

# The Role of the Supreme Audit Institution in NPM: International Trend

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## I. Introduction

Since the late 1980s, reforms of administrative and public finance systems based on the New Public Management (NPM) theory have been made, largely in Anglo-Saxon countries such as the United Kingdom and New Zealand. Since then, these reforms have gradually expanded to Nordic countries, including Sweden and Finland, and continental countries, including the Netherlands and France. The basic principle of this NPM theory requires that market principles should be introduced in the government sector and that administrative management should shift from an input control and process-oriented approach to an output (outcome) control and customer-oriented approach. NPM theory has been translated into action as follows: 1) The government's role is modified through the privatization of state-run enterprises and/or the introduction of Public Private Partnerships (PPP); 2) The "Performance-based Management" approach is practiced through the establishment of independent agencies and/or performance measurements; 3) Public accounting and budget systems are reformed through the introduction of corporate accounting methods such as accrual basis accounting.

In Japan too, reforms based on NPM theory have gradually been made through the introduction of policy evaluation and independent administrative institutions. It is quite likely that NPM theory will be widely adopted to improve the efficiency of administrative activities and the soundness of public finance. In advanced Western countries that have implemented NPM-based reforms, a framework to enable the market principle and the output (outcome) control approach to function effectively has been established. In these countries, the Supreme Audit Institutions (SAIs) are playing important roles. I would now like to examine the roles played by the SAIs in advanced Western countries in terms of helping to realize the effective implementation of NPM-based reforms, and to study future roles of the Board of Audit of Japan. In this paper, examples of Australia, New Zealand, the United Kingdom, and the United States (for selected data of these countries, refer to Table 1), where the writer conducted field surveys during a period from 2000 to 2001, are presented. (Note; the opinions expressed in this paper are the personal ones of the writer, and do not represent those of the Board of Audit of Japan.)

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Table 1. Outline of Surveyed Countries

Country	Australia (AU)	New Zealand (NZ)	The United Kingdom (UK)	The United States (US)	Japan (reference)
Government system	Parliamentary cabinet system/federal system	Parliamentary cabinet system	Parliamentary cabinet system	Presidential system/federal system	Parliamentary cabinet system
Parliamentary system	Bicameral system	Unicameral system	Bicameral system	Bicameral system	Bicameral system
Population <sup>1)</sup>	18.53 mil.	3.76 mil	58.2 mil	267.9 mil	125.64 mil
Land area <sup>2)</sup>	7.74 mil. km <sup>2</sup>	0.27 mil. km <sup>2</sup>	0.24 mil. km <sup>2</sup>	9.36 mil. km <sup>2</sup>	0.38 mil. km <sup>2</sup>
GDP <sup>3)</sup>	US\$388.5 bil.	US\$50.8 bil	US\$1,427.5 bil.	US\$9,810.2 bil	US\$4,764.0 bil
Budget scale of the central government (annual flow) <sup>4) 5)</sup>	AU\$190.0 bil. (¥11.9607 tri.)	NZ\$38.2 bil. (¥1.932 tri.)	£273.2 bil. (¥47.2636 tri.)	US\$2,705.8 bil. (¥321.9902 tri.)	¥199.4664 tri.
Budget scale of the central government (year-end stock) <sup>6) 7)</sup>	AU\$204.1 bil. (¥12.8483 tri.)	NZ\$65.1 bil. (¥3.2924 tri.)	—————	US\$926.1 bil. (¥110.2059 tri.)	¥701.23 tri.
Fiscal year	July - June	July - June	April - March	October - September	April - March

## Notes:

1) Estimated in 1997.

2) Surveyed in 1997.

3) Nominal value in 2000.

4) Annual gross expenses (expenditure) for FY 2000/01 (accrual basis for AU, NZ, and US; cash basis for UK and Japan)

5) Figures in parentheses represent the amounts in Japanese yen (reference figures) that are calculated using the basic rate of exchange or the arbitrated rate of exchange for the period of July through December, 2001.

6) Year-end gross amount of assets for FY 2000/01 (FY 1999/2000 for Japan)

7) Figures in parentheses represent the amounts in Japanese yen (reference figures) that are calculated using the basic rate of exchange or the arbitrated rate of exchange for the period of July through December, 2001.

## Sources:

"World Statistics 2001," Ministry of Public Management, Home Affairs, Posts and Telecommunications (2001).

"Annual Report on National Accounts" (2002), Economic and Social Research Institute, Cabinet Office.

AU: Department of Finance and Administration (2001), Consolidated Financial Statements for the year ended 30 June, 2001.

NZ: Treasury (2001), Financial Statements of the Government of New Zealand for the year ended 30 June, 2001.

UK: HM Treasury (2001), Public Expenditure Statistical Analyses 2001-02.

US: Department of the Treasury (2002), Financial Statements of the United States Government for the year ended September 30, 2001.

Japan: The Board of Audit of Japan (2001), Audit Report for FY 2000 (Net Total of Expenditure).

The Study Group on the Method to Explain Financial Performance (2001), the Balance Sheet for the Central Government (Tentative Plan) (FY 1999).

## II. General Trends in Advanced Western Countries

### 1. "Performance-based Management" and the role of SAIs

In advanced Western countries, the financial conditions of the central governments have worsened due to the slowdown in economic growth rates, etc. since the late 1980s. As a result, these central governments were required to improve administrative efficiency and regain their fiscal health. At the same time, it was widely understood that administrative approaches focusing on input controls for budgets, personnel, etc. have limitations. Since fiscal conditions worsened and citizens' demands for administrative services increased and diversified, it was increasingly important for central governments to allocate limited financial resources to each policy reasonably and efficiently.

To respond to these tasks, some advanced Western countries granted discretionary power for budgeting and staffing to the chief operating officer of each Ministry or independent agency. At the same time, these advanced countries introduced so-called "Performance-based Management," an administrative approach that aims at improving results and performance. In the "Performance-based Management" approach, goals are established, and performance measurements are conducted in light of such goals. In countries where the "Performance-based Management" approach has been adopted, Parliament controls the cabinet. Therefore, a performance plan in which goals and quantitative performance targets for each policy or for each independent agency are established must be submitted to Parliament for approval in advance. After the performance plan is implemented, a performance report

containing actual performance results is prepared and submitted to Parliament.

Performance measurements are self-evaluations made by Ministries, etc., and any budget and other proposals that reflect evaluation results, are examined by Parliament. In order for Parliament to ensure that “Performance-based Management” functions effectively, it is essential to improve the quality of evaluations and the reliability of evaluation results. To secure the reliability of evaluation results, a third party, on behalf of Parliament, must verify the following: 1) the targets of each policy are clearly established; 2) the performance indicators that can properly evaluate the effects of each policy are selected; 3) administrative tools that can attain the targets of each policy most efficiently and effectively have been adopted; 4) the target values of performance indicators are set at appropriate levels; and 5) the actual values of performance indicators are accurate and not biased.

To perform the above items, the third party must meet the following conditions: 1) be independent from the cabinet that implements policies; 2) be large enough in the size of the organization to respond to all policies of all Ministries; and 3) have knowledge gained through experience in administrative practices. In advanced Western countries that have implemented administrative reforms using NPM theory, SAIs are performing the role of the third party mentioned above. Detailed activities of these SAIs are discussed in “III. Trends in Advanced Western Countries.”

## **2. Reform of public accounting system/budget system and the role of the SAIs**

In advanced Western countries, the sustainability of the government sector has come into question due to the maturation of the economic structure and the progress of the aging society since the late 1980s. As a result, central governments have been required to explain the assets and liabilities that are held by the government sector, taxes/social insurance premiums that are to be borne by the citizens in the future, and other related matters. Since the performance measurement system was introduced to evaluate the outcomes/performances of each policy or each independent agency from the standpoints of 3Es (economy, efficiency, and effectiveness), it is necessary to grasp costs by policy or by the administrative work of each independent agency to make evaluations from the standpoints of economy and efficiency. After the financial conditions of the government sector were disclosed and performance measurements from the standpoints of 3Es were implemented, the central governments were increasingly required to establish a framework under which such financial and performance information is reflected in budgets.

To respond to these tasks, some advanced Western countries have reformed their public accounting systems and the budget systems as follows. They have introduced some elements of corporate accounting methods, such as accrual basis accounting, into the public accounting system, and have introduced accrual-based and output-based budgeting. Under this new public accounting system/budget system, a budget proposal containing budget amounts, etc. for each policy is prepared and submitted to Parliament for approval, as Parliament controls the cabinet. After policies are implemented, financial statements such as balance sheets and administrative cost statements are prepared and submitted to Parliament.

The financial statements prepared on an accrual basis contain the subjective judgments of each Ministry, and budget and other proposals which reflect the financial data of these financial statements are examined by Parliament. However, the public accounting system containing some elements of corporate accounting may function effectively only if the quality of accrual basis accounting improves and the reliability of financial statements is secured. To secure the reliability of financial statements, a third party, on behalf of Parliament must verify the following: 1) the financial statements are prepared by each Ministry in accordance with governmental accounting standards and related laws and regulations; and 2) these financial statements properly indicate the financial conditions and administrative costs of each Ministry.

To perform the above items, the third party must meet the following conditions: 1) be independent from the cabinet that prepares financial statements; 2) have the statutory authority to demand modification/improvement of inappropriate governmental accounting standards or related laws and regulations; and 3) have knowledge gained through experience in administrative practices. In advanced Western countries that have implemented administrative reforms using the NPM theory, SAIs are performing the role of the third party mentioned above. Detailed activities of these SAIs are discussed in “III. Trends in Advanced Western Countries.” (For an outline of the SAI of each country, refer to Table 2.)

Table 2. Outline of the Supreme Audit Institution (SAI) of each country

(FY 2000/01)

Item \ Country	Australia (AU)	New Zealand (NZ)	The United Kingdom (UK)	The United States (US)	Japan (reference)
Name of SAI	Australian National Audit Office (ANAO)	Audit Office (AO)	National Audit Office (NAO)	General Accounting Office (GAO)	Board of Audit
Enabling law	Auditor-General Act 1997	Public Audit Act 2001	National Audit Act 1983	Budget and Accounting Act of 1921	The Constitution of Japan
Status	Belongs to Parliament	Belongs to Parliament	Belongs to Parliament	Belongs to Congress	Independent from the Diet, the cabinet and judicial power
Number of staff <sup>1)</sup>	283	271	750	3,110	1,254
Annual total expense (expenditure) <sup>2) 3)</sup>	AU\$48.14 mil. (¥3,030.46 mil.)	NZ\$35.54 mil. (¥1,797.44 mil.)	£55.03 mil. (¥9,520.19 mil.)	US\$415.51 mil. (¥49,445.69 mil.)	¥16,126.52mil.
Ratio of performance audit to financial audit <sup>4) 5)</sup>	40:60	7:93	36:64	77:23	No distinction is made between performance and financial audits.
Number of performance audit reports per year	46	12	53	786	
Number of financial audit reports per year	293	4,007	640	101	
Ratio of contracted out financial audits to all financial audits <sup>6)</sup>	About 25%	About 30%	About 17%	0%	0%

## Notes:

1) For Japan, the number of staff represents the budgeted number.

2) Accrual basis for ANAO, AO and GAO; cash basis for NAO and the Board of Audit

3) Figures in parentheses represent the amounts in Japanese yen (reference figures) that are calculated using the basic rate of exchange or the arbitrated rate of exchange for the period of July through December, 2001.

4) On an expense basis

5) AO's financial audits include the results of audit of service performance reports (non-financial information).

6) This ratio represents the ratio of financial audits contracted out to audit corporations to all financial audits. Figures for ANAO and AO were obtained from a survey made in 2001 and those for NAO in 2000.

## Sources:

ANAO (2001), Annual Report 2000-01.

AO (2001), Annual Report 2000-01.

NAO (2001), Annual Report 2001, etc.

GAO (2002), Performance and Accountability Report 2001, etc.

Japan: The Board of Audit (2001), Audit Report for FY 2000 (Expenditure of the Board of Audit).

### III. Trends in Advanced Western Countries

#### 1. Australia

##### 1.1 Performance-based Management

###### (1) Outline of the system

In accordance with the government's decision made in 1997, Australia introduced the Accrual-based Outcomes and Outputs Framework (AOOF), under which accrual accounting and performance measurements are reflected in the budgeting process, for the first time in FY 1999-2000. Under this AOOF, each Ministry is required to establish the following in its Portfolio Budget Statement for a fiscal year: 1) outcomes (targets) to be attained; 2) performance targets that are needed to evaluate the degree of attainment of outcomes; 3) outputs (administrative

activities) that are needed to attain such outcomes; and 4) performance targets (quality, quantity, and price) that are needed to evaluate the degree of attainment of outputs. The degree of attainment of these outcomes and outputs is indicated in a performance report. The performance report, which is part of the Annual Report for each Ministry, is then submitted to Parliament.

## (2) Role of the SAI

In Australia, the Australian National Audit Office (ANAO) is taking the roles described below in “Performance-based Management.”

### a. Extensive implementation and qualitative improvement of performance measurements made by the federal government as a whole

Aiming at the qualitative improvement of performance measurements made by the federal government as a whole, ANAO prepared a comprehensive report<sup>1)</sup> in 2001 based on fact-finding surveys for ten ministries. In the report, ANAO pointed out that: 1) selected performance indicators are not appropriate for evaluating the degree of attainment of outcomes; 2) selected target values in performance indicators are not appropriate; and 3) actual values in performance indicators lack accuracy and reliability. In the report, ANAO also introduced the good practices made by the Ministries.

### b. Improvement of the reliability of performance reports made by Ministries

ANAO is not auditing all performance reports made by all Ministries. However, ANAO is auditing some performance reports made by selected Ministries in the performance audit, which contributes to the improvement of the reliability of such reports. In the 2001 report,<sup>2)</sup> for example, ANAO recommended that the Natural Heritage Trust introduce a verification system to improve the accuracy and reliability of performance data. In the 2001 report,<sup>3)</sup> ANAO recommended that the Australian Taxation Office introduce intermediate outcome targets to clarify the relationship between outcomes and outputs.

## 1.2 Reform of the public accounting system

### (1) Outline of reforms

In accordance with the government’s decision made in 1992, every Australian Ministry has been required to prepare accrual-based financial statements and submit these statements as a part of their Annual Report to Parliament since FY 1994-95. Every Ministry is obligated to prepare these financial statements by the Financial Management and Accountability Act 1997 (FMAA). Under the FMAA, the Department of Finance and Administration (DOFA) has prepared Consolidated Financial Statements (CFS) for the government as a whole, which combine the financial statements of all Ministries, Commonwealth Authorities and Commonwealth Companies, since FY 1996-97, and submits CFS to Parliament.

### (2) Role of the SAI

In the reform of the Australian public accounting system, ANAO plays the role as follows.

#### a. Extensive implementation and improvement of the accrual basis accounting

(a) Since FY 1992-93, Australia has implemented some pilot projects for accrual basis accounting, and gradually increased the number of Ministries subject to these pilot projects. To promote the adoption of accrual basis accounting by all Ministries, ANAO prepared in 1994 a comprehensive report on the actual conditions of how pilot projects are being implemented.<sup>4)5)</sup> In these reports, ANAO pointed out that: 1) there is not enough staff who have knowledge and experience of accrual basis accounting; 2) the benefits of accrual basis accounting are not

1) ANAO (2001-02), Performance Information in Portfolio Budget Statements (No.18).

2) ANAO (2000-01), Performance Information for Commonwealth Financial Assistance under the Natural Heritage Trust (No.43).

3) ANAO (2000-01), ATO Performance Reporting under the Outcomes and Outputs Framework (No.46).

4) ANAO (1993-94), Accrual Reporting: Are Agencies Ready? (No.32)

5) ANAO (1994-95), Accrual Reporting: Are Agencies Ready? (No.16)

understood by staff; and 3) not enough training is made for staff in charge of accounting, and made recommendations to improve these conditions.

(b) To improve the quality of financial statements made by Ministries, ANAO prepared a standard guidebook<sup>6)</sup> in 1996 that explains how to prepare financial statements in accordance with the Australian Accounting Standards. In the guidebook, ANAO explained: 1) standard form and contents of financial statements; 2) the criteria of appropriation or classification for items of financial statements; and 3) the evaluation criteria for items of financial statements, and introduced examples. Since then, ANAO has prepared a revised guidebook every year, reflecting changes of the system and requests from ministries.

(c) To promote the effective utilization of financial data obtained from accrual basis accounting, ANAO prepared in 1999 a comprehensive report<sup>7)</sup> based on fact-finding surveys of seven Ministries. In the report, ANAO pointed out that: 1) targets based on financial data had not been established; 2) financial data was not utilized in decision makings; and 3) financial data was not utilized in performance measurements, and made recommendations to improve these conditions. To improve the quality of accrual basis accounting, ANAO has prepared 28 standard guidebooks ("Better Practice Guide" series) for a period from 1996 to May 2002. In these guidebooks, ANAO explains: 1) accounting treatment of assets, etc.; 2) the method to implement internal audits; and 3) the method to design a financial information system, and also introduces the good practices made by Ministries.

#### b. Improvement of the reliability of financial statements

(a) The organization of financial statements to be prepared by Ministries is defined in the Financial Management and Accountability Orders issued by DOFA. Under these orders, each Ministry is required to prepare: 1) a Statement of Financial Performance; 2) a Statement of Financial Position; and 3) a Statement of Cash Flows. Under the FMAA, ANAO is authorized to audit these financial statements. ANAO expresses its views concerning: 1) whether financial statements are prepared in accordance with the Financial Management and Accountability Orders issued by DOFA; and 2) whether the financial statements properly indicate each Ministry's Financial Performance, Financial Position, and Cash Flows. The Independent Audit Report made by ANAO, which constitutes the Annual Report of each Ministry, together with its financial statements, is submitted to Parliament. Thus, ANAO's Independent Audit Report contributes to the improvement of the reliability of financial reports made by Ministries.

(b) The organization of Consolidated Financial Statements (CFS) to be prepared by DOFA is defined in the Financial Management and Accountability Regulations 1997. Under these Regulations, DOFA is required to prepare CFS composed of: 1) a Statement of Financial Performance; 2) a Statement of Financial Position; and 3) a Statement of Cash Flows. Under the FMAA, ANAO is authorized to audit CFS. ANAO expresses its views concerning: 1) whether CFS is prepared in accordance with the Financial Management and Accountability Regulations 1997; and 2) whether CFS properly indicates the federal government's Financial Performance, Financial Position and Cash Flows. ANAO's Independent Audit Report, together with CFS, is submitted to Parliament. Thus, ANAO's Independent Audit Report contributes to the improvement of the reliability of CFS for the federal government.

### 1.3 Role of the SAI in other fields of NPM

In addition to the roles mentioned in above 1.1 and 1.2, ANAO is playing the role in NPM as described below.

#### a. Auditing of independent agencies

In Australia, policy implementation functions are rarely transferred to independent agencies. One of few exceptions, however, is Centrelink, which is an independent agency that was established as a spin-off from Department of Social Security under the Commonwealth Service Delivery Agency Act 1997. Each Ministry is required to conclude a Business Partnership Agreement with Centrelink to purchase services, such as social security payments, etc. In 2000, ANAO conducted a performance audit for Centrelink to evaluate its efficiency and

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6) ANAO (1996), AMODEL, (Agency, Non-Commercial Authority) Illustrative Financial Statements.

7) ANAO (1999-00), Use of Financial Information in Management Reports (No.2).

effectiveness. In an audit report,<sup>8)</sup> ANAO pointed out that: 1) the budget and the number of staff for local branches were insufficient for the service volume; 2) performance data of local branches was not collected in a uniform manner, and therefore the comparison of data and the evaluation of performance of the Centrelink as a whole were impossible; and 3) the cost accounting system that is needed to evaluate efficiency had not been established. It then made a number of recommendations to improve these conditions.

#### b. Auditing of Commonwealth Authorities and Commonwealth Companies

In Australia, Commonwealth Authorities and Commonwealth Companies are required to prepare accrual-based financial statements under the Commonwealth Authorities and Companies Act 1997 (CACA). Under the CACA, ANAO is authorized to audit financial statements prepared by Commonwealth Authorities and Commonwealth Companies. ANAO's audit report, which constitutes the Annual Report of each Commonwealth Authority or Commonwealth Company, together with their financial statements, is submitted to Parliament through the competent Ministry. Thus, ANAO's audit report contributes to the improvement of the reliability of financial statements prepared by Commonwealth Authorities and Commonwealth Companies.

Of Commonwealth Authorities and Commonwealth Companies, those that are fully financed by the federal government and classified as Government Business Enterprises (GBEs) are obligated to prepare Corporate Plans in which performance targets for the coming three years or so are established. To improve the quality of performance measurements made by all GBEs, ANAO prepared in 2000 a comprehensive report<sup>9)</sup> based on fact-finding surveys of all GBEs. In this report, ANAO pointed out that: 1) some GBEs did not submit Corporate Plans to competent Ministers; 2) targets based on financial data, such as weighted average cost of capital, etc., were not established by some GBEs; and 3) some GBEs' Annual Reports did not include a performance report on the degree of attainment of performance targets, and made recommendations to improve these conditions.

#### c. Audits in connection with the privatization of Commonwealth Companies, etc.

Since 1993, assets of Commonwealth Authorities have been sold and Commonwealth Companies have been privatized on a large scale because the roles of the federal government had to undergo reviews as a result of the worsening of its financial condition. Revenues from the sale of such assets and stocks have greatly contributed to an improvement in the budget balance of the federal government. To evaluate the influences of the sale of assets or privatization on the revenue of the federal government or competition in the domestic market, ANAO conducted performance audits in connection with the sale of assets by Commonwealth Authorities in railway and aviation sectors, and the privatization of Commonwealth Companies. In a 1995 audit report,<sup>10)</sup> for example, ANAO pointed out that Australian National Line Limited considered the sale of stocks despite the fact that no ordinary profit was expected. Furthermore, ANAO recommended in a 1999 audit report<sup>11)</sup> that Federal Airports Corporation employ an outside consultant through a competitive bid to reduce cost of asset sales.

## 2. New Zealand

### 2.1 Performance-based Management

#### (1) Outline of the system

Under the 1988 State Sector Act, Chief Executive (CE) of a Ministry and the competent Minister are required in and after 1989 to conclude a Performance Agreement in which performance targets to be attained by the CE are established. In and after 1993, Chief Executive (CE) of a Ministry and the competent Minister are required to conclude a Purchase Agreement in which the outputs to be provided from CE to the competent Minister are clarified and performance targets for quality, time of delivery, quantity and cost are established. Quarterly performance reports on the degree of attainment of these performance targets are then submitted to a competent Minister.

8) ANAO (1999-00), Planning and Monitoring for Cost Effective Service Delivery - Staffing and Funding Arrangements - Centrelink (No.43).

9) ANAO (2000-01), Agencies' Performance Monitoring of Commonwealth Government Business Enterprises (No.15).

10) ANAO (1995-96), Matters Relating to the Proposed Sale of ANL Ltd (No.2).

11) ANAO (1998-99), Phase 2 of the Sales of the Federal Airports (No.48).

Under the Public Finance Act 1989 (PFA), each Ministry is required to prepare a Departmental Forecast Report (DFR), in which performance targets to be attained are established, and submit the DFR to the House of Representatives. The performance targets established in the DFR correspond to the outputs established in a Purchase Agreement. A Statement of Objectives and Service Performance (SOSP) that shows the degree of attainment of performance targets is then prepared, and submitted to the House of Representatives as data for the Annual Report of the Ministry.

## (2) Role of the SAI

In New Zealand, the Audit Office (AO) plays the role as described below in “Performance-based Management.”

a. Extensive implementation and qualitative improvement of performance measurements made by the government as a whole

To improve the quality of performance measurements made by the government as a whole, the AO prepared comprehensive reports<sup>12)13)</sup> in 2001 and 2002. In these audit reports, the AO explained: 1) the method to secure the relationship between outcome goals and output performance indicators; 2) the method to collect highly-reliable performance data; and 3) the method to select performance information to be included in an Annual Report, and also introduced the good practices undertaken by the Ministries.

b. Improvement of the reliability of performance reports made by Ministries

Under the PFA, the AO is authorized to audit SOSPs made by Ministries. AO expresses its views on whether SOSPs properly indicate the degree of attainment of performance targets. The AO’s audit report, which constitutes an Annual Report together with SOSPs, is submitted to the House of Representatives. Thus, the AO’s audit report contributes to an improvement in the reliability of performance reports made by Ministries. In addition to these audit reports, the AO prepares Financial Reviews in which evaluations are made for each Ministry’s financial control system and financial information system from the viewpoints of management. The AO submits these Financial Reviews to the Select Committee of the House of Representatives, which examines SOSPs made by Ministries.

## 2.2 Reform of the public accounting system

### (1) Outline of reforms

Under the PFA, every Ministry in New Zealand has prepared financial statements in accordance with the Generally Accepted Accounting Practice (GAAP) since 1991, and submitted these financial statements as part of its Annual Report to the House of Representatives. Under the PFA, the Treasury prepares the Financial Statements of the Government of New Zealand (FSGNZ) that consolidate the financial statements of all Ministries, Crown Entities and State-Owned Enterprises, and submits these documents to the House of Representatives.

Under the PFA, each Ministry has been required to prepare an accrual-based and output-based budget since 1991. Under this budget system, the total amount indicated in an Estimate of Appropriations represents the aggregate amount of costs of the outputs that were agreed between the competent Minister and the CE in a Purchase Agreement.

### (2) Role of the SAI

In New Zealand, the AO plays the role as described below in the reform of the public accounting system.

a. Extensive implementation and improvement of accrual basis accounting

(a) As then Auditor-General, Fred Shailes, had advocated the introduction of accrual basis accounting<sup>14)</sup> in 1978, the AO has actively addressed the reform of the public accounting system from that point. When a draft of the PFA was prepared, for example, the AO sent an officer as advisor to the Finance and Expenditure Committee of the

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12) AO (2001), Reporting Public Sector Performance - 1st edition.

13) AO (2002), Reporting Public Sector Performance - 2nd edition.

14) AO (1978), Report of the Controller and Auditor-General on Financial Management in Administrative Government Departments.



House of Representatives that examined the draft. In New Zealand, Ministries have adopted accrual basis accounting system in stages since 1991. To ensure that the accrual basis accounting system is implemented by all Ministries, the AO conducts audits of opening balance sheets and interim financial statements of Ministries.

(b) In New Zealand, a draft of GAAP was prepared by the Financial Reporting Standard Board (FRSB) that was established by the Institute of Chartered Accountants in 1992. The draft of GAAP was examined and finalized by the Accounting Standard Review Board, an independent institution. The FRSB has ten members, including the AO's Assistant Auditor-General who works as co-chairman.

b. Improvement of the reliability of financial statements

(a) In addition to SOSP mentioned in 2.1 (1), each Ministry is required to prepare: 1) a Statement of Financial Performance; 2) a Statement of Financial Position; 3) a Statement of Cash Flows, etc. Under the PFA, the AO is authorized to audit these financial statements. The AO expresses its views concerning: 1) whether financial statements are prepared in accordance with the GAAP; and 2) whether financial statements properly indicate each Ministry's Financial Performance, financial conditions, etc. The Audit Report made by the AO, which constitutes the Annual Report of each Ministry together with financial statements, is submitted to the House of Representatives. Thus, the AO's Audit Report contributes to the improvement of the reliability of financial reports made by the Ministries.

(b) The Treasury is required to prepare FSGNZ composed of: 1) a Statement of Financial Performance; 2) a Statement of Financial Position; 3) a Statement of Cash Flows, etc. Under the PFA, the AO is authorized to audit FSGNZ. The AO expresses its views concerning: 1) whether FSGNZ is prepared in accordance with the GAAP; and 2) whether FSGNZ properly indicates the state government's Financial Performance, financial conditions, etc. The AO's Audit Report, together with FSGNZ, is submitted to the House of Representatives. Thus, the AO's Audit Report contributes to the improvement of the reliability of FSGNZ for the state government.

(c) In New Zealand, a Fiscal Strategy Report (FSR) is prepared in the budgeting process every year, under the Fiscal Responsibility Act 1994 (FRA). In this Report, financial targets are established such that the average Net Debt be 20% or less of GDP during the economic cycle. In advanced Western countries that establish financial targets, financial indicators are usually determined by the System of National Accounting (SNA) calculation. In New Zealand, however, financial indicators, including Net Debt but excluding GDP, are determined based on FSGNZ that is subject to the AO's audit. Under the FRA, Forecast Financial Statements (FFS) for the government as a whole are also prepared, every year, in the budgeting process. Evaluations of the government's fiscal management are made by comparing target/forecast values established in FSR and FFS with actual values. The AO contributes to an improvement in the reliability of these evaluations by examining actual values in the audit of FSGNZ.

### 2.3 Role of the SAI in other fields of NPM

In New Zealand, the AO plays the roles as described below in NPM, in addition to the roles mentioned in above 2.1 and 2.2.

a. Auditing of independent agencies

In New Zealand, Crown Entities, including Crown Agents (CAs) in charge of implementation of policies, are established outside Ministries, under the PFA. Under the PFA, CAs are required to prepare a Statement of Intent in which three-year performance targets are established, and prepare a Statement of Service Performance (SSP) on the degree of attainment of performance targets. Under the PFA, each CA is also required to prepare financial statements in accordance with GAAP. Under the PFA, the AO is authorized to audit SSP and financial statements prepared by each CA. The AO's audit report, which constitutes the Annual Report of each CA together with SSP and financial statements, is submitted to the House of Representatives through the competent Ministry. Thus, the AO's audit report contributes to an improvement in the reliability of performance reports and financial statements prepared by all CAs.

To improve the governance of Crown Entities by each Ministry, the AO prepared a comprehensive report<sup>15)</sup> in 1996 based on fact-finding surveys of six Crown Entities. In the report, the AO pointed out that: 1) a competent

15) AO (1996), Report of the Controller and Auditor-General on Governance Issues in Crown Entities.

Minister does not adequately control Crown Entities; 2) performance measurements of Crown entities are not conducted in a proper manner; and 3) an excessively high compensation is paid to Directors-General of Crown Entities, and made recommendations to improve these conditions.

b. Auditing of State-Owned Enterprises

In New Zealand, the State-Owned Enterprises Act 1986 (SOEA) requires that the government's production and commercial activities be carried out by State-Owned Enterprises. Since 1987, State-Owned Enterprises have been established as companies in the power sector (Electricity Corporation of New Zealand Limited), the communications sector (Telecom Corporation), etc. The State-Owned Enterprises are required to prepare financial statements in accordance with GAAP under the SOEA. Under the SOEA, the AO is authorized to audit financial statements prepared by each State-Owned Enterprise. The AO's audit report, which constitutes the Annual Report of each State-Owned Enterprise together with financial statements, is submitted to the House of Representatives through a competent Ministry. Thus, the AO's audit report contributes to an improvement in the reliability of financial statements prepared by all State-Owned Enterprises.

As the case may be, the AO conducts performance audits for selected State-Owned Enterprises. In a 2000 audit report,<sup>16)</sup> for example, the AO focused on the case of National Air Traffic Services Consortium, which was established as a joint venture of Airways Corporation of New Zealand Limited and a foreign company. The supplier of air traffic control systems was changed from a conventional domestic company to a foreign company that was part of a joint venture. This change resulted in a loss suffered by domestic companies.

c. Auditing of local governments

Under the Local Government Act 1974, local governments are required to prepare Annual Plans in which performance targets are established, and prepare performance reports on the degree of attainment of such performance targets. Local governments are required to prepare financial statements in accordance with GAAP under the Local Government Amendment Act 1989. Under the Public Finance Act 1977, the AO is authorized to audit performance reports and financial statements prepared by each local government. The AO's audit report, which constitutes the Annual Report of each local government together with performance reports and financial statements, is then disclosed to the general public. Thus, the AO's audit report contributes to an improvement in the reliability of performance reports and financial statements prepared by all local governments.

As necessary, the AO conducts individual or theme-based comprehensive performance audits for local governments. To improve the quality of fiscal management by all local governments, for example, the AO prepared comprehensive audit reports in 1994 and 1999 based on extensive fact-finding surveys of all local governments. In these reports, the AO introduced a financial analysis approach using financial data from accrual basis accounting,<sup>17)</sup> and introduced good outsourcing practices of the administrative services.<sup>18)</sup>

### 3. The United Kingdom

#### 3.1 Performance-based Management

(1) Outline of the system

In the United Kingdom, Executive Agencies (EAs) in charge of the implementation of policies have been established within Ministries under the 1988 "Next Steps." Under a government decision made in 1992, each EA is required to prepare a Business Plan in which performance targets are established. A Performance Report on the degree of attainment of performance targets, which constitutes the Annual Report and Accounts of each EA, is then submitted to Parliament.

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16) AO (2000), Airways Corporation of New Zealand Limited: Review of Certain Matters Concerning the National Air Traffic Services (UK) Consortium.

17) AO (1994), A Guide to Monitoring the Financial Condition of Local Authorities.

18) AO (1999), Contracting out Local Authority Regulatory Functions.

Under the government's decision concerning the Comprehensive Spending Review (CSR) made in 1998, each Ministry was required to prepare a Public Service Agreement (PSA) for FYs 1999 through 2002, in which three-year policy objectives and performance targets to be attained by the Ministry were established. At present, performance measurements are made based on the PSA for FYs 2001 through 2004 and the Service Delivery Agreement for FYs 2001 through 2004 in which administrative activities to attain the policy objectives of the PSA are established. A Performance Report on the degree of attainment of performance targets, which constitutes the Departmental Annual Report of each Ministry, is submitted to Parliament.

## (2) Role of the SAI

Under "Performance-based Management" in the United Kingdom, the National Audit Office (NAO) plays the role as described below.

a. Extensive implementation and qualitative improvement of performance measurements made by the government as a whole

(a) To improve the quality of performance measurements made by all Ministries, the NAO prepared a comprehensive report<sup>19)</sup> on the performance measurements made by EAs, etc. in 2000, based on past performance audits and on such verification works for performance reports that were conducted upon the request of EAs. In the comprehensive report, the NAO explained: 1) the method of selecting appropriate performance indicators for evaluating the activities of EAs, etc.; 2) the method of collecting quality performance data; and 3) the method of preparing a persuasive performance report, and introduced good practices of EAs, etc.

(b) PSAs include Technical Notes that explain the definitions of established performance indicators, the method to measure performance indicators, and data sources. The draft Technical Notes are prepared by Ministries, and examined and finalized by the Technical Review Panel, including the NAO staff as advisory member.

(c) To improve the quality of performance measurements made by all Ministries, in 2001 the NAO prepared a comprehensive report<sup>20)</sup> on performance measurements for PSAs made by Ministries, based on fact-finding surveys of 17 major Ministries. In the comprehensive report, the NAO explained: 1) the method of selecting appropriate performance indicators for evaluating EA's policies; 2) the method of collecting quality performance data; and 3) the method to improve the achievement rate of performance targets, and introduced good practices made by Ministries.

b. Improvement of the reliability of performance reports, etc. made by EAs and Ministries

(a) The NAO is not auditing all performance reports made by all EAs. As the case may be, however, the NAO audits performance reports made by selected EAs, or audits performance reports of some EAs upon their request. The NAO's audit report, which constitutes the Annual Report of each EA together with the performance report, is submitted to Parliament. Thus, the NAO's audit report contributes to an improvement in the reliability of performance reports made by EAs.

(b) At present, the NAO is not conducting audits of performance reports on PSAs made by Ministries with the aim of improving the reliability of these reports. However, the NAO has the intention to improve such reliability in the future. This is because a project team of the House of Lords examined the necessity of external audits of performance reports, and publicized a report (the Sharman Report)<sup>21)</sup> in 2001, recommending that the NAO conduct audits of performance reports made by Ministries. Based on this report, the NAO prepared a standard guidebook<sup>22)</sup> containing the checklist to verify: 1) relationship between policies subject to evaluation and performance indicators; 2) the accuracy and reliability of performance data; and 3) the clarity of performance reports in collaboration with Her Majesty's Treasury that has jurisdiction over PSAs and other organizations. Thus, the NAO is making preparations for auditing all performance reports made by all Ministries.

19) NAO (1999-00), Good Practice in Performance Reporting in Executive Agencies and Non-Departmental Public Bodies (HC272).

20) NAO (2000-01), Measuring the Performance of Government Departments (HC301).

21) Sharman Report (2001), Holding to Account - The Review of Audit and Accountability for Central Government

22) NAO et al. (2001), Choosing the Right FABRIC - a Framework for Performance Information.

(c) In the United Kingdom, fiscal targets, including a target that the ratio of net debt to GDP be 40% or less, are established under the Code for Fiscal Stability 1998. Under the CSR, the gross amount of expenditures for three years is determined in consideration of estimated revenues, such as tax revenue, and fiscal targets, and a budget is allocated for the attainment of performance targets established in a PSA. Thus, the estimation of revenues is an important factor to determine the financial framework for the "Performance-based Management." To improve the reliability of the estimation of revenues, therefore, the NAO is obligated by the Code for Fiscal Stability 1998 to audit various preconditions: 1) economic growth rate, interest rates and price increase rate as preconditions for estimating tax revenue; 2) stock prices as preconditions for estimating revenue from the sale of stocks as a result of privatization; and 3) crude oil prices as preconditions for estimating revenue from North Sea oil fields.

### **3.2 Reform of the public accounting system**

#### **(1) Outline of reforms**

In the United Kingdom, EAs have prepared financial statements in accordance with the UK GAAP since FY 1988-89. These financial statements are submitted to Parliament as part of the Annual Report of EAs. Ministries have prepared financial statements (consolidated financial statements of each Ministry and EAs under its control) in accordance with the UK GAAP and submitted these documents to Parliament since FY 1999-00. All Ministries are obligated to prepare financial statements by the Government Resource and Accounts Act (GRAA) enacted in 2000. Under the GRAA, Her Majesty's Treasury is required to prepare the Whole of Government Accounts (WGA) that consolidate all financial statements of all Ministries. Her Majesty's Treasury prepares the WGA on a trial basis starting in FY 2000-01. In and after FY 2005-06, Her Majesty's Treasury will prepare the official WGA and submit this document to Parliament.

#### **(2) Role of the SAI**

In the reform of the public accounting system in the United Kingdom, the NAO takes the role as described below.

##### **a. Extensive implementation and improvement of accrual basis accounting**

(a) In the United Kingdom, the Resource Accounting Manual (RAM) was established as the government accounting standards in 1997. Her Majesty's Treasury prepared an original draft of the RAM, and since then the RAM was revised reflecting institutional changes and actual conditions. The NAO assisted Her Majesty's Treasury in preparing the original draft and revising the RAM. The original draft of the RAM and proposals for the revision of the RAM were examined and finalized by the Financial Reporting Advisory Board (FRAB) established in Her Majesty's Treasury in 1996. The Assistant Auditor General of NAO as member of this Board expresses the NAO's views.

(b) In the United Kingdom, starting in 1998, the Resource Accounting and Budgeting System applies to Ministries after these Ministries pass four Trigger Points (TP1 - TP4). To ensure that accrual basis accounting is adopted by all Ministries, the NAO conducts an audit of each Ministry at each TP. For example, the NAO conducts an audit of accounting standards for each Ministry at TP1, an audit of opening balance sheet at TP2, and an audit of trial financial statements at TP3. The results of these audits are then reported to the Public Accounts Committee of the House of Commons.<sup>23)</sup>

(c) Before the start of the TP process, in 1997 the NAO prepared a standard guidebook<sup>24)</sup> to supplement the RAM in order to improve the quality of trial financial statements made by Ministries and the efficiency of audits of these documents. In the guidebook, the NAO gives advice and guidance to Ministries as to: 1) the procedure of preparing trial financial statements; 2) the establishment of an internal control system; and 3) the procedure of

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23) NAO (1999-00), Note by the Comptroller and Auditor General (PAC191).

24) NAO (1997), Resource Accounts: Preparing for Audit.

undergoing NAO's audit of trial financial statements.

(d) To improve the quality of financial statements made by EAs and Ministries and the efficiency of audits of these documents, the NAO prepared a standard guidebook<sup>25)</sup> in 2001. In the guidebook, the NAO provides a checklist (yes/no formula) of matters to be noted by EAs and Ministries, such as: 1) compliance with accounting standards, including the RAM and the Companies Act 1985; 2) consistency between various financial statements; and 3) the effectiveness of the internal control system.

b. Improvement of the reliability of financial statements

(a) The organization of financial statements to be prepared by EAs is defined in the RAM. Under the RAM, each EA is required to prepare financial statements composed of: 1) an Operating Cost Statement; 2) a Balance Sheet; and 3) a Cash Flow Statement. Under the Exchequer and Audit Department Act 1921, the NAO is authorized to audit these financial statements. The NAO expresses its views concerning: 1) whether financial statements properly indicate each EA's operating costs, financial conditions and cash flows; 2) whether financial statements are prepared in accordance with related laws and regulations; and 3) the revenue and expenditure of each EA meet the intention of the House of Commons. The Certificate and Report of the Comptroller and Auditor General, which constitutes the Annual Report of each EA together with financial statements, is submitted to the House of Commons. Thus, the NAO contributes to the improvement of the reliability of financial statements made by EAs.

(b) The organization of financial statements to be prepared by Ministries is defined in the RAM. Under the RAM, each Ministry is required to prepare financial statements composed of: 1) an Operating Cost Statement; 2) a Balance Sheet; 3) a Cash Flow Statement, etc. Under GRAA, the NAO is authorized to audit these financial statements. The NAO expresses its views concerning: 1) whether financial statements properly indicate each Ministry's operating costs, financial conditions, etc.; 2) whether the budget amounts approved by Parliament were allocated to appropriate objectives; and 3) whether each Ministry's accounting treatment is made in accordance with related laws and regulations. The Certificate and Report of the Comptroller and Auditor General, which constitutes the Annual Report of each Ministry together with financial statements, is then submitted to the House of Commons. Thus, the NAO contributes to the improvement of the reliability of financial statements made by Ministries. Under the GRAA, the NAO is obligated to audit the WFA that is scheduled to be officially prepared with effect from FY 2005-06.

### 3.3 Role of the SAI in other fields of NPM

In addition to items 3.1 and 3.2 above, the NAO takes the role as described below in the field of NPM.

a. Auditing of agencies other than EAs

In the United Kingdom, Non-Departmental Public Bodies (NDPBs) are established outside Ministries under related laws. Those NDPBs that have the function to implement policies are referred to as "Executive NDPBs." Under the government decision made in 1992, Executive NDPBs are required to prepare Corporate Plans in which performance targets for the next 3~5 years are established. A performance report on the degree of attainment of these performance targets, which constitutes the Annual Report and Accounts of the Executive NDPB, is submitted to the House of Commons. In 2000, the NAO prepared a comprehensive report mentioned in 3.1(2)a.(a) to improve the quality of performance measurements made by all Executive NDPBs.

Under a government decision made in 1996, Executive NDPBs are required to prepare financial statements in accordance with UK GAAP in and after FY 1999-00. The NAO conducts auditing of financial statements made by some Executive NDPBs. These audit reports, which constitute Annual Reports and Accounts of Executive NDPBs together with financial statements, are submitted to the House of Commons. Thus, the NAO contributes to the improvement of the reliability of financial statements made by Executive NDPBs. As the 2001 Sharman Report<sup>21)</sup> recommended that the NAO conduct auditing of all NDPBs, the NAO expressed its intention to follow this

25) NAO (2001), Guidance for Departments: NAO Checklists (NAO form 113a, 113b, 113f, 113g).

26) NAO (2001-02), 2000-2001 General Report of the Comptroller and Auditor General.

recommendation.<sup>26)</sup>

b. Auditing of PPP projects

In the United Kingdom, the roles of the government were reviewed as economic conditions worsened. As a result of these reviews, the PFI (the Labour government changed this term to “PPP”) under which know-how and funds of the private sector are utilized in the fields of transportation, hospitals, etc. was introduced in 1992. For PPP projects, the NAO conducts individual or theme-based comprehensive performance audits. In the 1998 audit report,<sup>27)</sup> for example, the NAO pointed out that in the present value approach for the expressway PPP project being implemented by the Highways Agency and the Department of the Environment, Transport and the Regions, the discount rate of 8%, which is the rate for projects under the direct control of the government, was used instead of the discount rate of 6%, which is the rate for PPP projects, and as a result, the computed effect of the PPP project is overvalued by £68 million. To improve the quality of PPP projects implemented by all Ministries, in 1999 the NAO prepared a comprehensive audit report<sup>28)</sup> based on the past performance audits for PPP projects. In this audit report, the NAO explained: 1) the method of encouraging competition when inviting tenders; 2) the method of comparing alternative proposals; and 3) the method of appraising the contract performance capability of bidders, and introduced the good practices of Ministries.

c. Audits in connection with the privatization of state-owned enterprises, etc.

Since 1979, assets of Ministries have been sold and state-owned enterprises have been privatized in the United Kingdom because the roles of the government were reviewed as a result of the worsening of its fiscal situation. Revenues from the sale of such assets and stocks have greatly contributed to an improvement in the budget balance of the government. To evaluate the influences of the sale of assets or privatization on the revenue of the government or competition in the domestic market, the NAO conducted performance audits in connection with the sale of assets by Ministries or the privatization of state-owned enterprises in oil and aviation sectors. In its 1997 audit report,<sup>29)</sup> for example, the NAO pointed out that British Petroleum and British Airways sold stocks not by public tender but by the method of underwriting by institutional investors, and as a result, selling prices of stocks were 0.11% to 4.3% below market value.

## 4. The United States

### 4.1 Performance-based Management

(1) Outline of the system

In the United States, cabinet-level Departments (24 major Departments) have been required to prepare Annual Performance Plans in and after FY 1999 under the Government Performance and Results Act of 1993 (GPRA). In the Annual Performance Plan, each Department establishes: 1) Strategic Outcomes to be attained; 2) Performance Goals needed to evaluate the degree of attainment of Strategic Outcomes; 3) strategies and resources needed to attain Performance Goals; and 4) the procedure to verify actual figures in Performance Goals. These Performance Goals are established in accordance with the Strategic Plan in which Strategic Goals for 5 years or so are established. Annual Performance Reports on the degree of attainment of Performance Goals are prepared every year, and submitted to Congress.

(2) Role of the SAI

The General Accounting Office (GAO) takes the roles as described below in the field of “Performance-based Management.”

a. Extensive implementation and improvement of performance measurements made by the federal government as a whole

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27) NAO (1997-98), The Private Finance Initiative: the First Four Design, Build, Finance and Operate Roads Contracts (HC476).

28) NAO (1998-99), Examining the Value for Money of Deals under the Private Finance Initiative (HC739).

29) NAO (1996-97), Sales of the Government’s Residual Shareholdings in BP, BAA and in Other Privatised Companies (HC265).

(a) Before performance measurements were introduced in the United States, pilot projects were implemented for a period from FY 1994 to FY 1996. Based on the results thereof, performance measurements have been implemented on a full scale. To ensure that performance measurements are adequately made by all Departments, the GAO continued to prepare comprehensive reports on the results of pilot projects, and expressed its views on matters to be noted in improving the quality of performance measurements. In the 1996 report<sup>30)</sup> on FY 1994 performance reports for 13 pilot projects, for example, the GAO commented that: 1) the degree of attainment of Strategic Outcomes can be evaluated only if there is a clear relationship between Strategic Outcomes and Performance Goals; 2) an evaluation of efficiency can be made only if Performance Goals have Goals based on cost information; and 3) the realistic evaluation of Performance Goals can be made only if actual figures of performance indicators for the past few years are disclosed in an annual performance report.

(b) Even after pilot projects were completed, the GAO has prepared 19 comprehensive reports (“Managing for Results” series) (as of May 2002) on performance measurements made by Departments. In these reports, the GAO expressed its views on matters to be noted in improving the quality of performance measurements. In the 2002 report<sup>31)</sup> on FY 2002 Annual Performance Plans and FYs 1999/2000 Statements of Net Cost that were prepared by 24 Departments, for example, the GAO pointed out as follows: 1) to reflect the results of performance measurements in budget, it is desirable that items of Performance Goals in an Annual Performance Plan correspond to items of Program Activities in the budget document, but this kind of correspondence is observed only for a few Departments; and 2) to make evaluations based on cost information, it is desirable that items of Strategic Outcomes in an Annual Performance Plan correspond to items as computation units in a Statement of Net Cost, but this kind of correspondence is observed only for a few Departments. At the same time, the GAO introduced representative samples concerning the degree of correspondence between items of Annual Performance Plans, budget documents and Statements of Net Cost.

(c) To improve the quality of performance measurements made by all Departments, the GAO prepared three standard guidebooks (“Executive Guide” series) that describe issues to be noted by Departments in preparing Strategic Plans and Annual Performance Plans, within the period from 1994 to May 2005. In the 1996 guidebook,<sup>32)</sup> for example, the GAO explained: 1) the necessity to analyze social and economic conditions surrounding Departments when establishing Strategic Outcomes; 2) the necessity of establishing Performance Goals for each Strategic Outcome and for each section that contributes to the attainment of the Strategic Outcome; and 3) the necessity of analyzing the causes if the degree of attainment of Performance Goals is low for certain policies, and introduced the good practices of the Departments.

The reason why the GAO is actively making an effort to encourage performance measurements and improve the quality thereof is probably because the GAO is deemed to be the supervisory organization under the GPRA, and Office of Management and Budget (OMB) is not active in this regard, as the GPRA was enacted by an initiative of Congress.

#### b. Improvement of the quality of performance reports made by departments

At the request of Congress, the GAO has so far audited all Annual Performance Plans and Annual Performance Reports made by all Departments. Of the policies subject to evaluation by a certain Department, the GAO points out problems for such important policies that are considered to be of primary concern to Congress, and makes recommendations for improvement to the Department. In the 2001 report<sup>33)</sup> on FY 2000 Annual Performance Report and FY 2002 Annual Performance Plan made by the Department of Transportation, for example, the GAO recommended that: 1) if a Performance Goal is not set at a proper level for a certain policy, the Performance Goal be set at the proper level and the reason of such change be clarified; 2) if the degree of attainment of a Performance Goal is low for a certain policy, an alternative strategy be adopted; and 3) as a policy to secure safety for pipelines is increasingly important for the Department of Transportation, the number of dead and injured

30) GAO (1996), GPRA Performance Reports (GAO/GGD-96-66R).

31) GAO (2002), Managing for Results - Agency Progress in Linking Performance Plans and Budgets and Financial Statements (GAO-02-236).

32) GAO (1996), Executive Guide - Effectively Implementing the Government Performance and Results Act (GAO/GGD-96-118).

33) GAO (2001), Department of Transportation - Status of Achieving Key Outcomes and Addressing Major Management Challenges (GAO-01-834).

persons in connection with pipelines be included in Performance Goals. The GAO's audit reports are submitted to Congress, and contributing to an improvement in the reliability of Performance Plans and Performance Reports made by all Departments.

## 4.2 Reform of the public accounting system

### (1) Outline of reforms

In the United States, Departments (24 major Departments) have been required to prepare accrual-based financial statements since 1996 under the Chief Financial Officers Act of 1990 (CFOA) and the Government Management Reform Act of 1994 (GMRA). These financial statements, as part of the Annual Reports of Departments, are submitted to Congress. Under the CFOA and GMRA, the Department of the Treasury (DOT) has prepared the Financial Statements of the United States Government (FSUSG) that consolidate financial statements of all Departments, part of the law-making organs/legal authorities, Government Corporations (GCs), etc. since FY 1997, and submitted these documents to Congress.

### (2) Role of the SAI

In the reform of the public accounting system in the United States, the GAO takes the role as described below.

#### a. Extensive implementation and improvement of accrual basis accounting

(a) In the United States, the Federal Accounting Standards Advisory Board (FASAB), established in 1990, prepares a draft of accounting standards to be applied to the federal government, and this draft is finalized through approval from the DOT, OMB and GAO. Under the CFOA, the DOT, OMB and GAO, which are responsible for financial reports made by the federal government, have jointly established the FASAB comprising nine members, including a member from the GAO (Chief Accountant). For the period from 1993 to May, 2002, the FASAB has prepared three Statements of Federal Financial Accounting Concept (SFFAC) and 22 Statements of Federal Financial Accounting Standard (SFFAS), both as Federal Accounting Standards. In 1999, the American Institute of Certified Public Accountants recognized the FASAB as the appropriate institution to prepare the Generally Accepted Accounting Principles (GAAP) to be applied to the federal government.

(b) Under the 1990 CFOA, Departments were required to prepare accrual-based financial statements only for Revolving Funds/Trust Funds and commercial activities. Under the 1994 GMRA, however, accrual basis accounting has been applied to the financial statements for all operations of all Departments, and to the consolidated Financial Statements of the United States Government. This may be because in 1994 then Comptroller General of the United States, Charles A. Bowsher, testified before the House of Representatives' Committee on Government Operations,<sup>34)</sup> based on the results of audits of financial statements that were made by the GAO over three-and-a-half years after the CFOA was enacted. In his testimony, Bowsher pointed out that: 1) correct and useful financial information was made available due to the introduction of accrual basis accounting; 2) defects of the internal control system and the financial management system were clarified; and 3) the necessity of the financial information system exploiting the latest IT technology was recognized. At the same time, Bowsher requested that Congress apply accrual basis accounting to the financial statements for all operations of Departments and to the consolidated Financial Statements of the United States Government itself.

(c) To improve the quality of accrual-based financial statements, the Federal Financial Management Improvement Act of 1996 (FFMIA) was enacted in the United States. Under the FFMIA, Departments were obligated to operate the financial management system in accordance with: 1) the Federal Financial Management System Standards; 2) the Federal Accounting Standards (including SFFAS); and 3) the U.S. Government Standard General Ledger. Under the FFMIA, every year since FY 1997, the GAO has prepared a comprehensive report<sup>35)</sup> on how the requirements of the FFMIA are to be met by Departments. In this report, the GAO has clarified: 1) whether Departments' financial management system is operated in accordance with the requirements of the

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34) GAO (1994), Financial Management - CFO Act is Achieving Meaningful Progress - (GAO/T-AIMD-94-149).

35) GAO (1998), Financial Management - Federal Financial Management Improvement Act Results for Fiscal Year 1997 - (GAO/AIMD-98-268), etc.



FFMIA; 2) whether Departments' financial statements are prepared in accordance with Federal Accounting Standards (including SFFAS); and 3) whether appropriate Federal Accounting Standards (including SFFAS) are established, and these findings have been submitted to Congress.

(d) Out of recognition that the quality of accrual-based financial statements made by Departments cannot be improved unless Departments meet the requirements of the FFMIA, the GAO has prepared 10 standard guidebooks (the "Checklist" series) detailing the issues to be noted by Departments in operating their financial management systems, for a period from 1998 to May 2002. In the "Checklist" series, the GAO provides a checklist (yes/no formula) of points to be noted by the 24 Departments in meeting the requirements of the FFMIA, concerning: 1) traveling expense management system, the personnel and compensation management system and the asset management system; 2) the cost accounting system used for processing financial data; and 3) the financial management system as a whole, which integrates all the systems mentioned in items 1) and 2).

**b. Improvement of the reliability of financial statements**

(a) The organization of financial statements to be prepared by Departments is defined in the OMB Bulletin No.01-09. Under this Bulletin, Departments are required to prepare: 1) a Balance Sheet; 2) a Statement of Net Costs; 3) a Statement of Changes in Net Position, etc., as financial statements. Under the CFOA, these financial statements are audited by the Inspector General (IG) of each Department, or by an external audit corporation that concludes an audit contract with the IG. The GAO has prepared the Government Auditing Standards<sup>36)</sup> and the Financial Audit Manual<sup>37)</sup> that are used by the above auditors. Thus, the GAO contributes to an improvement in the reliability of audit reports.

Under the CFOA, the GAO is authorized to audit financial statements in place of the above auditors. So far, the GAO has not audited the financial statements covering all the institutions of each Department, but has audited the financial statements of some institutions of a particular Department (for example, the Internal Revenue Service or Bureau of the Public Debt belonging to the DOT). Based on these audits, the GAO has expressed its views on: 1) whether financial statements are prepared in accordance with the GAAP to be applied to the federal government (such as SFFAS), and these financial statements properly indicate the financial conditions and Net Costs of an institution; 2) whether the internal control over the process of making financial statements is effective; and 3) whether financial statements are prepared in accordance with related laws and regulations.

(b) The DOT prepares the FSUSG comprising 1) a Balance sheet; 2) a Statement of Net Costs; 3) a Statement of Operations and Changes in Net Position, etc. Under the GMRA, the GAO is authorized to audit the FSUSG. The GAO expresses its views on: 1) whether the FSUSG is prepared in accordance with the GAAP to be applied to the federal government (such as SFFAS), and whether the FSUSG properly indicated the financial conditions and Net Costs of the federal government; 2) whether the internal control over the process of making the FSUSG is effective; and 3) whether the FSUSG is prepared in accordance with related laws and regulations. The Auditor's Report made by the GAO, together with the FSUSG, is submitted to Congress. Thus, the GAO contributes to an improvement in the quality of the FSUSG made by the federal government. (For reason that the federal government's financial information system was unreliable and its internal controls ineffective, the GAO has not expressed its views on the appropriateness of the FSUSG for FYs 1997 through 2001: the FSUSG for FY 1997 was the first such statement.)

### 4.3 Role of the SAI in other fields of NPM

In addition to items 4.1 and 4.2, the GAO takes the role as described below in the field of NPM in the United States.

**a. Auditing of Government Corporations (GCs)**

In the United States, GCs are required to prepare Strategic Plans in which Overall Goals for approximately a five-year period are established, and Annual Performance Plans in which Performance Goals needed to attain these

36) GAO (1994), Government Auditing Standards (1994 Revision).

37) GAO et al. (2001), Financial Audit Manual (GAO-01-765G).

Overall Goals are established. GCs prepare Annual Performance Reports on the degree of attainment of such Performance Goals, and submit these Reports to Congress. The GAO is not auditing all Annual Performance Plans made by all GCs. Upon request of Congress, the GAO audits some Annual Performance Plans made by selected GCs. Auditor's Reports made by GAO are submitted to Congress, and thus, the GAO contributes to an improvement in the reliability of Annual Performance Plans and Annual Performance Reports made by selected GCs.

Under the Government Corporation Control Act of 1945 and the CFOA, GCs are required to prepare financial statements in accordance with the US GAAP. Under the CFOA, these financial statements are audited by the IG of each GC, or by an external audit corporation that concludes an audit contract with the IG. The GAO has prepared the Government Auditing Standards and the Financial Audit Manual that are used by the above auditors. Thus, the GAO contributes to an improvement in the reliability of audit reports. Under the CFOA, the GAO is authorized to audit financial statements in place of the above auditors. So far, the GAO has audited only the financial statements of the Federal Deposit Insurance Corporation (FDIC), mainly in accordance with the stipulations of the Federal Deposit Insurance Act. Auditor's Report for the FDIC and its financial statements are then submitted to Congress. Thus, the GAO contributes to an improvement in the reliability of financial statements made by the FDIC.

b. Auditing of PPP projects

In the 1990s, the roles of the U.S. federal government were reviewed due to the worsening of fiscal conditions. Under the Executive Order No.12803 dated April 1992, etc., the PPP concept that utilizes know-how and funds from the private sector was introduced for the construction or management of national property, such as parks, government buildings, etc. The GAO has conducted comprehensive performance audits for existing or planned PPP projects, based on fact-finding surveys, or contracted out studies by private asset management companies. In 2001, for example, the GAO contracted out cost-benefit analyses to audit corporations, etc. for the proposed ten PPP projects that were studied by General Services Administration (GSA). In a comprehensive report<sup>38)</sup> made based on the results of such analyses, the GAO pointed out: 1) in two out of ten cases, Internal Rate of Return (IRR) is likely to be low; and 2) in six out of ten cases, cash flow is likely to be negative. At the same time, the GAO recommended that GSA implement pilot programs to demonstrate that the PPP approach is more desirable than other options, including new budgetary appropriation or the disposition of existing national property, in terms of IRR, cash flow, etc. (For a list of roles of the SAI in NPM in selected countries, refer to Table 3.)

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38) GAO (2001) Public-Private Partnerships-Pilot Program Needed to Demonstrate the Actual Benefits of Using Partnerships (GAO-01-906)

Table 3. List of roles of the Supreme Audit Institution (SAI) in NPM

(FY 2000/01)

Item	Country	Australia (ANAO)	New Zealand (AO)	The United Kingdom (NAO)	The United States (GAO)
"Performance-based Management" in government Ministries/ Departments		<ul style="list-style-type: none"> <li>• Auditing of the implementation of performance measurements and the introduction of good practices</li> <li>• Auditing of performance reports made by selected Ministries</li> </ul>	<ul style="list-style-type: none"> <li>• Auditing of the implementation of performance measurements and the introduction of good practices</li> <li>• Auditing of performance reports made by all Ministries</li> </ul>	<ul style="list-style-type: none"> <li>• Auditing of the implementation of performance measurements and the introduction of good practices</li> <li>• Auditing of performance reports made by selected Executive Agencies</li> <li>• Auditing of estimated revenues</li> </ul>	<ul style="list-style-type: none"> <li>• Auditing of the implementation of performance measurements and the introduction of good practices</li> <li>• Preparation of a guidebook for preparing performance reports, etc.</li> <li>• Auditing of Annual Performance Plans and Annual Performance Reports made by all Departments</li> </ul>
Reform of the public accounting system in government Ministries/ Departments		<ul style="list-style-type: none"> <li>• Audits in a transitional phase</li> <li>• Preparation of a guidebook for preparing financial statements</li> <li>• Auditing of financial statements of all Ministries</li> <li>• Auditing of consolidated financial statements of the federal government</li> </ul>	<ul style="list-style-type: none"> <li>• Audits in a transitional phase</li> <li>• Participation in the government accounting standards advisory board</li> <li>• Auditing of financial statements of all Ministries</li> <li>• Auditing of consolidated financial statements of the government</li> </ul>	<ul style="list-style-type: none"> <li>• Audits in a transitional phase</li> <li>• Participation in the government accounting standards advisory board</li> <li>• Preparation of a guidebook for preparing financial statements</li> <li>• Auditing of financial statements made by all Executive Agencies and Ministries</li> </ul>	<ul style="list-style-type: none"> <li>• Audits in a transitional phase</li> <li>• Participation in the federal accounting standards advisory board</li> <li>• Auditing of the financial management systems adopted by all Departments</li> <li>• Preparation of a guidebook for operating financial management systems</li> <li>• Preparation of the Government Auditing Standards and the Financial Audit Manual</li> <li>• Auditing of financial statements made by selected Departments</li> <li>• Auditing of consolidated financial statements made by the federal government</li> </ul>
Others (government-owned corporations)		<ul style="list-style-type: none"> <li>• Auditing of the Centrelink</li> <li>• Auditing of performance reports made by selected Commonwealth Authorities and Commonwealth Companies</li> <li>• Auditing of financial statements made by all Commonwealth Authorities and Commonwealth Companies</li> <li>• Audits in connection with the privatization, etc., of Commonwealth Companies</li> </ul>	<ul style="list-style-type: none"> <li>• Auditing of performance reports and financial statements made by all Crown Agents</li> <li>• Auditing of financial statements made by all State-Owned Enterprises</li> <li>• Auditing of performance reports and financial statements made by all local governments</li> </ul>	<ul style="list-style-type: none"> <li>• Auditing of financial statements made by selected Executive NDPBs</li> <li>• Auditing of PPP projects</li> <li>• Audits in connection with the privatization, etc. of state-owned enterprises</li> </ul>	<ul style="list-style-type: none"> <li>• Auditing of performance reports and financial statements made by selected Government Corporations</li> <li>• Auditing of PPP projects</li> </ul>

Note: ANAO, AO, and NAO contract out a part of the auditing of financial statements to audit corporations.

## IV. Implications for Japan

In Japan, the basic principles of NPM theory are adopted in administrative management. As for “Performance-based Management,” a policy evaluation system was introduced in January 2001, and independent administrative institutions were established in April 2001. As for the reform of the public accounting system, corporate accounting principles are applied to independent administrative institutions. At the central government level, however, only balance sheets (on a trial basis) have been prepared since FY 1998. Under these conditions, the writer would like to examine the roles of the Board of Audit of Japan hereunder with reference to the trends in advanced Western countries.

### 1. Performance-based Management

(1) Extensive implementation and improvement of performance measurements made by the government as a whole

The policy evaluation system requires that three evaluation methods, which are project evaluation, performance measurement and program evaluation, be adopted. Since some of these evaluation methods were introduced for the first time in Japan, it seems to take a long time for policy evaluations to take root and demonstrate the expected effects. This is because it may take time to refine evaluation methods to the level that they are really effective as it is rather difficult to identify the effects of policies, or to establish a causal link between the outputs (administrative activities) and their effects.

Therefore, it is recommended that the Board of Audit of Japan: 1) audit the implementation of policy evaluations made by all Ministries and the conditions of the use of evaluation results,<sup>39)</sup> and 2) ask for improvements if there are inappropriate practices based on audit results,<sup>40)</sup> and introduce good practices. Thus, the Board of Audit of Japan can contribute to the extensive implementation and improvement of policy evaluations by all Ministries.

(2) Improvement of the reliability of performance reports, etc. made by all Ministries

Under the Government Policy Evaluation Act, the Ministry of Public Management, Home Affairs and Posts and Telecommunications (MPHP) is authorized to undertake evaluation activities to ensure that policy evaluations will be objectively and strictly made by all Ministries under the policy evaluation system. The details of these evaluation activities are defined in the Basic Principle of Policy Evaluations approved by the cabinet in December 2001 and the Administrative Evaluation Program announced by the MPHP in April 2002. According to the definition, the MPHP is authorized to conduct “examinations of objectivity and strictness in the formality of policy evaluations made by administrative organizations.” In other words, the Ministry’s examinations are only superficial.

Therefore, it is recommended that the Board of Audit of Japan: 1) in the project evaluations, verify economy calculation as a precondition for approval of projects<sup>41)</sup> and verify the cost-benefit ratio computed beforehand in comparison with actual figures at the time of audit;<sup>42)</sup> and 2) in the performance measurements, verify that target values of performance indicators are set at appropriate levels and actual figures of performance indicators are correct and not biased. The Board of Audit of Japan may then contribute to an improvement in the reliability of performance reports made by Ministries by conducting audits of the details of policy evaluations made by Ministries.

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39) Refer to the Board of Audit of Japan (1999), “The Conditions of Introduction of the Evaluation System in Ministries, etc.” (FY 1998 audit report).

40) Refer to the Board of Audit of Japan (2001), “The Re-Evaluation of Public Works” (FY 2000 audit report).

41) Refer to the Board of Audit of Japan (2000), “The Case that Action Demand was Made so that the Project May be Implemented Efficiently through the Exhaustive Examination of Economy Efficiency when Determining the Location of Wastewater Treatment Facility under the Rural Sewage Project” (FY 1999 audit report).

42) Refer to the Board of Audit of Japan (1998), “The Case that Action Demand was Made so that the Irrigation and Sewage Project May be Implemented Efficiently by Correctly Grasping the Scheduled Timing of the Start of Affiliated Projects and by Reflecting Results in the Evaluation of the Project” (FY 1997 audit report).

## 2. Reform of the public accounting system

### (1) Extensive implementation and improvement of accrual basis accounting

In Japan, corporate accounting principles have been applied to independent administrative institutions since FY 2001. At the central government level, however, the Study Group on the Method to Explain Fiscal Conditions (the Ministry of Finance) only began to prepare balance sheets (on a trial basis) in FY 1998, and the Fiscal System Council only began to study the guidelines for the preparation of accrual-based financial statements for special accounts in FY 2001. These moves, however, are not made under any uniform initiative. If corporate accounting methods are introduced in the public accounting system, government accounting standards will be needed because there are differences between administrative and corporate activities. To ensure that accrual basis accounting takes root, it is important to establish a board to examine the government accounting standards to be applied to general account, special accounts, public corporations, and independent administrative institutions.

Therefore, if a government accounting standards advisory board is established, it is recommended that the Board of Audit of Japan participate in the board as a member, and express its views on the principles and procedures of accounting treatment as an organization to verify the financial statements of all Ministries. This is because government accounting standards will be the criteria for determining whether financial statements are properly made or not. Thus, the Board of Audit of Japan may contribute to ensuring that accrual basis accounting is adopted by all Ministries.

### (2) Improvement of the reliability of financial statements, etc.

In Japan, the financial statements of government corporations and independent administrative institutions are audited by the Internal Auditors. In the case of independent administrative institutions whose capital is above 10 billion yen, their financial statements are also audited by external auditors. The audit reports made by these auditors are playing an important role in improving the reliability of financial statements. However, the government auditing standards to which auditors should conform in their audits have not so far been established, although they are important in ensuring the appropriateness of contents of audit reports and in establishing the limitations of audit activities.

The Board of Audit of Japan may not always audit all financial statements of all government corporations and independent administrative institutions, because its budget and staff are limited. However, the Board of Audit of Japan may contribute to the improvement of the reliability of audit reports by preparing government auditing standards that define: 1) the conditions of eligible auditors; 2) the auditing procedure; and 3) the entry items for such an audit report.

Financial statements will be made in accordance with related laws and regulations, government accounting standards, etc. However, if these laws and regulations do not properly reflect institutional changes or actual conditions, those financial statements that are prepared in accordance with these laws and regulations will not always properly indicate the financial conditions or costs of government corporations or independent administrative institutions. Since Internal Auditors or external auditors are not given the authority to ask for the amendment to these laws and regulations and therefore they must admit these laws and regulations as given conditions, they enter their opinions in financial statements.

If related laws and regulations do not reflect actual conditions, the Board of Audit of Japan may contribute to the improvement of the reliability of financial statements: 1) by clarifying the matters to be noted in correctly understanding the financial statements of government corporations or independent administrative institutions;<sup>43)</sup> 2) by asking for amendments, if any financial statements do not properly reflect financial conditions, etc. of government corporations or independent administrative institutions;<sup>44)</sup> or 3) by asking for amendments, when any laws or regulations do not reflect actual conditions.

43) Refer to the Board of Audit of Japan (1998), "Land Development Projects of Tomakomai Tobu Kaihatsu Corporation and Mutsu Ogawara Kaihatsu Corporation that are Invested and Financed by Hokkaido-Tohoku Development Corp." (FY 1997 audit report).

44) Refer to the Board of Audit of Japan (1998), "Investment and Finance Projects for the Exploration of Oil, etc." (FY 1997 audit report).

## V. Concluding remarks

From the viewpoint of government mechanisms, the basic principles of NPM theory admit that the cabinet is given extensive discretionary power in implementing Policies and Parliament controls the cabinet based on the effects of policies. Before policies are implemented, budget proposals reflecting performance plans are submitted to Parliament, and after policies are implemented, performance reports and financial statements are submitted to Parliament. After having understood the effects of policies implemented by the cabinet with reference to such performance reports and financial statements, Parliament examines budget proposals for a new fiscal year in which policies are to be reviewed. To ensure that Parliament's control over the cabinet is effective, therefore, it is essential to maintain the reliability of performance reports and financial statements. In advanced Western countries that have introduced NPM theory, it is the SAI—independent from the cabinet—that makes an effort to maintain and improve the reliability of performance reports and financial statements.

In Japan, "Performance-based Management" is implemented as policy evaluations are conducted by all Ministries. The public accounting system has been partially reformed as corporate accounting principles are applied to independent administrative institutions. To ensure that administrative methods utilizing NPM theory will be effective, it is essential to improve the reliability of performance reports and financial statements because Ministries' subjective views tend to be included therein. Therefore, the Board of Audit of Japan, which is independent from the cabinet, is expected to play the important role of improving the reliability of performance reports and financial statements.

### [Bibliography]

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3. The Japan Productivity Center for Socio-Economic Development (2001), "Research and Studies on the Current Conditions and Problems of the Reform of Public Accounting System and of the Analysis of Financial Statements and Fiscal Conditions in Major Advanced Western Countries—Focusing on the Case of the United Kingdom—" (FY 2000 report contracted by the Board of Audit of Japan).
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5. The Institute of Statistical Research (2000), "Case Studies on Performance Audits by the Supreme Audit Institution—Focusing on Field Surveys in the GAO—" (FY 1999 report contracted by the Board of Audit of Japan).