The Impact of Company Performance on Risk Disclosure: From the Perspective of Audit Quality

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Abstract
With the ongoing development of capital markets, information disclosure has become an essential tool for improving market transparency and protecting investor interests. As a core element of non-financial reporting, the disclosure of risk-related information significantly influences investor decision-making and the efficient functioning of financial markets. This research investigates annual report data from A-share listed companies on the Shanghai and Shenzhen stock exchanges spanning from 2013 to 2022. It centres on the connection between corporate performance and the degree of risk disclosure. The findings indicate a notable inverse relationship: companies with stronger performance are more likely to limit the disclosure of risk information in order to maintain an optimistic corporate image. In contrast, firms experiencing weaker or declining performance tend to provide more extensive risk disclosures, potentially to meet regulatory expectations and minimize the risk of sanctions. Further investigation reveals that audit quality plays a moderating role in this dynamic. High-quality audits help alleviate the negative link between firm performance and risk disclosure, highlighting their importance in fostering more accurate and transparent reporting practices. These insights not only enrich the existing body of research on risk disclosure but also provide practical evidence to support regulatory initiatives aimed at strengthening disclosure standards and enhancing market transparency. **Purpose:** This paper aims to examine how the performance of companies listed on China's A-share market correlates with the extent of their risk information disclosure, and to further evaluate how external audit quality moderates this relationship, thereby uncovering key influencing factors and governance mechanisms behind corporate risk disclosure practices. **Design/methodology/approach:**

This paper integrates both literature review and empirical analysis approaches. The literature review method is employed to organize relevant theories and prior research, providing a theoretical explanation for how corporate performance affects risk disclosure and examining the role of audit quality in influencing this relationship. Meanwhile, the empirical analysis method utilizes textual data from annual reports to develop a model that tests the correlation between company performance and the extent of risk information disclosure. Additionally, audit quality is introduced as a moderating variable to conduct a more in-depth investigation. **Findings:** This paper find a significant negative correlation between a company's performance and the extent of risk information disclosure. The better the performance, the less risk information the management discloses to maintain a positive market image. Conversely, the poorer the performance, the more likely it is to increase risk disclosure to meet compliance requirements and avoid regulatory penalties. Further research indicates that high-quality external auditing can effectively mitigate this negative correlation, suggesting that as an important corporate governance mechanism, external auditing can restrain the management's disclosure motives and enhance the transparency of risk information. **Research limitations/implications:** This paper is based solely on the risk information disclosed in the annual reports and does not cover the risk information disclosed through other communication channels. There are still certain limitations in the research on risk disclosure. In terms of external supervision, it is not limited to audit quality only. In the future, more external supervision factors can be considered, such as media attention. **Practical implications:** This paper uncovers the motives behind company risk disclosure, cautioning investors to interpret the disclosure behaviour of companies under different performance backgrounds with caution and make decisions by integrating multiple sources of information. It also provides empirical evidence for improving the information disclosure supervision system, suggesting that the completeness of risk disclosure by companies with excellent performance should be given priority attention, and that high-quality auditing can enhance the overall transparency of the market. **Originality/value:** This paper contributes to the field of risk information disclosure both theoretically and empirically. It provides empirical evidence on the negative correlation between corporate performance and risk disclosure within China's capital market, along with an analysis of its underlying governance mechanisms. Furthermore, by incorporating the moderating role of audit quality, the study highlights how external oversight serves as a key governance mechanism in curbing opportunistic disclosure practices by management. These findings extend the scholarly discourse on the interplay between corporate governance and information disclosure.
Keywords: Company Performance, Risk Disclosure, Audit Quality

Introduction

In modern capital markets, information disclosure is an important mechanism for safeguarding investors' interests, enhancing market transparency, and reducing information asymmetry. As a core component of company annual reports, the authenticity, completeness, and comparability of risk information disclosure directly affect the efficiency of investors' decision-making. Detecting risks at an early stage is crucial. It helps market participants prevent and avoid potential risks. This can effectively reduce the losses they might suffer. Moreover, it contributes significantly to stabilizing the securities market. Ultimately, it supports the sustained and healthy development of the capital market.

In recent years, the China Securities Regulatory Commission and the stock exchanges have gradually brought their regulations on risk disclosure by listed companies in line with international standards. The risk information disclosure of Chinese listed companies has been continuously improving, but in practice, there are still problems such as insufficient disclosure form and scope (Deng Chuanzhou and Li Zheng, 2003), and lack of comparability of risk information among companies (Sun Peng and Bian Wenhong, 2005). In China, although the annual report risk disclosure is mandatory, it is essentially selective disclosure (Yao Yi & Zhao Mei, 2016). The motivation for listed companies to proactively disclose risks is insufficient, and companies may choose a " it's wiser to avoid unnecessary trouble" disclosure strategy. Especially, some studies have found that there may be a "negative correlation" between company performance and risk disclosure. Companies with good performance tend to downplay risk information to create a positive image, while companies with poor performance may increase risk disclosure to counter investor doubts or avoid administrative penalties.

Currently, studies investigating the connection between corporate performance and risk disclosure in China remain limited. To deepen the understanding of the motivations behind risk disclosure practices, this study seeks to examine whether a consistent negative relationship exists between the performance of listed companies and the extent of their risk disclosure within China's emerging market context.

Independent auditing serves as a critical external governance mechanism, functioning to validate the accuracy of managerial reports and thereby limit opportunistic behavior (Jensen and Meckling, 1976). As a key oversight tool, external auditing has the potential to curb selective or strategic disclosure practices by listed firms. Accordingly, this paper aims to investigate whether audit quality influences the relationship between company performance and risk disclosure, with the goal of offering insights for regulators to enhance standards for risk information disclosure and improve auditing oversight policies.

Literature Review
Risk information disclosure is one of the non-financial information most closely watched by regulatory authorities and investors in a company's annual report. Existing research suggests that the main motivations for companies to disclose risk information include: meeting regulatory requirements, avoiding legal risks (Linsley & Shrives, 2006); establishing a market image of stable operation through moderate risk disclosure (Abraham & Cox, 2007); and reducing financing costs when raising capital in the capital market by proactively disclosing risk information (Campbell et al., 2014).

Research indicates that when companies disclose risk information, they are often influenced by multiple factors such as management incentives, company performance levels, governance structures, industry competition environments, and external regulatory environments (Hodder, Koonce, & McAnally, 2001; Huang Qingcheng, 2024).

Feng Li (2008) studied the relationship between the readability of annual reports and company performance and earnings sustainability. The research found that the annual reports of companies with poor performance are usually longer and less readable. Penman (1980) used signalling theory to study managers' voluntary disclosure behaviour. The results

showed that companies that voluntarily disclose earnings forecasts tend to have better performance. On the contrary, companies with poor profitability usually do not actively disclose earnings forecast information. Good financial performance is often associated with higher information disclosure quality because companies hope to attract investors through positive signals (Hope, 2003).

However, some studies have found that there is a negative relationship between company performance and risk disclosure. When a company performs well, risk disclosure may be weakened to maintain the market's positive expectations of the company; when performance is poor, the company may increase risk disclosure to avoid greater reputational losses due to "information concealment" (Kravet & Muslu, 2013). Company performance may not always promote information disclosure, especially when it comes to risk disclosure. Managers may act opportunistically by providing extensive narrative disclosures in the MD&A to conceal weak corporate performance (Li, 2008).

Balakrishnan and Bartov (2011) analyzed U.S. IPO prospectuses spanning from 1997 to 2005 and found a negative correlation between the level of risk factor disclosure and the firm's future financial performance. They also observed that financial analysts generally made limited use of the disclosed risk information in their forecasting activities. Yao Yi and Zhao Mei (2016) further suggested that, from the perspective of corporate disclosure behavior, firms with weaker anticipated performance tend to exhibit a greater willingness to disclose risks compared to high-performing firms. This tendency, however, is not necessarily driven by increased transparency or foresight, but rather by the desire to avoid potential regulatory penalties that may arise from future declines in performance.

Behn and Kang (2008) demonstrated that high-quality auditing enhances the quality and transparency of financial information, reduces information uncertainty, and indirectly restrains companies from manipulating and selectively disclosing earnings information. Wang Yanyan and Chen Hanwen (2006) found that companies audited by the international "Big Four" and large domestic firms have higher information transparency, indicating that high-quality auditing effectively improves the overall quality of information disclosure and reduces information concealment and selective disclosure. Based on data from Chinese listed companies, they discovered that audit quality and external supervision jointly moderate the relationship between risk disclosure and company value; audit quality can mitigate certain negative associations, suggesting that audit quality influences the market perception and effect of risk disclosure.

International research has been increasingly devoted to exploring the factors that influence the disclosure of risk information by publicly traded companies, as well as the depth and volume of such disclosures. In contrast, studies on risk disclosure in China are still in a relatively early stage. There remains a limited body of empirical literature examining the determinants of risk information disclosure, and few studies have investigated the role of audit quality as a moderating factor in this context.

Hypothesis Development
The signalling theory (Spence, 1973) holds that in an information-asymmetric market environment, companies convey their true value to the outside world through various

"signals". The information asymmetry theory (Akerlof, 1970) points out that there is an information gap between management and external investors, and the core of corporate disclosure behaviour lies in alleviating this asymmetry. Campbell, et al (2014) suggest that mandatory risk factor disclosure helps reduce information asymmetry.

The information disclosure behaviour of companies in the capital market is influenced by multiple factors such as company characteristics, performance, financing motives, external supervision, and internal governance. Especially for risk information disclosure, it can not only reflect the true risk situation of the company but also may become a strategic tool for management.

When a company performs good, its financial indicators themselves can convey the company's value and competitiveness to the market. In such circumstances, the management may tend to engage in "selective disclosure", that is, by reducing risk disclosures to maintain the good expectations of external investors.

However, companies with poor performance face greater pressure from the capital market and regulatory risks. The management may increase risk information disclosure to explain the reasons for the financial decline, thereby alleviating investors' doubts and preventing the market from attributing the decline in performance entirely to the management's incompetence. At the same time, more risk disclosures also help meet regulatory requirements and reduce the risk of future administrative penalties.
Therefore, this paper proposes Hypothesis 1.
H1: There is a significant negative correlation between the performance level of listed companies and the risk information disclosure.

High-quality auditing is a key factor in enhancing the quality of disclosure and reducing selective disclosure (Healy and Palepu, 2001). As an external supervision mechanism, auditing can effectively restrain the opportunistic behaviour of company management. Among numerous auditing institutions, the Big Four accounting firms are generally regarded as having higher auditing quality due to their global networks, professional human capital and strict quality control systems (Che, Hope, and Langli, 2020). When listed companies are audited by one of the Big Four accounting firms, the enhanced professionalism and independence of the auditors lead them to encourage more thorough disclosure of potential risks in annual reports. This, in turn, helps mitigate the negative impact of company performance on the extent of risk disclosure.
Therefore, Hypothesis 2 is proposed in this paper.
H2: Compared with non-Big Four auditing companies, the negative correlation between company performance and risk disclosure in companies audited by the Big Four is significantly weakened.

Methods
Sample Selection and Data Sources
To verify the relationship between corporate performance and risk information disclosure, this paper selects A-share listed companies on the Shenzhen and Shanghai stock exchanges from 2013 to 2022 as the research objects. The reasons for choosing this period are as follows: First, in 2012, the China Securities Regulatory Commission revised the "*Content and*

Format Standards for Information Disclosure of Companies Offering Securities to the Public No. 2 - Content and Format of Annual Reports", which put forward more explicit requirements for risk information disclosure. Second, after 2013, the risk disclosure of listed companies gradually became institutionalized and standardized, and the data comparability was stronger.

The data processing in this study adopts the following procedures: (1) observations from abnormally operating companies, including those are marked as ST, *ST, and PT, are removed; (2) companies in the financial industry are excluded; (3) observations with missing variable values are omitted; (4) Single observation samples of individual companies within the sample period are excluded. (5) all continuous variables are winsorized at the 1% and 99% to mitigate the effect of outliers. After data processing, the final sample consists of 4,131 listed companies, with a total of 29,231 sample observations. The explained variable, risk information disclosure, is sourced from the WinGo database, while other data are from the CSMAR(China Stock Market Accounting Research) database.

Variable Design
The primary dependent variable utilized in this study is risk disclosure. Following a comprehensive review of existing literature, three key attributes, readability, accessibility, and credibility, of risk indicators were taken into account. Ultimately, the risk indicator derived from the WinGo financial textual database was chosen to assess the extent of risk disclosure by listed companies. This indicator quantifies risk disclosure by calculating the proportion of risk-related keywords appearing in the management discussion and analysis (MD&A) section's future outlook relative to the total word count in the annual report.

For the independent variable, company performance, this paper employs Tobin's Q as the measurement metric. Tobin's Q represents the ratio of a company's market value to the replacement cost of its assets and serves as a widely accepted measure of company performance. A higher Tobin's Q value indicates stronger performance of the listed company. Audit quality is measured by whether the auditing firm of the listed company belongs to one of the Big Four international accounting firms. As these firms are globally recognized for delivering high-standard audit services, being audited by one of them is generally regarded as an indicator of superior audit quality.

The control variables are the debt-to-asset ratio, revenue growth rate, company size and the shareholding ratio of the largest shareholder.
All the variables and their definitions selected in this paper are shown in Table 1.

Table 1
Variable Definition Table

Variable Name	Variable Symbol	Definition
Risk Disclosure	**Riskd**	The ratio of the number of risk keywords to the total word count of the annual financial report
Tobin's Q	**TobinQ**	Market Value / Total Assets
Audit quality	**Big4**	Is the auditor from the Big Four? If yes, it is 1; if no, it is 2
Asset-Liability Ratio	**lev**	Total Liabilities / Total Assets
Operating Income Growth Rate	**grow**	Current period operating income growth/base period operating income
Company Size	**lnsize**	Natural logarithm of the listed company's total assets at the beginning of the year
Ownership Concentration	**top1**	Shareholding ratio of the largest shareholder

Model Design
Based on Wang Yanyan and Chen Hanwen (2006), a multiple regression model is constructed to verify the hypotheses proposed above:

$$Riskd_{it} = \alpha + \beta_1 \mathbf{TobinQ}_{it} + \beta_2 lev_{it} + \beta_3 grow_{it} + \beta_4 lnsize_{it} + \beta_5 top1_{it} + \varepsilon_{it}$$

Findings
Descriptive Statistical Analysis
Descriptive statistical analysis was conducted on the variables, and the results are presented in Table 2.

Table 2
Summary Statistics

VarName	Obs	Mean	SD	Min	Max
Riskd	29231	0.008	0.002	0.004	0.013
TobinQ	29231	2.029	1.259	0.835	8.176
lev	29231	0.411	0.200	0.057	0.870
grow	29231	0.351	0.883	-0.680	6.030
lnsize	29231	22.131	1.332	19.741	26.218
top1	29231	0.345	0.146	0.092	0.747

As can be seen from Table 2, the maximum value of the dependent variable Riskd, which represents risk disclosure, is 0.013, the minimum value is 0.004, and the mean is 0.008. The standard deviation is 0.002, indicating that the degree of difference in risk disclosure among companies is not significant. The independent variable TobinQ has a maximum value of 8.176 and a minimum value of 0.835. A TobinQ score above 1 implies that, on average, the market value of the sample companies exceeds their asset replacement costs, reflecting a positive

market outlook. The standard deviation of 1.259 suggests considerable variation in firm values across the sample.

Regression Analysis
A fixed-effect regression model was adopted to conduct a basic regression analysis of the variables., and the analysis results are shown in Table 3.

Table 3
Regression Analysis

	(1) Riskd
TobinQ	-0.000130***
	(-12.90)
lev	-0.000246***
	(-3.48)
grow	-0.000162***
	(-12.11)
lnsize	-0.00000984
	(-0.89)
top1	0.000251***
	(3.05)
_cons	0.00883***
	(37.46)
N	29231
F	70***
r2	0.0118
r2_a	0.0116

t statistics in parentheses
* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

Table 3 displays the regression outcomes regarding the influence of company performance on risk disclosure. The findings reveal a statistically significant negative relationship between company performance and the extent of risk disclosure. Specifically, the coefficient associated with firm performance is -0.000130, which is significant at the 1% significance level. This suggests that with each one-unit increase in company performance, the level of risk disclosure by publicly traded companies decreases by 0.000130 units. The observed negative correlation strongly supports Hypothesis 1 of this study.

Table 3 reports the regression results examining the effect of corporate performance on risk disclosure. The findings reveal a statistically significant negative influence of company performance on the extent of risk disclosure. The estimated coefficient of –0.000130, significant at the 1% level, suggests that a one-unit improvement in company performance corresponds to a reduction of 0.000130 units in the level of risk disclosure. These results confirm a significant inverse relationship between company performance and risk disclosure, thereby supporting Hypothesis 1 of this study.

Grouped Regression Analysis

A grouped regression analysis was performed according to whether the sampled companies were audited by one of the Big Four international accounting firms. The corresponding regression outcomes are presented in Table 4.

Table 4
Group Regression Analysis

	(1) Riskd	(2) Riskd
TobinQ	-0.0000499	-0.000136***
	(-1.30)	(-12.98)
lev	-0.000501*	-0.000217***
	(-1.88)	(-2.96)
grow	-0.000108**	-0.000165***
	(-2.29)	(-11.82)
lnsize	-0.0000442	-0.0000164
	(-1.34)	(-1.33)
top1	0.000922***	0.000180**
	(3.46)	(2.08)
_cons	0.00946***	0.00899***
	(12.78)	(34.26)
N	1798	27433
F	6***	66***
r2	0.0152	0.0120
r2_a	0.0124	0.0118

t statistics in parentheses
* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

Table 4 displays the regression outcomes for sample companies categorized by whether they are audited by a Big Four accounting firm. Column (1) corresponds to Big Four-audited companies, and column (2) to those audited by non-Big Four firms. The results indicate that the coefficient in column (1) is 0.0000499 with a P-value exceeding 0.1, implying that the negative association between company performance and risk disclosure is not statistically significant among Big Four-audited companies. In contrast, for companies without Big Four auditors, a significant negative correlation remains, showing a coefficient of 0.000136 at the 1% significance level. These findings highlight the moderating role of audit quality in the relationship between performance and risk disclosure. Specifically, high-quality auditing appears to weaken the negative impact of performance on disclosure, likely by enhancing the information environment and corporate governance mechanisms. Thus, Hypothesis 2 is supported.

Considering the possible endogeneity issue, this paper uses the company's performance of the previous period for regression. The regression results show that the correlation coefficient between company performance and risk disclosure is -0.0000828, with a significance level of 1%. This is consistent with the original test results, indicating that there is no endogeneity. In terms of robustness tests, this paper replaces TobinQ with ROE for regression analysis. The regression results show that the correlation coefficient between company performance and risk disclosure is -0.001714, with a significance level of 1%. This proves that the research results are robust.

Discussion and Conclusion

The empirical findings of this paper demonstrate a statistically significant negative relationship between firm performance and risk disclosure among Chinese listed companies. This suggests that when a company's performance is strong, its management is more inclined to project a favourable and optimistic company image in order to sustain investor confidence and stabilize the company's stock price. At this time, listed companies will choose to disclose less risk information or reduce the content and detail of the disclosure.

Conversely, when a company's performance is poor, the management may increase the disclosure of risk information. There are two possible motivations for doing so: First, to meet regulatory requirements. A listed company with poor performance may attract more attention from regulatory authorities, so fully disclosing risk information is a way to deal with supervision. Second, for the management's motivation to avoid responsibility. By disclosing risk information in detail, the management can attribute part of the poor performance to uncontrollable external factors, thereby excusing their own poor management.

The research conclusion of this paper is contrary to the traditional signal transmission theory which holds that high-quality companies are more willing to disclose information to prove their strength. It reveals the complex relationship between company performance and risk disclosure under the institutional environment of China's socialist market, expands the application scenarios of the signal transmission theory, and provides a new case for the application of the signal transmission theory in the field of information disclosure.

The paper further reveals that high-quality audit services mitigate the negative association between firm performance and the extent of risk disclosure. This finding strongly underscores the role of external auditing as an effective corporate governance tool in curbing managerial opportunistic behaviour in disclosure practices, thereby promoting greater transparency in the capital market as a whole. For companies with good performance, high-quality auditors can curb the tendency of management to reduce risk disclosure due to overconfidence or self-interest, and supervise companies to disclose more complete risk information. For companies with poor performance, high-quality auditors prevent management from over-disclosing or exaggerating irrelevant risks to avoid responsibility, thus making risk information more credible.

The moderating effect of audit quality indicates that introducing strong external supervision is an effective way to maintain the accuracy of risk information disclosure by listed companies and protect the interests of investors. This suggests that high-quality auditing enhances information transparency and corporate governance levels, possibly making management more rational, mature, and prudent in decision-making when seizing investment opportunities, and reducing overly conservative or risky behaviours caused by information distortion. This conclusion provides strong empirical support for regulatory authorities to advocate and improve audit quality, highlighting the governance value of auditing in information disclosure in the capital market.

Theoretical Implications

This paper enriches the research on the motives of risk information disclosure of listed companies and empirically confirms the negative impact of company performance on risk

disclosure. It reveals that risk disclosure behaviour is not only a passive response to compliance with standards but also a possible active strategic choice. Further research also confirms that high-quality external auditing is an effective governance mechanism to alleviate agency problems and improve the quality of information disclosure. It provides new and important evidence for the core position of auditing in the corporate governance framework.

Practical and Social Implications
The research findings of this paper are of great significance to listed companies, investors and regulatory authorities. For listed companies, they should be aware that more honest and transparent risk information disclosure can win the trust of investors. Even when the company's performance is good, they should not adopt the attitude of " it's wiser to avoid unnecessary trouble " and reduce the disclosure of risk information. For investors, they need to fully recognize the motives behind the company's risk disclosure and should be vigilant against companies that disclose too little risk information even when their performance is good. For regulatory authorities, it provides a new perspective for improving the risk information disclosure system and encourages and supports the supervisory role of external audits.

Limitations and Suggestions for Future Research
This study exclusively examines risk information disclosed in annual reports and does not account for information communicated through other channels. As a result, there are certain limitations in the current exploration of risk disclosure. Additionally, the measurement approach, focusing on the volume of risk-related vocabulary, primarily emphasizes quantity while potentially overlooking the depth and quality of the disclosed information. In the future, qualitative analysis or sentiment analysis of risk information can be considered. In terms of the measurement of audit quality, only the "Big Four and non-Big Four" have been taken into account, which still has deficiencies in the Chinese context. In the future, the audits of the top ten accounting firms in China can be included, and the audit quality can be measured by the audit report opinion or audit fees.

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