

# The Mediating Effects of Audit Quality on the Relationship between Corporate Governance and Cash Dividends

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## Abstract

This study expands prior studies of the informative value of corporate governance on firm performance by adding audit quality as a mediating variable into analysis. This study measures firm performance using cash dividends as the dependent variable, while the independent variables are corporate governance mechanisms. Furthermore, the study introduces the mediating variable using audit quality to observe the accelerating power of auditors in supporting corporate governance that finally affects firm performance. The data set includes the top 100 listed companies (SET 100) which can be considered as the highest corporate governance level for the Stock Exchange of Thailand (SET) from 2013 – 2016. Both descriptive statistics and multiple regression models are performed.

The results confirm those of previous studies showing that corporate governance mechanisms including the notification of general shareholder meetings in advance and director remunerations are likely to increase cash dividends. When entering audit quality as a mediating variable into the analysis, it is found that not only corporate governance mechanisms but also audit quality significantly influence cash dividends. Also, control variables including firm size, leverage ratios and net profit margin tend to increase cash dividends. Overall, the result of this study indicates that corporate governance mechanisms promote firm performance. In addition, auditors also have accelerating power to firm performance.

**Keywords:** Audit Risk, Auditors, Firm Performance, Audit Fees

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# ผลของตัวแปรส่งผ่านของคุณภาพงานสอบบัญชีต่อความสัมพันธ์ ระหว่างการกำกับดูแลกิจการและเงินสดปันผล

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## บทคัดย่อ

การศึกษานี้ต่อยอดงานวิจัยในอดีตเรื่องคุณค่าของการกำกับดูแลกิจการต่อผลการดำเนินงานโดยการเพิ่มคุณภาพงานสอบบัญชีในฐานะตัวแปรส่งผ่านเข้าไปในการวิเคราะห์ การศึกษานี้วัดผลการดำเนินงานโดยใช้เงินสดปันผลเป็นตัวแปรตาม ตัวแปรอิสระ ได้แก่ การกำกับดูแลกิจการ และตัวแปรส่งผ่าน คือ คุณภาพงานสอบบัญชี ทั้งนี้เพื่อศึกษาบทบาทของผู้สอบบัญชีในการสนับสนุนการกำกับดูแลกิจการ และส่งผลการต่อผลการดำเนินงานในท้ายที่สุด การวิเคราะห์ใช้กลุ่มบริษัทจดทะเบียนในไทย 100 อันดับแรกซึ่งถือได้ว่ามีผลการกำกับดูแลที่ดี ระหว่างปี พ.ศ. 2556 – 2559 การวิเคราะห์ข้อมูลมีทั้งเชิงพรรณนาและการถดถอยพหุคูณ

ผลการศึกษานี้ยืนยันการศึกษาในอดีตที่ว่าผลการกำกับดูแล ได้แก่ การแจ้งการประชุมสามัญผู้ถือหุ้นล่วงหน้า และผลตอบแทนกรรมการ มีผลต่อการจ่ายเงินสดปันผล เมื่อเพิ่มคุณภาพงานสอบบัญชีเข้าไปในการวิเคราะห์ พบว่าไม่เพียงแต่ตัวแปรการกำกับดูแลกิจการเท่านั้น คุณภาพการสอบบัญชียังมีผลกระทบต่อผลการจ่ายเงินสดปันผลอีกด้วย ตัวแปรควบคุมที่มีผลต่อการจ่ายเงินสดปันผล ได้แก่ ขนาดของกิจการ อัตราส่วนการก่อหนี้ และอัตราส่วนการทำกำไร การศึกษานี้ชี้ให้เห็นว่าการกำกับดูแลกิจการมีผลต่อผลการดำเนินงานของกิจการ นอกจากนั้นผู้สอบบัญชียังมีส่วนในการทำให้เกิดผลการดำเนินงานที่ดีขึ้นอีกด้วย

**คำสำคัญ:** ความเสี่ยงการสอบบัญชี ผู้สอบบัญชี ผลการดำเนินงาน ค่าธรรมเนียมการสอบบัญชี

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## Introduction

Several studies have long examined the linkage between corporate governance and firm performance. However, those studies appear to miss significant analysis. This is because the International Federation of Accountants (IFAC) stated that within the process of financial report preparation, auditors are considered as “middlemen” between management and shareholders or financial statements’ users. This is because auditors have the responsibility to audit financial statements and provide assurance to the public regarding the truth and fairness of information presented in the audit client’s financial statements. Also, auditing standards require auditors to assess business risk and control the risk of the clients. One of the issues of the assessment is that of corporate governance structures (Cohen, Krishnamoorthy, & Wright, 2002). Furthermore, in a practical nature, auditors play a great role in monitoring companies’ corporate governance to make sure that they employ a “true and fair view” or “fair representation” of financial reporting which ultimately increases firm performance (Bhattacharya, 2008). Therefore, auditors should be considered as the “middlemen” between management and the shareholders. This indicates a research gap in the previous study which just attempted to find a direct link between corporate governance and firm performance. In fact, the middlemen, or monitoring role, of auditors are also very energetic and powerful.

Therefore, it is still a controversial issue and there is debate as to whether corporate governance mechanisms indeed help to improve firm performance, especially in emerging markets. The recent research carried out in Turkey by Ararat, Black, and Yurtoglu (2017). stating that corporate governance index enabled to predict higher firm-level profitability. In addition, Samaha, Dahawy, Hussainey, and Stapleton (2012) carried out a study in Egypt stating that the extent of corporate governance disclosure reduced information asymmetry and agency costs. Also, corporate governance improved investor confidence in the reported accounting information. However, quite a few studies argued against the informative value of corporate governance. Arora and Sharma (2016) found out that return on equity and profitability were not related to corporate governance indicators. Ng’eni (2015) pointed that not all corporate governance mechanisms were eligible to increase firm performance. It was because corporate governance did not exist as a single event. On the other hand, it was formed by some events and committees that surrounding both internal and external factors. Therefore, it was both more and less likely that corporate governance would increase firm performance. Therefore, this study intends to reinvestigate of the informative value of corporate governance on firm performance once again.

For the issue of what indicators should be employed to measure the effectiveness of corporate governance, Mueller (2018) stated that one of the best ways for companies to communicate financial wealth and shareholder value was to pay dividends. Many companies pay out regularly from earnings to stockholders. This sent a clear and powerful message about prospects and performance. A company’s willingness and ability to pay steady dividends over time – and its power to increase them – provided

good clues about its fundamentals. Allen (2005) also supported the notion that in imperfect and incomplete markets, like emerging ones, firms run in the interest of shareholders; thus, these companies tended to pay higher dividends to help overcome market failure. This means that cash dividends should be one of the important indicators showing firm performance and may be a more appropriate index than others in terms of profitability (Lin & Jen, 2011).

This study makes important contributions to existing literature and differs from previous research in three main ways. Firstly, and importantly, this study expands on previous research by adding audit quality as a mediating variable between corporate governance and firm performance. This study positively finds that the mediating role of auditors improves firm performance. Secondly, the effect of corporate governance on firm performance may differ between efficient markets like the United States and Europe and emerging markets due to differences in the corporate governance environment. This study uses the data from companies listed in the Stock Exchange of Thailand as a representative of emerging markets from 2013 – 2016. This study successfully introduces cash dividends as a firm performance index and important corporate governance mechanisms which influence firm performance. Finally, unlike previous studies which introduced corporate governance indicators based on scoring systems using their own judgement, this study attempts to use the OECD's corporate governance framework and successfully introduce appropriate proxies covering all corporate governance mechanisms recommended by the OECD.

### **Objectivity of The Study**

This research aims to extend prior studies on the informative value of corporate governance on firm performance by introducing a mediating variable between corporate governance and firm performance. The researchers intend to determine:

- 1) Whether auditors play a great role as a monitoring entity (a mediator) between management and shareholders.
- 2) The fundamental relations and strength of association between corporate governance mechanisms and firm performance.

### **Literature Review**

A collection of studies has been carried out on the informative value of corporate governance on firm performance. However, the association between them is questionable because auditors are considered as “middlemen” between management who is responsible for the sustainability of companies and shareholders and other financial statements users who needs returns and a clear view of decision-making. Therefore, the following literature review demonstrates the linkage among firm performance, auditors and corporate governance.

### Cash Dividends as a Firm Performance Index

Previous studies were looking for proxies representing firm performance index. Damodaran (2001) stated that two basic gauges to measure firm performance; one is profitability relative to the capital employed (return on assets, ROA), while another is profitability relative to equity (return on equity, ROE). ROA gives investors an idea of how effectively the company is converting assets into net income, while ROE is a profitability ratio that measures the ability of enterprise to generate profits from its shareholders' investments in the company. The higher value of the two ratios, the better the situation, because the companies are earning more money on less investment. However, Lin, and Jen, 2011 stated that ROA and ROE formulas are calculated by dividing the net income by total assets or shareholders' equity. Under these accounting standards, managers are given discretion and judgment in reporting their earnings. This indicates that accounting earnings can be "managed" by managers through various means by manipulating items such as depreciation and accruals among other provisions. In addition, to prove whether a company remains wealthy by considering just its profitability index may not be enough information. Cash dividends are another piece of information which investors should take into consideration when investment decision is needed (Lin & Jen, 2011). Prior studies found that dividend payment had informative value, especially stock prices. For example, Hussainey, Mgbame, and Chijoke-Mgbame (2011) found a positive relationship between dividend yield and stock price changes. Also, Hunjra, Ijaz, Chani, Hassan, and Mustafa (2014) inserted that dividend yield was negatively related with stock price and dividend payout ratio was positively related with stock price. Prior research of dividend policies has indicated that dividend payout related to profitability. Truong and Heaney (2007) found that firms were more likely to pay dividends when profitability is high. Some debates whether profitability ratios (i.e. earnings per share, ROA, ROE) presents firm performance are still controversial issues. By referring Rockefeller's speech "*Dividends, those cash distributions that many companies pay out regularly from earnings to stockholders, send a clear, powerful message about future prospects and performance. A company's willingness and ability to pay steady dividends over time provide good clues about its fundamentals.*", many financial advisors recommend investors to pay attention to dividend payment rather than earnings and insert that "*dividend payment is the gold standard by which to measure the profitability of a company's operations. Dividend payment is not perfect, but it is more difficult to manipulate than net income or earnings per share.*" From the above statements, therefore, this study employs cash dividend payment to measure firm performance.

For the studies of corporate governance on dividend policy, Gugler and Yortoglu (2003) stated that dividend signals the severity of the conflict between the large controlling owner and small outside shareholders. The results suggested that dividend payouts increase when larger shareholders hold common stocks. Chen, Cheung, Stouraitis, and Wong (2005) provided evidence that small market capitalization firms were a negative relationship between dividends and family ownership. Zhang (2008)

studied cash dividend policy, governance mechanisms and firm value of Chinese firms listed in Hong Kong and mainland China. The results showed that the coefficient on the dividend payout ratio was significantly positive to a board structure. Firms with the same CEO and board chair tended to pay lower cash dividends. Baba (2009) suggested that dividends and foreign ownership were positively related to each other since foreign investors were exposed to a higher degree of information asymmetries as compared to domestic investors, and thus dividends were preferred to retain earnings by foreigners. Fairchild, Guney, and Thanatawee (2014) studied dividend policy in Thailand. They found that corporate ownership such as institutional and foreign investors tended to affect dividend policy. For firms with higher ownership concentration, shareholders preferred more dividend payments, while institutional shareholders avoided dividend reductions. Domestic institutional investors favored dividend increases. The overall findings indicated that types of investors influenced dividend policy.

### **Auditors as a Mediator Between Management and Shareholders**

The International Federation of Accountants (IFAC) released its report entitled ‘Financial reporting value chain — current perspectives and direction’. The financial reporting value chain refers to three stages: the preparation, audit, and use of financial reports. This process finally provides firm permanence. This is because the management team has a vital role in preparing financial reports. Then, auditors express their opinion as to whether financial reports are presented in a “true and fair view”. Finally, financial statements users employ these reports for better decision-making (IFAC, 2014). Within this process, auditors are considered as “middlemen” between management and financial statements users. This is because auditors have a responsibility to audit financial statements and provide assurance to the 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 market. Also, auditors play a great role in monitoring companies’ corporate governance which ultimately increase firm performance (Bhattacharya, 2008).

In addition, auditing standard setters attempt to provide an important foundation supporting audit quality by issuing auditing standards describing the auditor’s objectives and establishing minimum requirements. However, The majority of the requirements either provide only a framework for the judgments made in an audit or require judgment for them to be properly applied. Auditing is therefore a discipline that relies on competent individuals using their experience and applying integrity, objectivity, and skepticism to enable them to make appropriate judgments that are supported by the facts and circumstances of the engagement (IAASB, 2013).

Selected auditing standards reflect the mediating role of auditors. The International Standards of Auditing (ISA) 315 states that the objective of the auditor is to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels, through understanding the entity and its environment, including the entity's internal control, thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement (ISA 315 para 3). If the auditor finds misstatements in financial reporting, ISA 700 requires the auditor to issue modified audit opinions or unclean opinions of financial statements. Moreover, ISA 260 requires auditors to communicate with the client's governance body regarding significant matters which may come to the auditors' attention during the engagement. The matters include internal control weaknesses and deficiency, significant delays in management providing required information, extensive unexpected effort required to obtain sufficient and appropriate audit evidence, restrictions imposed on the auditor by management, and management's unwillingness to make or extend its assessment of the entity's ability to continue as a going concern when requested. In other words, auditors attempt to monitor the quality of financial statements (Donelson, Ege, & McInnis 2017).

Previous studies stated identified the auditing fee as one of important factors of auditing quality (e.g., DeAngelo, 1981; Francis, 2004; Hay & Davis, 2004). In addition, higher auditing fees are also associated with higher qualified auditors (Hay & Davis, 2004). Clients are confident that large audit firms have greater monitoring and bonding to capture higher audit quality (Hay & Davis, 2004). In terms of auditor competence including technical auditing and continuing education, larger audit firms employ better staff in comparison to smaller size firms. So, the larger the audit firm, the higher the auditor's specialization and quality; thus, higher audit fees are needed (DeAngelo, 1981). Also, as demand for higher audit quality and additional activities increase, higher fees are expected by clients (Houghton & Jubb, 1999). Moreover, the reputation of audit firms can be negatively influenced by high-risk clients, and so, because of such influences, higher audit fees are charged by larger audit firms (Hogan, 1997). Choi, Kim, and Zang (2010) examined whether the association between audit fees and audit quality is asymmetric and thus nonlinear in the sense that the association is conditioned upon the sign of abnormal audit fees. Their results show that the proxy for audit quality is insignificantly associated with abnormal audit fees for their total sample of client firms with both positive and negative abnormal audit fees. In sum, higher audit fees may result in greater audit quality (Eshleman & Guo, 2014) through increasing audit efforts as well as the utilization of higher qualified auditors. In terms of brand name, larger audit firms may demand higher audit fees (Basioudis & Fifi, 2004).

Prior researchers have carried out the studies to observe of informative value of audit fees and firm performance in a limited manner. Using a sample of U.S. listed companies, the study found the empirical evidence on the relationship between firm performance and audit fees. Specifically, increases (decreases) in operating performance are connected with decreases (increases) in audit fees (Moutinho,

Cerqueira & Brandão, 2012). In addition, Using Malaysian listed companies, the study used audit fees and audit firm rotation as proxies for audit quality and return on assets and Tobin's q were used as measures for firm performance. The study found that there was insignificant relationship between audit quality and ROA. However, the study found audit fee was significantly and positively related to Tobin's Q. However, audit firm rotation was insignificantly related to Tobin's (Sayyar, Basiruddin, Rasid, & Elhabib, M 2015). The relationship between audit fee and firm performance is still ambiguous, therefore this present prefers to investigate the studied association.

### **Corporate Governance as Influencing Factors to Firm Performance**

Previous studies have been carried out by introducing corporate governance proxies. However, it is somewhat difficult to justify which index should be used to measure the corporate governance of firms. The OECD principles were initially issued in 1999 and have since become the international benchmark for corporate governance, forming the basis for a number of initiatives, both in government and the private sector. The principles were revised in 2004 and later again in 2013. The OECD principles of corporate governance have transformed the internal benchmarks for policymakers, investors, corporations and other stakeholders worldwide. Its guidelines on corporate governance provide specific guidance for policymakers, regulators and market participants in improving the legal, institutional and regulatory framework that underpin corporate governance, with the focus on publicly traded companies, while also providing practical suggestion for stock exchanges, investors, corporations and other parties that have a role in the process of developing good corporate governance. In addition, the principles are recognized by the Financial Stability Board as one of the twelve key standards for international financial stability and form the basis of the corporate governance component of the World Bank Report on the Observance of Standards and Codes (OECD, 2004). The Stock Exchange of Thailand (SET) has adopted the OECD principles of good corporate governance for listed companies and defines corporate governance as a set of structures and processes covering the relationships between a company's board of directors, its management, and its shareholders to encourage the company's competitiveness, growth and long-term shareholder value, considering the interests of other company stakeholders. The principles cover five key areas of corporate governance including rights of shareholders, equitable treatment of shareholders, role of stakeholders, disclosure and transparency and board responsibilities. The explanation of corporate principle and literature reviews are as follows.

**Rights of shareholders** means that equity shareholders have proper rights. For example, shareholders have the right to participate in shareholder meetings (OECD, 2013). In 2006, the regulatory bodies in Thailand including the Securities and Exchange Commission (SEC), Thai Investors Association and Thai Listed Companies Association launched the annual general meeting assessment project (AGM) to raise corporate governance awareness of the shareholder's participation and protection. They stated that the efficiency of the AGM would be advantageous to not only listed companies in reaching international

standards but also to investors in evaluating the listed firms' corporate governance based on their protection of shareholders' rights. Later, AGM has become a requirement of the regulatory bodies to conduct a survey of AGM rating by shareholders. In addition, ASEAN Capital Market Forum and the Asian Development Bank (2013) stated that Thailand follows good practices in allowing shareholders to elect the director individually, disclosing the outcome of the AGM by the next working day, disclosing the voting results including approving, dissenting, and abstaining votes for each agenda item, providing rationale and explanation for each agenda item in the notice of the AGM, and organizing the AGM in an easy-to-reach location. Therefore, this study employs AGM rating to represent rights of shareholders.

**Equitable treatment of shareholders** means shareholders should safeguard equitable treatment from companies. For example, all shareholders carry equal voting rights in the meeting as the numbers of shares held. (OECD, 2013) Bethel and Gillan (2002) explored the impact on shareholder voting and proposal passage of certain features of firms' institutional and regulatory environment. They found that in a number of instances, state and federal securities laws and the rules of the securities exchange governing the voting of shares held by brokers affected shareholder voting and proposal messages. Connelly, Limpaphayom, and Nagarajan (2012) carried on the study measuring the voting rights of shares by the standard of "one share, one vote". Also, the studies by the Stock Exchange of Thailand and the Thai Institute of Directors (2012) measured the equitable treatment of shareholders from the company's offer of "one-share, one-vote". These studies found that "one share, one vote" increases management efficiency.

**Role of stakeholders** refers to shareholders having the right to elect the directors, and the board of directors having the right to hire a management team. If shareholders are not satisfied with the performance of the directors, they may take away the directors or decline to re-elect them, meaning the management team is no longer valid (OECD, 2013). Based on this concept, the management team is a representative of both the shareholders and other stakeholders. Normally, the pay performance link is important because it measures the extent to which the directors' remuneration is tied to changes in firm performance, and therefore the extent to which management and shareholder incentives are aligned via performance pay. Therefore, directors and management teams should be considered as representatives of stakeholders (Clarkson, Walker, & Nicholls, 2011). De Franco, Hope, and Larocque (2013) suggested that a strong pay-performance association in the post-reform period indicates that the regulatory changes have improved the board's ability to evaluate and reward management effectiveness and confirms the agency theory prediction that disclosure leads to better monitoring. Haye (1997) studied remuneration in small and medium-size banks to holding companies located throughout the United States, accounting for all executives within the senior hierarchy. Dependent variables included total compensation received by the executive, salary compensation or base pay received by the executive, bonus payment received by the executive, and profit-sharing payments received by the executive. The results showed that the senior

executives of banking companies located in concentrated deposit markets received more incentive compensation and less salary than executives in more competitive markets. Clarkson et al. (2011) studied the effect of increased shareholder oversight and disclosure of executive remuneration on pay-performance and controlling for contemporaneous changes in corporate governance practice. The results showed that pay-performance relating to CEO remuneration is positively associated to firm performance. Therefore, this study employs director remuneration to represent the role of stakeholders.

**Disclosure and transparency** means accurate disclosures such as the financial situation, performance, ownership structure, and corporate governance are made to the public on all material basis. Disclosure regime that encourages real transparency is a crucial feature of the market-based monitoring of companies and is central to shareholders' ability to exercise their ownership rights on an informed basis (OECD, 2013). The Stock Exchange of Thailand and Thai Institute of Directors (2012) found that information alerts for shareholders have significant effects on meeting quality. The more day meetings are announced in advance, the more the meeting quality is improved because shareholders can spend more time getting familiar with the issues. Therefore, this study employs this concept by introducing numbers of days in advance announcement of general shareholder meetings from the following three channels: direct to shareholders and via websites and newspapers to represent disclosure and transparency.

**Board responsibilities** refers to the active monitoring of management by the board. The board's accountability to the company and the shareholders is highly vital. With corporate strategy, the board is primarily responsible for monitoring managerial performance ongoing basis and achieving an adequate return for shareholders (OECD, 2013). Previous studies used board of director meeting attendance to measure corporate governance level. For example, Vafeas (1999) examined the relationship between board activity measured by the frequency of board meetings and corporate performance. The study asserted that board meeting frequency was positively related to corporate governance level and positively related to firm value. Brick and Chidambaran (2010) observed at the factors of board monitoring activity and its impact on firm value. They noticed that board activities had a positive impact on firm value. Balasubramanian, Black, and Khanna (2010) used board composition and independence and the number of board meetings per year to study the relation between firm level corporate governance and market value in India. The study found that the number of board meeting frequency was positively related to market value. Connelly et al. (2012) measured board responsibilities from the index of board monitoring/control efforts (board member training, board meeting frequency, attendance of board members, and risk management policy). They found that the increase of board monitoring/control efforts reflect on firm profitability. Chou, Chung, and Yin (2013) investigated board meeting frequency and its effects on firm performance of Taiwanese listed companies and discovered that higher meeting

frequency by directors can enhance firm performance but high attendance by their representatives had an adverse effect.

In sum, this study intends to employ all significant corporate governance mechanisms recommended by OECD and are significant related to firm performance found by previous studies. This is to investigate the informative value of corporate governance on firm value. The definitions of corporate governance measurements of this study will be explained in Table 1.

### **Control variables**

To reduce the probability of omitted variable bias, the study includes a number of control variables. Bartov, Gul, and Tsui (2000) suggested that omitting control variables may cause to failure rejecting the hypothesis when in fact it should be accepted. In this study, the controls variables included firms' size (market capitals), leverage ratio and net profit margin. These control variables were identified based on prior studies (i.e. Al-Jaifi (2015)).

In sum, the literature review of the previous studies above helps to develop this study's conceptual framework. To build a relevant extensive model, this study has adopted important fundamental factors studied in prior research on the informative value of corporate governance and firm performance via the mediating role of auditors.

## **Research Methodology**

This section focuses on the research methodology used in this study. Firstly, the samples are identified, followed by the concept of mediating variables and multiple regression model specification. All variables set up in the analysis are mentioned later.

### **Samples**

An empirical research method based on secondary data is applied in this study. The samples used in this study comprised the Top 100 Thai listed companies traded on the Stock Exchange of Thailand (SET) during 2013-2016. The Top 100 Thai listed companies were selected because these companies are considered as having the best corporate governance implementation. Also, institution investors highly invest in these companies. Missing data, those for the fiscal year not ended 31 December and those not in the Top 100 all 4-year period were not included in the dataset. A total of 315 observations is included in the analysis. Data collection relating to corporate governance mechanisms is publicly available in annual reports, companies' websites and annual general meeting assessment (AGM) from the Thai Investors Association. In addition, the data on financial information was retrieved from SETSMART (SET Market Analysis and Reporting Tool).

After data collection was completed, all variables were tested including error or residual as to whether they were normally distributed. If the analysis revealed multicollinearity to be an issue, Natural log (ln) was employed to transform the data. After transforming the data, the test results showed that tolerance was less than 10, while VIF was not higher than 3. Therefore, the dependent variables did not have any multicollinearity concerns (Hair, Black, Babin & Anderson 2010). Then, multiple regression was performed. The multiple regression results also show that Durbin-Watson was near to 2 which means autocorrelation is not an issue (Field 2009).

### Mediating variable concept

As this study adopts a mediating variable into the analysis, a summary explanation of the mediating variable concept is as follows. Baron and Kenny (1986) explained that a mediating variable is a variable that pursues to identify and clarify the mechanism or process that underlies an observed association between a dependent variable and an independent variable thru the inclusion of a third hypothetical variable. Rather than a direct causal association between the dependent variable and the independent variable, a mediation variable suggests that the independent variable influences the (non-observable) mediator variable, which in turn influences the dependent variable. Thus, the mediator variable helps to clarify the nature of the relationship between the dependent and independent variables. Testing for mediation involves establishing four conditions:

- 1) The independent variables are significantly related to the dependent variable (C).
- 2) The independent variables are significantly related to the mediating variable (A).
- 3) The mediating variables are significantly related to the dependent variable (B).
- 4) When controlling for the effects of the mediating variable, the effect of the independent variable on the dependent variable no longer significant (D).

Figure 1 shows the diagram of testing for mediation.

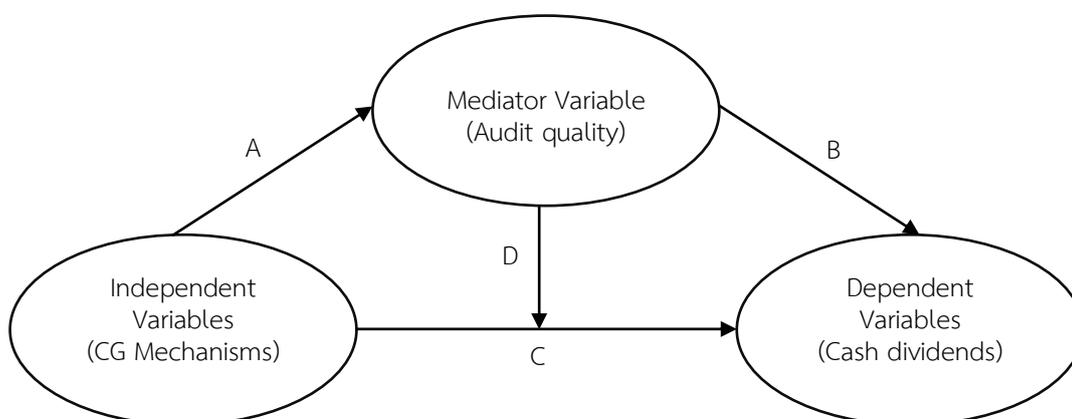


Figure 1 The Relationship of Mediating Variable and Independent and Dependent Variables

Table 1 Definition of variables

Variables	Acronym	Measurement
Dependent Variable	DIV	Cash dividend payment from statement of cashflows scaled by total assets
Control Variables	SIZE	Market capital
	LEV	Debt to equity
	NPM	Net profit margin (net profit divided by total income)
Mediating Variable	AQ	Audit fees divided by market capital
Independent Variables		
1) Rights of Shareholders	AGM	Rating of Shareholder participation in Annual General Meeting (AGM); Outstanding = 6 Excellent = 5 Very good = 4 Good = 3 Rather = 2 Need improvement = 1;
2) Equitable Treatment of Shareholders	VOTE	If a firm provides “one-share, one-vote” for shareholder rights = 1; otherwise, 0.
3) Disclosure and Transparency	INFO	Number of the days in advance the company sent out the notification of general shareholders meeting directly to shareholders and/or website and newspaper notification
4) Roles of Stakeholders	DR	Director remunerations
5) Boards Responsibility	BDM	Percent of board of director meeting attendance

### Multiple Regression Model Specification

The study specifies the multiple regression model below to examine the relationship between corporate governance, firm performance and audit quality of Thai listed companies. In equation (C), the left-hand side variable is cash dividends. On the right-hand side, the variables are control variables and corporate governance mechanisms that may relate to cash dividends. In equation (A), the left-hand side variable is audit quality as the mediating variable. On the right-hand side, the variables are control variables and corporate governance mechanisms that may relate to audit quality. In equation (B), the left-hand side variable is cash dividends. On the right-hand side, the variables are control variables and audit quality. In equation (D), the left-hand side variable is cash dividends. On the right-hand side, the variables are control variables, audit quality and corporate governance mechanisms that may relate to cash dividends. The equations are as follow:

$$DIV_{it} = \beta_0 + \beta_1 SIZE_{it} + \beta_2 LEV_{it} + \beta_3 NPM_{it} + \beta_4 AGM_{it} + \beta_5 VOTE_{it} + \beta_6 DR_{it} + \beta_7 INFO_{it} + \beta_8 BDS_{it} + \beta_9 BDM_{it} + \epsilon \quad (C)$$

$$AQ_{it} = \beta_0 + \beta_1 SIZE_{it} + \beta_2 LEV_{it} + \beta_3 NPM_{it} + \beta_4 AGM_{it} + \beta_5 VOTE_{it} + \beta_6 DR_{it} + \beta_7 INFO_{it} + \beta_8 BDS_{it} + \beta_9 BDM_{it} + \epsilon \quad (A)$$

$$DIV_{it} = \beta_0 + \beta_1 SIZE_{it} + \beta_2 LEV_{it} + \beta_3 NPM_{it} + \beta_4 AQ_{it} + \epsilon \quad (B)$$

$$DIV_{it} = \beta_0 + \beta_1 SIZE_{it} + \beta_2 LEV_{it} + \beta_3 NPM_{it} + \beta_4 DR_{it} + \beta_5 INFO_{it} + \beta_6 AQ_{it} + \epsilon \quad (D)$$

### Variables

The definition of variables used in this study are shown in Table 1 as follows:

## Results and Analysis

### Descriptive statistics

Table 2 presents descriptive statistics for independent variable, control variables, mediating variable and corporate governance mechanisms for the full period (2013 – 2016) of the Top 100 Thai listed companies. Descriptive statistics include minimum, maximum mean and standard deviation of all variables in this study. It is found that the companies paid dividends (DIV) ranging from zero to 127.16 times with the average of 1.46 times the total assets. Market capital (SIZE) of these companies is considered high ranging from 217.23 to 552 billion Thai Baht. The average leverage ratio (LEV) is reasonable at about 2.47 times. Some of the companies had negative operation results. However, the average net profit margin can be considered quite high at 14.23%. For corporate governance mechanisms, mostly the shareholders of the companies ranked annual general meeting (AGM) quite high with an average of 4.86 out of 6. About 80% of the companies had a “one share, one vote” policy (VOTE). Management of the companies sent annual shareholder meeting information to shareholders (INFO) on average of 26.71 days in advance. The companies paid remunerations to directors (DR) ranging from 0.56 to 1,388 million Baht with an average of 127 million for each company, while the boards of directors were quite active in terms of meeting attendance (BDM) with 90.64% meeting attendance. Audit fees comparing with market capital (AQ) of the companies range from 0.01% - 16.19%, with an average of 4.29%.

Table 3 shows Pearson correlation among variables. Between independent variables and dependent variables, it was found that there is a significant and negative correlation between cash dividends and market capital (SIZE) at a 1% level, while a significant and positive correlation between cash dividends and leverage ratios (LEV), net profit margin (NPM), notification of general shareholders meeting in advance (INFO), director remuneration (DR) and audit quality (AQ) were found at a 1 – 5% level. Between mediating variables and dependent variables, it was found that there is a significant and positive correlation between audit quality and cash dividends, market capital (SIZE), annual general meeting (AGM) at a 1% level. Table 2 also shows that Pearson correlations between variables are below

0.8. Field (2005) states that multicollinearity becomes an issue only when the correlation coefficient exceeds 0.8. Therefore, the dependent variables did not have any multicollinearity concerns.

**Table 2 Descriptive Statistics**

	Min	Max	Mean	SD
DIV (Times)	0.00	127.16	1.46	7.98
lnDIV	17.58	4.85	2.74	2.74
SIZE (Billion Thai Baht)	217.23	552.00	384.05	106.94
lnSIZE	26.10	27.04	26.53	0.31
LEV (Times)	0.40	20.17	2.47	3.09
lnLEV	3.27	3.00	0.35	1.06
NPM (%)	-52.24	59.26	14.23	12.40
lnNPM	-1.27	4.08	2.39	0.92
AGM	1.00	6.00	4.86	1.66
VOTE (Dummy)	0.00	1.00	0.79	0.41
INFO (Days)	7.00	120.00	26.71	20.51
DR (Million Thai Baht)	0.56	1,388.00	127.00	139.00
lnDR	13.24	21.05	18.24	0.97
BDM (%)	68.85	100.00	90.64	7.48
lnBDM	4.23	4.60	4.50	0.09
AQ (%)	0.01	16.19	4.29	169.36
lnAQ	12.98	7.39	6.07	5.98

**Table 3 Pearson Correlation**

	DIV	SIZE	LEV	NPM	AGM	VOTE	INFO	DR	BDM	AQ
DIV	1									
SIZE	-0.723**	1								
LEV	0.9291**	0.077	1							
NPM	0.142*	0.030	0.120*	1						
AGM	0.103	0.136*	0.176**	0.049	1					
VOTE	0.008	0.001	0.003	0.048	0.004	1				
INFO	0.085*	0.001	0.002*	0.069	0.163**	0.059	1			
RD	0.002*	0.001	0.180*	0.054	0.125**	0.122	0.026	1		
BDM	0.082	0.028	0.112	0.041	0.024	0.039	0.053	0.009	1	
AQ	0.707**	0.788**	0.049	0.045	0.172**	0.008	0.013	0.055	-0.066	1

\*Correlation is significant at the 0.05 level (2-tailed) and \*\* at the 0.01 (2-tailed).

## Regression Models

In this section, the results will be demonstrated following the four-step analysis as mentioned in mediating variable concept

### The Effects of Corporate Governance on Cash Dividends

Table 4 shows the multiple regression result of Step 1: corporate governance on cash dividends. It was found that the F-statistic was significantly equal to 0.001 and the  $R^2$  of the model was 0.645, which mean that explanatory variables can explain and predict the dependent variable by 64.5%, and Durbin-Watson is equal to 1.722. Therefore, these statistics indicators are considered valid for analyzing the outcomes. All control variables significantly relate to the dependent variables. The analysis found that cash dividends (DIV) are negatively associated with firm size (SIZE). This means smaller firms are more likely to pay higher cash dividends to shareholders. This result is in line with previous studies (i.e. Gugler & Yurtoglu, 2003; Harada & Nguyen, 2011). The companies with a lower leverage ratio (LEV) tend to pay higher cash dividends. This result is consistent with previous research (i.e. Harada & Nguyen, 2011; Su, Fung, Huang, & Shen, 2014; Al-Jaifi, 2015). Also, companies with higher net profit margins (NPM) are more likely to pay higher cash dividends. This result is consistent with previous studies (i.e. Cheng, Fung, & Leung, 2009; Denis & Osobov, 2008; Al-Jaifi, 2015).

**Table 4 Step 1: Multiple Regression Result of Corporate Governance on Cash Dividends**

Variables	Dependent variable = cash dividends				
	$\beta$	t-stat	p-value	VIF	Tolerance
Constant		0.329	0.043		
SIZE	-0.314	-2.250	0.001	0.951	1.051
LEV	-0.631	-7.074	0.001	0.896	1.117
NPM	0.425	4.140	0.001	0.965	1.037
AGM	0.044	0.800	0.424	0.889	1.125
VOTE	0.073	0.326	0.745	0.979	1.021
INFO	0.010	2.204	0.028	0.963	1.039
DR	0.090	0.929	0.035	0.940	1.064
BDM	0.038	0.105	0.105	0.973	1.028
F-stat Sig.= 0.001 Durbin-Watson = 1.722 Adj. $R^2$ =0.645					

For corporate governance, the p-value of the advance notification of annual shareholder meeting (INFO) and director remunerations (DR) are positively related to cash dividends. This means longer advance notification is likely to increase cash dividends, and higher remunerations paid to directors are likely to increase

cash dividends. This result is consistent with the studies conducted by Jiraporn, Kim, and Kim, 2011 and Clarkson et al. (2011).

It was found that the independent variables are significantly associated to the dependent variables; therefore, Step 2 could proceed.

### The Effect of Corporate Governance on Audit Quality

Table 5 shows the results of Step 2: corporate governance on audit quality. It was found that F-statistic significant was equal to 0.001 and the  $R^2$  of the model was 0.891, which means that explanatory variables can explain and predict the dependent variable by 89.1% and Durbin-Watson was equal to 1.502. Therefore, these statistical indicators are considered valid for analyzing the outcomes. All control variables were significantly related to the dependent variables. The analysis found that audit quality is negatively associated with firm size. This means smaller firms are more likely to have higher audit quality than larger firms. The companies with a lower leverage ratio tend to have higher audit quality. Also, companies with higher net profit margin are more likely to have lower audit quality. These results are in line with previous studies (i.e. Fan & Wong, 2005).

For corporate governance, the p-value of the notification of annual shareholder meetings in advance (INFO) is negatively related to audit quality. This means that shorter period notification is likely to show higher audit quality. In addition, the p-value of director remunerations is positively related to audit quality. This means higher director remunerations are likely to increase audit quality. This result is in line with the previous study by Wysocki (2010).

**Table 5 Step 2: Multiple Regression Result of Corporate Governance on Audit Quality**

Variables	Dependent variable = cash dividends				
	$\beta$	t-stat	p-value	VIF	Tolerance
Constant		3.335	0.001		
SIZE	-1.799	-4.754	0.001	0.859	1.164
LEV	-1.429	-1.974	0.001	0.805	1.242
NPM	0.179	1.399	0.016	0.967	1.034
AGM	0.208	2.991	0.911	0.905	1.105
VOTE	-0.431	-1.515	0.131	0.976	1.024
INFO	-0.001	-0.112	0.003	0.963	1.038
DR	0.626	5.053	0.001	0.933	1.071
BDM	0.108	0.235	0.814	0.974	1.026
F-stat Sig.= 0.001 Durbin-Watson = 1.502 Adj. $R^2$ =0.891					

The independent variables were significantly associated to the dependent variable; therefore, Step 3 could proceed.

### The effect of audit quality on cash dividends

Table 6 shows the results of Step 3: audit quality on firm performance. It was found that the F-stat was equal to 0.001 and the  $R^2$  was equal to 0.651, which means that explanatory variables can explain and predict the dependent variable by 65.1% and the Durbin-Watson was equal to 1.731. Therefore, these statistical indicators can be considered valid for analyzing the outcomes. All control variables, independent variables and the mediating variable are significantly related to the dependent variables. The analysis found that cash dividends are negatively associated with firm size. This means smaller firms are likely to pay higher cash dividends to investors, while the companies with a lower leverage ratio tend to pay higher cash dividends. Also, companies with higher net profit margins are likely to pay higher cash dividends. The coefficient of audit quality (AQ) is significantly related to cash dividends in a positive manner. This means companies with higher audit quality are likely to pay higher cash dividends.

The independent variables were significantly associated to the dependent variable; therefore, Step 4 could proceed.

**Table 6 Step 3: Multiple Regression Result of Audit Quality on Cash Dividends**

Variables	Dependent Variable = Cash Dividends				
	$\beta$	t-stat	p-value	VIF	Tolerance
Constant		0.734	0.046		
SIZE	-0.179	-2.181	0.001	0.109	3.621
LEV	-0.487	-4.348	0.001	0.551	1.055
NPM	0.395	3.958	0.001	0.981	1.017
AQ	0.231	5.429	0.001	0.122	3.469
F-stat Sig.= 0.001 Durbin-Watson = 1.731 Adj. $R^2$ =0.651					

### The Effect of Corporate Governance on the Audit Quality via Cash Dividends

Table 7 shows the results of Step 4: corporate governance on firm performance via audit quality. In the Step 4 analysis, only significant independent variables from Steps 1-3 were employed. It was found that the F-stat was equal to 0.001 and the  $R^2$  was equal to 0.466, which means that explanatory variables can explain and predict the dependent variable by 46.6% and the Durbin-Watson was equal to 1.720. Therefore, these statistical indicators were considered valid for analyzing the outcomes. All control variables, independent variables and mediating variables were significantly related to the dependent

variables. The analysis found that cash dividends were negatively associated with firm size. This means smaller firms were likely to pay higher cash dividends to investors, while companies with a lower leverage ratio tend to pay higher cash dividends. Also, companies with higher net profit margins are more likely to pay higher cash dividends. For corporate governance, the p-value of the advance notification of annual shareholder meetings (INFO) and director remunerations (DR) are positively related to cash dividends. This means greater advance notification was likely to increase cash dividends and higher remunerations paid to directors were more likely to increase cash dividends. Finally, the coefficient of audit quality (AQ) was significantly related to cash dividends in a positive manner. This means higher audit quality was more likely to increase cash dividends.

**Table 7 Step 4: Multiple Regression Result of Corporate Governance on the Audit Quality via Cash Dividends**

Variables	Dependent variable = cash dividends				
	$\beta$	t-stat	p-value	VIF	Tolerance
Constant		-0.260	0.005		
SIZE	-0.800	-9.363	0.001	0.099	1.119
LEV	-0.477	-4.278	0.001	0.549	1.823
NPM	0.410	4.129	0.001	0.977	1.023
INFO	0.010	2.307	0.052	0.005	1.005
DR	0.068	0.969	0.067	0.875	1.142
AQ	0.222	4.954	0.001	0.111	0.035
F-stat Sig.= 0.001 Durbin-Watson = 1.720 Adj. R <sup>2</sup> =0.466					

## Conclusion and Recommendation

This research aims to observe the fundamental relations and strength of association between corporate governance mechanisms and firm performance via the mediating role of auditors. Unlike previous studies, this study introduces a mediating variable between corporate governance and firm performance (i.e. cash dividends). This is because auditors play a great role as a monitoring entity between management and shareholders or financial statements users. The study was based on a panel data regression analysis of the Top 100 Thai listed companies traded on the Stock Exchange of Thailand (SET) from 2013-2016. The analysis shows vital outcomes of all control variables including firm size, leverage and net profit margin significantly related to the dependent variable of cash dividends. Similarly, the results also show that all control variables including firm size, leverage and net profit margin are significantly related to the mediating variable of audit quality. In addition, the corporate governance variables including number of days in advance of notification of general shareholder meetings and

director remunerations are significantly related to cash dividends and audit quality. Finally, corporate governance mechanisms are significantly related to cash dividends via audit quality. In sum, this study is consistent with prior studies that examined whether corporate governance mechanisms drive firm performance also auditors monitor the manager to maintain corporate governance integrity. This study successfully introduces the mediating role of auditors to provide the balance of power between managers and shareholders.

The results of this study shed additional light on the inconclusive issues regarding the effects of corporate governance aspects in emerging markets. Rather than using profitability indices like returns on equity (ROE) and returns on assets (ROA), cash dividends could be considered as a proxy representing companies' wealth and sustainability. This is because listed companies in emerging markets seems to have liquidity concern. Paying cash dividend should indicate survival of the companies. For corporate governance concerns, managers should send advance notification of general meetings to shareholders very early before meetings are held. Regulators should also enforce related law and regulations monitoring listed companies to follow these rules. This is to allow shareholders sufficient time to digest necessary information to monitor management teams. In turn, shareholders should allow reasonable remunerations to management teams. This is to enjoy increased benefits and require management teams to put more effort to operations. In addition, auditors should get paid reasonable audit fees. This is to allow auditors to put more effort into their responsibility. This reciprocal model should be beneficial among the value chain of financial reporting quality and should fit into emerging markets.

The study provides new light for stock market regulators. The reciprocal model among shareholders, managers and auditors should come be scrutinized. Regulators should find ways or even regulate how to balance dividend policy, director remunerations and audit fees. The result should support the sustainable concept among these parties. Shareholders or financial statements users should benefit from the results of this study. They should use information like corporate governance raking, director remuneration and audit fees to make decisions for their investment. Finally, auditors should not adopt a "low bowling" strategy to increase the audit fees of their firms. This strategy may reduce audit quality. Instead, enhancement of audit quality should be the strategy used to maintain their reputation.

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