Basic Structure of Government Auditing by a Supreme Audit Institution

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1. Introduction

In recent years in Japan, there has been an increasing demand for the external auditing of government departments and agencies, as a result of criticism from citizens on issues concerning public accountability, including the misuse of public funds, evaluation of the effectiveness and outcomes of government programs, information disclosure based on the “right-to-know,” and requests for disclosure of government financial data through balance sheets. To meet these challenges, it is necessary to establish our public accounting and auditing systems. In particular, as the final step to ensure public accountability, a system for government auditing by a supreme audit institution (hereinafter called “government auditing”) must be built as a part of public audits. Public audit carried out in the U.S. and the U.K. incorporates government auditing and functions as external auditing systems. Regarding the aim of auditing in the two countries, public audits are carried out as comprehensive audits that include financial auditing and performance auditing or value-for-money (VFM) auditing. This paper examines the structure of government auditing, in particular performance auditing, incorporating an evaluation of the administration itself (government programs). Performance auditing has been increasingly requested in recent years. Also in the paper, in order to develop a theory of external auditing, I would like to present the tasks to be performed and the direction to be taken in Japan, regarding criteria for the country to establish a government auditing system, referring to the systems implemented in the U.S., the U.K., and in other countries.

2. Paradigm Shifts in Government Auditing

(1) Aim of government auditing

In considering the structure of government auditing, the first focus should be on the necessity and aims of government auditing. Accordingly, it is necessary to clearly distinguish the differences between government auditing and other related concepts, such as private auditing, public auditing, and the auditing of profit-oriented organizations. Government auditing is also sometimes referred to as public auditing. The U.K. Exchequer and Audit Departments Act of 1866 and the U.S. Budget and Accounting Act of 1921, both of which adopt the concept of public auditing, deem the aim of public auditing to be the discharge of public accountability. Examinations

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should be made on the differences between public accountability and accountability associated with the auditing of profit-oriented organizations (audits of corporate financial statements). The idea of “public” accountability can be classified into the following patterns, according to its point of focus: 1) that highlighting the public sector; 2) that highlighting public authority and power, and national and local governments themselves; 3) that highlighting the function of governmental services; 4) that highlighting the expenditure of the public sector; 5) that highlighting the interest in, concern for, and degree of trust in public organizations; and 6) that highlighting the management of public funds and resources.

What is focused on in terms of public accountability will influence public accounting and auditing, namely the structure of government auditing.

Government auditing is carried out to ensure accountability. The scope of auditing national and local governments is expanding due to the quantitative expansion in their sizes, as well as to qualitative changes oriented towards the evaluation of government programs. Accordingly, the scope of accountability is also expanding to include not only financial accountability but also management accountability and program accountability in order to ensure comprehensive public accountability. The shift from accountability to public accountability specifically means that in the history of public auditing, the emphasis has shifted from public responsibility for the use of public money, to which traditional accountability generally refers, towards performance auditing, including the auditing of effectiveness, which is the focus of today’s public accountability. It can be said that this clearly shows the first paradigm shift in the basic structure of government auditing. In effect, the focus of government auditing has changed from financial auditing to performance auditing in response to the demands for performance-related information from the users of government auditing information (mainly taxpayers and citizens) and to the resulting necessity of performance evaluation. This change has led to an expansion in the scope of auditing. Thus, regarding the aim of audits, government auditing has some audit areas that are completely different from those concerning the auditing of corporate accounts. In government auditing, the scope of financial auditing includes audit areas other than the audit of accounts, and performance auditing includes the evaluation of economy, efficiency, and effectiveness. In the U.S., performance auditing is conducted on the “three Es” as a comprehensive audit, while in the U.K. and Canada, performance auditing is conducted as a VFM audit. In the three countries, performance audit criteria are set for government auditing, including VFM auditing criteria, and the tasks and responsibilities of auditors engaged in performance auditing of the government are clearly defined. The performance audit criteria are used for auditing the economy, efficiency, and effectiveness of government programs, and the definitions of these “three Es” are considered to be similar in all these countries. Economy audits and efficiency audits are conducted for evaluating productivity and are collectively termed “efficiency auditing” in its broader sense. Inputs to and outputs from governmental activities are used as evaluation measures for carrying out this audit. Effectiveness auditing is also referred to as program auditing. Its evaluation measures are the outcomes and the social influence of government programs. At present, many countries, in particular the U.S. and the U.K., are aggressively developing technologies and procedures for auditing the effectiveness of programs, and are strongly promoting research and development on indicators or measures that will constitute measurement criteria, based on cost-benefit analysis and distinctions between “outputs” and “outcomes.” For the evaluation of performance, cost-based budgeting is required as a premise and accrual basis accounting needs to be introduced into public accounting.

What is the background to the shift in focus regarding economy, efficiency and effectiveness, which are the objectives of performance auditing? It should be noted that this process of change represents an important paradigm shift in the objectives of government auditing. Economy and efficiency, by their nature, have been the clear objectives of government auditing from the very beginning. For the shift of focus from regularity to economy and to efficiency, although there have been some common processes observed in different countries, the specific steps taken by various countries differed depending upon the degree of importance they attributed to economy and

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efficiency. For effectiveness auditing, as the financial scale of the government expanded, the progress towards the
tainment of program goals and program outcomes began to be included in the criteria to evaluate the propriety
of control over government programs. Thus there was the second paradigm shift in the objectives of government
auditing, which now incorporates an evaluation of progress towards the attainment of program goals and an
evaluation of program values.

In the U.S., importance is attributed to performance auditing within government auditing. Specifically, the
agencies of state and local governments are required to prepare Service Efforts and Accomplishments (SEA)
reports and agencies of the federal government need to prepare annual performance reports pursuant to the
Government Performance Results Act (GPRA) of 1993.4) In the U.K., performance auditing is carried out as VFM
auditing, for which performance indicators have been developed. It is now seriously questioned whether
performance auditing carried out by government auditing institutions should incorporate auditing to check the
propriety, merits and demerits, and misadministration of government programs. Regarding this, program
evaluation can justifiably be incorporated in the broader category of performance auditing.

It is more rational to think that the role of performance auditing is not to criticize the government but to
monitor and instruct the government based on the evaluation of its programs. In government performance
auditing, the subjects to be audited are mutually related in multiple layers and it is difficult to fix the level of
assurance based on evaluation criteria. Some basic conditions are therefore required in order for government
auditing to be carried out appropriately. Specifically, at the government agencies to be audited, evaluation criteria,
especially performance indicators, should urgently be established in reference to the instruction standards clarified
by the auditing institutions and to the outstanding shift in focus of such instructions. It is, however, impractical for
external auditors to directly audit the performance of the entire administration (their programs) and therefore the
third paradigm shift is required, that is, from direct auditing to the auditing of statements and assertions made by
the audited agencies in their service efforts and accomplishment reports. That is why government agencies are
now required to create such reports. Through the creation of such reports, the feasibility of effectiveness auditing
will dramatically increase.

(2) Structures of government auditing

Government auditing is carried out to assess the performance of public accountability by government entities:
the administration will be able to complete the process of providing public services to citizens through government
auditing. Government auditing was initially conducted as compliance audits, which means accurate account auditing
or financial auditing. Subsequently, government organizations were required to provide effective public services by
efficient management in the performance of their trusteeship obligations, which in turn necessitated performance
auditing. According to R. M. Malan, the scope of auditing thus naturally and reasonably expanded.5) Historically, the
U.S. General Accounting Office (GAO) stated in its comprehensive auditing manual published in 1976 that the
scope of government auditing should be expanded to encompass all the important service areas in which a
government agency is engaged. Accordingly, the subjects of auditing were no longer limited to accounts, books,
records, and documents and were classified into the following three categories:6) 1) financial activities and legal
compliance; 2) service efficiency and economy; 3) program results. Item 1) refers to account auditing and
compliance auditing, which are at present collectively termed as “regularity auditing.” As the financial scale of the
government and the size of its programs expanded, there was an increasing demand for auditing the economy and
efficiency of government programs. Accordingly, the scope of audits to assess the performance of public
accountability was expanded and performance auditing began to be carried out to evaluate items 2) and 3) above.
In practical auditing, however, it is observed that the audits of items 2) and 3) often overlap and both audits may

4) GASB, Concepts Statement No. 2 of the Governmental Accounting Standards Board: on Concepts related to Service Efforts and Accomplishments
Reporting, April 1994
incorporate effectiveness evaluation. Presently, the audits of items 2) and 3) are collectively termed as "performance auditing," and the economy, efficiency, and program audits are called “auditing on the three E’s,” "comprehensive auditing" or “value for money (VFM) auditing.” In the U.S., it is said that the first major program evaluation was carried out earlier, in 1967, and that the program evaluations made by the GAO developed into program result audits in the 1970s. Thus in the period called GAO’s second reform period, its audit functions were expanded. Also, in the U.K., a similar process was followed: the duties and responsibilities of public sector auditors were expanded from the certification of accounts to auditing to detect illegality or abuse and to examine VFM.

Regarding the question of whether performance auditing should incorporate compliance auditing or not, the administrative activities and spending of government organizations are conducted in compliance with budgetary laws and regulations, and programs are implemented according to relevant laws and regulations. In performance auditing, it is therefore necessary to audit compliance with the applicable laws and regulations. This shows a difference between government auditing and the auditing of non-government non-profit organizations. It is believed that government organizations need to comply with laws and regulations more strictly than non-government bodies, which affects the financial and performance auditing of government organizations. In the performance auditing of non-government non-profit organizations, beneficiaries of their services may expect economy and efficiency in the use of resources through the management of these organizations, but there would be a lesser need from these beneficiaries for the evaluation of effectiveness. As a feature of performance auditing, the Auditing Standards of the International Organization of Supreme Audit Institutions (INTOSAI) point out that “performance audits should

<table>
<thead>
<tr>
<th>Pattern of government auditing</th>
<th>Auditing standards and measures</th>
<th>Development</th>
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</thead>
<tbody>
<tr>
<td>Financial auditing</td>
<td>Legality or compliance auditing in the broad sense</td>
<td>Legality auditing in the narrow sense</td>
</tr>
<tr>
<td></td>
<td>Regularity and compliance auditing</td>
<td>Verification of the appropriateness and propriety of programs and of the budgetary objectives, procedures, and contract terms</td>
</tr>
<tr>
<td>Accuracy or account auditing</td>
<td>Auditing of financial statements</td>
<td>Verification of the appropriateness of financial statements and accuracy of account settlement</td>
</tr>
<tr>
<td>Performance auditing</td>
<td>Auditing of financial issues</td>
<td>Verification of the accuracy and propriety of financial issues</td>
</tr>
</tbody>
</table>

Figure 1. Structure of government auditing

<table>
<thead>
<tr>
<th>Type of measure</th>
<th>Major measure</th>
<th>Feature of measure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inputs</td>
<td>Cost, work amount, service needs and amount, program inputs</td>
<td>Relevance, 2.Effectiveness, 3.Responsiveness, 4.Economy (controllability), 5.Comparability, 6.Clearness (understandability)</td>
</tr>
<tr>
<td>Activities</td>
<td>Service efforts, activity process, resource utilization process</td>
<td>Stage 5</td>
</tr>
<tr>
<td>Outputs</td>
<td>Deliverables, service amount, amount of service of a certain quality, output process</td>
<td>Stage 6</td>
</tr>
<tr>
<td>Efficiency</td>
<td>Program efficiency, policy efficiency</td>
<td>Stage 7</td>
</tr>
</tbody>
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7) ibid., p. 177.
8) GAO, Governmental Auditing Standards, Exposure Draft, July 1993, pp. 2-4.
For government agencies, the indication of budgetary figures and actual results in balance sheets constitutes one way of performance evaluation. In response to an increasing necessity for performance measurement, the U.S. Governmental Accounting Standards Board (GASB) requested federal government agencies to make program result reports based on the Government Performance Result Act (GPRA) of 1993, and the state and local government agencies to create service efforts and accomplishments reports for performance evaluation. For efficiency and effectiveness auditing, the following three items are seen as essential: 1) information about the efforts, costs, and performance regarding services to be provided by the government to citizens; 2) information about the evaluation of the “three E’s”; 3) reporting about the efficient and effective use of subsidiaries. The expansion of the scope of auditing to assess the performance of public accountability requires the expansion of the objectives of government auditing.

### Figure 2. Auditing patterns by supreme audit institutions

<table>
<thead>
<tr>
<th>Auditing type</th>
<th>Auditing report type</th>
</tr>
</thead>
<tbody>
<tr>
<td>Priori auditing</td>
<td>Posteriori auditing</td>
</tr>
<tr>
<td></td>
<td>Financial auditing report</td>
</tr>
<tr>
<td>Judicial</td>
<td>Financial</td>
</tr>
<tr>
<td>Austria</td>
<td>★</td>
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<tr>
<td>Belgium</td>
<td>★</td>
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<tr>
<td>Denmark</td>
<td>★</td>
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<tr>
<td>Finland</td>
<td>★</td>
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<tr>
<td>France</td>
<td>★</td>
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<tr>
<td>Germany</td>
<td>★</td>
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<tr>
<td>Greece</td>
<td>★</td>
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<tr>
<td>Ireland</td>
<td>★</td>
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<td>Italy</td>
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<td>Luxembourg</td>
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<td>Holland</td>
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<td>Portugal</td>
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<tr>
<td>Spain</td>
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<tr>
<td>Sweden</td>
<td>★</td>
</tr>
<tr>
<td>U.K.</td>
<td>★</td>
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</tbody>
</table>

Note: The star (★) mark implies “applicable.”

3. Structure of Performance (Administrative Evaluation) Auditing

(1) Necessity and scope of performance auditing

It is necessary to identify the features peculiar to government organizations in order to find out the reasons why government performance auditing should be carried out in the widest possible scope and in the most sophisticated manner. The following points, which show the characteristics of the administration, imply the scope of performance reports that government organizations should prepare for performance auditing:

1) Government organizations have financial resource inflows other than revenues and it is necessary to establish the standards for reporting these non-revenue inflows.
2) Government organizations need to evaluate the final outcomes of their programs in a wider scope.
3) Holders of public bonds issued by government organizations might suffer loss from such public bonds, which

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11) INTOSAI, Auditing Standards, June 1992
would exert a significant financial influence both on the holders and the issuing government organizations. Both parties therefore require supplemental information in relation to public bonds.

4) Government organizations have administrative responsibilities to citizens, which require the organizations to fulfill larger public accountability duties than non-government organizations.\(^{14}\)

Accordingly, for information to be obtained from government organizations, citizens are interested in the efficiency and effectiveness of administrative services. In response, government organizations should be held accountable to all the citizens in their administrative areas, including the disclosure of performance (or outcomes)-related information.

There are various similarities and differences between government organizations and profit-oriented ones in terms of organizational structure, policies, and budgeting that are considered to affect the functions of government organizations, and the scope of government auditing is influenced by these similarities and differences.

It is of utmost importance in the discussion of the objectives of government auditing to think about the peculiarity of performance auditing as part of government auditing. According to the Financial Accounting Standards Board (FASB), those providing capital to non-profit organizations pay attention to the performance indicators and information regarding the trusteeship of the managers of the organizations. Non-profit organizations do not have a common performance indicator, while profit-oriented companies have a single common performance indicator: profitability. The American Institute of Certified Public Accountants (AICPA) makes it clear that government organizations and non-profit organizations should be held accountable for their performance and progress towards the achievement of pre-established objectives. Also, the Australian National Audit Office (ANAO), in their “three E’s” auditing, deems it necessary to evaluate the rationality of performance measurement standards as well as their relevance to pre-established goals. As mentioned earlier, there are some differences between non-profit organizations and profit-oriented organizations in terms of the need for performance information and the specific details of accountability (to be fulfilled through accounting and auditing).

The objective of government auditing is to assess the performance of public accountability, which means to assess the attainment of administrative objectives so that government agencies can complete the process of providing services to citizens. Government auditing was first started as compliance audits, which implies the auditing of the accuracy of accounting reports, namely, financial auditing. Then government organizations began to be required to provide high-quality services based on efficient and effective administrative management to perform their trusteeship obligations, which in turn required performance auditing to evaluate the outcomes of government programs. Various foreign reference materials show that such expansion of the scope of auditing was natural and logical.

(2) Characteristics of performance auditing

What are the requirements for performance auditing conducted as part of the auditing of national and local governments to be qualified as “audits”? Comparing the requirements with those for performance auditing of profit-oriented organizations in reference to the four factors described in the American Accounting Association’s (AAA’s) report entitled “A Statement of Basic Auditing Concepts” (ASOBAC), similar relations can be observed between public audits incorporating government auditing and the audits of profit-oriented organizations. The establishment of a public auditing system was necessitated for similar reasons as for the auditing of profit-oriented organizations. Specifically, government auditing is required out of social necessity. Basically, the government has public stewardship and trusteeship obligations\(^{15}\) and has to be accountable for these obligations at different levels in order to meet public expectations. Consequently, as the final step to fulfill its accountability obligations, the administration needs to report the audit results to the legislature.

Performance auditing conducted in government auditing is different from the auditing of financial statements carried out targeting profit-oriented organizations; however, it is believed that the requirements for valid auditing

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\(^{15}\) R. M. Malan, op.cit., p. 3.
are met. The CCAF in Canada lists the following as premises for the valid auditing of the administration: 1) management shall be responsible for performance reporting; 2) performance reports shall be created based on generally accepted standards; 3) information shall be credible and the reports shall be ensured to be appropriate. The CCAF admits that these requirements are met in the performance auditing of government agencies and approves it as comprehensive auditing.\(^{16}\)

For the relationship between performance auditing and assurance that is discussed as a function of contemporary auditing, the elements of assurance engagement are as follows: an accountant, a subject matter, a responsible party, the intended users, suitable criteria, procedures, and conclusion. The level of assurance to be provided is dependent upon the interrelationship of four variables: subject matter, criteria, procedures, and quantity and quality of evidence available.\(^{17}\) For assurance engagement to be provided in performance auditing, there should be independent auditors, performance result reporting on items as subject matters, and substantial performance measures. In Western countries such as the U.S. and the U.K., it is deemed that independence and discretion for audit reporting are ensured for accountants, and accordingly the requirements are considered to be met.

For the relationship between the evaluation of government programs (or of the administration) and performance auditing, it is considered that the main feature of program evaluation is that it incorporates the evaluation of process, leading to program outcomes. Program evaluation is therefore conducted according to social scientific evaluation and research procedures, which imply responsive, nonjudgmental, and cooperative arrangements.\(^{18}\) Regarding the relationship between program evaluation and performance auditing, the GAO shows its basic concept on performance reports and the audits of these reports based on the GPRA in 1998, deeming program evaluations as one type of study done by GAO under the broad category of performance audits. According to GAO, program evaluations are individual systematic studies conducted periodically or on an ad hoc basis to examine aspects of program operations or factors in the program environment. Additionally, program evaluations may systematically compare the effectiveness of alternative programs aimed at the same objective.\(^{19}\)

Performance auditing incorporates program audits, and accordingly, advance audits, foreseeable future audits, or on-going service and program audits are carried out as well, which would raise a question regarding the responsibility of auditors. It should be considered that the responsibility of an auditor will be limited depending upon the quantity and quality of performance measures and indicators available, namely audit evidence.

The following shows the concepts regarding the scope and features of performance auditing. They are grouped by development stage.\(^{20}\)

1) To be conducted independently by a third-party; to enhance credibility of information;
2) To check the degree of conformity; to provide critical conclusions;
3) To be based on generally accepted sound management principles; to measure management (as performance measurement);
4) To aim to improve economy and efficiency; to verify integrity;
5) To aim at minimizing risks and costs; to measure costs and outcomes (as performance measurement);
6) To measure progress towards goals (as performance measurement);
7) To measure the appropriateness and usefulness of managerial decision-making; to evaluate the usefulness of management; to verify program compliance;

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8) To evaluate the results and influence of programs;  
9) To verify the cost effectiveness of alternative approaches;  
10) To evaluate whether the performance results are incomplete or not;  
11) Monitoring by Parliament;  
12) Peer reviews.

The concepts described above lead to the scope of performance auditing as shown in Figure 1. Currently in most countries, performance auditing is conducted at Stages 5 to 8 shown in Figure 1. Only GAO in the U.S. conducts performance auditing at Stage 9 and partially at Stage 10 in federal government auditing.

### (3) Features and forms of performance measures

In performance auditing, performance reports (administrative outcomes) are audited. Seen as important information, performance measures are described and disclosed in performance reports. Performance auditing procedures are conducted on these performance measures and the appropriateness of these measures is the first audit subject in performance auditing. That is, performance auditing is first carried out regarding the quantity and quality of performance measures. For the effective implementation of performance auditing, the features, forms and patterns of performance measures suitable for performance reporting and auditing should be identified.

The following describes some of the typical features of performance measures required in the performance auditing of the U.S. federal, state and local governments and in the performance auditing recommended by the International City/County Management Association (ICMA).

1) Relevant: meaning to reflect the administrative management objectives properly and can be substituted by "results-oriented" or "objective-oriented";

2) Valid: meaning to match with the intended use of information and can be substituted by “useful,” meaning to be useful for the users of information in making decisions and in deciding corrective actions;

3) Responsive: meaning to respond sensitively to changes in performance level;

4) Economic: meaning economy in the cost for data collection and retaining and can be substituted by "controllability";

5) Comparable: meaning to be directly comparable with the performance of other agencies or with the performance during other periods;

6) Clearly: meaning that the meaning is clearly shown and can be substituted by “understandability”;

7) Compatible: meaning to be compatible with the data stored on current financial and functional systems;

8) Accessible: meaning the regular availability of information about the outcomes;

9) Comprehensive: meaning to cover all the important points;

10) Selective: meaning to be selected as one of the most important indicators;

11) Reliable: meaning to be reasonably accurate;

12) Uniqueness: meaning not to be covered by other performance measures;

13) Timeliness: meaning to be provided in time for decision-making;

14) Completeness: meaning the entire description of the administrative services and their objectives.

Performance measures having the features described above should be established and disclosed in budgetary documents or administrative plans.\(^{21}\)

Performance reports or administrative (program) evaluation reports compare the budgetary plans and actual results. Among the important audit subjects in performance auditing implemented in recent years, the evaluation of the following is especially important for performance auditing to be carried out in Japan: necessity, priority, conventionality, continuity, substitutability of programs, and what would have occurred in the nonexistence of the program. Further, the performance measures required for such auditing should be maintained.\(^{22}\)

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\(^{22}\) GAO, Government Auditing Standards, 1994 Revision.
4. Composition of Government Auditing Standards

Government auditing standards are composed of general standards, field standards, and reporting standards, as in the auditing of profit-oriented organizations. Government auditing incorporates financial auditing and performance auditing as its major objectives. In addition, as described above, compliance auditing may also be carried out prior to financial and performance auditing. Accordingly, there are five patterns concerning the composition of auditing standards adopted in countries. In Pattern 1, according to the major two audit objectives, government auditing standards are roughly divided into two, each of which incorporates compliance auditing standards. The government auditing standards of GAO fall under Pattern 1. In Pattern 2, compliance standards are established in parallel with financial auditing standards and performance auditing standards. The standards adopted by the Canadian Institute of Chartered Accountants (CICA) fall under Pattern 2. In Pattern 3, legal compliance is given first priority in the government auditing objectives. In Pattern 4, compliance auditing standards are given priority, noting that regularity auditing is incorporated in financial auditing. The INTOSAI's Auditing Standards 1992 are considered to fall under this pattern.23) In pattern 5, financial auditing standards, attestation engagement standards, and performance auditing standards are established in parallel. It falls under GAO 2003 revision. Depending upon which of these five patterns is selected, there will be differences in the objectives, scope and procedures and, importantly, the framework of government auditing.

In the following, the major government auditing standards that should be established will be described. These standards will also be compared with the Generally Accepted Auditing Standards (GAAS) applicable to profit-oriented organizations to show differences between government auditing standards and GAAS.

(1) Nature and composition of general standards

Although the general standards are similar between the GAAS for profit-oriented organizations and the standards for government auditing, the government auditing standards are wider in scope because government auditing is more comprehensive and differs in multiple aspects from the auditing of profit-oriented organizations.  
1) For standards related to qualification, the GAO standards clearly stipulate that the standards shall be applied to government auditors, private accounting offices engaged in government auditing, and also to consulting companies. 
2) The standards related to independence are the most important standards for government auditors. The following summarizes the main factors that would affect these standards, referring to the existing government auditing standards such as GAO’s Government Auditing Standards, the Code of the Audit Commission and the Standards of the NAO in the U.K., and the Standards of the CCAF in Canada.24)
   a. Whether the auditor belongs to the legislature or is under the monitoring of the legislature; 
   b. Whether the head of the auditing organization is unduly influenced by the administration; 
   c. Whether the auditing organization is working in cooperation with the legislature; 

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d. Whether the auditing organization is funded by the legislature;
e. Whether the employment of the staff of the auditing organization and their salaries are decided independently;
f. Whether the auditing organization can collect audit evidence and ask questions at its discretion;
g. Whether discretion is guaranteed for professional judgment by the auditing organization;
h. Whether the provision of services can be prohibited by the auditing organization for the agency being audited;
i. An approval is required from the regulator of the auditing organization regarding services that are related to an audited agency which does not affect the independency of the auditing organization;
j. Whether the legislature supervises or monitors the appointment and dismissal of the head of the auditing organization.

3) The standards for due professional care or professional judgement are established for similar purposes as in the auditing standards for profit-oriented organizations.

(2) Field standards for financial auditing are composed of the following standards:
1) Standards for compliance with GAAS for profit-oriented organizations: the standards specifically show which GAAS standards implemented in the country are applicable to the public sector or government agencies, while clarifying which standards are not applicable.
2) Standards for audit objectives: the standards set out that the aim of financial auditing is to grant the government a discharge of trusteeship obligations and to assure that the financial statements have been prepared in compliance with GAAP (Generally Accepted Accounting Principles) and other related laws and regulations and that these statements give a true and fair view or an appropriate representation of the state of affairs of the audited entity. The standards differ from GAAS in terms of focus on legal compliance.
3) Standards for compliance with the standards for public accounting: the standards are based on the GAAP and show stronger tendency for accrual basis accounting.
4) Standards for planning: the standards have similarities to GAAS.
5) Standards for fraud, illegal acts and noncompliance: the standards focus on legal compliance as stated above and in that point differ from GAAS.
6) Standards for internal control: these standards may be established as part of the compliance auditing standards as described below.
7) Standards for risk approach to be applied to national and local governments: these standards are similar to those applied in the auditing of profit-oriented organizations. The standards for materiality, however, are different from GAAS in that lower materiality levels may be set than in the audits of profit-oriented organizations.
8) Standards for audit records.
9) Standards for quality control: these standards set out the establishment of monitoring and inspection systems by supervising and regulating agencies as external quality control systems for government auditing and in that point differ from GAAS.
10) Standards for the auditing of financial issues: these standards set out the standards for attestation engagement and for agreed-upon procedures and in that point differ from the standards applied in the audits of profit-oriented organizations.

(3) The reporting standards for financial auditing are composed of the following:
1) Standards for communication: these standards aim to monitor the adherence to the principle of dual responsibilities to ensure that both the management of the audited entity and the auditor fulfill their responsibilities and differ from the GAAS in that there is a stronger demand for the notification of audit objectives, procedures, and results.
2) Standards for compliance with GAAS.

27) A.C., op. cit., p. 15.
3) Standards for internal controls and legal compliance.
4) Standards for auditors’ opinions: the standards set out that the auditor should express his/her opinion regarding the appropriateness or true and fair view of the financial statements according to professional auditing standards in every important aspect, and in that point differ from GAAS.
5) Standards for the expression of opinions in the audits of financial issues: the standards clearly set out that opinions shall be provided and reports shall be made based on different assurance levels, and in that point differ from GAAS.
6) Standards for privileged and confidential information: the standards differ from GAAS.
7) Standards for report issuance and distribution: the standards should be followed in government auditing, in which the senders and receivers of such reports are often specified.  

In the U.S., the GAO reported about the auditing of financial statements, expressing the following opinion regarding financial and compliance auditing:

<Example 1>

DISCLAIMER OF OPINION ON THE CONSOLIDATED FINANCIAL STATEMENTS

Because we were unable to determine the reliability of significant portions of the accompanying U.S. government’s consolidated financial statements for fiscal year 2000, we are unable to, and we do not, express an opinion on such consolidated financial statements. (Notes: It means disclaimer of opinion.)

As a result of material deficiencies in the government’s systems, record-keeping, documentation, and financial reporting, readers are cautioned that amounts reported in the consolidated financial statements and related notes may not be a reliable source of information. These material deficiencies also affect the reliability of certain information contained in the accompanying Management’s Discussion and Analysis and any other financial management information—including information used to manage the government day to day and budget information reported by agencies—which is taken from the same data sources as the consolidated financial statements.

While we have not audited and do not express an opinion on the Stewardship Information and Supplemental or Other Information included in the accompanying Fiscal year 2000 Financial Report of the United States Government, we noted certain material omissions related to the presentation of national defense assets and issues related to the reconciliation of operating results to budget results, which are discussed below.

Material Deficiencies

The following material deficiencies contributed to our disclaimer of opinion and also constitute material weaknesses in internal control. Appendix II highlights the primary effects of these material deficiencies on the accompanying consolidated financial statements and on the management of government operations. (Notes: According to the result of evaluation of internal control, it is disclaimer of opinion caused by fault of internal control.)

We performed our work in accordance with U.S. generally accepted government auditing standards.

APPENDIX

Primary Effects Caused by the Material Weaknesses and FFMIA Noncompliance Described in This Report (Notes: It shows a violation of accounting standards and compliance with laws and regulations.)

1) Property plant, equipment and inventories and related property
2) Loans receivable and loan guarantee liabilities
3) Liabilities

4) Cost of government operations
5) Disbursement activity
6) Preparation of consolidated financial statements
7) Improper payments
8) Computer security weaknesses
9) Tax collection activities
10) FFMIA (Federal Financial Management Improvement Act) requirements

Also, in Consolidated Resource Accounts 1999-2000 by the U.K. Department of Social Security, the following opinion <Example 2> is offered regarding the financial and compliance auditing:30)

<Example 2>

Basis of opinion
I conducted my audit in accordance with Auditing Standards issued by the Auditing Practices Board, except that the scope of my work was limited as explained below.

An audit includes examination, on a test basis, of evidence relevant to the amounts, disclosures and regularity of financial transactions included in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Department in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Department’s circumstances, consistently applied and adequately disclosed.

I planned and performed my audit so as to obtain all the information and explanations which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by error or by fraud or other irregularity and that, in all material respects, the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conformed to the authorities which govern them. (Notes: Considering with standards for materiality, it positively assures legal compliance.)

However, the evidence available to me was limited because:
· £855 million of the £1,801 million balance sheet debt relates to customer overpayments, benefit prepayments and other programme debtors, and
· £1,487 million of the £2,403 million balance sheet creditors relates to benefit accruals, the encashment control creditor and other programme creditors, over which there was no system of control on which I could rely for the purposes of my audit. There were no other satisfactory audit procedures I could adopt to confirm these balances were properly recorded.

In forming my opinion I have also evaluated the overall adequacy of the presentation of information in the financial statements. (Notes: It is an auditing opinion about the whole financial statements.)

Qualified opinion arising from limitations in audit scope and because of irregular expenditure arising from errors in benefit awards and from fraudulent benefit claims

As disclosed in Note xx of the Accounts, Schedule xx expenditure includes benefit payments calculated erroneously and benefit payments arising from fraudulent claims. Under Social Security legislation, the Department must calculate benefits due in accordance with the regulations, it has no authority to vary benefit awards. Fraudulent transactions cannot, by definition, be regular since they are without proper authority. Accordingly I have concluded that expenditure arising from erroneous benefit awards and fraudulent benefit claims has not been applied to the purposes intended by Parliament and is not in conformity with the authorities which govern it.

In my opinion:
except for any adjustments that might have been found to be necessary had I been able to obtain sufficient
evidence concerning:
completeness and the valuation of customer overpayment debt and other programme debtors and creditors; and
valuation of benefit accruals, benefit prepayments and the encashment control creditor,
the financial statements give a true and fair view of the state of affairs of the Department of Social Security at 31
March 2000 and of the net resource outturn, resources applied to objectives, recognised gains and losses and cash
flows for the year then ended, and have been properly prepared in accordance with the Exchequer and Audit
Departments Act 1921 and directions made thereunder by the Treasury. (Notes: It is the expression of audit
opinion of reasonable expression.); and
except for the expenditure relating to erroneous benefit awards and arising from fraudulent benefit claims
referred to above, in all material respects the expenditure and income have been applied to the purposes intended
by Parliament and the financial transactions conform to the authorities which govern them. (Note: It is a legal
compliant opinion in the broad sense.)
In respect alone of the limitations on my work relating to customer overpayment debt, benefit prepayments,
benefit accruals, the encashment control creditor, and other programme debtors and creditors:
I have not obtained all the information and explanations that I considered necessary for the purpose of my audit;
and
I was unable to determine whether proper accounting records had been maintained.
Details of these matters are set out in my report.
Comptroller and Auditor General (C&AG)
National Audit Office (NAO)

(4) Examination of the field standards for legal compliance auditing
1) The standards for the scope of compliance require that the scope of applicable laws and regulations should be
clarified in auditing. In this point, the standards differ from the GAAS.
2) Standards for materiality.
3) Standards for corporate governance.
4) The standards for the legality of financial transactions require the verification of legal compliance and are
different from the GAAS.
5) Standards for financial implementation and for the detection and prevention of fraud and abuse.
6) Standards for financial status.
7) The standards for internal control regard internal control as internal management or financial control and are
different from the GAAS in that the standards define internal controls in a broader sense.
8) The standards for additional procedures differ from the GAAS.

(5) Examination of the structure of reporting standards for legal compliance auditing
1) According to the standards for the expression of audit opinions, it is required to include reference to legal basis,
the Parliament’s spending purposes and to the prescribed objectives of the audit.
2) Standards for the reporting of noncompliance.
3) The standards for communication require, in particular in view of independence, that auditors closely
communicate with the legislature throughout the entire auditing process.
4) Reporting standards related to corporate governance.
5) Standards for the special rights and duties of auditors.
6) The standards for special reporting in response to interests shown by citizens are different from the GAAS.
Both <Example 1> and <Example 2> intend to express the financial and legal compliant opinions. And they seem to
intend to be auditing assurance standards as assurance standards.
(6) The field standards for performance auditing include the following standards:

1) Standards in relation to planning.
2) Standards for three E’s auditing, which is also referred to as performance auditing or VFM auditing: these standards require the auditing and evaluation of administrative services financed by the government in terms of three E’s. Auditors are therefore required to understand the meaning of three E’s and provide reasonable assurance concerning their competence.\(^{31}\) These standards are different from the GAAS.
3) Standards for performance measures and indicators: the standards require that performance audits be conducted based on performance measures and indicators, that audits be discontinued if the validation of appropriate performance measures is impossible, and that auditors express qualified opinions if their audit scope is limited.
4) Standards for creating performance reports have some similarities with the GAAS in that they involve the audit of attestations. The content and form of attestations, however, are different.
5) Standards for legal compliance.
6) Standards for the study and evaluation of internal controls.
7) Standards for materiality.
8) Compliance standards and the standards for setting guidance: they are different from the GAAS.
9) Standards for audit evidence: the evidence types, auditing techniques and procedures defined in the standards differ from those defined in the GAAS.
10) Standards for audit records.
11) Standards for systematic auditing.
12) Standards for follow-up.
13) Standards for the use of other experts: the standards cover a wider range than the GAAS.

(7) Examination of the reporting standards for performance auditing

1) Standards for the form of performance audit reports.
2) Based on the standards for timeliness, audit reports shall be made on programs or projects before, during, and after the implementation of these programs and projects. They differ from the GAAS in that they require advance audits and audits on on-going projects and the preparation of relevant reports.
3) For the content of performance reports, there are no general standards. In particular, in the case of VFM auditing, the standards vary depending upon the objectives and scope of auditing. The performance reports are prepared in compliance with GAAS in terms of form and composition, but not in terms of content.
4) Standards for reporting the objectives and scope of audit.
5) Standards for reporting audit results and reasons.
6) The standards for recommending improvements are different from the GAAS.
7) For the standards for creating performance audit reports, completeness, accuracy, objectivity, conviction, clearness and conciseness are required. The descriptions regarding completeness and conviction are different from GAAS.
8) In the standards for the distribution of audit reports, legal requirements are highlighted.

5. Conclusion: the Development of Government Auditing Standards in Japan

In the preceding paragraphs, the structures and elements of government auditing standards were examined in reference to the standards for government auditing or public auditing adopted in countries such as the U.S., the U.K., Canada, and Australia. In the following, I will discuss the auditing structures and issues to be examined for establishing government auditing standards in Japan.

(1) In Japan, the national government and independent administrative institutions are audited externally, by the Board of Audit of Japan and accounting auditors, respectively. The scope of auditing, however, is narrow compared

Basic Structure of Government Auditing by a Supreme Audit Institution

with other countries. For audits by the Board of Audit of Japan, the scope is mainly at Stage 6 in Figure 1, and partly at Stage 7 or 8, while the audits of independent administrative institutions are at Stage 4. National government auditing should be at Stage 8 or Stage 9 in view of the necessity of strict procedures for the discharge of public accountability. It is therefore necessary to establish a system for legislative auditors, commissioned by citizens, to carry out external auditing of the government and to clarify the objectives of such auditing.

(2) In recent years, evaluation of government programs (or of the administration) has begun to be conducted for both the national and local governments. First of all, the standards for creating performance reports (reports of administrative outcomes) should be established and the reports should be created according to these standards. If the standards are insufficient, direct reporting or agreed-upon procedures shall be applied, which will lead to lower assurance levels.

(3) For government auditing, it is necessary to establish a performance auditing system targeting government programs. At present, the concepts of evaluation and auditing are mixed up and it is urgently required to establish the framework for performance auditing as assurance engagements.

(4) The following shows the issues to be examined in establishing government auditing standards in Japan:

a. General standards for government auditing
   Examinations should be made on the independence and qualification of government auditors and as aforementioned, measures should be implemented to promote their independence.

b. Standards for financial audits
   Examinations should be made regarding the objectives of financial audits: the scope of auditing financial statements and accounting reports; and the scope of auditing fraud, illegal acts, and noncompliance. Also, examinations should be made regarding the establishment of an external quality control (QC) system including peer reviews.

c. Standards for performance audits (including the evaluation of the administration)
   Examinations should be made on the following: establishment of the standards for creating performance reports; establishment of the standards for performance measures and indicators; clarification of the objectives of performance auditing, including “three E’s” auditing, namely clarification of the objectives for Stage 7; clarification of the objectives of program auditing, namely clarification of the objectives for Stages 8 to 10; propriety of the exemption of audits on the propriety and values of programs from program auditing; and clarification of the assurance level required in relation to the audit objective. For increasing the feasibility of performance auditing, it is urgently required to develop performance measures and performance measurement systems. In foreign countries, various expert organizations are studying and developing performance measures and measurement methods and collecting relevant information. Also in Japan, examinations should be made regarding the establishment of social institutions like these expert organizations.

d. For government auditing by external auditors, it is indispensable to establish government auditing standards. (In some countries these are called public auditing standards.) In Japan, there are only auditing standards for the accounting auditors of independent administrative institutions and they are not general or comprehensive government auditing standards. It is therefore necessary to establish public auditing or government auditing standards, for which it is urgently required to establish independent institutions to set the auditing standards, similar to the ones established in foreign countries.
The International Organization of Supreme Audit Institutions (INTOSAI) is a worldwide affiliation of governmental entities. Its members are the Chief Financial Controller/Comptroller General/Auditor General Offices of nations. INTOSAI was founded in 1953 in Havana, Cuba. Thirty-four audit organizations formed the group originally and as of 2010 the current membership includes 193 institutions (188 national institutions, the European Court of Auditors and 4 associated members).