The Relationship Between Audit Quality and Audit Firm Inspection Scores: Evidence from SEC-Registered Audit Firms in Thailand

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Abstract

This study investigates the alignment between traditional academic proxies of audit quality and the regulatory inspection scores issued by the Office of the Securities and Exchange Commission (SEC) of Thailand. The sample firms provided services to companies listed on the Stock Exchange of Thailand (SET) between 2016 and 2021, the research employs Partial Least Squares Structural Equation Modeling (PLS-SEM). The investigation is necessitated by the Thai market's transition toward more rigorous oversight following the implementation of the Thai Standard on Quality Control 1 (TSQC 1). The empirical results reveal a moderate positive correlation between audit quality and SEC inspection scores. Analysis of indirect proxies indicates that audit fees and audit firm size demonstrate high reliability and significant positive association with quality. Conversely, audit report lag exhibits a significant negative correlation, suggesting that engagement efficiency serves as a hallmark of professional excellence. Notably, audit tenure did not show a statistically significant relationship, likely due to the structural mitigation of familiarity threats through Thailand's mandatory rotation regulations. These findings provide critical insights for the SEC to refine its scoring weights and for firms transitioning to the proactive risk management frameworks mandated by TSQM 1.

Keywords: Audit Quality, SEC Inspection Scores, Thailand, TSQM 1, PLS-SEM.

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ความสัมพันธ์ระหว่างคุณภาพการสอบบัญชีกับคะแนนการตรวจสอบของสำนักงาน: หลักฐานเชิงประจักษ์จากสำนักงานสอบบัญชีที่ขึ้นทะเบียนกับสำนักงาน ก.ล.ต. ในประเทศไทย

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บทคัดย่อ

การศึกษานี้มีวัตถุประสงค์เพื่อตรวจสอบความสอดคล้องระหว่างตัวชี้วัดคุณภาพการสอบบัญชีแบบดั้งเดิมกับคะแนนการตรวจสอบที่กำหนดโดยสำนักงานคณะกรรมการกำกับหลักทรัพย์และตลาดหลักทรัพย์ (ก.ล.ต.) ทั้งนี้สำนักงานสอบบัญชีในกลุ่มตัวอย่างได้ให้บริการแก่บริษัทจดทะเบียนในตลาดหลักทรัพย์แห่งประเทศไทยในช่วงระหว่างปี พ.ศ. 2559 ถึง 2564 งานวิจัยนี้ใช้แบบจำลองสมการโครงสร้างด้วยวิธี Partial Least Squares (PLS-SEM) โดยมีแรงจูงใจจากการเปลี่ยนผ่านของตลาดทุนไทย ไปสู่การกำกับดูแลที่เข้มงวดมากยิ่งขึ้นภายหลังการบังคับใช้มาตรฐานการควบคุมคุณภาพงานสอบบัญชีฉบับที่ 1 (TSQC 1) ผลการศึกษาพบว่าคุณภาพการสอบบัญชีมีความสัมพันธ์เชิงบวกในระดับปานกลางกับคะแนนการตรวจสอบของ ก.ล.ต. การวิเคราะห์ตัวแปรตัวทางอ้อมชี้ให้เห็นว่าค่าธรรมเนียมการสอบบัญชีและขนาดของสำนักงานสอบบัญชีมีความน่าเชื่อถือสูง และมีความสัมพันธ์เชิงบวกอย่างมีนัยสำคัญกับคุณภาพการสอบบัญชี ในทางตรงกันข้ามระยะเวลาล่าช้าในการออกรายงานสอบบัญชีมีความสัมพันธ์เชิงลบอย่างมีนัยสำคัญ ซึ่งสะท้อนให้เห็นว่าประสิทธิภาพในการปฏิบัติงานเป็นตัวบ่งชี้ถึงความโดดเด่นทางวิชาชีพ อย่างไรก็ตามระยะเวลาการดำรงตำแหน่งของผู้สอบบัญชีไม่พบความสัมพันธ์อย่างมีนัยสำคัญทางสถิติ อันอาจเป็นผลมาจากกลไกการลดทอนความเสี่ยงด้านความเป็นอิสระผ่านข้อกำหนดการหมุนเวียนผู้สอบบัญชีในประเทศไทย ข้อค้นพบดังกล่าวมีนัยสำคัญเชิงนโยบายต่อ ก.ล.ต. ในการปรับปรุงน้ำหนักคะแนนการประเมินและต่อสำนักงานสอบบัญชีในการปรับตัวสู่กรอบการบริหารความเสี่ยงเชิงรุกตามมาตรฐานการจัดการคุณภาพ ฉบับที่ 1 (TSQM 1)

คำสำคัญ: คุณภาพการสอบบัญชี คะแนนการตรวจสอบของ ก.ล.ต., ประเทศไทย TSQM 1, PLS-SEM

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Introduction

In the contemporary Thai capital market, the auditor functions as a vital independent "insurer" of financial reporting integrity. By validating the financial disclosures prepared by management, auditors play a fundamental role in mitigating information asymmetry between internal stakeholders and the broader investment community (Watts & Zimmerman, 1981). High-quality auditing transcends mere compliance; it provides an implicit assurance of accuracy that enhances market credibility and protects the economic interests of financial statement users (Mansi et al., 2004).

The imperative for robust systemic quality oversight was historically underscored by global audit failures, most notably the collapse of Arthur Andersen, which catalyzed a paradigm shift toward stricter regulatory controls (Shanti, 2022). In Thailand, this led to the adoption of the Thai Standard on Quality Control 1 (TSQC 1), effective January 1, 2014, which is evolved to the Thai Standard on Quality Management (TSQM 1&2). This standard requires firms to establish a system of quality control based on six core elements: (1) Leadership responsibilities for quality, (2) Relevant ethical requirements, (3) Acceptance and continuance of client relationships, (4) Human resources, (5) Engagement performance, and (6) Monitoring.

The SEC of Thailand actively supervises the market by inspecting audit firms against these six elements, assigning a score from 1 to 4. However, a significant transparency gap remains: of the 31 audit firms approved to audit SET-listed companies, only a fraction publicly disclose their specific inspection scores. This study seeks to bridge the gap between regulatory assessment and academic theory by determining if these SEC inspection scores serve as a reliable proxy for audit quality in the Thai context.

Literature Review And Hypothesis Development

Defining Audit Quality

Audit quality remains a multi-faceted and inherently unobservable construct that serves as a cornerstone of financial market integrity. DeAngelo (1981) provided a foundational conceptualization, defining audit quality as the joint probability that an auditor will both detect a breach in the client's accounting system and subsequently report that breach. This definition highlights two critical dimensions: the auditor's technical competence (to detect errors) and their independence (to report them). In addition, the theoretical underpinnings of audit quality encompass multiple perspectives that collectively explain the determinants and implications of auditing practices. Among these, agency theory, signaling theory, and institutional theory offer complementary insights into how audit quality

is shaped and perceived. While each framework highlights distinct dimensions, their integration provides a more comprehensive understanding of audit quality, particularly in addressing its inherent complexity and contextual variability. Relying on a single theoretical lens may lead to partial interpretations; therefore, a synthesized approach enables scholars and practitioners to better diagnose audit-related challenges and formulate effective improvement strategies.

Agency Theory

Agency theory conceptualizes the relationship between shareholders (principals) and management (agents), emphasizing the potential for conflicts of interest arising from divergent objectives. Within this framework, auditors serve as independent intermediaries who mitigate agency problems by assuring the credibility of financial reporting. High-quality audits reduce agency costs by enhancing the reliability of disclosed information and strengthening investor confidence. The theory underscores the necessity of auditor independence, often advocating mechanisms such as mandatory audit rotation to preserve objectivity. However, its explanatory power is somewhat constrained by assumptions that managerial opportunism is pervasive and by its limited consideration of broader stakeholder influences (Adams, 1994; Toumeh & Yahya, 2017).

Signaling Theory

Signaling theory focuses on how information asymmetry between firms and external stakeholders is reduced through credible signals. In auditing contexts, audit quality functions as a market signal regarding the trustworthiness of financial statements. Engagement with reputable audit firms enhances perceived credibility, thereby fostering investor confidence and potentially reducing the cost of capital. Audit opinions further reinforce this signaling mechanism, where unqualified opinions convey financial soundness, while modified opinions may indicate underlying concerns. Nonetheless, this theory has limitations, particularly in situations involving auditor switching to obtain favorable opinions, and in its assumption that stakeholders interpret signals consistently across contexts (Abdalmuttaleb Musleh & Reyad, 2018; Al-Adwan et al., 2022).

Institutional Theory

Institutional theory explains audit quality through the influence of external pressures, including regulatory, normative, and cultural forces. Regulatory frameworks—such as professional standards and oversight bodies—play a central role in ensuring consistency and compliance in audit practices. Normative pressures derived from professional ethics and education promote auditor skepticism and integrity, while mimetic pressures encourage firms to adopt widely accepted best practices to maintain legitimacy. Despite its strengths in explaining environmental influences, institutional theory

may overstate conformity and does not fully account for organizational resistance to quality improvements or the role of innovation in advancing audit practices (Vadasi et al., 2020).

In summary, these foundational theories collectively enrich the understanding of audit quality by addressing different but interrelated dimensions—contractual relationships, market perceptions, and institutional environments. Their integration is essential for developing a holistic perspective that reflects both the technical and contextual nature of auditing.

The U.S. Government Accountability Office (Government Accountability Office, 2003) supplements this by emphasizing adherence to generally accepted auditing standards (GAAS). According to the GAO, high-quality audits provide reasonable assurance that financial statements are devoid of material misstatements, whether resulting from error or fraud. Similarly, the Australian Securities and Investments Commission (2022) notes that audit quality is achieved when the auditor meets objectives to obtain reasonable assurance that financial reports are free from material misstatements and ensures that any detected defects are corrected or communicated through the audit report. In the context of the Thai capital market, auditors act as essential intermediaries that reduce information asymmetry between management and shareholders, effectively providing an insurance-like guarantee on the accuracy of financial data.

Direct vs. Indirect Measurement of Quality

Scholars generally categorize audit quality measurement into two streams: direct and indirect measures. The direct measures involve evaluating the technical compliance of financial statements and the underlying effectiveness of internal quality control systems. In Thailand, this is exemplified by the SEC's firm inspection scores, which assess whether audit firms comply with professional standards such as TSA 220 and TSQC 1 (Puangpayom et al., 2012). While due to the difficulty of observing the actual audit process, the indirect measures utilize observable characteristics of the audit engagement. These proxies—such as Audit Firm Size (Lennox, 1999; Francis & Yu, 2009), Audit Tenure (Krueratanapaibool, 2022), Audit Fees (Copley et al., 1994), and Audit Report Lag (Rusmin & Evans, 2017) —are used to infer the latent quality of the audit.

The Evolution from TSQC 1 to TSQM 1 and 2

The Thai regulatory environment is currently undergoing a transformative shift from the Thai Standard on Quality Control 1 (TSQC 1) to the Thai Standard on Quality Management 1 & 2 (TSQM 1 & 2). This evolution represents a transition from a "reactive" compliance-based model to a "proactive" risk-based management framework.

Under the outgoing TSQC 1 framework, the SEC evaluates audit firms based on six core elements: (1) leadership responsibilities, (2) ethical requirements, (3) client acceptance and continuance, (4) human resources, (5) engagement performance, and (6) monitoring. While effective, this model often relies on static checklists. Mirroring the global alignment with ISQM 1 and 2, the new TSQM framework emphasizes a systemic System of Quality Management (SoQM). This proactive approach requires firms to identify specific risks to quality and implement continuous monitoring and remediation strategies rather than relying on a fixed set of controls. The SEC's current inspection process, utilizing the QAQR (Quality Assurance and Quality Review) questionnaire, is the primary tool for measuring this compliance and issuing the scores that this study investigates.

Audit Quality Proxies

Audit Firm Size

Scholarly consensus posits that large audit firms, specifically the Big 4, deliver higher quality audits. This is attributed to their deeper resource pools, superior technological infrastructure, and more standardized training programs. Furthermore, larger firms face heightened litigation risk and potential reputation loss, providing them with a greater incentive to maintain high quality (Lennox, 1999; Francis & Yu, 2009).

Audit Tenure

The impact of Audit Tenure—the duration of the auditor-client relationship—is a point of contention. While extended tenure may enhance client-specific knowledge and industry expertise, it also poses a "familiarity threat" that can impair independence. To address this, the Thai SEC mandates auditor rotation every seven years. Interestingly, recent evidence in emerging markets suggests that tenure may have a negligible impact on quality when regulated by such mandatory rotation policies (Krueratanapaibool, 2022).

Audit Fees

Audit Fees serve as a granular indicator of audit effort. Following Simunic (1980) theory, fees reflect the deployment of skilled personnel and the extensiveness of testing procedures. Research by Copley et al. (1994) suggests a significant positive relationship between fees and quality review outcomes, as higher fees allow firms to invest in the resources necessary to meet rigorous regulatory standards. Conversely, market competition that leads to "low-balling" or fee reduction can significantly degrade audit quality. Although there are some studies showing different results (Sari et al., 2019 and Pham et al. (2017), the audit fees obviously signals audit quality.

Audit Report Lag

Audit Report Lag (ARL)—the time elapsed between the fiscal year-end and the issuance of the audit report—is a proxy for efficiency and expertise. Firms with higher expertise and more resources (typically Big 4) tend to have shorter lags (Rusmin & Evans, 2017). A shorter lag indicates the auditor's ability to resolve complex accounting issues promptly, whereas a long lag may signal audit difficulties or a lack of adequate resources, both of which correlate with lower quality.

Hypothesis Development

The SEC’s inspection scores are intended to provide an objective, direct measure of an audit firm's internal quality controls and adherence to professional standards (TSQC 1). If these regulatory scores are accurate reflections of quality, they should logically align with the market-based proxies that stakeholders use to judge audit firms. Firms that are larger, charge higher fees (reflecting effort), and are more efficient (shorter report lag) should theoretically achieve higher inspection scores from the regulator.

While some studies suggest these metrics may not always be perfectly interchangeable, the regulatory intent of SEC inspections is to identify and promote high-quality auditing. Therefore, we examine whether the SEC’s internal assessment of a firm's quality management system correlates with these observable market indicators. Based on the preceding literature, we propose the following hypothesis and research frameworks as figure 1:

H1: There is a significant positive relationship between audit quality (as measured by traditional proxies: firm size, tenure, fees, and report lag) and SEC inspection scores.

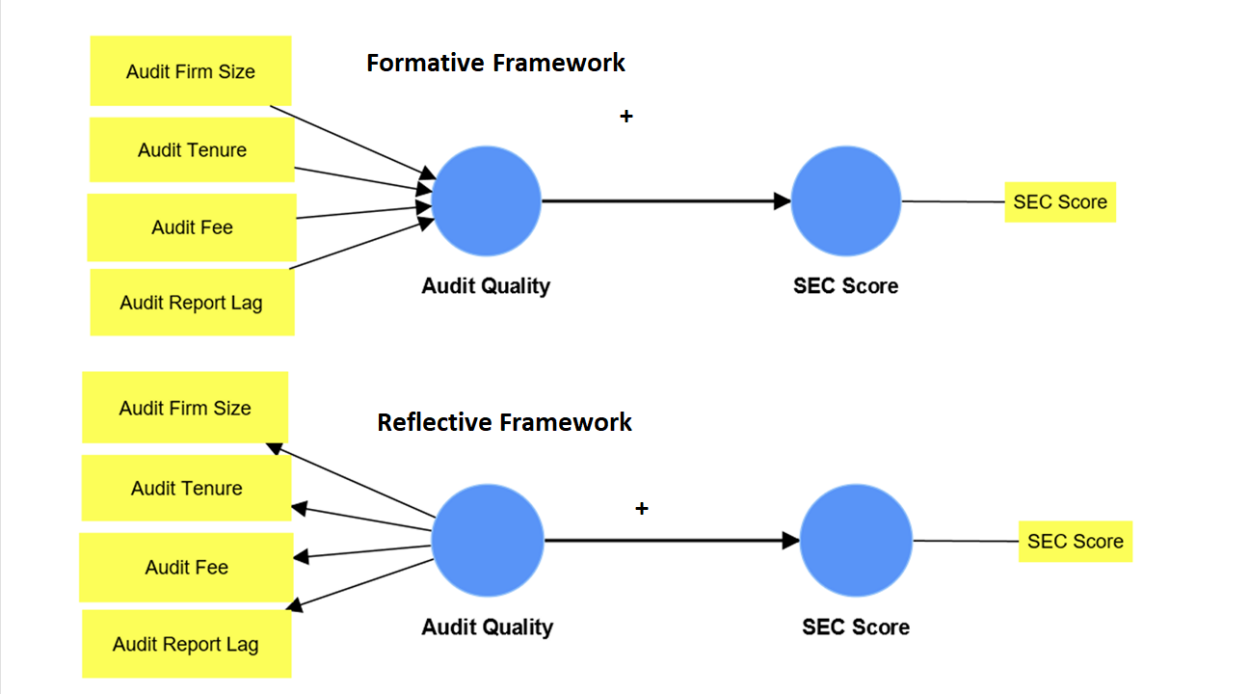

Figure 1 Formative and Reflective frameworks of the study

Research Methodology

Population and Sampling

The study focuses on audit firms approved by the SEC to provide services to the Thai capital market. Due to disclosure limitations, the final sample consists of 10 audit firms (20 observation groups) between 2016 and 2021. This transparency hurdle—where only 10 out of 32 approved firms disclosed scores—highlights a significant issue in the Thai audit market. Data were extracted from SEC inspection reports and Form 56-1.

Variable Operationalization

To ensure statistical alignment, the SEC's original scoring scale (where 1 is "Excellent") was mathematically inverted for this study. In the table below, a higher score represents higher quality. The summary of variable measurement is demonstrated in Table 1

Table 1 The summary of variable construction for the study.

Variable Name	Definition / Measurement
Audit Firm Size (Size)	Dummy: 1 for Big 4, 0 for Non-Big 4.
Audit Tenure (Tenure)	Average years serving the client (capped at 5 to cut outliner).
Audit Fee (Fee)	Sum of audit fees in Baht received from SET clients.
Audit Report Lag (Lag)	Average days from fiscal year-end to report date.
SEC Score	Converted 1–4 Scale (4 = Excellent, 1 = Needs Improvement).

Statistical Model Analysis

Partial Least Squares Structural Equation Modeling (PLS-SEM) was selected. This method is uniquely suited for studies with small sample sizes and complex relationships involving latent behavioral constructs like Audit Quality. The assessment of relationships between indicators and latent variables processes both formative and reflective measurement model evaluations. For the formative measurement model evaluation, the study tests multicollinearity by measuring Variance Inflation Factor (VIF) to assess the degree of correlation between indicators which should be < 3 (Becker et al., 2014). The reflective measurement model evaluation is performed by indicator reliability, internal consistency reliability, and convergent validity. Indicator reliability is assessed via Outer Loadings, which explain the variance of each indicator relative to the latent variable (Criteria: High reliability: > 0.7; Acceptable reliability: > 0.5) (Hair et al., 2021). Internal consistency Reliability is evaluated by using Composite Reliability (rho_A). This value sits between Cronbach's Alpha and Composite Reliability (rho_C).

(Criterion: A value between 0.6 – 0.7 is considered acceptable for research purposes) (Hair et al., 2021). For convergent validity, it is assessed through Average Variance Extracted (AVE), which determines if indicators consistently measure the same latent variable (Criterion: AVE should be ≥ 0.5 for the latent variable to adequately explain the variance) (Hair et al., 2021).

Results

Analysis of 717 client engagements confirms high market concentration: Big 4 firms audited 675 clients, whereas non-Big 4 firms audited 42. The mean audit report lag was 54 days (Big 4: 53; non-Big 4: 55). Audit fees averaged 779.8 million THB for Big 4 firms, compared to 5.6 million THB for smaller firms, indicating a vast resource disparity. Significantly descriptive statistics of 20 samples demonstrate in Table 2

Table 2 Descriptive statistics analysis

	Fee	Tenure	Lag	Size	SEC Score
Min	2,110,000.00	2.5000	52.6667	0.0000	2.1000
Max	1,062,081,717.04	5.0000	59.0000	1.0000	4.0000
Mean	237,891,621.85	4.4237	54.6191	0.3000	3.3000
SD	377,391,314.94	0.6549	1.6526	0.4702	0.5482
Skewness	1.1758	-1.3397	0.9516	0.9453	-0.8687
Kurtosis	-0.3558	2.4205	0.9019	-1.2418	0.2600
N	20.0000	20.0000	20.0000	20.0000	20.0000

The analysis shows valid in both Reflective Model and Formative Model via the measurement model evaluation. For Reflective Model, Outer Loadings demonstrates high reliability for Size (0.927), Fee (0.923), and Lag (-0.765). The Average Variance Extracted (AVE) was 0.574, exceeding the 0.5 threshold and confirming strong convergent validity (see in Table 3) and, in addition, Composite Reliability (rho a) shows high reliability (0.761) (see in Table 4). The measurement of Formative Model shows that Variance Inflation Factor (VIF) of Audit Firm Size (Size) was removed due to a VIF > 3 (14.388) while Audit Fees (Fee) are retained as the primary indicator because they provide a continuous numerical variable that minimizes data-gathering bias compared to the binary nature of the firm size dummy. The valid VIF result is shown in Table 5.

Table 3 Outer Loadings

	Audit Quality	SEC Score
Average Lag	-0.765	
Average Tenure	-0.001	
Sum of Fee	0.923	
Size	0.927	
SEC Score		1.00

Table 4 Composite Reliability rho A

	Cronbach's Alpha	Composite Reliability (rho a)	Composite reliability (rho c)	Average Variance Extracted (AVE)
Audit Quality	-0.498	0.761	0.408	0.574

Table 5 Variance Inflation Factor (VIF) of Formative Model

	VIF
Average Lag	1.390
Average Tenure	1.067
Sum of Fee	1.457
SEC Score	1.000

For structural model evaluation, the R^2 values were 0.242 for the reflective model and 0.263–0.268 for the formative model which are > 0.1 so that the models can explain the latent variable (Audit Quality). While these values are categorized as low-to-moderate, they are considered acceptable in social science research involving latent behavioral constructs (Hair et al., 2011). The results of Reflective Model and Formative Model are shown in Figure 2. The path coefficients from Quality to SEC Score (0.492–0.513) confirm a significant positive relationship, supporting the hypothesis of the study.

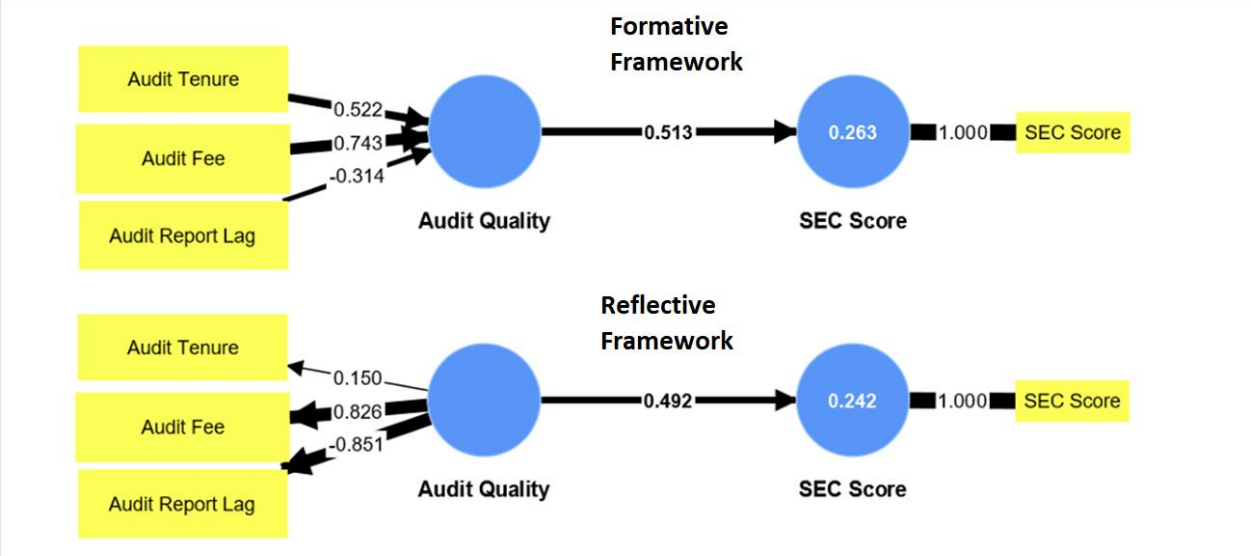

Figure 2 Results of Formative Model and Reflective Model of the study

The strong positive loading of audit fees (0.826 in reflective) suggests that in the Thai market, the pricing of audit services is a valid reflection of the resources and technical effort required to maintain professional standards. Large firm size also correlates strongly with quality, confirming that the resource-heavy environment of Big 4 firms facilitates better compliance with the SEC's six elements of quality control.

The negative correlation between audit report lag and quality (-0.851) highlights efficiency as a critical component of professional excellence. Following Rusmin & Evans (2017), this suggests that

firms with superior technological infrastructure and industry specialization can issue reports more quickly without compromising rigor, thereby earning higher SEC scores.

The non-significant relationship between audit tenure and SEC scores (path coefficient 0.15) suggests a "Tenure Paradox." In the Thai context, this is likely explained by the mandatory auditor rotation rules (the 7-year limit). These regulations structurally mitigate the familiarity threat, ensuring that the length of the relationship does not significantly erode the independence or quality of the audit in a manner that would impact regulatory scoring.

Conclusion

This research validates that SEC inspection scores are a meaningful, albeit moderate, indicator of audit quality in Thailand. Higher audit fees and shorter report lags emerge as the most robust signals of quality within the SEC's framework.

The primary limitation is the restricted sample size (10 firms) caused by the lack of transparency regarding inspection scores among SEC-approved firms. This prevents a full-market synthesis and suggests that current disclosure requirements may be insufficient for complete market oversight. This study has theoretical contribution by confirming the agency theory, signaling theory, and institutional theory. This study also provides some recommendations. First, the SEC should consider increasing the weight of industry-specific expertise and technical resource investment in its scoring system. Next, to improve market transparency, the SEC should mandate the disclosure of inspection scores for all 32 approved firms, enabling investors to make informed decisions. Finally, as firms transition to TSQM 1, they must prioritize a proactive quality management culture, moving beyond reactive compliance to ensure long-term regulatory alignment and audit excellence.

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