			8.44***
				(12.24)			(49.52)
InstOwn					41.64***		2.24***
					(45.09)		(13.20)
policy						3.99***	7.08***
						(9.84)	(38.07)

R-square	0.105	0.001	0.011	0.006	0.071	0.004	

4.2. Dynamic Treatment Effects of the Policy Shock

We will focus on developing an empirical test strategy using the Difference-in-Differences (DID) approach. Below, we outline how we construct DID models and assess the effectiveness of parallel trends through visual and regression analysis. Additionally, we ensure the robustness of our regression results through placebo tests and other robustness checks.

As mentioned earlier, we selected August 2, 2022, the date when the audit cooperation agreement was announced by both countries, as the policy shock date. We consider a sample period of 6 months before and after this date, spanning from May 31, 2022, to November 25, 2022.

DID analysis relies on the parallel trend assumption, which assumes that both types of companies exhibit consistent behavior in the absence of the event. This assumption is crucial to demonstrate that the observed changes after the event can be attributed to the event itself. To verify the parallel trend assumption, we present the time series charts of the dependent variable, stock return, and stock liquidity in Figure 2 to Figure 4. These figures display the cumulative abnormal return rates calculated using the CAPM, FAMA 3-factor, and FAMA 4-factor models, respectively.

The charts indicate that the trends in abnormal stock yield and stock liquidity of both previously shorted and unshorted companies were similar before the PCAOB event on August 26, 2022. This finding suggests that the parallel trend assumption holds. However, after the PCAOB event, the previously shorted companies experienced a significantly higher abnormal yield compared to the unshorted companies. This observation suggests that the PCAOB event led to an increase in the abnormal yield of previously shorted companies.

Next, we will conduct an empirical parallel trend test, focusing on whether the abnormal yield of the corresponding company in advance will change significantly at other specific times. So we constructed the following model to test the parallel trend hypothesis:

$$CAR_{it}=\sum_{k=-11}^{12} d_k T_i^k + c_i + w_t \times d_i \times l_i + \gamma x_{it} + \mu_{it}$$

The formula is consistent with the previous basic formula, which controls the fixed effect of the company and the three-dimensional fixed effect of week, industry and company size. $\mathrm{d_k}$ The dependent variable is the cumulative abnormal return, which represents the fixed effect of each week. When the company belongs to the experimental group and the current time point is afterwards, the value of $\mathrm{T_i^k}$ is 0.

Then we plot the week as the x-axis, and the coefficients of the experimental company and time interaction term as y-values, removing the pre-event period as the control. When the pre-event interaction term coefficient is significantly 0, it means that the parallel trend assumption is satisfied. The observation Figure 5、Figure 6 shows that the pre-event coefficient value can be significantly taken as 0, so the experiment satisfies the corresponding hypothesis.

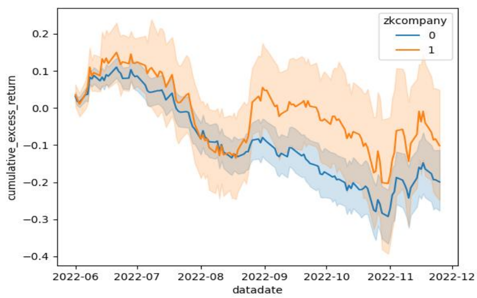


Figure 2

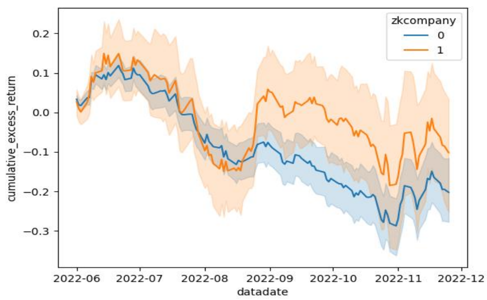


Figure 3

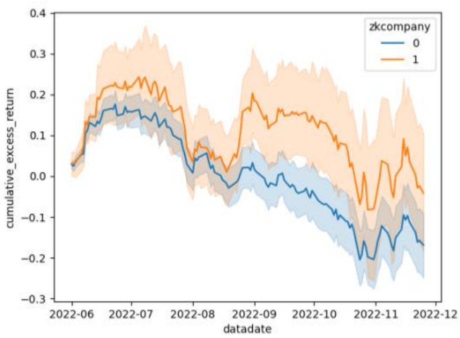


Figure 4

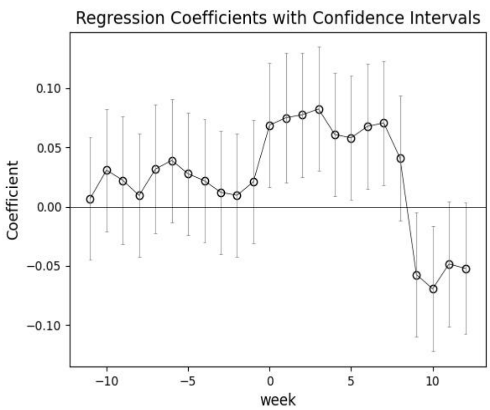
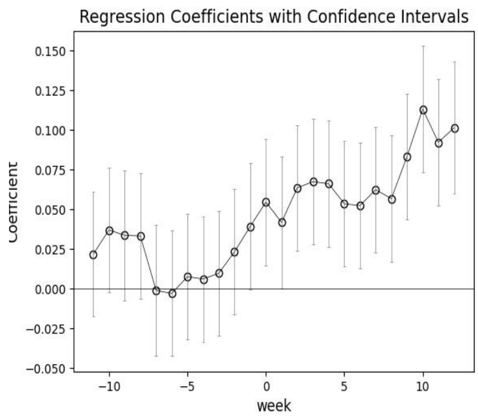


Figure 5



F

Figure 5

4.3. Effects of the Policy Shock on CAR

To examine whether there are changes in the cumulative rate of return for shorted companies or companies with political links following the policy announcement, we employ the Difference-in-Differences (DID) method for event analysis.

In the first six columns, we use the daily cumulative abnormal return obtained from regression using the CAPM model as the dependent variable. Subsequent columns replace the dependent variables with the cumulative abnormal gains adjusted using the three-factor and four-factor models proposed by Fama and French. The independent variables include control variables such as market value, book market value ratio, price/earnings ratio, and institutional shareholding ratio. The key independent variables of interest are the intersection of "Treat" (indicating whether the company is affected by the policy) and "Post" (representing the post-policy period).

The consideration of endogenous issues arises from the significant variation in market value among Chinese concept stocks (CCS). Large-scale companies with high market capitalization listed in the United States tend to have lower sensitivity to policy shocks. Conversely, small and medium-sized companies, which choose the U.S. market to avoid stringent listing requirements in China, exhibit greater sensitivity to policy shocks. As a result, the cumulative abnormal revenue we consider may be higher, potentially leading to overestimated results. To address this, we introduce interaction terms between company size and week, accounting for both the impact of time elapsed and company size.

In column (1) and (2), we control for weeks and company fixed effects. In column (3), we additionally control for company, week, and industry cross-fixed effects. Similarly, column (4) controls for company, week, and cross-fixed effects. Moving to column (5), we introduce controls for company, industry, week, and the cross-effect of size and week. Finally, column (6) includes controls for company, industry, scale, and the interaction between size and week fixed effects. The model in column (7) remains consistent with column (6), with the dependent variable changing to Fama-French three-factor adjusted cumulative abnormal returns (CAR), expressed as a percentage (%).

By employing these models, we aim to provide robust regression results and address potential endogeneity concerns.

Table 5 presents significant positive coefficients for all cross items, indicating that the cumulative abnormal yield of previously shorted companies is higher compared to non-shorted companies. This suggests a positive and significant stock price recovery for companies that have experienced short selling.

Moving on, we examine the cumulative abnormal returns for companies with political connections. We find that companies with political links exhibit positive and significant price recoveries, with larger responses compared to those with accounting problems. This can be attributed to the cooperative agreement between PCAOB and CSRC, which can be seen as a compromise between the two countries. China acknowledges the political management concerns raised by the US regarding accounting activities, even though the collaboration seeks to normalize accounting reviews for Chinese stocks. Our findings indicate that investors investing in both US and Chinese stocks place greater emphasis on the political relationship between China and the United States than accounting issues.

Given the complex context of the event in 2022, various events related to Chinese companies occurred in both the US and Chinese markets. Some listed Chinese stocks that were shorted or had political links may have been influenced by other events, which could impact the cumulative abnormal returns. For instance, the Chinese government issued policies favorable to the positive development of the Chinese concept sector, leading to positive expectations for the listing of Chinese concept stocks within the industry. An example of such a policy occurred on June 7, 2022, when the National Press and Publication Administration of China approved 60 online games and granted licenses for a small batch of games in April. These actions followed a period of no game approvals since the previous July, indicating a shift in the Chinese government's attitude towards promoting the electronic entertainment sector. It is foreseeable that such incidents could introduce interference in our results.

In addition to industry-level factors, collective expectations regarding Chinese stocks also play a role. On June 10, 2022, Didi ended the November listing process for raising funds in the US market. The obstacles encountered during the listing process for Chinese concept stocks in the United States are closely linked to the China-US relationship. Therefore, the impact of other policy events at the industry or macro level may influence the regression results. To account for this, we introduce the cross-fixed effect of industry and week. Notably, even after controlling for these factors in column (3), we still observe significantly positive regression results, with a cross-term of 9.11%. This indicates the unique impact of our research events on the Chinese concept sector.

Table 5 :Market response to accounting review agreements: : Difference-in-Differences ①

	CAR-capm							CAR-FF3		CAR-FF4	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
Treat × Post	10.14***	10.13***	9.11***	2.39***	3.58***	1.47*			1.13		1.51*
	(11.16)	(11.16)	(11.09)	(8.69)	(3.78)	(1.77)			(1.39)		(1.86)
Political connect * Post							4.81***	4.63***		5.09***	
							(7.92)	(7.71)		(8.51)	
TED		1.76	1.92	1.84	2.02	0.0297**	0.982**	1.27	1.27	0.91	0.90
		(0.82)	(1.13)	(0.87)	(1.21)	(2.03)	(2.04)	(0.88)	(0.88)	(0.64)	(0.62)
VIX		0.61***	2.03	0.62***	0.65***	0.75***	0.75***	0.72***	0.72***	0.80***	0.80***
		(4.86)	(0.80)	(5.03)	(6.70)	(8.72)	(8.74)	(8.62)	8.61	(9.62)	(9.59)
c ontrols	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Firm FE	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	
Week FE	✓	✓							✓		
Industry × Week FE			✓		✓						
Size × Week FE				✓	✓						
Industry × Size × Week FE						✓	✓	✓	✓	✓	✓
R–square–Adj.	0.76	0.76	0.88	0.77	0.88	0.90	0.76	0.89	0.76	0.89	0.75
N	23714	23714	23714	23714	23714	23714	23714	23581	23581	23581	23581

① The symbols *, **, and *** represent statistical significance at the 10%, 5%, and 1% level, respectively.

4.4. Robustness checks

4.4.1. Placebo tests: Alternative policy dates

During our sample period, there are also some policies and events that may have a significant impact, which will greatly affect people's expectations for the development of CCS, and may interfere with the analysis of the results. To test that these events do not affect the regression results, we selected events that may have a significant impact on accounting and political expectations

alternate time nodes were selected for placebo testing. For events affecting accounting expectations, the events that SEC Chairman Gernsler selected on July 14,2022 were publicly doubtful whether the US and China could reach an audit agreement. If a cooperation agreement is not reached, the Chinese companies on the pre-delisting list will be delisted from the US stock exchange.

As for political events, the 2022 visit is Taiwan on May 30, which violates the one-China principle.① The Chinese government has long adhered to the One-China principle and has been particularly sensitive to the Taiwan issue, and the US high-level US political provocation against China often comes from the Taiwan issue. Of course, we foresee that these two events will not fundamentally affect the abnormal returns of CCS, because the event is not directly associated with CCS. From table columns (1) and (2), the regression results show that the interaction term is not significant in either the accounting or political level. The placebo test indicates that the conclusions we reached were not directly significantly associated with events other than the two-country accounting review cooperation.

Table 6 :DID Estimation: Placebo Tests②

	(1)	(2)
	Fake date:2022/7/14	Fake date:2022/5/30
Treat × Post	0.76	−35.96
	(0.88)	(−0.19)
TED	1.26	1.26
	(0.87)	(0.87)
VIX	0.72***	0.73***
	(8.59)	(8.60)

①Regarding the placebo test incident, the other conflict between China and the United States over Taiwan was visited on August 2,2022 by Nancy Pelosi, Speaker of the House of Representatives. However, the event is too close to the time node we concerned, so we choose to pay attention to the Taiwan visit event selected in the article.

② The symbols *, **, and *** represent statistical significance at the 10%, 5%, and 1% level, respectively.

C ontrols	√	√
Firm FE	√	√
Industry × Size × Week FE	√	√
R-square	0.89	0.89
N	23577	23577

4.4.2. Subsample

To further show the robustness of our regression results, excluding the influence of other factors, we adopted the strategy of group discussion. The regression results are shown in Table 6.

Firstly, we only consider companies with a market capitalization above the median. Smaller companies may be more susceptible to emergencies or their responses may be magnified. However, they may receive less attention from investors, leading to their absence in the analysis. To address this, columns (1) and (2) select companies with a market value above the median. The regression results indicate that the income recovery resulting from political effects is still greater than that from accounting improvements. However, the absolute level of improvement decreases to 3.58%, which is lower than the benchmark regression's 4.63%. Nevertheless, this does not impact our conclusion.

We exclude data from the five weeks following the event to account for short-term emotional reactions and avoid the interference of short-term emotional trading on the results. Columns (3) and (4) present the regression results after this exclusion. We observe that the regression coefficient for the short selling effect decreases to -2.23%, indicating a decline in the recovery of previous price increases. In the long run, accounting improvements do not fully restore the confidence of US investors in CCS. In the short term, prices may be influenced by emotions, while the regression coefficient for the political connection level remains significantly positive at 5.40%, consistent with the previous analysis.

We also exclude stocks with a Variable Interest Entity (VIE) structure. Given that most CCS listed in the US adopt the VIE structure, which entails inherent accounting opacity and increases the difficulty of identifying investors, it introduces policy risks associated with the Chinese government's stance on VIE listing structures. These factors can significantly impact the financial situation of Chinese operating entities and the legal effect of VIE agreements. Since the short-term development trend is unpredictable, we select CCS that do not adopt the VIE structure in columns (5) and (6). Additionally, when discussing the two types of cross terms, we find that the coefficient for the political correlation remains positive and reaches 19.59%, indicating a stronger influence of political factors.

In summary, the regression results demonstrate that the political relaxation surrounding the Sino-US accounting review cooperation has improved the prices of CCS. This finding holds across various subsamples, indicating consistent results.

Table 7:Market response to accounting review collaboration agreements：DID Estimation for Additional Results[①]

	Short	To politics	Short	To politics	Short	To politics
Treat × Post	2.17***	3.58***	−2.33**	5.40***	−2.50*	19.59***
	(3.62)	(6.47)	(−2.24)	(7.17)	(−1.77)	(15.14)
TED	7.47***	7.51***	2.34	2.35	−1.69	−1.77
	(5.26)	(5.31)	(1.17)	(1.17)	(−1.07)	(−1.14)
VIX	1.16***	1.17***	0.81***	0.81***	0.41***	0.41***
	(13.91)	(14.00)	(7.44)	(7.47)	(4.44)	(4.51)
Controls	√	√	√	√	√	√
Firm FE	√	√	√	√	√	√
Industry × Size × Week FE	√	√	√	√	√	√
R-square	0.932	0.933	0.877	0.877	0.943	0.944
N	12429	12429	18053	18053	9407	9407

4.5. Heterogeneity analysis

We mentioned that the companies that have been shorted are not controlled or difficult to control, and the return of political linked companies will be affected by their own accounting problems, which will be biased in the comparison and discussion. Therefore, we controlled certain conditions in the subsequent DID model, in order to analyze our conclusions more accurately.

To solve the problem of cannot review Chinese stocks accounting papers, SEC decided to put pressure on Chinese stocks and the Chinese government, since the end of 2020 the foreign company accountability act, will be part of the accounting review unqualified in the company to the list, if the company within 15 days cannot submit successfully to the SEC certificate to solve the problem, in 2-3 years will face the risk of being delisted. Analyzing the improvement effect of the company's accounting transparency after the event, and only considering that the actual shorting may ignore the companies that have accounting problems but are not shorted, it will make it difficult for us to determine whether the improvement of accounting problems is related to whether

① The symbols *, **, and *** represent statistical significance at the 10%, 5%, and 1% level, respectively.

the institution actually shorted.

[①] Therefore, according to the pre-delisting list published by the SEC on the official website, we screened the variables into two groups, existing in the pre-delisting list and not shorted by institutions, and existing in the pre-delisting list that had been shorted by institutions. The normative model that we choose is consistent with the column (7) of the basic model, and the dependent variable is the cumulative abnormal income under Fama-3 model. It can be seen that in the regression results, excluding the accounting improvement effect under the background of delisting, the actual improvement effect of shorting still brings, significant 5.28% of the cumulative abnormal return after Fama-French three-factor adjustment. It shows that the state of being shorted, rather than the nature of accounting problems, dominates the expected improvement effect of the accounting level brought about by policy collaboration.

To further support the existence of the effect of accounting transparency on people's expectations, we also consider companies from the preliminary delisting list. We divide the companies into three categories: those that are neither shorted nor have political links but appear on the delisting list, those that do not appear in any of the aforementioned categories, and those that do not have larger accounting fraud. The difference between these categories lies solely in the presence of significant accounting fraud. From the regression results, we observe a 2.35% recovery in cumulative abnormal earnings after the event. This indicates that events associated with improving accounting expectations can attract investors to drive up the stock prices of Chinese stocks.

Finally, we examine the impact of the event on stock price earnings from the perspective of improving political relations. To eliminate interference from accounting issues, we categorize companies into two groups: those that are not delisted, not shorted, and have political ties, and those that are not delisted, not shorted, and have no political ties. This category represents the focal point of our analysis. We classify these companies as relatively "clean," meaning they can be considered free from accounting opacity risks. However, the regression results reveal a significant cumulative earnings recovery of 18.76% for companies with political links, surpassing the earnings recovery brought about by short selling. Therefore, we can conclude that the PCAOB accounting cooperation has enhanced investors' confidence in the political relations between the two countries.

Table 8: Market response to accounting review collaboration agreements: DID Estimation for Alternative Treatment and Control Groups[②]

	(1)[③]	(2)	(3)

[①] The list is confirmed to come from the Law on the Accountability of Foreign Companies, but as of December 15,2022, the SEC has revoked the requirement for the pre-delisting list within three years. SEC.gov | Holding Foreign Companies Accountable Act

[②] The unit of the regression results in the figure is percentage (%), and the regression results shown are the difference between the coefficient of the cross term of the two types of companies under the same model regression, representing the difference in the response of the two types of companies to the same event.

[③] The first column indicates the disparity in the inclusion of delisted companies within the designated group. The second column highlights variations in the delisting of companies without any accounting concerns or political affiliations from the overall group. The third column examines the

Treat control			
Treat × Post	5.28***	2.35***	18.76***
	(8.53)	(3.45)	(14.36)
TED	4.47***	1.28	-1.75
	(3.34)	(0.86)	(-0.78)
VIX	0.01***	0.01***	0.01***
	(14.33)	(8.05)	(2.90)
Controls	√	√	√
Firm FE	√	√	√
Industry × Size × Week FE	√	√	√
R-square	0.941	0.897	0.899
N	12399	21717	10682

4.6. Additional Effects of the Policy Shock on stock liquidity

Next, we turn our attention to the potential conversion of Chinese Concept Stocks (CCS) to alternative listing locations. When US-listed Chinese state-owned enterprises encounter difficulties, particularly during periods of escalating political tensions between China and the US, various strategies are adopted. For instance, in May 2021, China Mobile, China Telecom, and China Unicom issued statements announcing their delisting from the US stock market. Cnooc was subsequently delisted from the New York Stock Exchange in October 2021. Another common approach is to shift to Hong Kong or pursue dual listings. For example, Zhihu completed its dual listing on the Hong Kong Stock Exchange on April 22, 2022. Other companies, including Paikche Shenzhou, Xiaopeng Automobile, and Ideal Automobile, have also pursued dual listings in Hong Kong and have been included in the Hong Kong Stock Connect.

Despite the numerous advantages of raising capital in the US, companies are responding to the deteriorating listing environment by taking extreme measures. However, this trend may reverse in the coming years, as more Chinese companies are likely to opt for US listings. Therefore, we begin by examining the trading volume of CCS in the United States to determine whether the cooperative agreement has impacted the liquidity of these stocks. Specifically, we focus on the difference between CCS with political links and those without. Investors observe the sincerity of the China Securities Regulatory Commission (CSRC) and the US Securities and Exchange Commission (SEC),

presence of divergences in political connections among companies without accounting issues that are grouped together.

and China also aims to support the development of Chinese enterprises in the US capital market. Consequently, investors may increase their investments in CCS. Furthermore, since China has made significant concessions on this matter, it is unlikely that the US will introduce policies to restrict CCS in the future. Both countries are expected to introduce policies that promote the healthy and stable development of CCS.

We utilize three indicators: (1) daily dollar-weighted effective spread; (2) daily high and low spreads of stocks; and (3) volatility in the daily expected earnings of stocks. The regression model remains consistent with the benchmark model, with the regression outcomes presented in the table. For companies with political links, there is a significant decrease of 3.29% in the daily high and low spreads, and a 0.25% reduction in the volatility of daily expected real yield differences. Therefore, we can conclude that the stock liquidity of these companies has improved. In contrast, compared to companies with accounting problems, the stock liquidity has not improved and has shifted towards reduced liquidity.The figure above is based on the stock liquidity, with the highest and heterogeneous volatility of the day.① Politics and short selling represent the cross study of the two types of companies, respectively, and political linked companies' liquidity (heterogeneous volatility) declines after the PCAOB event. Liquidity (both definitions) increased after the PCAOB event.

Table 9: Other effects of accounting cooperation agreements: DID Estimation②

	ES	ES	High-Low	High-Low	Vol —— heterogeneous volatility	Vol —— heterogeneous volatility
Treat control	politics	going short	politics	going short	politics	going short
Treat × Post	−0.01	−0.36	−3.29	0.25***	−0.25***	0.21***
	(0.02)	(−0.39)	(−0.60)	(3.23)	(5.35)	(3.21)
TED	1.13***	1.13***	0.08	0.08	0.00	0.00
	(72.38)	(72.38)	(0.61)	(0.61)	(0.02)	(0.02)
VIX	−0.77***	−0.77***	1.50*	1.50*	−0.00	−0.00
	(−8.43)	(−8.43)	(1.94)	(1.94)	(−0.28)	(−0.28)

①Unique volatility (IVOL) was calculated according to the method described in Ang et al. (2006). It is the volatility of the difference between realized return and expected return (based on the respective risk model, such as FF3).

② The symbols *, **, and *** represent statistical significance at the 10%, 5%, and 1% level, respectively.

Controls	√	√	√	√	√	√
Firm FE	√	√	√	√	√	√
Industry × Size × Week FE	√	√	√	√	√	√
R-square	0.933	0.933	0.417		0.871	0.871
N	26579	26580	26581	26582	26583	26584

5. Conclusion

In this paper, we utilize the Audit Supervision Cooperation Agreement signed and released by the PCAOB and China Securities Regulatory Commission on August 26, 2022, to conduct an event study and quantify the economic impact of the signing of the audit regulatory agreement on general stocks listed in the United States. Using the two-difference method, we compare the stock prices of two types of companies that have political connections to the Chinese government with the reactions of stock prices in other general companies.

Our findings reveal that companies with both accounting issues and political links exhibit positive responses to the events, with average cumulative abnormal returns 1.47% and 4.81% higher than those of other Chinese companies. Furthermore, the impact of the events on the company's stock price is more significant and lasts longer in terms of political factors compared to accounting issues. Moreover, when accounting problems are excluded from politically linked companies, the average cumulative abnormal return reaches 18.76%.

To ensure the robustness of our results, we conducted a series of rigorous tests. Our study focuses on examining the influence of political relations between the two countries on overseas listed companies, which differs from previous research that primarily focuses on political risk within individual countries. Given the escalating international landscape and growing tensions between nations, this paper offers a fresh perspective on exploring the value of overseas listed companies.

Reference

[1] Bae K H, Tan H, Welker M.International GAAP differences: The impact on foreign analysts[J].The Accounting Review, 2008, 83(3): 593-628.

[2] Black F.International capital market equilibrium with investment barriers[J].Journal of Financial Economics, 1974, 1(4): 337-352.

[3] Boehmer E, Duong T X, Husz á r Z R.Short covering trades[J].Journal of Financial and Quantitative Analysis, 2018, 53(2): 723-748.

[4] Bradshaw M T, Bushee B J, Miller G S.Accounting choice, home bias, and US

investment in non-US firms[J].Journal of accounting research, 2004, 42(5): 795-841.
[5] Cantale S.The choice of a foreign market as a signal[R].INSEAD working paper, 1996.
[6] Cooper C.Ideology, hegemony and accounting discourse: a case study of the National Union of Journalists[J].Critical Perspectives on Accounting, 1995, 6(3): 175-209.
[7] Cooper I, Kaplanis E.Home bias in equity portfolios, inflation hedging, and international capital market equilibrium[J].The Review of Financial Studies, 1994, 7(1): 45-60.
[8] Covrig V M, Defond M L, Hung M.Home bias, foreign mutual fund holdings, and the voluntary adoption of international accounting standards[J].Journal of accounting research, 2007, 45(1): 41-70.
[9] DeFond M, Hu X, Hung M, et al.The impact of mandatory IFRS adoption on foreign mutual fund ownership: The role of comparability[J].Journal of accounting and economics, 2011, 51(3): 240-258.
[10] Deng, X., and G.Lei ."The monitoring of short selling: Evidence from China." Research in International Business and Finance 43.jan .(2018):68-78.
[11] Desai H, Krishnamurthy S, Venkataraman K.Do short sellers target firms with poor earnings quality?Evidence from earnings restatements[J].Review of Accounting Studies, 2006, 11: 71-90.
[12] Diether K B, Lee K H, Werner I M.Can short-sellers predict returns?Daily evidence[J].Daily Evidence (July 14, 2005), 2005.
[13] Dou C, Yuan M, Chen X.Government-background customers, audit risk and audit fee[J].China Journal of Accounting Studies, 2019, 7(3): 385-406.
[14] Easterbrook F H.Two agency-cost explanations of dividends[J].The American economic review, 1984, 74(4): 650-659.
[15] Fanto J A, Karmel R S.A report on the attitudes of foreign companies regardng a US listing[J].Stan.JL Bus.& Fin., 1997, 3: 51.
[16] French K R, Poterba J.Investor diversification and international equity markets[J].1991.
[17] Fuerst O.A theoretical analysis of the investor protection regulations argument for global listing of stocks[J].Available at SSRN 139599, 1998.
[18] Fung S Y K, Raman K K, Zhu X K.Does the PCAOB international inspection program improve audit quality for non-US-listed foreign clients?[J].Journal of Accounting and Economics, 2017, 64(1): 15-36.
[19] Goddard A.Development of the accounting profession and practices in the public sector–a hegemonic analysis[J].Accounting, Auditing & Accountability Journal, 2002, 15(5): 655-688.
[20] Goddard A.Reform as regulation–accounting, governance and accountability in UK local government[J].Journal of Accounting & Organizational Change, 2005.
[21] Grinblatt M, Keloharju M.How distance, language, and culture influence stockholdings and trades[J].The Journal of Finance, 2001, 56(3): 1053-1073.
[22] He Y, Li B, Liu Z, et al.Does the Threat of a PCAOB Inspection Mitigate US

Institutional Investors' Home Bias?[J].Contemporary Accounting Research, 2021, 38(4): 2622-2658.
[23] Jeske K.Equity home bias: Can information cost explain the puzzle?[J].Economic Review-Federal Reserve Bank of Atlanta, 2001, 86(3): 31.
[24] Karolyi G A, Stulz R M.Are financial assets priced locally or globally?[J].Handbook of the Economics of Finance, 2003, 1: 975-1020.
[25] Krishnan G V, Yang Y, Li Z.Do blockades to PCAOB inspections suggest lower audit quality?The case of Chinese companies listed in the US[J].The Case of Chinese Companies Listed in the US (March 11, 2022), 2022.
[26] Lamoreaux P T.Does PCAOB inspection access improve audit quality?An examination of foreign firms listed in the United States[J].Journal of Accounting and Economics, 2016, 61(2-3): 313-337.
[27] Leuz C, Lins K V, Warnock F E.Do foreigners invest less in poorly governed firms?[J].The Review of Financial Studies, 2009, 22(8): 3245-3285.
[28] Li H, Meng L, Wang Q, et al.Political connections, financing and firm performance: Evidence from Chinese private firms[J].Journal of development economics, 2008, 87(2): 283-299.
[29] Liu F, Lin H, Wu H.Political connections and firm value in China: an event study[J].Journal of Business Ethics, 2018, 152: 551-571.
[30] Lundholm R J, Rogo R, Zhang J L.Restoring the tower of Babel: How foreign firms communicate with US investors[J].The accounting review, 2014, 89(4): 1453-1485.
[31] Mittoo U R.Managerial perceptions of the net benefits of foreign listing: Canadian evidence[J].Journal of International Financial Management & Accounting, 1992, 4(1): 40-62.
[32] Moel A.The role of information disclosure on stock market listing decisions: the case of foreign firms listing in the US[J].Unpublished working paper, Harvard Business School, MA, 1999.
[33] Subrahmanyam A, Titman S.The going-public decision and the development of financial markets[J].The Journal of Finance, 1999, 54(3): 1045-1082.
[34] The handbook of country and political risk analysis[M].PRS Group, 1998.
[35] Xia, et al."The quality of financial reporting in China:An examination from an accounting restatement perspective. Chinese Accounting Journal: English edition 4 (2011): 30.
[36] Yee H.The re-emergence of the public accounting profession in China: A hegemonic analysis[J].Critical Perspectives on Accounting, 2009, 20(1): 71-92.
[37] Young O R, Guttman D, Qi Y, et al.Institutionalized governance processes: Comparing environmental problem solving in China and the United States[J].Global Environmental Change, 2015, 31: 163-173.
[38] Zhai S, Xie L, Zhang S.Bank connections and corporate risk-taking: evidence from China[J].Asia-Pacific Journal of Accounting & Economics, 2017, 24(1-2): 183-194.

Appendix

Table1

US Ticker	Company Name
BABA	Alibaba Group Holding Ltd
BEST	Best Inc
BILI	Bilibili Inc
BNR	Burning Rock Biotech Limited
BZ	Kanzhun Limited
CD	Chindata Group Holdings Ltd
CJJD	China Jo-Jo Drugstores Inc
CLEU	China Liberal Education Holdings Ltd
CLPS	CLPS Inc
CPHI	China Pharma Holdings Inc
CPOP	Pop Culture Group Co Ltd
DDL	Dingdong (Cayman) Limited
EH	Ehang Holdings Ltd
FENG	Phoenix New Media Ltd
GDS	GDS Holdings Limited
GHG	Greentree Hospitality Group Ltd
GTH	Genetron Holdings Ltd
HTHT	H World Group Limited
HUDI	Huadi International Group Co Ltd
HUIZ	Huize Holding Ltd
ICLK	iClick Interactive Asia Group Ltd
IFBD	Infobird Co Ltd
IQ	iQIYI Inc
JD	JD.com Inc
JG	Aurora Mobile Ltd
JKS	JinkoSolar Holding Co Ltd
KC	Kingsoft Cloud Holdings Limited
KRKR	36Kr Holdings Inc
LFT	Lument Finance Trust Inc
NCTY	The9 Ltd
NTES	Netease Inc
OCFT	OneConnect Financial Technology Co Ltd
PBTS	Powerbridge Technologies Co Ltd
PDD	PDD Holdings Inc
RTC	Baijiayun Group Ltd
SOHU	Sohu com Ltd

SOL	Emeren Group Ltd
TCOM	Trip com Group Ltd
TME	Tencent Music Entertainment Group
TOUR	Tuniu Corp
UTSI	Utstarcom Holdings Corp
VNET	VNET Group Inc
WAFU	Wah Fu Education Group Ltd
XNET	Xunlei Ltd
ZKIN	ZK International Group Co Ltd
ZTO	ZTO Express (Cayman) Inc