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State Audit and Governance of State-owned Enterprises: Mechanisms and Paths of Influence

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Abstract: Supervision of state-owned enterprises and state-owned capital operation is the statutory duty of state audit. This paper analyses the function and positioning of state audit in the governance of state-owned enterprises, researches the influence mechanism of state audit on the governance of state-owned enterprises, and discusses in depth the path of state audit influencing the governance of state-owned enterprises from the formation of effective power supervision and information transmission mechanism, respectively, with a view to providing theoretical and practical references for the high-quality development of state-owned enterprises.

Keywords: State audit; State-owned enterprises; Corporate governance

1. Introduction

The report from the Twentieth National Congress of the Communist Party of China (CPC) calls for "strengthening, improving, and expanding state-owned capital and enterprises to enhance their core competitiveness." Effectively optimizing the governance of state-owned enterprises requires stronger, better, and more effective constraints and incentives. Supervising the operations of state-owned enterprises and capital is a statutory duty of state audits. This paper begins by analyzing the function and role of state auditing, studying how it influences the governance of state-owned enterprises. The goal is to provide theoretical and practical insights to better fulfill the governance role of state audits and promote the high-quality development of state-owned enterprises.

2. Literature review

Current academic research on state auditing and the governance of state-owned enterprises (SOEs) is abundant. In terms of internal governance, state auditing can improve the control environment (Danting Cao et al., 2022) and reduce financial risk (Yingchen Chen and Shihqiao Zheng, 2022), as well as inhibit earnings management (Songsheng Chen et al., 2013). The announcement of audit results can increase media and public supervision and encourage management to invest in R&D, promoting long-term development (Hu Zhiying and Yu Li, 2019). Liu Liyun (2021) notes that SOEs keep debt levels reasonable to avoid audit authority attention and penalties, responding positively to recommendations by adjusting capital structures. In terms of performance, Li Jiangtao et al. (2015) argue that state auditing can improve firm performance by enhancing corruption governance efficiency. Cai Li and Marko Na Na (2014) found a lag period before state audits significantly impact total profits, as rectifications take time. Espejo et al. (2011) showed that higher government information disclosure reduces corruption and improves governance. Asiedu et al. (2017) found that higher-level audit offices significantly enhance SOE governance effectiveness.

In summary, current academic research on state auditing and the governance of state-owned enterprises mainly consists of empirical studies. This paper will adopt a normative perspective to systematically outline how state auditing influences SOE governance mechanisms and pathways, aiming to optimize its governance role.

3. Research on the Mechanism of State Audit Influencing the Governance of State-owned Enterprises

3.1 Revealing Functions

The revealing function of state auditing in the governance of state-owned enterprises (SOEs) involves collecting evidence through effective auditing procedures to identify and expose issues within these enterprises, prompting them to address system deficiencies and management loopholes. By publicly announcing audit results, state audit authorities disclose violations and operational problems, guiding SOEs to rectify these issues and mitigate negative impacts. This transparency enhances information for investors, shareholders, and management, potentially affecting share prices, investment relations, and market share. To stabilize their market value, investment relationships, and market share, audited SOEs will actively rectify the identified problems and convey positive information to the market and stakeholders.

3.2 Resistance function

The defensive function of state auditing in the governance of state-owned enterprises involves the auditing authorities' comprehensive analysis and proposal of rectification measures to promote system soundness, standardized management, and improved risk mechanisms. State audit authorities use their expertise to identify root causes and offer tailored suggestions, aiding SOEs in addressing issues and improving governance. Continuous monitoring of rectification ensures a positive response to audit findings. This ongoing supervision prompts timely problem resolution and strengthens the enterprise's focus on audit results, significantly improving SOE governance.

3.3 Preventive function

Leveraging their authority, independence, and professionalism, state audits effectively deter potential violations by both audited and unaudited state-owned enterprises (SOEs) and provide early warnings of hidden risks. For audited enterprises, increased accountability raises awareness of responsibility and crisis, prompting them to regulate their behavior, participate more in governance, and reduce opportunistic motives. For unaudited enterprises, national audits heighten risk perception and cost expectations, diminishing the incentive for opportunistic behavior. These enterprises also learn from audited ones, improving their systems, management, governance, and risk prevention capabilities, thus reducing the likelihood of similar issues. Through these measures, state audits enhance the governance and overall operational quality of SOEs.

4. Pathways for State audits to influence the governance of State-owned enterprises

4.1 Developing effective oversight of authority and strengthening internal governance

(1) State audits supervise and restrain the exercise of power within state-owned enterprises through compliance audits, economic responsibility audits, and performance audits. These audits verify adherence to laws and regulations, fulfillment of economic targets, and accuracy of financial reporting. When misuse of power or inadequate outcomes are identified, responsible individuals are held accountable. This institutional oversight effectively curbs executives' inclination to misuse authority for personal gain or neglect their responsibilities. Additionally, auditing procedures uncover and correct irregularities in decision-making, implementation, and internal management. By doing so, state audits ensure comprehensive and effective supervision of enterprise operations, promoting better governance.

(2) Enhancing the effectiveness of boards of directors and supervisory boards in state-owned enterprises is essential. The board of directors, representing shareholders, participates in strategic decision-making and supervises management. State audits prompt executives to address identified issues, perform their roles actively, ensure sound major decisions, and support the enterprise's strategy, preventing inaction or excessive risk aversion due to personal interests.

The supervisory board oversees the board and senior management, ensuring legal compliance and implementing risk, financial, and internal control supervision. State audits, with their authority and professionalism, thoroughly examine the corporate environment, uncovering issues in accounting, decision-making, management, and integrity. This provides vital information to the supervisory board, compensating for its limitations and enabling more effective governance, ensuring timely resolution of problems.

4.2 Formation of information transfer mechanisms and strengthening of external oversight

(1) Improving the quality of information disclosure by state-owned enterprises (SOEs) is crucial for informed decision-making by stakeholders. State audit institutions, with their authority, independence, and professionalism, can independently audit SOEs, gather ample evidence, identify issues in financial and non-financial disclosures, and provide targeted rectification recommendations. According to the Audit Law, these institutions can enforce administrative measures, impose penalties, and make referrals. The problems identified and suggestions made by the audit draw the attention of enterprises, prompting timely rectifications and curbing opportunistic behaviors in information disclosure. By addressing these disclosure issues effectively, state audit authorities can improve the quality of information disclosure, ensuring it accurately reflects the enterprise's situation. This reduces investment risk due to information asymmetry and enhances the effectiveness of shareholder supervision over management and executive investment behavior.

(2) Enhancing shareholder participation in decision-making in state-owned enterprises is essential. The agency problem can harm shareholders' rights, but active involvement in decision-making can protect them. Information asymmetry and participation costs often disadvantage non-controlling shareholders. However, as the capital market matures, these shareholders are more aware of their rights. Audit results improve corporate transparency, attracting attention to issues affecting reputation and performance. Shareholder meetings are crucial for decision-making, and online voting platforms reduce costs for non-controlling shareholders. State-audited enterprises see higher participation in these meetings, with shareholders focusing on problem rectification and long-term interests, preventing unfavorable decisions, and ensuring management prioritizes the enterprise's long-term goals.

(3) Enhancing the effectiveness of public supervision is crucial. The release of national audit result bulletins provides the public with im-

portant information on state-owned enterprises. By monitoring and following up on problem rectifications, the public plays a role in supervision, prompting timely solutions. Additionally, the public can offer new information and clues to auditing authorities, enriching audit sources and improving social supervision. This cooperation mechanism promotes transparency and accountability, enhances public understanding of SOE operations, and fosters a sense of participation. It ultimately helps improve corporate governance and drives SOEs towards high-quality development.

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