

## **AUDITOR'S ROLE IN CORPORATE GOVERNMENT: EVIDENCE FROM TOP 50 QUOTED COMPANIES IN THAILAND**

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### **ABSTRACT**

This pilot research aims to clarify whether auditors take their role as corporate governance watchdog to firms. The long-range project dreams to use several research methodologies to investigate auditors' role in corporate governance. This study primarily attempts to use public data to answer the concern. The data set comprises the SET 50 quoted companies between 2008 and 2009 in the emerging Thai Stock Market. The study introduces auditors' contributions (i.e. audit reports) as well as audit quality (i.e. Big 4) as proxy of auditors' role in corporate governance. In addition, this study also adopts specific characteristics Thai culture into the analysis among others. The research methodology employs multiple regression analysis. Fortunately, the results show that Thai auditors take their roles in corporate governance. However, discretionary accrual (DCA) as the interesting variable is not statistically significant to firm value. This empirical study points out auditors can be considered as "watchdog" of the firms.

**Keywords:** Auditors, discretionary accrual, SET 50

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## Introduction

Traditionally defined corporate governance as the ways in which a firm safeguards the interests of its financiers (investors, lenders, and creditors). The modern definition calls it the framework of rules and practices by which a board of directors ensures accountability, fairness, and transparency in the firm's relationship with its all stakeholders (financiers, customers, management, employees, government, and the community). (<http://www.businessdictionary.com>) In other words, recently corporate governance is now perceived as a system that ensures optimal utilisation of resources for the benefit of shareholders while meeting societal expectations.

In March 2008 International Federation of Accountants (IFAC) released its report entitled 'Financial reporting value chain — current perspectives and direction'. The financial reporting supply chain refers to the people and processes involved in the preparation, approval, audit, analysis and use of financial reports. The report is based on a global survey conducted by IFAC. The report observes "The results of this survey are clear. Participants feel that the three key areas of the financial reporting supply chain — corporate governance, the process of preparing financial reports and the audit of financial reports. Unfortunately, however, the respondents do not feel that the products of this supply chain, the financial reports, have become more useful to them." In fact, the revelation that the usefulness of financial reports has not improved over the years is not new. In addition, many respondents are not happy with the auditor's communication with investors. They felt that excessive oversight and litigation has led to the 'compliance audit' approach and the 'boiler plate' audit report. Respondents expect that the financial auditor should be innovative and that they should apply their professional judgement. They look for more detailed report from the auditor. (Bhattacharya, 2008)

The external auditor has long played an important role in the corporate governance function. External auditors are employees of a public accounting firm which has been engaged to conduct the audit of a particular company's financial statements (audit client). The external auditor's responsibility is to

provide assurance to the general public regarding the truth and fairness of the information presented in the audit client's financial statements. Since the public relies heavily upon an audit opinion published by a public accounting firm to make investment decisions, it is imperative that they view accounting firms as being independent, objective and free from the influence of the audit client or any other parties. Indeed, some authors have gone as far as to say that this assurance is the basis of the world's capital markets. The main objective of this study is to investigate auditors' role in corporate governance. Firm value is considered as a proxy to capture their role. The research question is mainly focus on whether auditors help to increase firm vales via their contributions. Also, the study introduces some other interesting dependent variables which represent dataset environment.

## Data set environment

Thailand, an emerging economy has a GDP worth Baht 8.5 trillion in 2008. This classifies Thailand as the 2nd largest economy in Southeast Asia after Indonesia. Thailand ranks high among the world's automotive export industries along with manufacturing of electronic goods. Most of Thailand's labor force is working in agriculture. However, the relative contribution of agriculture to GDP has declined while exports of goods and services have increased. ([http://en.wikipedia.org/wiki/Economy\\_of\\_Thailand](http://en.wikipedia.org/wiki/Economy_of_Thailand)) Since 1948, Thai accounting society has started its accounting activities by setting up Institute of Certified Accountants and Auditors of Thailand (ICAAT). The main objective of the ICAAT was to establish accounting and auditing standards in response to the rapid expansion of the Thai economic environment. In addition, ICAAT was responsible for approval Thai CPA using standard examinations. The turning point of Thai accounting profession was driven by the establishment of Stock Exchange of Thailand in 1962. (ICAAT, 1998). The development of accounting standards and procedures in Thailand has been initially influenced by the US GAAP, later influenced by the International Accounting Standards (Kuasirikun, 2004). Like many countries, the Thai Commercial Codes (like the Company Acts) requires all Thai registered

limited companies to have their financial statements audited by Thai auditors (Section 1197, Thai Civil and Commercial Codes). In addition, Thai listed companies must be audited by Thai CPAs who are also approached by the Thai Securities Exchange Commission (SET, 2009). On the other hands, Thai limited partnership is required to have their financial statements audited by Thai Tax Auditors.

For Thai auditing standard, the first official wordings were most likely the 2-paragraph wording standards of the US audit reports. Later, in 1999, the ICAAT, as a member of International Federation of Accountants (IFAC), introduced auditing standards in the so-called 3-paragraph audit reports for the auditor's report on financial statements. Since then, Thai accounting and auditing standards have paralleled to those established by IFAC. By 2011, the Federation of Accounting Profession (formerly ICAAT) has planned to fully adopt auditing standards recommended by IFAC.

**Variables: Dependence variable**

The study has long been defined how to measure value of the firms. Much research has introduced various types of measurements. Most of the measures tent to involve with market value of firms (i.e. stock prices) among other market price factors. However, when considering how accounting profession measures firm values, it is somewhat difficult to ignore the value of shareholders' equity. In spite of the fact that even of some other hidden assets may not booked in accounting numbers, other concepts may have severe measurement to firm values. Accounting concepts that should be good explanation; "objectivity" concept defines as accounting will be recorded on the basis of objective evidence (invoices, receipts, bank statement, etc...). This means that accounting records will initiate from a source document and that the information recorded is based on fact and not personal opinion. Therefore, this study introduces "Total shareholders' equity to measure firm value.

**Variables: independence variable**

The study introduces interesting independent variable into analysis. It aims to do "tailed-made" dependent variables in data set environment. For example,

"POLITICS" represents shareholders who have influence to the stock market. This is because research has long been observed whether politics always have insider information. Also, auditors' contributions to firm values are included in the analysis.

**Discretionary accruals**

Discretionary accruals models involved first the computation of total accruals. Therefore total accruals models are presented first, followed by discretionary accruals models. Total accruals (TA<sub>t</sub>) can be decomposed into non-discretionary accruals (NDA<sub>t</sub>) and discretionary accruals (DA<sub>t</sub>) with NDA representing the normal accruals that would be reported without managerial management such that:

$$TA_t = NDA_t + DA_t$$

On the prior study (Hibra and Collins 2002) suggested a straightforward approach that computes total accruals as the difference between reported net income and operating cash flow (Cash flow based approach)

$$TA_t = NI - CFO \text{ where}$$

$$NI = \text{earnings before extraordinary items and discontinued operations}$$

$$CFO = \text{operating cash flow}$$

Several approaches to measuring discretionary accruals have been used in prior studied (Dechow et al. 1995, Guay et al. 1996) report evidence that the modified Jones model as described in Dechow et al. 1995 is superior to other models in isolating the effect of discretionary accruals. In this study, the cross-sectional modified Jones model is used as in other earnings management studies (Gul et al. 2003; Heninger 2001). The industry-specific parameters of the Jones model are estimated using data:

$$TA_t / A_{t-1} = \alpha_1 (1/A_{t-1}) + \beta_1 (\Delta REV_t / A_{t-1}) + \beta_2 (PPE_t / A_{t-1}) + \epsilon$$

$$TA_t = \text{total accruals}$$

$$A_{t-1} = \text{the beginning balance of total assets}$$

$$\Delta REV_t = \text{the change in revenues of firm}$$

$$PPE_t = \text{net property, plant, and equipment of firm}$$

$$\epsilon = \text{the error term}$$

$$\alpha_1, \beta_1 = \text{the coefficient of the regression}$$

$$\beta_2$$

Discretionary accruals are calculated using the modified Jones model as follow:

$$DA_t = TA_t / A_{t-1} - [\alpha_1 (1/A_{t-1}) + \beta_1 [(\Delta REV_t - \Delta REC_t) / A_{t-1}] + \beta_2 (PPE_t / A_{t-1})]$$

where

$$DA_t = \text{discretionary Accruals}$$

$$\Delta REC_t = \text{the change in receivables of firm}$$

Cross-sectional Modified Jones model

$$NDA_t = \alpha_1 (1/A_{t-1}) + \beta_1 [(\Delta REV_t - \Delta REC_t) / A_{t-1}] + \beta_2 (PPE_t / A_{t-1})$$

### Models in the analysis

$$\begin{aligned} \text{FIRM VALUE} = & \beta_0 + \beta_1 \text{DISCACC} + \beta_2 \text{LSH} \\ & + \beta_3 \text{BOARD} + \beta_4 \text{POLITICS} \\ & + \beta_5 \text{BIG 4} + \beta_6 \text{OPIN} \\ & + \beta_7 \text{SIZE} + \epsilon \end{aligned}$$

where

FIRM VALUE = Total Shareholders' Equity/  
Weighted Average Number of Ordinary Shares

DISCACC = Discretionary Accruals

LSH = Largest shareholder's shareholding as  
a percentage of total shares

BOARD = Number of board which was the  
supervisory board

POLITICS = State Enterprises or Concession Business

BIG 4 = auditor firms size

OPIN = auditor's opinion

SIZE = Total assets

### Data set

This study used an empirical study as research methodology. The data set in this presentation contains listed companies in the Thai stock market during 2008 and 2009. The data did not include finance sector because its businesses are somewhat different from other industries and its financial statements were unclassified. A full year financial data of the data set, including financial ratios, and Largest shareholder's shareholding were mainly collected from the information prepared by the Security Exchange of Thailand (SET) and from annual registration statement and annual report in website called [www.setsmart.com](http://www.setsmart.com) and [www.sec.or.th](http://www.sec.or.th). To overcome some missing data, data was also collected from the Registrar Department (RD), Ministry of Commerce. After the data collection was completed, random verification of the information from the database against the hard copy of annual reports also indicated high accuracy of database information. The information were collected based on the year occurring. This was to avoid the development of accounting numbers. Table 1 reports the 100 (50 listed companies x 2 years) observations of the SET 50 companies in the Stock Exchange of Thailand (SET) included in the data set. Total 80 observations were used in the analysis as shown in Table 2. Tables 3 and 4 show the descriptive statistics of data set.

Table 1 Total observations

Industry	Population	Sample (%)
Agro& Food Industry	8	8 (10.0)
Financials	16	0 (0.0)
Industrials	4	4 (5.0)
Property & Construction	16	14 (17.5)
Resources	20	18 (22.5)
Services	25	25 (31.25)
Technology	11	11 (13.75)
<b>Total</b>	<b>100</b>	<b>80 (100.0)</b>

Table 2 Samples in this study

Industry	2008	2009	Total observations
	(No. of companies)		
Agro& Food Industry	4	4	8
Industrials	2	2	4
Property & Construction	7	7	14
Resources	8	10	18
Services	13	12	25
Technology	6	5	11
<b>Total</b>	<b>40</b>	<b>40</b>	<b>80</b>

Table 3 descriptive statistics

Variable Name	Minimum	Maximum	Mean	Std. Deviation
FIRM VALUE	1.71293	176.21500	28.60935	37.77507
DISCACC	(0.19727)	0.29878	(0.04094)	0.07619
LSH	0.10435	1.18997	0.40994	0.19172
BOARD	-	9.00000	2.60000	2.23100
SIZE	9.00014	13.91408	10.85033	1.06502
<i>N = 80 samples</i>				

Table 4 descriptive statistics

Variable Name	Frequency	%
POLITICS	21	26.2
NON POLITICS	59	73.8
BIG 4	63	78.8
NON BIG 4	17	21.2
QUALIFIED OPINION	33	41.2
CLEAN AUDIT OPINION	47	58.8
<i>N = 80 samples</i>		

Table 5 presents multivariate tests of the hypothesis that included interesting variable (i.e. Largest shareholder's shareholding as a percentage of total shares) and controls for factors identified in prior research and introduced by this study. Before analyzing, autocorrelation of serialcorrelation and multicollinearity

were tested in order to fit in multiple regression analysis assumption. The results showed that there were no concern which may result in misleading outcomes in regression analysis of both autocorrelation of serialcorrelation and multicollinearity. Table 5 shows correlation matrix of variables.

**Table 5** Correlation matrix of variables

		FIRM VALUE	DIS- CACC	LSH	BOARD	POLI- TICS	BIG4	OPIN	SIZE
FIRM VALUE	Pearson Correlation	1	.117	-.049	-.315**	.430**	-.134	-.153	.571**
	Sig. (2-tailed)		.302	.664	.004	.000	.236	.176	.000
DISCACC	Pearson Correlation			-.005	-.039	.063	.191	.026	-.054
	Sig. (2-tailed)			.962	.733	.577	.089	.820	.634
LSH	Pearson Correlation			1	-.180	.321**	-.273*	-.101	.135
	Sig. (2-tailed)				.110	.004	.014	.373	.233
BOARD	Pearson Correlation					-.392**	-.052	.128	-.352**
	Sig. (2-tailed)					.000	.645	.257	.001
POLITICS	Pearson Correlation					1	-.454**	-.154	.492**
	Sig. (2-tailed)						.000	.174	.000
BIG4	Pearson Correlation						1	-.061	-.175
	Sig. (2-tailed)							.589	.121
OPIN	Pearson Correlation								.204
	Sig. (2-tailed)								.069
SIZE	Pearson Correlation								1
	Sig. (2-tailed)								

\*\* Correlation is significant at the 0.01 level (2-tailed).

\* Correlation is significant at the 0.05 level (2-tailed).

a. Listwise N=80

### Multiple regression models

Table 6 presents multivariate tests of the hypothesis that included interesting variable and controls for factors identified in prior research and introduced by this study. The analysis shows, at the confidential level 95%, firm values statistically relate to Largest shareholder's shareholding as a percentage of total shares (LSH), auditor's opinion and size of the

firms. However, no significant has been found in other dependent variables. The interpretation of the above empirical findings is as follows. The expected negative coefficient and significant of LSH demonstrates that if commons' shares of the companies are help by largest shareholders, it seems that it will increase firm values. In addition, the expected negative coefficient and significant regression of OPIN shows that listed

companies whose financial statements are issued with modified opinions are more likely to have lower firm values. Finally, The expected positive coefficient and significant regression of SIZE shows that listed

companies whose total assets are somewhat large more likely to have more firm value. Unexpectedly, some other factors introduced by this present study are not significant to firm values.

Table 6 Multiple regression results

Variables Name	Expected signs	( $\beta$ )	p-value
<b>Dependent (FIRM VALUE : Total Shareholders' Equity/ Weighted Average Number of Ordinary Shares)</b>	N/A	N/A	N/A
<b>INTERCEPT</b>	None	-154.300	0.000***
<b>Independent</b>			
DISCACC (Discretionary Accruals)	+	83.152	0.064
LSH (Largest shareholder's shareholding as a percentage of total shares)	-	-44.589	0.016***
BOARD (Number of board which was the supervisory board)	-	-1.421	0.400
POLITICS (1 if the company was listed company which privatization from State Enterprises or Concession Business; 0 otherwise)	+	6.669	0.535
BIG 4 (1 if auditor is Big 4; 0 otherwise)	-	-10.347	0.291
OPIN (1 if opinion is qualified; 0 otherwise)	-	-21.564	0.004***
SIZE (Natural log of total assets)	+	20.606	0.000***
N = 80 samples, Model p-value = 0.000, Adjusted R <sup>2</sup> = 0.431			

## Conclusions

Previous research has long proved auditors' ability in various perspectives. This paper showed important information that auditors play their roles in corporate governance. It should take into account that auditors are "watchdog" of the firms. They help to increase firm values. The contribution of auditors in corporate governance could be observed via their opinion. Investors are able to take auditors' opinions into their consideration to decision making processes. This study also brings the idea that other not-big listed firms may not prove this ability. The next study should extend to adopt various types of firms into the analysis.

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