

# Performance of Regional Government-Linked Companies in Indonesia: The Influence of State Audit Board and Regulations

(*Prestasi Syarikat Milik Kerajaan Negeri di Indonesia: Pengaruh Lembaga Audit Negara dan Peraturan*)

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## ABSTRACT

*Regional Government-Linked Companies (RGLCs) in Indonesia have suffered from the unhealthy image and loss of respect from the public. The RGLCs are incapable of independently running the companies without financial support from the government. Accordingly, this research determines the effects of audits conducted by the State Audit Board of the Republic of Indonesia on the performance of RGLCs. This study also examines the influence of regulations on the RGLCs'. Agency theory and resource dependence theory provide the bases in developing the proposed hypotheses. The survey questionnaire was used to collect primary data. A total number of 57 out of 113 RGLCs (50.44%) made up the final sample. Each RGLC represented by six respondents, and the total final sample size was 342. The results provide new evidence that the financial audit does not affect the performance of RGLCs, while the Compliance audit indicates a positive effect on the performance of these RGLCs.*

*Keywords: Regional Government-Linked Companies, State Auditor, Agency Theory, Resources Dependence Theory*

## ABSTRAK

*Syarikat Milik Kerajaan Negeri (RGLCs) di Indonesia telah menderita akibat imej tidak sihat dan hilangnya hormat masyarakat. RGLCs tidak berupaya menjalankan syarikat secara bebas tanpa sokongan kewangan daripada kerajaan. Sehubungan dengan itu, kajian ini memeriksa kesan audit yang dikendalikan oleh Lembaga Audit Negara Republik Indonesia terhadap prestasi RGLCs. Kajian ini juga mengkaji pengaruh peraturan ke atas prestasi RGLC. Teori agensi dan teori kebergantungan sumber menyediakan asas dalam membangunkan hipotesis yang dicadangkan. Soal selidik tinjauan digunakan bagi tujuan mengumpul data primer. Sejumlah 57 daripada 113 RGLCs (50.44%) membentuk sampel akhir. Setiap RGLC diwakili enam responden dan jumlah sampel akhir adalah sebanyak 342. Hasil kajian memberi bukti baharu bahawa audit kewangan tidak memberi kesan ke atas prestasi RGLCs, manakala audit pematuhan menunjukkan kesan positif terhadap prestasi RGLCs.*

*Kata kunci: Syarikat milik kerajaan negeri; juruaudit negara; teori agensi; teori kebergantungan sumber*

## INTRODUCTION

Many studies have examined the performance of central government-owned companies or often referred to as Government-Linked Companies (GLCs) in various countries including Indonesia (e.g., Ang & Ding 2006; Appiah-Kubi 2001; Borisova et al. 2012; Feng, Sun & Tong 2004; Lau & Tong 2008; Mansor, Bahari & Justine 2008; Rodan 2004; Ting & Lean 2011; Wicaksono 2008; Wright & Nguyen 2000). Existing research on GLCs is not only addressing the performance problem alone but also on comparing between GLCs and non-GLCs (Abdul-Razak, Ahmad & Joher 2011; Hamid 2011; Ramirez & Tan 2004; Ting & Lean 2015).

Beside GLCs, Indonesia also has Regional Government-Linked Companies (RGLCs). The RGLCs represent government-owned companies which were established using capital from the local governments. The existence of RGLCs also attracts academics and researchers to research and understand more about their performance aspects. Among these studies include Agustin (2016) who compared the financial performance of RGLCs in the banking industry with commercial banks; Amdanata and Mansor (2018) who studied the influence of political relations on the performance of RGLCs; Bahri et al. (2015) who observed the performance of RGLCs in Aceh Province; Sari and Purwanegara (2016) whose study examined the influence of accounting information system on RGLCs in West Java Province; and Widjajanti (2012) who examined the RGLCs' performance.

In Indonesia, studies of RGLCs have not been as comprehensive as those related to the GLCs. Thus, various operational and management issues pertaining to RGLCs still remain unexplored and debatable. In particular, the issue of allowing state auditors to perform an audit of the RGLCs (Constitutional Court of the Republic of Indonesia 2013b, 2013a; Kurniawan 2013) needs further examination.

After succeeding through the economic crisis, regional autonomy, and reforms in various fields occurred in 1998; the Indonesian government began providing opportunities for local governments to explore the economic potential of each region, one of which was by establishing RGLCs. However, to date, the performance of these RGLCs has not been as aspired by the government, and many RGLCs continue to report losses and even suffer from bankruptcy (Rahardjo & Yasir 2019; Umay 2019; Widjajanti 2012).

Recent research evidence suggest that weak corporate governance is one of the factors contributing to the weak RGLCs' performance and their continuous financial losses (e.g., Amdanata & Mansor 2016; Darsa & Arifin 2015; Holida & Suryadi 2012). However, these studies have not yet described the actual conditions or causes of the losses. Insufficient data of the RGLCs could have been the fundamental block for the lack of research. Amdanata and Mansor (2016) provide evidence of a lack of transparency among RGLCs in presenting their audited financial reports and annual reports. Also, the finding suggests that the regional government's supervision on the RGLCs was weak, causing the local governments to have insufficient data on the RGLCs, especially the financial data. This condition complicates the efforts to analyze the causes of RGLC losses.

The weakness of corporate governance in RGLCs (Holida & Suryadi 2012) has become a concern for the central government because of the significant funds invested in all RGLCs in Indonesia. The total number of RGLCs throughout Indonesia, both at the provincial and district levels, totaled 426 companies and 102 of them (24%) are owned by the local governments (Ministry of Home Affairs of the Republic of Indonesia 2014). In its effort to strengthen the practice of corporate governance, the Indonesian government has appointed state auditors to audit the RGLCs. The same initiative has been exercised in several countries, including China (Tang, Chow & Lau 1999) and Vietnam (Nhi et al. 2013).

The intended effect of this effort is still too early to be determined. However, based on the Republic of Indonesia's Board of Auditors' Brief Report for 2017 concerning RGLC, state auditors were able to detect potential state losses of USD101.5 million due to the weak performance of RGLC (State Audit Board of the Republic of Indonesia 2017).

The primary purpose of the present study is to determine the effect of state auditors' audits on the performance of RGLCs in Indonesia. The lack of research and literature in RGLCs provides the motivation for this study, guided by research related to external auditors and company performance. Specifically, in this case, both the central government and local governments have their interests in safeguarding their respective investments. For this purpose, principals are allowed to use third parties to audit the RGLCs. The agency theory and Resources Dependence Theory (RDT) form the bases for hypotheses development. The agency theory explains the relationship between agents and principals. Meanwhile, the RDT predicts how RGLCs use state auditors to improve their performance.

## LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

### STATE AUDITORS

State Auditors (Schwartz 1999; Colquhoun 2013) or in some literature also termed as government auditors (Radcliffe 2008; Pearson 2014) or public sector auditors (Loke, Ismail & Fatima 2016) refer to the auditor in-charge of conducting financial audits of government agencies. The type of audit that is usually carried out by the state auditors is a public sector audit. According to Bastian (2001), public sector audits are activities aimed at entities that provide services and supply of goods and services whose financing comes from tax revenues and other state revenues.

According to Lee et al. (2016), state auditors have the authority to oversee the implementation of government budgets and evaluate the use of legal administrative resources to ensure that government funding is used wisely, economically, and effectively. In practice, in addition to examining existing financial records, government audit authorities must also maximize the use of resources by ensuring that administrative units, departments, and parts of the executive branch achieve the desired goals economically and efficiently.

Cosserat (2004) defines state auditors as the audit executors from one of the government departments and responsible for the implementation and results of the audit. They are the National Audit Office chaired by the Financial Supervisor and Auditor Chair. The Financial Supervisor and the Auditor Chair are appointed directly by Parliament and report to the Parliamentary Public Accounts Committee. The Public Accounts Committee has the authority to order the Financial Supervisors and General Auditors to conduct special audits and investigations on the departments within the government. In the audit of government departments, most auditors are the staff of the National Audit Office. However, external experts outside of the government, including from public accounting firms, may be called upon to conduct special investigations (Bradbury 2017; Chong et al. 2009; Cosserat 2004).

Almost every country has its definition of the state auditors since the auditors' work is governed by the state. According to the Indonesian government, state auditors are positions that have the scope, duties, responsibilities, and authority to carry out internal supervision in government agencies, institutions and/or other parties in which there are state's interests in accordance with the legislation, which is occupied by employees Civil State with

rights and obligations that are given in full by the authorized official (Ministry of Administrative and Bureaucratic Reform of the Republic of Indonesia 2008).

As for the United States government, state auditors are executive officers of the states who serve as auditors and comptrollers for state funds (the U.S. Government Accountability Office 2019). The office of state auditors is often a constitutional office. In Malaysia, the Chairperson of the State Audit is a public service associate and, except for other than provided in the Alliance Institution and under Act 62 of Malaysia, laws concerning community service and its members should be used by the Head of State Audit (Laws of Malaysia 2006). Based on the definitions of state auditors from these various countries, the conclusion is that the state auditor is a public servant and assigned to oversee and control the country's financial resources used by state agencies.

Although in some sense the state auditors are those auditors whose task is to audit public institutions that use state money, but in its development, along with changes in the public sector (Hood 1995; Lapsley 2008) state auditors are also subject to changes (Pearson 2014) and adjustments in performing their duties as auditors. These changes can be caused by amendments to regulations (Colquhoun 2013) issued by the state, or it could also be due to changes caused by the will to increase efficiency and improve audit performance (Santosa, Maarif, & Andati 2016; Skaerbaek 2009).

The changes experienced by state auditors in Indonesia include additional jobs for the state auditors to audit GLCs and RGLCs. Since RGLCs are state-owned companies, state auditors should not be involved in the audits of RGLC in order to ensure auditors' independence (Tang et al. 1999). However, the law of Indonesia has legalized this situation because it considers the RGLCs to be answerable to the government because of their sources of funds are from the government's budget.

#### STATE AUDITORS AND RGLCS

In this study, the main focus is on the effect of State Auditors on the RGLCs' performance. Several studies have examined the relationship between state auditors and state-owned companies. For example, Nhi et al. (2013) studied the relationship between state auditors and GLCs in Vietnam. They concluded that the GLCs had received capital from the state, and the state auditors had the responsibility to obtain the evidence that the state money was properly used by the GLCs.

Tang et al. (1999) also studied the relationship between state auditors and GLCs before China implemented its economic reforms. However, they did not examine the effect of state auditors on the performance of GLCs but instead criticized that state auditors should not audit GLCs which should be audited by independent auditors.

Nhi et al. (2013) revealed that they had difficulty finding literature on studies which examined the relationship between state auditors and the performance of GLCs since not many countries had such an arrangement. The lack of such literature led the present study to utilize audit reports by state auditors on RGLCs.

Since 2008, the Republic of Indonesia's Supreme Audit Agency has published a summary report on their audit results, including audit on the RGLCs (State Audit Board of the Republic of Indonesia 2017). Legally, State auditors are authoritatively permitted by the state to audit RGLCs, the reason being that the primary funding source for the RGLCs is the state's money. According to the agency theory, it is natural that the government demands to know the outcome of their investment, whether consistent with the plan or otherwise.

According to Zimmerman (1977), the application of agency theory can also be extended to public organizations. Lane states that modern democracies are based on a series of principal-agent relations (Lane 2000), who also explained the economic concept of public sector organizations using agency theory. Regional government and the management of RGLCs form the relationship between principles and agents, and the principal shall employ outsiders from the agent and principal, i.e., the external auditors or in this case, are the state auditors.

According to the RDT perspective, the role of external auditors is essential in companies' success. External auditor may influence the quality of financial reports. Cohen, Krishnamoorthy, and Wright (2004) created a corporate governance mosaic to illustrate that essential role of external auditors in ensuring information availability. Furthermore, external auditors are one of the factors that contribute to improvement in companies' performance (Beasley et al. 2009; Cohen, Krishnamoorthy, & Wright 2008).

State Audit Board in Indonesia performs three types of audits, i.e., financial audits, performance audits, and audits with specific objectives. In this study, the type of audit examined was the financial audit. Dwiputrianti (2011) states that financial audits can be further divided into financial audits and compliance audits. Based on Dwiputrianti (2011), this study also extends the financial audits into financial audits and compliance audits.

Dwiputrianti (2011) states that there are three relationships between financial audits conducted by state auditors on public sector institutions. Firstly, financial audits related to assessment and verification of whether financial transactions, evidence, records, and reports of auditees have been presented with adequate transparency by standards audit. Secondly, financial audits (also called regulatory/compliance audits or process audits) verify financial processes to ensure that financial transactions comply with laws and regulations, including audit standards. Thirdly, financial audits present the auditor's opinion to the public about the transparency and

accountability of the public sector in managing state finances; and prevent or reduce corruption, fraud, and various other state funds.

Hamid (2009) examined auditor relations as a form of corporate governance towards GLCs' performance in Malaysia. He studied GLCs for the financial year 2001 to 2003, and documented mixed results, showing a significant relationship between auditors and the GLCs' performance only in the year 2003. Based on the explanation above, the following research hypothesis is proposed:

H<sub>1</sub> Financial audits conducted by the state auditors have a positive effect on the performance of the RGLCs.

Dwiputrianti (2011) states that the financial audits conducted by state auditors on RGLCs also included compliance audits. This audit has many aspects of measurement, including the measurement of those of the State Audit Report towards the RGLCs (State Audit Board of the Republic of Indonesia 2014). In the report, companies are encouraged to comply with Indonesia's GCG guidelines. Based on this explanation, the following research hypothesis is proposed:

H<sub>2</sub> Compliance audits conducted by the state auditors have a positive effect on the performance of the RGLCs.

#### GOVERNMENT RULES

Julien and Rieger (2003), in their article, list laws and rules as one of the seven components of corporate governance to assist companies in understanding their rights and responsibilities of shareholders, the board of commissioners, directors, and employees of the company. Companies can achieve their objectives if there were rules that define the rights and responsibilities of all component in the companies. Borisova et al. (2012) report that regulations issued for GLCs by the government have a positive impact on corporate governance practices where companies have formal operational guidelines. In China, Yu (2013) found that regulations issued by the government, especially related to privatization have a positive effect on state companies and thus, increase corporate profits. Although regulation lead to reduced government ownership of companies, it proves that laws and regulations play essential roles in improving the performance of GLCs.

The importance of the existing laws and regulations is, of course, already understood by various parties, but the rules and regulations that support and regulate the activities of RGLCs are still very few. In some studies of RGLCs, the lack of laws and regulations for RGLCs has always been a significant factor affecting the RGLCs' performance (Widjajanti 2012). Due to the lack of laws and regulations governing RGLCs, commissioners and directors experience difficulties in making strategic decisions.

In Indonesia, Law No. 40 of the Year 2007 on Limited Liability Company has been used as a reference in running the company, but the Law No 40 is intended for all companies operating in Indonesia. Meanwhile, highly regulated companies such as banks, insurance, and investment firms have industry-specific laws and regulations. Even the GLCs have their laws and additional regulations, such as guidelines for determining the income of directors, use of capital, business development, and others. However, Law No. 40 is still considered lacking to manage RGLCs. At the very least, RGLCs should have similar rules and regulations as GLCs.

Auditors can influence or provide recommendations to regulators, primarily related to the results of audits performed (Hupkes 2006). Watts and Zimmerman (1983) concluded that auditors attempted to influence the standard-setting process in audits to benefit themselves and their clients' managers. External auditors are also expected to have a corporate governance role in the company (Ashbaugh & Warfield 2003; Fan & Wong 2005; Ojo 2013).

The absence of laws and regulations has contributed to local governments' difficulty in supervising RGLCs. Local governments as shareholders do not know precisely their rights and responsibilities, as shareholders. However, the results of the examination conducted by the state auditors, namely the audit reports, and submitted to the people's representative council, can be used as a reference and recommendations for the government to establish regulations relating to the RGLCs. Based on the explanation above, the following hypotheses are proposed:

H<sub>3</sub> Financial audits have a positive effect on government regulations.

H<sub>4</sub> Compliance audits have a positive effect on government regulations.

Business regulations are needed to guide companies, including GLCs and RGLCs to achieve their goals (Mohamad & Said 2011). It is reasonable if RGLCs can benefit from the higher allocation of resources from local or central government, and have timely access to related information about changes in government policy, compared to companies that are not connected to the bureaucracy (Su, Fung & Yau 2013). All of these advantages are primarily driven by government policies (Su et al. 2013). Government regulations enable companies with

favorable business classification or qualifications to enjoy competitive advantages and perform better (Chen et al. 2005). Based on this explanation, the following hypothesis is proposed:

H<sub>5</sub> Government regulations have a positive effect influence on the performance of RGLC's.

## METHODOLOGY

### DATA SOURCE

A total of 102 RGLCs formed the final sample in this study, covering the entire country of Indonesia. Data from the Ministry of Home Affairs of the Republic of Indonesia revealed that there are 426 RGLCs, both in the form of regional companies, and regional companies owned by the provincial government as well as by district/city governments. All of the RGLCs included in this study must fulfill the following requirements: (i) RGLCs owned by the provincial government; (ii) established before 2015, because most likely RGLCs that were established before 2015 have been audited by state auditors; and (iii) not in the form of banking institution, because RGLCs in the form of banks are subject to specific regulations and supervision such as those from the Central Bank and the Financial Services Authority. Based on these criteria, only 57 RGLCs complied with the criteria and, thus, made-up the final sample. A set of six questionnaires were sent to each of the RGLC.

Respondents chosen in this study were Directors, Internal Supervisory Unit, Audit Committee, Internal Auditor, Financial Manager, Accounting Manager, Finance Supervisor, Accounting Supervisor, Finance Staff, and Accounting Staff. The selection of respondents was based on their position because, in the audit proses of the audit, they would be consulted by state auditors pertaining to the information on the RGLCs' financial condition. Thus, they should be well-informed and have vast experience with state auditors. Their selection as the unit of analysis was based on their knowledge of auditing and familiarity with the RGLCs' finance and accounting. For the 57 RGLCs, the total questionnaires sent to the identified respondents were 342 sets. Data collection started from the beginning of May 2018 until the end of July 2018.

The survey questionnaires use the 7-point Likert scale. A total of 290 questionnaires (85%) were returned by the respondents. However, 81 of those questionnaires had to be removed from the final sample due to various reasons including incomplete responses and respondents had never been audited by the state auditor. The latter category of the respondents was not included in this study in order to remove potential response bias since they were considered to have a lack of experience in dealing with state auditors. Thus, only 209 of them were used in the final analyses using Partial Least Square (PLS) method.

### DEPENDENT VARIABLE

RGLCs' performance represents the dependent variable in this research. This study uses both financial and non-financial performance measures since RGLCs as government-owned companies are not only responsible for achieving financial targets but also need to satisfy the government's agenda in the up-grading of social well-being in the country (Feng et al. 2004; Harefa 2010; Ting & Lean 2015).

### INDEPENDENT VARIABLE

Financial audit and compliance audit of RGLCs form the independent variables in this study.

*Financial Audit* Based on the audit report issued by the state auditors, the financial audits conducted by the state auditors are based on the RGLCs' financial statements that have been audited by independent auditors. Only selected accounts were examined in this study, in particular, company income, operating costs and expenses, profit, remuneration, and company budget.

*Compliance Audit* In auditing the RGLCs, state auditors focus on compliance audits to ensure compliance with regulations in business. However, the scope of audits for this research was limited to adherence to compliance with the implementation of corporate governance guidelines set by the government. The corporate governance guidelines established by the Indonesian government are transparency, accountability, responsibility, independence, and fairness.

*Government Rules* In this study, government regulations represent the mediating variables. Both RGLCs and state auditors work according to the regulations that govern them. Therefore regulations have an essential role in guiding the performance of state auditors and RGLCs.

## RESULTS AND FINDINGS

### DATA ANALYSIS TECHNIQUE

In PLS, a two-stage analytical procedure was used to analyze the data in testing the proposed hypotheses (Anderson & Gerbing 1988; Hair et al. 2010). The first step focused on measuring the proposed model, analyzing its reliability and validity. After that, the second stage involved providing empirical evidence to support the theoretical and hypothetical models for structural model assessment. The hypotheses were tested using structural equation modeling with the partial least squares (PLS) technique (Chin 2003), which offers a flexible statistical approach using strict and robust procedures (Wold 1980).

### ANALYSIS OF THE MEASUREMENT MODEL

Most of the respondents worked on RGLCs in the Oil, Gas, and Coal sectors (42%). Based on the questionnaire, it is evident that the local government utilizes regional autonomy by establishing RGLCs that can explore natural resources available in each province. A total of 172 respondents (82.3%) worked on RGLCs, which had been operating for more than ten years. Respondents had a fair gender representation with 127 (61%) men and 82 (39%) women. Most of the respondents hold positions related to accounting and finance.

The main results of the measurement model are presented in the following sections. The Variance Inflation Factor (VIF) values of all models are less than 10, indicating multicollinearity was not an issue (Hair et al. 2014). As an essential prerequisite for achieving valid results, reliability, convergent validity, and discriminant validity from the measurement model were also assessed. The reliability and convergent validity of the scale are verified using the three criteria suggested by Fornell and Larcker (1981): First, the reliability of individual items from each standard factor loading must be significant and exceed 0.7; second, to build reliability, composite reliability (CR) and Cronbach alpha for each construct must exceed 0.7 (Hair et al. 2014); and third, for convergent validity, the Average Variance Extracted (AVE) for each construct must exceed the variance due to a measurement error for that construct (i.e., AVE must exceed 0.50).

In this case, all latent variable sizes are reflective. As can be seen in Table 1, loading factors for all items exceeded the recommended level of 0.7, and all weighting factors were statistically significant at  $p < 0.001$ . Cronbach alpha construct ranges from 0.864 to 0.954, and composite reliability ranges from 0.902 to 0.963, both of which exceeded the benchmark of 0.7, thus confirming the reliability of the dataset. Convergent validity can be assessed in the case that AVE is extracted from a latent variable. All latent variables have an AVE value above the praised value of 0.50, ranging from 0.649 to 0.814.

As shown in Table 1, the measurement models are valid regarding individual reliability, build reliability, and convergent validity.

TABLE 1. Results of the measurement model

Construct	Items	Factor Loading ( <sup>b</sup> ) (>0.7) <sup>a</sup>	Cronbach's Alfa (>0.7) <sup>a</sup>	CR (>0.7) <sup>a</sup>	AVE (>0.05) <sup>a</sup>
Financial Audit	SARF1	0.882 (26.963)	0.954	0.963	0.814
	SARF2	0.917 (38.430)			
	SARF3	0.928 (42.827)			
	SARF4	0.914 (44.588)			
	SARF5	0.889 (33.765)			
	SARF6	0.882 (32.060)			
Compliance Audit	SARC1	0.817 (21.548)	0.864	0.902	0.649
	SARC2	0.825 (25.796)			
	SARC3	0.848 (28.297)			
	SARC4	0.714 (14.476)			
	SARC5	0.818 (30.843)			
Government Rules	GR1	0.845 (28.362)	0.912	0.932	0.698
	GR2	0.811 (21.926)			
	GR3	0.845 (36.029)			
	GR4	0.903 (51.908)			
	GR5	0.877 (31.852)			
	GR6	0.720 (17.862)			
Firm Performance	FP1	0.838 (25.477)	0.949	0.958	0.767
	FP2	0.818 (18.066)			

FP3	0.897 (53.585)
FP4	0.910 (50.035)
FP5	0.897 (42.112)
FP6	0.918 (54.916)
FP7	0.847 (20.276)

<sup>a</sup> Indicates an acceptable level of reliability and validity.

<sup>b</sup> All t values are  $p < 0.001$ . CR = Composite reliability; AVE = Average variance extracted

Furthermore, the discriminant validity of the scale was assessed using the benchmark suggested by Fornell and Larcker (1981): that is, the square root AVE of the construct must be higher than the correlation divided between the construct and other constructs in the model. Table 2 lists the correlations between constructs, with the square root AVE on diagonal. All diagonal values exceed the correlation between each pair of constructs, indicating that the size has adequate discriminant validity. Evidence of nomological validity is manifested in the intercorrelation matrix because most of the correlations in the expected direction, and the many associations expected are statistically significant. Convergent validity and discriminant validity can also be examined by loading factors (Fornell & Larcker 1981). As shown in Table 3, all loading items in the related construct are significant, and the load on the corresponding construction is higher than that in cross-loading, which again confirms construct validity (Gefen & Straub 2005).

TABLE 2. Means, standard deviations, and correlations among study constructs

Construct	Mean	S.D.	AVE	1	2	3	4
1. Financial Audit	5.54	1.09	0.814	0.902			
2. Compliance Audit	5.85	0.70	0.649	0.515**	0.806		
3. Government Rules	5.68	0.91	0.698	0.489**	0.691**	0.835	
4. Firm Performance	5.89	0.80	0.767	0.436**	0.670**	0.537**	0.876

Bold values: the square root of the average variance extracted (AVE) for each construct.  
 S.D.= standard deviation

TABLE 3. Item loading and cross-loading

Construct	Item	Finance Audit	Compliance Audit	Government Rules	Firm Performance
Financial Audit	SARF1	0.882	0.401	0.474	0.326
	SARF2	0.917	0.451	0.437	0.314
	SARF3	0.928	0.441	0.460	0.378
	SARF4	0.914	0.522	0.496	0.432
	SARF5	0.889	0.459	0.420	0.402
	SARF6	0.882	0.465	0.492	0.424
Compliance Audit	SARC1	0.344	0.817	0.620	0.624
	SARC2	0.294	0.825	0.508	0.570
	SARC3	0.278	0.848	0.518	0.591
	SARC4	0.630	0.714	0.573	0.447
	SARC5	0.525	0.818	0.590	0.504
Government Rules	GR1	0.410	0.711	0.845	0.549
	GR2	0.320	0.560	0.811	0.556
	GR3	0.273	0.560	0.845	0.552
	GR4	0.512	0.615	0.903	0.586
	GR5	0.440	0.598	0.877	0.556
	GR6	0.659	0.424	0.720	0.399
Firm Performance	FP1	0.390	0.665	0.599	0.838
	FP2	0.334	0.536	0.470	0.818
	FP3	0.366	0.589	0.599	0.897
	FP4	0.417	0.623	0.622	0.910
	FP5	0.383	0.589	0.577	0.897
	FP6	0.362	0.616	0.567	0.918
	FP7	0.336	0.554	0.472	0.847

Note: The sample size is 209.

ANALYSIS OF THE STRUCTURAL MODEL

Structural models and hypotheses were assessed primarily by: first, checking the measured variance ( $R^2$ ) by the antecedent construct. Cohen (1988) proposed 0.02, 0.13, and 0.26 as a small, medium, and large variances, respectively; second, the significance of path coefficients and the total effects obtained by using the bootstrap procedure and calculating t-values. Figure 1 shows a positive and significant effect of financial audits on government regulations (H3,  $\beta = 0.216$ , t-value = 5.486,  $p < 0.001$ ) and audits of compliance with government regulations (H4,  $\beta = 0.589$ , t-value = 12.396,  $p < 0.001$ ). Therefore, it can be emphasized that the audit conducted by the state auditors has a strong and significant effect on government regulations (H3 and H4).

Furthermore, we found a significant positive effect of compliance audits on the performance of the RGLCs (H2,  $\beta = 0.449$ , t-value = 6.082,  $p < 0.001$ ) and government regulations on the performance of the RGLCs (H5,  $\beta = 0.309$ , t-value = 4.017,  $p < 0.001$ ). Therefore, it can be confirmed that audit compliance by state auditors and government regulations, respectively, have positive effects on the performance of the RGLCs (H2 and H5). For H1, the performance of the RGLCs was found to be not significantly affected by the financial audit by the state auditor ( $\beta = 0.037$ , t-value = 0.769,  $p > 0.05$ ).

Government regulation provides a mediating effect between financial audits on company performance so that the indirect relationship between the two variables becomes significant. This finding is in line with the opinion of Hupkes (2006), which states that auditors can also influence or provide recommendations for regulators, primarily related to the results of audits conducted by auditors so that the company's performance to be better.

The results for testing the hypotheses are summarized in Table 4 and Figure 1. The model explains 52.3% of the variance in government regulations and 52% of the variance in RGLCs performance. The result for indirect effects are in Table 5.

TABLE 4. Result of hypothesis testing

H	Path	Path Coefficient	t-value	Result
H <sub>1</sub>	Financial Audit --> Firm Performance	0.037	0.769	Not Supported
H <sub>2</sub>	Compliance Audit --> Firm Performance	0.449***	6.082	Supported
H <sub>3</sub>	Financial Audit --> Government Rules	0.216***	5.486	Supported
H <sub>4</sub>	Compliance Audit --> Government Rules	0.589***	12.369	Supported
H <sub>5</sub>	Government Rules --> Firm Performance	0.309***	4.017	Supported

Notes: \* $p < 0.05$ ., \*\* $p < 0.01$ ., \*\*\* $p < 0.001$

TABLE 5. Specific Indirect Effects

Path	p-value	t-value	Result
Compliance Audit --> Government Rules --> Firm Performance	0.000	4.020	Significant
Financial Audit --> Government Rules --> Firm Performance	0.007	2.691	Significant

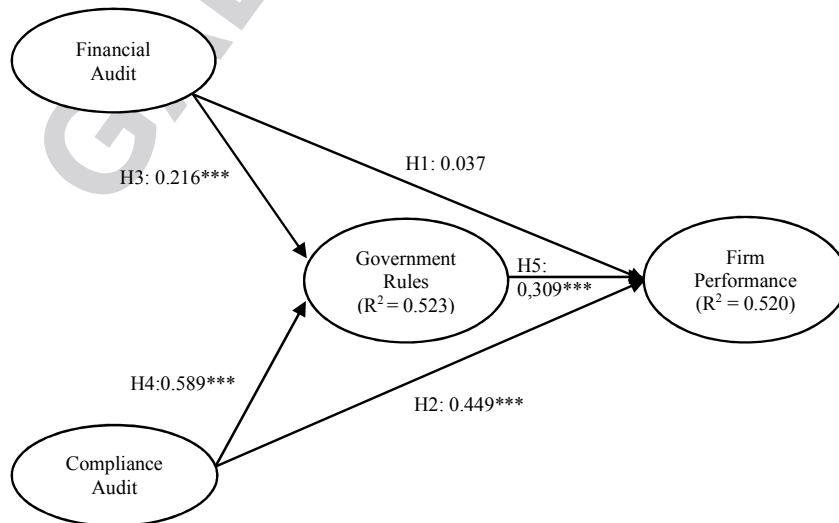


FIGURE 1. PLS results for the hypotheses test



## DISCUSSION & CONCLUSION

According to this study, the effects of state auditors and RGLCs' performance show mixed findings. Although in this study, the audits performed by the state auditors are financial audits and compliance audits, but in conducting the audits, both of the audits are carried out simultaneously. The results of the study provide new evidence that the financial audit does not affect the performance of RGLCs, while the compliance audit shows a positive effect on the performance of RGLCs. This study is consistent with Hamid (2009), who examined the effect of audits on the performance of GLCs in Malaysia for 2001, 2002, and 2003. The findings of the research were, however, mixed where no significant effect was detected in the years 2001 and 2002, but the audit in 2003 showed a positive effect on the GLCs' performance.

Government regulations also have a positive effect on the performance of the RGLCs. Empirically, financial audits do not affect the RGLCs' performance, but if the government translates the financial audit results in the form of regulations that will be obeyed by the RGLCs, financial audits could indirectly have a positive effect on the RGLCs.

This research is intended to enhance understanding of the relationship between a financial audit and compliance audit conducted by the state auditors, as well as regulations issued by the government for the benefits of the RGLCs. The study has several theoretical implications. First, the results indicate that the state audit has a positive effect on the performance of the RGLCs, and this is a new development in accounting theory. The relationship between state auditors is based on the agency theory discussing the relationship between principal and agent. The government has invested funds in the RGLCs, collected mostly from various taxes including from the citizens. Thus, the government has to use them responsibly. Therefore, as a principal, the government uses the available instruments at its disposal, namely the state auditors to oversee the use of these funds. Accordingly, the theoretical relationship between state auditors and RGLCs can be developed. The relationship between the state auditors and the company has provided a new research space for accounting and auditing, particularly in the public sector audits. The findings of this research can provide the first step for future research related to government auditors and government-owned companies such as GLCs and RGLCs. Also, this research can be developed further to examine the relationship between state auditors of social institutions that receive funding from the government.

Second, this study uses the Resource-Dependence Theory (RDT) and based on this theory, and it is predicted that RGLCs can use outside sources to improve their performance. Empirically, it can be proven that the audits conducted by the state auditors on the RGLCs have a positive effect on performance. Although direct financial audit does not suggest a significant effect, compliance audits empirically prove that state auditors have a positive effect on the performance. These results also show that the state auditors have the potential to influence the RGLCs' performance through regulatory intermediaries. With these regulations, RGLCs performance can be improved. Furthermore, RGLCs, as government-owned companies with capital sources channeled by state funds, should be governed with sufficient regulations to ensure sustainability.

## MANAGERIAL AND REGULATION IMPLICATIONS

Performance improvement for RGLCs is crucial in order for them to compete ethically with private companies. So far, RGLCs have always been regarded as companies that cannot be independent and always associated with financial losses. With the improvement in performance, professionalism will also increase (Caiden 1998).

RGLCs, as government-owned companies, must be able to take advantage of the superiority of the RGLCs compared to private companies. With the support of owners who are none other than the government, RGLCs have competitive advantages compared to private companies. By increasing performance, professionalism and supervision, continuous monitoring, and attention from the government, it can be used as a stepping stone for the RGLCs to be independent of the local government. In the future, RGLCs should no longer depend totally on the government for funding, but can be independent and compete with private companies (Ang & Ding 2006; Ramirez & Tan 2004).

This study also has implications for the relationship between local governments, RGLCs, and state audits. This implication is directed toward the need for improved regulations governing RGLCs. The results of this study provide the fact that all components of the government, local government, central government, state auditors, and RGLCs could optimize their performance if they could support each other. This relationship cannot be accomplished directly but through regulations issued by the central government and regional governments. In this case, the local government should also have a clear vision and mission of the RGLCs. With the existence of clear regulations from the government, RGLCs can focus on effectively running the business and achieve sustainability.

The regulations can also allow state auditors to carry out their duties clearly with regards to audits of the RGLCs since their work procedures will be governed by regulations issued by the government. Thus, synchronization between the government and RGLCs can be achieved and consistent with the initial purpose of establishing the RGLCs.

## LIMITATIONS AND SUGGESTIONS FOR FUTURE RESEARCH

The current research examines only selected variables in predicting the performance of RGLCs, particularly state auditors and government regulations. Other potential variables, including government intervention, political connections between directors and the government, and the government's vision of the RGLCs, may be included in future studies. Also, from the perspective of state auditors, it is interesting to examine their perceptions on the performance of RGLCs.

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