Technical Assistance Report

People’s Republic of China: Enhancement of the Performance Audit Capacity of the China National Audit Office
(Financed by the Cooperation Fund in Support of Managing for Development Results)

Asian Development Bank
CURRENCY EQUIVALENTS
(as of 30 November 2007)

Currency Unit – yuan (CNY)
CNY1.00 = $0.136
$1.00 = CNY7.30

ABBREVIATIONS

ADB – Asian Development Bank
CSPA – case studies of performance audit
CNAO – China National Audit Office
DFFAA – Department of Foreign Funds Application Audit
FYP – five-year plan
M&E – monitoring and evaluation
MDR – managing for development results
PATP – performance audit theories and best practices
PRC – People’s Republic of China
TA – technical assistance

TECHNICAL ASSISTANCE CLASSIFICATION

Targeting Classification – General intervention
Sector – Law, economic management, and public policy
Subsector – Economic management
Themes – Governance; capacity development
Subthemes – Financial and economic governance; organizational development

NOTE

In this report, “$” refers to US dollars.

Vice President
C. Lawrence Greenwood, Jr., Operations 2
Director General
H. S. Rao, East Asia Department (EARD)
Director
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Team leader
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I. INTRODUCTION

1. The Government of the People's Republic of China (PRC) requested the Asian Development Bank (ADB), during the 2006 country programming mission, for technical assistance (TA) for the Enhancement of the Performance Audit Capacity of the China National Audit Office (CNAO). The Fact-Finding Mission visited Beijing during 22–24 August 2007. Following the discussions, an understanding was reached on the objectives, scope, and implementation arrangement of the TA. The design and monitoring framework is in Appendix 1.

II. ISSUES

2. An important element of the reform agenda of ADB is mainstreaming managing for development results (MfDR). The 11th Five Year Plan (11FYP) announced by the Government in 2006 also stresses MfDR. The 11FYP includes—for the first time—a matrix with 22 monitoring indicators, 8 of them with targets and 14 with benchmarks. Also for the first time, the plan contains specific text discussions on the importance of monitoring and evaluation (M&E) work and is explicitly committed to carrying out a mid-course evaluation of the 11FYP, which will then be subject to review by the standing committee of the National People's Congress. The design of the M&E framework followed an internationally recognized model that includes selecting key performance indicators to monitor and sustain the M&E system.

3. CNAO is the supreme audit institution in the PRC, established in 1983. CNAO has traditionally focused on compliance audit and financial audit. Given the recent increasing emphasis on MfDR, CNAO started to introduce the concept of performance audit in its work program and targeted reaching 50% of all projects audited before 2008. Performance audits will help government better align investments and project implementation with development targets and results, thus ensuring that goals under the 11FYP are met satisfactorily.

4. The CNAO Department of Foreign Funds Application Audit (DFFAA), established in 1984, is responsible for auditing projects financed with loans and grants provided by international organizations and foreign governments. It is required to provide audit certification for projects financed by international institutions including ADB and the World Bank. Since its establishment, DFFAA has provided over 500 audit certificates for foreign-financed projects and performed audits of over 5,000 executing agencies, involving grants and loans totaling more

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1 The TA first appeared in ADB Business Opportunities on 15 November 2007. The TA was listed in the ADB TA program as standby for 2007 and firm for 2008 during the country programming mid-term review in March 2007. The Cooperation Fund in Support of Managing for Development Results, under ADB management, approved funding for the TA in May 2007. The MfDR cooperation fund was established in March 2004 to support the introduction of MfDR approaches in ADB's developing member countries. The Fund—with contributions from Canada, Netherlands, and Norway—amounts to $2.9 million. It is a multidonor umbrella facility that allows for further donor contributions.

2 Performance audit refers to an examination of a program, function, or operation, or the management systems and procedures, of a governmental or nonprofit entity to assess whether the entity is achieving economy, efficiency, and effectiveness in the employment of available resources. The examination is objective and systematic, generally using structured and professionally adopted methodologies. Results and findings are stated in terms of yardsticks derived from the entity's mission, vision, values, or goals, or on metrics based on these. Many national governments support professional or advisory bodies that publish standards and guides for conducting performance audits. Performance audits are often conducted by internal auditors who are employees of the entity being audited. However, some national governments require agencies, departments, and branches to periodically retain outside auditors to conduct them. Although there are separate professional credentials and certifications for financial auditors, the people that conduct performance audits are often certified public accountants. Findings from a performance audit can sometimes indicate situations that should be examined by law enforcement investigators.
than $60 billion. Through external assistance provided to CNAO, including assistance from ADB, staff at DFFAA and the audit bureaus of local governments have received training on international accounting principles and accounting standards, plus financial statement auditing, analysis, and presentation. The high quality of DFFAA audit work has been well recognized by international organizations.

5. Institutionally, foreign-funded projects are audited by provincial audit bureaus at the corresponding project sites under the overall leadership of DFFAA, which provides regular guidance to provincial audit bureaus to bring them abreast of procedures adopted by international organizations including those of ADB and the World Bank. Capacity-building measures include regular training on ADB practices and procedures, sharing experiences, and undertaking individual research.

6. The audits performed by DFFAA have traditionally been largely financial audits and compliance-based audits. DFFAA started to conduct performance audits in 2004 to expand the scope of audit to cover issues such as the delivery of project objectives, implementation, and fund management, as well as environmental impacts, social benefits, and the sustainability of projects. In 2007, DFFAA completed performance audits of a sample of 100 World Bank and ADB-financed projects. The report of this audit exercise was reviewed by the auditor general and senior officials of the state council. DFFAA received strong encouragement from the senior leadership to continue this work.

7. Performance audit covers a broader scope as compared with financial audits and requires different techniques and skills as compared with compliance and financial auditors. Performance audit is also a critical part of broader efforts for MfDR. ADB has supported MfDR in the PRC with a series of TA grants and regional activities. The most recent TA assisted government agencies in developing modules of developmental result indicators (i.e., outcome and impact) in the results-based M&E system for key projects and training of staff members.

8. At present, DFFAA has neither critical mass in terms of human resources in the area of performance audit, nor guidelines or manuals to ensure its staff apply a consistent approach to performance audit. Moreover, the knowledge and professional capacity of many auditors fail to satisfy the requirements of performance audit. It is necessary for auditors to know international best practices and learn advanced theories, methodologies, and techniques concerning performance audit. A recently conducted assessment by ADB identified CNAO’s need to fully understand the principle and process, and be able to conduct performance audits to the highest professional standard, and recommended that ADB assist CNAO in the area of performance audit. A recently completed technical assistance performance evaluation for selected TA

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4 The financial statements on which DFFAA has to express an audit opinion normally include the balance sheet, income statement, source and application of funds statement, and any other supplementary statements that may be required by the funding agency concerned. The reporting requirements are normally specified in the relevant loan agreement.

5 Twenty-seven projects were financed by ADB, mainly in the sectors of agriculture, manufacturing, energy, transportation, environment, and urban infrastructure.


projects in public administration\(^8\) recommended that CNAO’s performance audit capacity could be enhanced through collaboration with the program of ADB’s Operations Evaluation Department (OED) and its project evaluations in the PRC and the region.

III. THE TECHNICAL ASSISTANCE

A. Impact and Outcome

9. The impact of the TA is an improved organizational structure for executing program and portfolio management of publicly financed projects.\(^9\) The outcome of the TA is mainstreaming performance audits for assessing the impact, efficiency, and effectiveness of publicly financed projects, including foreign-funded projects. CNAO will be the direct beneficiary of the proposed TA. Public sector institutions and project sponsors, as well as beneficiaries of public investment projects, are indirect beneficiaries.

B. Methodology and Key Activities

10. The TA will be implemented through a combination of policy advice that draws upon international best practice and results-based institutional capability-building programs for DFFAA and CNAO. Specifically, the TA will

(i) assist the DFFAA staff to draft two books; one will describe performance audit theories and best practices (PATP) based on experiences of developed countries,\(^10\) and the second will contain selected case studies of performance audit (CSPA) from the PRC. The two books will serve as essential instruments and training materials for DFFAA and CNAO auditors and their associates;

(ii) develop through targeted training programs\(^11\) a core group of auditors who will be familiar with advanced performance audit theories, methodologies, and techniques, to become resource persons on performance audit capable of training other auditors;

(iii) identify the training needs for mainstreaming performance audit in CNAO and help the core group to develop a curriculum for performance audit training, aiming at proper implementation of the PATP, and to develop a set of systematic training approaches on the subject of performance audit; and

(iv) produce, as by-products of the TA to disseminate among policymakers and general public finance professionals, a series of high-level best practice and development plans.

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9 Results and findings will be compared with targets and benchmarks as identified in 11FYP and with specific yardsticks of project sponsors’ mission, vision, values, or goals. As indicated in the 11FYP, most government-sponsored projects are geared towards the development of the western region and poverty reduction. The proposed TA will directly contribute to the effective implementation of national and subnational poverty-reduction and development plans.
10 The United States Government’s audit guidelines (which include performance auditing) and the International Organization of Supreme Audit Institutions performance audit guidelines are generally considered as international best practices.
11 The first batch of three training sessions are planned, including one for performance audit for environment projects, one for basic infrastructure, and one for general performance audit theories and practices. On average, 30 people will attend each session.
technical notes on specific techniques and approaches of performance audit for particular sectors or types of projects.

11. The PATP is expected not only to provide theoretic background of performance audit but also to be detailed enough to provide specific technical parameters for performance audit in various sectors such as agriculture, manufacturing, healthcare, education, forestry, transportation, energy, environment, and urban infrastructure, as well as specific treatments for revenue-generating and not-for-profit projects.

12. The training activities will be a combination of classroom teaching, coaching, and learning on the job, as well as internships at audit organizations of other countries with advanced performance audit practices, and possibly in ADB.

C. Cost and Financing

13. The total cost of the TA is estimated at $550,000 equivalent. The Government has requested ADB to finance $400,000 equivalent. The TA will be financed on a grant basis by the Cooperation Fund in Support of Managing for Development Results\(^\text{12}\) and administered by ADB. The Government will provide the remaining $150,000 of local currency costs in kind, covering office accommodation, counterpart staff, transportation, and other related services. Detailed cost estimates are in Appendix 2.

D. Implementation Arrangements

14. DFFAA of CNAO will be the Executing Agency (EA). A leading group will be set up comprising senior officials of CNAO to provide overall guidance for project implementation. The EA will provide the necessary office space, counterpart staff, transportation, and other services to consultants and arrange appointments for the consultants with relevant agencies and organizations.

15. The TA will engage one international and two national consultants for a total of 9.5 person-months, including the team leader and international performance audit specialist (2.5 person-months), national performance audit specialist (3.5 person-months), and national sector project evaluation specialist (3.5 person-months). There will be a separate budget to engage additional international and national resource persons for specific technical areas during TA implementation, as the need arises. The terms of reference for consultants are in Appendix 3. The consultants will be selected and engaged on an individual basis in accordance with ADB’s Guidelines on the Use of Consultants (2007, as amended from time to time). Equipment will be purchased in accordance with ADB’s Procurement Guidelines (2007, as amended from time to time). The advance payment facility can be considered under TA for training, seminars and conferences, equipment, and publications under TA, with DFFAA responsible for administering such payment.

16. The TA is expected to begin in January 2008 and end in April 2009. The consultants will submit (i) inception reports 3 weeks after the commencement of their services, (ii) interim progress reports every quarter during TA implementation, (iii) draft final reports before the conclusion of the contract, and (iv) final reports 2 weeks after incorporating comments from DFFAA and ADB. Knowledge products such as high-level best practice and technical notes will

\(^{12}\) Contributors are the Governments of Canada, Netherlands, and Norway.
be produced from time to time as the need arises. All reports must be submitted in English and Chinese. Workshops will be organized periodically.

IV. THE PRESIDENT'S DECISION

17. The President, acting under the authority delegated by the Board, has approved ADB's administering technical assistance not exceeding the equivalent of $400,000 to the Government of the People's Republic of China to be financed on a grant basis by the Cooperation Fund in Support of Managing for Development Results for Enhancement of the Performance Audit Capacity of the China National Audit Office, and hereby reports this action to the Board.
## DESIGN AND MONITORING FRAMEWORK

<table>
<thead>
<tr>
<th>Design Summary</th>
<th>Performance Targets/Indicators</th>
<th>Data Sources/Reporting Mechanisms</th>
<th>Assumptions and Risks</th>
</tr>
</thead>
</table>
| **Impact**     | • Strengthened program and project administration and portfolio management of publicly financed projects | • 10% increase in ratio of successful projects financed by government by 2010  
• More capable executing and implementing agencies and other stakeholders by 2010 | • Performance audit reports  
• Post evaluation reports of publicly financed projects |
| **Outcome**    | • Mainstreamed performance audits for assessing the impact, efficiency, and effectiveness of publicly financed projects, including foreign-funded projects | • Performance audit guidelines finalized, and at least 10 core CNAO staff able to conduct performance audits and implement a training program by 2008  
• Performance audits are conducted consistently for 50% of foreign-funded projects by December 2009 | • Good awareness of MfDR issues among policymakers, executing and implementation agencies, and other stakeholders |
| **Outputs**    | • Finalized performance audit theories and best practices (PATP) for approval  
• Core group of auditors able to conduct, and train others to conduct, performance audits  
• Performance audit training curriculum finalized for approval and implementation  
• Knowledge products on specific techniques and approaches of performance audit | • High-quality and easy-to-understand PATP in Chinese language is prepared and accepted by auditor general by February 2009  
• Core group of 10 auditors is selected and well trained by February 2009  
• Curriculum is well developed, tested, and approved by CNAO training center | • Effective coordination among agencies concerned  
• CNAO remains committed to adopting performance audit |

**Activities with Milestones**

1.1 Recommendation of the overall structure of the PATP with reference to advanced performance audit experience and case studies from developed countries, as well as case studies from the PRC

1.2 Recommendation of specific applicable technical parameters for performance audit in various sectors such as agriculture, manufacturing, healthcare, education, forestry, transportation, energy, environment, and urban infrastructure, as well as specific treatments for revenue-generating and not-for-profit projects

1.3 Preparation of the PATP sections covering the rationale, advanced theories, methodologies, and techniques of performance audit with the objective that the PATP will serve as the essential instrument and training material for DFFAA and CNAO auditors and their associates

2.1 Identification of knowledge and management gaps for achieving consistency in performance audit practices

2.2 Delivery of the first batch of three planned training sessions, including one for performance audit for environment projects, one for basic infrastructure, one for general performance

**Outputs**

1. High-quality and easy-to-understand PATP in Chinese language is prepared and accepted by auditor general by February 2009

2. Core group of 10 auditors is selected and well trained by February 2009

3. Curriculum is well developed, tested, and approved by CNAO training center

**Assumptions**

• Acceptance of draft PATP by DFFAA and CNAO, and by relevant government agencies

• Timely availability of required data and good participation of stakeholders

**Inputs**

• ADB grant of $400,000 equivalent

• Government in-kind support of $150,000

• In-kind contributions of other stakeholders
<table>
<thead>
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<th>Assumptions and Risks</th>
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<tbody>
<tr>
<td>audit theories and practices</td>
<td>2.3 Guidance for DFFAA in organizing both domestic and foreign training activities to be</td>
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<td></td>
<td>undertaken by selected DFFAA officers</td>
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<tr>
<td>3.1 Development of a training strategy and plan for mainstreaming performance</td>
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<td>audit</td>
<td>3.2 Recommendation of how to mainstream performance audit in other parts of CNAO and</td>
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<td></td>
<td>conduct general familiarization courses for colleagues from other CNAO departments</td>
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<tr>
<td>3.3 Assistance for the core group in developing a curriculum for performance</td>
<td>4.1 A series of high-level best practice and technical notes on specific techniques and</td>
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<tr>
<td>audit training, targeting proper implementation of the PATP, and in developing</td>
<td>approaches of performance audit for particular sectors or types of projects</td>
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<td>a set of systematic training courses</td>
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ADB = Asian Development Bank, CNAO = China National Audit Office, CSPA = case studies of performance audit, DFFAA = Department of Foreign Funds Application Audit, MfDR = managing for development results, PATP = performance audit theories and best practices, TA = technical assistance.
## COST ESTIMATES AND FINANCING PLAN

($'000)

<table>
<thead>
<tr>
<th>Item</th>
<th>Total Cost</th>
</tr>
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<tbody>
<tr>
<td><strong>A. Cooperation Fund in Support of Managing for Development Results</strong>&lt;sup&gt;a&lt;/sup&gt;</td>
<td></td>
</tr>
<tr>
<td>1. Consultants</td>
<td></td>
</tr>
<tr>
<td>a. Remuneration and Per Diem</td>
<td></td>
</tr>
<tr>
<td>i. International Consultants&lt;sup&gt;b&lt;/sup&gt;</td>
<td>70</td>
</tr>
<tr>
<td>ii. National Consultants&lt;sup&gt;c&lt;/sup&gt;</td>
<td>40</td>
</tr>
<tr>
<td>b. International and Local Travel</td>
<td>15</td>
</tr>
<tr>
<td>c. Reports and Communications&lt;sup&gt;d&lt;/sup&gt;</td>
<td>10</td>
</tr>
<tr>
<td>2. Equipment&lt;sup&gt;e&lt;/sup&gt;</td>
<td>5</td>
</tr>
<tr>
<td>3. Training, Seminars, and Conference</td>
<td></td>
</tr>
<tr>
<td>a. Facilitators (Interpreters and Translators)</td>
<td>10</td>
</tr>
<tr>
<td>b. Domestic Workshop&lt;sup&gt;f&lt;/sup&gt;</td>
<td>50</td>
</tr>
<tr>
<td>4. Miscellaneous Administration and Support Costs</td>
<td>5</td>
</tr>
<tr>
<td>5. Resource Persons&lt;sup&gt;g&lt;/sup&gt;</td>
<td>60</td>
</tr>
<tr>
<td>6. Publications&lt;sup&gt;h&lt;/sup&gt;</td>
<td>90</td>
</tr>
<tr>
<td>7. Contingencies</td>
<td>45</td>
</tr>
<tr>
<td><strong>Subtotal (A)</strong></td>
<td><strong>400</strong></td>
</tr>
<tr>
<td><strong>B. Government Financing</strong></td>
<td></td>
</tr>
<tr>
<td>1. Office Accommodation and Transport</td>
<td>80</td>
</tr>
<tr>
<td>2. Remuneration and Per Diem of Counterpart Staff</td>
<td>40</td>
</tr>
<tr>
<td>3. Contingencies</td>
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<tr>
<td><strong>Subtotal (B)</strong></td>
<td><strong>150</strong></td>
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<tr>
<td><strong>Total</strong></td>
<td>550</td>
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</tbody>
</table>

<sup>a</sup> Contributors are the Governments of Canada, Netherlands, and Norway. Administered by the Asian Development Bank.

<sup>b</sup> Responsible for introducing international experience to the Department of Foreign Funds Application Audit (DFFAA) staff in drafting performance audit theories and best practices (PATP), and delivering specific sessions at training workshops.

<sup>c</sup> Responsible for assisting DFFAA staff in drafting the PATP and delivering specific sessions at training workshops.

<sup>d</sup> Inception report, progress reports, final report, and knowledge products during technical assistance (TA) implementation.

<sup>e</sup> Equipment to be purchased includes projectors, scanners, and data-storage devices. Upon completion of the TA, equipment will be transferred to the China National Audit Office.

<sup>f</sup> Three domestic workshops, each lasting for 3 days, are planned, including one for performance audit for environment projects, one for basic infrastructure, and one for general performance audit theories and practices. On average, 30 people will attend each session.

<sup>g</sup> One additional international resource person and three additional national resource persons are expected to be engaged for each workshop. The unused portion of the budget in this category can be reallocated to other cost categories, such as publications.

<sup>h</sup> The budget is earmarked for publication of the PATP.

Source: Asian Development Bank estimates.
OUTLINE TERMS OF REFERENCE FOR CONSULTANTS

1. International consultants are primarily responsible for introducing international experience and best practices, providing advisory services on key technical issues, disseminating lessons learned, and providing recommendations to policymakers. National consultants are responsible for all technical aspects of TA implementation and training.

A. International Consultant (2.5 person-months)

2. Team Leader and Performance Specialist. The consultant will assume the role of the team leader and be responsible for the overall management of TA implementation, timely delivery of high-quality interim and final reports, identification and management of resource persons in various technical tasks, and organization of workshops and training activities. The consultant should possess good knowledge of and sufficient experience in the area of performance audit or project post evaluation in the context of the People’s Republic of China (PRC) and other countries at a similar development stage. Chinese language capability is an advantage. Specifically, the consultant will

(i) review existing auditing standards, procedures and practices and identify areas that need to be targeted in order to mainstream the performance audit practices in DFFAA;

(ii) identify knowledge and management gaps for achieving consistency in performance audit practices;

(iii) assist DFFAA staff in selecting contents of performance audit theories and best practices (PATP) of developed countries;

(iv) ensure that the PATP is consistent with existing CNAO manuals;

(v) recommend specific applicable technical parameters for performance audit in various sectors such as agriculture, manufacturing, healthcare, education, forestry, transportation, energy, environment, and urban infrastructure, as well as specific treatments for revenue-generating and not-for-profit projects;

(vi) recommend and produce, for dissemination among policymakers and general public finance professionals, knowledge products including high-level best practice and technical notes on specific techniques and approaches to performance audit for particular sectors or types of projects;

(vii) develop an overall training strategy and plan for mainstreaming performance audit and provide guidance to DFFAA in organizing both domestic and foreign training activities to be undertaken by selected DFFAA officers;

(viii) deliver specific sessions together with other international and domestic resource persons at the workshops;\(^{13}\)

(ix) develop through a targeted training program a core group of auditors who will be most familiar with advanced theories, methodologies, and techniques regarding

\(^{13}\) On average each resource person (either international or national) will be responsible for half a day of lecturing and will participate in all sessions of the workshop.
performance audit, to become resource persons on performance audit capable of training other auditors;

(x) help the core group to develop a curriculum for performance audit training, targeting proper implementation of the PATP, and to develop a set of systematic training courses;

(xi) recommend how to mainstream performance audit in other parts of CNAO and conduct general familiarization courses for colleagues from other CNAO departments;

(xii) recommend the establishment of a performance audit network among the local working staff, through a virtual learning process, which will be useful and cost effective in helping local auditors to exchange experiences and sustain the capacity-building process; and

(xiii) monitor the status of implementation and measure and report TA accomplishments, including the assessment of trained auditors’ capability in performance audit.

B. National Consultants (7 person-months)

3. National consultants with in-depth country and sector knowledge and solid background in performance audit theory and practice will be recruited. The national consultants will help the international consultant to quickly become familiar with the tasks by researching and compiling a set of policies, regulations, and procedures adopted by CNAO and DFFAA, as well as ensure that the output of the international consultant is appropriate. The national consultants are expected to assume key responsibilities in compiling the PATP and conducting training sessions. English language proficiency is a definite plus.

4. Performance Audit Specialist (3.5 person-months). The specialist will

(i) work together with the team leader to assist DFFAA staff in determining the overall structure of the PATP;

(ii) research lessons learned from developed countries at advanced stages of performance audit and identify the applicability of those lessons in the context of the PRC;

(iii) deliver specific sessions together with other international and national resource persons at the workshops; and

(iv) deliver relevant sections in the familiarization courses for the general audience regarding performance audit.
5. **Domestic Sector Project Evaluation Specialist (3.5 person-months).** The specialist will

(i) work with the team leader and the domestic performance audit specialist to determine the sector-specific procedures and parameters for performance audit in the sectors of agriculture, manufacturing, healthcare, education, forestry, transportation, energy, environment, and urban infrastructure, as well as specific treatments for different types of revenue-generating and not-for-profit projects;

(ii) research lessons learned from developed countries on how to conduct performance audits for projects in various sectors;

(iii) work with the team leader to deliver the training sessions to the core group of auditors based on the curriculum developed;

(iv) deliver specific sessions together with other international and national resource persons at the workshops; and

(v) deliver relevant sections in the familiarization sessions for the general audience regarding performance audit.