

# Risks and Countermeasures of National Audit Office Purchasing Social Audit Services

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## Abstract

With the process of "full audit coverage", the expectations of national audit work are getting higher and higher, which means that the requirements for national auditors will increase accordingly. However, due to the disparity between audit resources and work requirements, purchasing external audit services has become a normalized collaborative cooperation model. This article starts with the analysis of the motivations for the state auditing agency's purchase of social auditing resources. Through the exploration of the business outsourcing process, it summarizes several potential risks, and then discusses the decision-making optimization of purchasing external services and the construction of a quality management system based on the risks. Relevant materials and actual work development, and put forward optimization suggestions on the control and management of national audit business outsourcing, with a wish to optimizing audit work results and improving audit work efficiency.

## Keywords

Government Audit; Business Outsourcing.

## 1. Introduction

With the development of the audit coverage process, government audit institutions in China will face more arduous audit tasks, especially some new types of audit business, which are obviously a big challenge to the traditional working methods. Therefore, we should plan ahead and actively deal with the difficulties to ensure the smooth completion of the audit.

With the continuous development and improvement of government agencies' purchase of public services, the purchase of external services has become a normal trend. According to the 2020 final accounts report of the National Audit Office, the expenditure earmarked for purchasing related external services is 26.7408 million yuan; In 2019, this part of the expenditure was 28.2206 million yuan; In 2018, it was 29,906,700 yuan. It can be seen that in the process of constructing the "full audit coverage" system, it is more and more common for state audit institutions to purchase external services (such as hiring social auditors and technology). As a service provider of macro-economy, national audit not only plays a supervisory role in public funds, state-owned assets and resources, but also plays a role in safeguarding security and the implementation of major policies. The idea of purchasing social audit services can make comprehensive use of social audit resources, and can also better combine the advantages of both. And the purchase of social audit services is mainly targeted at social audit, so that the purchase behavior with the government as the main body can not only help to realize the effective integration and utilization of public resources, but also maximize public interests.

This paper will analyze the risk, necessity and feasibility of purchasing external services (social audit services as the main research object) by the national audit department, and give some targeted countermeasures from different angles based on the results. Admittedly, there will be some inevitable defects in this process, and most of the potential risks can be avoided through

prior research and analysis. Therefore, strengthening the risk prevention in the purchasing process and accurately identifying the risk types and their probability are the necessary procedures to improve the efficiency of purchasing social audit services by state audit institutions and ensure the quality of audit work.

## 2. Theoretical Basis

### 2.1. The Concept of National Audit

State audit refers to the audit and supervision by state audit institutions on the financial revenues and expenditures and economic benefits of various departments of the State Council, local people's governments at all levels and their departments, state-owned financial institutions, state-owned enterprises and institutions and other state-owned assets in accordance with relevant laws and regulations. [Qin Rongsheng: Auditing, Renmin University of China Press, 2017, p. 16] In addition to specialized audit institutions (such as the Audit Office), state audit institutions also include professional audit institutions such as finance, taxation, customs, the People's Bank of China or specialized banks. the author sorts out the main projects of government audit in various countries, see Figure 1.

Obligation & Country	1. Audit of policies, plan implementation and compliance with laws and regulations		2. Financial audit								3. Audit on the performance of government responsibilities				4. Audit of state-owned financial institutions and enterprises		5. Foreign audit	6. Consultation	7. Expenditure control	8. Prior audit of laws and regulations	9. Participation in budgeting	10. Review the income and property declaration of public officials
	1. Audit of the implementation of national policies and plans	2. Audit of compliance with laws and regulations	1. Audit of financial budget implementation and draft final accounts	2. Audit of financial statements or other reports	3. Audit of financial transfer payment	4. Government investment audit	5. Government procurement audit	6. Social security audit	7. Tax audit	8. Government debt audit	1. Audit on the performance of public officials in government departments	2. Government administrative performance audit	3. Responsibility audit of development, management and maintenance information system	4. Environmental responsibility audit	1. Audit of state-owned financial institutions	2. Audit of state-owned enterprises						
USA	yes	yes		yes	yes									yes	yes	yes		yes				
FR	yes							yes	yes	yes	yes			yes	yes	yes						
BRA	yes			yes				yes	yes					yes	yes	yes					yes	
RUS	yes	yes	yes	yes										yes	yes	yes				yes		
ITA	yes	yes	yes	yes							yes	yes	yes	yes	yes	yes				yes		
GER	yes							yes						yes	yes	yes	yes	yes		yes		
GBR	yes	yes		yes			yes						yes	yes	yes	yes	yes	yes			yes	
KOR		yes		yes							yes			yes	yes	yes						
AUS			yes	yes	yes				yes	yes				yes	yes	yes					yes	
CAN				yes	yes									yes	yes	yes			yes			
JPN						yes	yes		yes	yes					yes	yes						
IND								yes						yes	yes	yes			yes			

Figure 1. Main contents of government audit in major countries

### 2.2. The Concept of Full Audit Coverage

On December 8th, 2015, the Chinese government website published the "Implementation Opinions on Implementing Full Audit Coverage" issued by the CPC Central Committee and the General Office of the State Council, which covers seven parts: the target requirements for implementing full audit coverage, full audit coverage of public funds, full audit coverage of state-owned assets, full audit coverage of state-owned resources, full audit coverage of leading cadres' performance of economic responsibilities, strengthening the overall integration of audit resources, and innovating audit techniques and methods. In March, 2018, in order to build a centralized, unified, authoritative, efficient and comprehensive audit supervision system, the Central Audit Committee was established, which is also a sign that audit supervision has become an important part of national governance, which means that the full coverage of audit will be based on the full coverage of business, realizing the systematic transformation to full coverage of supervision.

### 3. The Motivation of National Audit Purchasing Social Audit Service

#### 3.1. Staff

##### 3.1.1. Lack of the Number of Auditors

Relevant data show that by the end of 2018, there were 92,000 government auditors in China, and more than 113,000 enterprises and institutions needed to be audited. With the process of "full audit coverage", such disparity in manpower will only present a severe situation of yoga. At the same time, due to the limitation of the administrative system, it is difficult for audit institutions in most countries to expand their staffing at will to expand the demand for manpower. Therefore, it is inevitable to use external audit forces to perform business.

##### 3.1.2. Lack of Competence of National Auditors

According to the annual final report of the National Audit Office, in 2018, the National Audit Office spent 36,407,900 yuan on education (various education and training expenditures for improving the knowledge structure of audit teams, improving the party spirit, auditing ability according to law and comprehensive professional quality of auditors); The expenditure in 2019 was 30,232,700 yuan, see Figure 2. With the progress of science and technology, in the process of audit informatization, the demand direction of auditors is developing towards compound talents, that is, they have a high level of information technology while mastering audit professional knowledge. However, as far as the current situation is concerned, most auditors in Chinese audit institutions are accounting and auditing majors, and their knowledge is narrow. Although the professional ability of auditors can meet the needs of audit informatization, their level is far from the standard, which affects the work efficiency and restricts the scope of work to a certain extent.

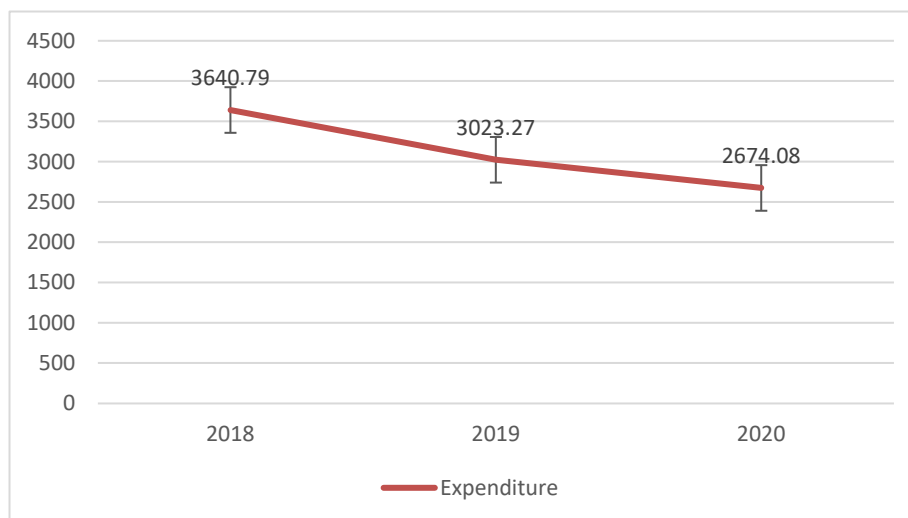


Figure 2. Statistics of the National Audit Office's expenditure on education in recent three years (unit: 10000 yuan)

##### 3.1.3. Expansion of Social Auditing Power

According to statistics, in 2018, CICPA had 106,020 practicing members (CPAs). By December 31, 2020, the number had reached 111,113, with 35,768 partners (shareholders). At the same time, the number of stock exchanges is increasing year by year, even far exceeding the number of listed companies. According to the financial secretary's disclosure, as of December 31, 2020, there were 111,113 certified public accountants, 35,768 partners (shareholders) and 8,628 accounting firms (excluding branches) in the whole country. The whole industry provided audit verification and other professional services for more than 4,000 listed companies and more than 8,000 New Third Board enterprises. It can be seen that social audit resources are sufficient

and audit strength is strong. The purchase of social audit resources by the state audit can not only fill the gap between auditors and business, but also make efficient use of CPA's human resources.

### **3.2. Job Responsibility**

#### **3.2.1. Expansion of the Scope of Work**

On the one hand, China will set up a central audit committee; On the other hand, it will continue to optimize the responsibilities of the Audit Commission. This also means the expansion of the scope of national audit work. With the development of full coverage, national audit institutions will face more arduous audit tasks, especially some new audit businesses (such as big data audit), which are obviously a big challenge to the traditional working methods.

#### **3.2.2. Commonness of Working Methods**

According to the development status of domestic and foreign audit, it is usually divided into government audit, social audit and internal audit according to audit subjects. Although they are different in the subject and object of execution, the auditing methods are the same. In the process of national audit and social audit, review method, check method, comparison method, analysis method, etc. are all needed. It is also necessary to use sampling technology and related information technology to assist the implementation of audit work. In addition, both kinds of audits must go through three stages: preparation, implementation and completion. From the directory of CPA's business guidance, it can be found that more than a quarter of the business contents are like those of audit institutions, such as budget fund audit, audit related to enterprises and institutions, etc. Therefore, it is feasible to use external audit force to complete the national audit business.

#### **3.2.3. Advantages of Cooperation**

Certified public accountants can flexibly use diverse audit experiences and methods. On the one hand, outsourcing can make use of social audit resources, which helps to improve audit efficiency and optimize audit results. On the other hand, the integration of business is conducive to the realization of the guiding role of government audit in the macro direction, so as to better standardize the social audit industry. Therefore, this kind of purchase behavior is not only in line with the principle of cost-effectiveness, but also conducive to the macro-control of the national economy and the unified norms of the audit industry.

### **3.3. Summary of Relevant Laws and Regulations**

In 2006, the National Audit Office promulgated the "Administrative Measures of the National Audit Office on Engaging External Personnel to Participate in Audit Work". Since then, there have been rules for government audit outsourcing. In 2010, Shanghai took the lead in promulgating the relevant implementation regulations and issued the Interim Measures for Implementing the CPA Audit System for Municipal Financial Special Funds. Subsequently, more provinces and cities clearly put forward relevant standardized management measures for purchasing behavior; In 2016, Qinghai and Gansu introduced the relevant management measures for purchasing social audit services, and proposed that audit services can be purchased from other external institutions in case of special circumstances such as insufficient audit strength; At the end of 2015, China Central Office issued the "Framework Opinions on Several Major Issues in Improving the Audit System", which made full audit coverage the primary task of improving the audit system. It is clearly pointed out that subordinate units can outsource audit business to social audit units to seek external support on the premise of establishing an effective verification mechanism.

### **3.4. Use of Foreign Audit Service Outsourcing**

In the 1980s, the Australian government carried out microeconomic reform, and the Joint Committee of Public Accounting questioned the Australian Audit Office, which promoted the application and promotion of the outsourcing of the Australian Audit Office. Take the Australian Audit Office as an example. In 2012 alone, 350 employees had to undertake more than 370 audit projects. Therefore, outsourcing some audit projects has been the consistent practice of Australian Audit Office in resource management since 1988. At present, more than half of Australian Audit Office's financial audit and some performance audit projects are undertaken by external companies. In western countries, such as the United States, Germany, Sweden, etc., performance audit outsourcing will also be adopted. Thus, the outsourcing of national audit has become a common measure in all countries of the world.

## **4. Risk Analysis of National Audit Purchasing Social Audit Service**

### **4.1. Risk to Staff**

#### **4.1.1. Particularity of National Audit Work**

The state audit mainly accounts and supervises the use of state financial funds, which means that some important information that should not be made public will inevitably be involved in the work process, and it involves a wide range of fields. However, the implementation of audit requires auditors to fully understand the relevant situation of the audited entity, which increases the risk of information leakage. In addition, due to the complexity of the leadership system of China's administrative system, the objectivity and independence of internal control and internal audit information may be insufficient, and it is difficult to provide effective help to outsourcing staff.

#### **4.1.2. Moral Hazard of Foreign Personnel**

As shown in the previous data, the supply of certified public accountants is in short supply, while the national audit focuses on budget audit, and the risk of misstatement is smaller than that of external enterprises. Therefore, there may be risks in the audit process such as mere formality and inadequate audit work. In addition, because the national audit work is based on the theory of public entrusted economic responsibility, there are certain requirements for auditors' sense of mission and dedication, while social auditors may lack awareness in this respect, which also leads to increased risks such as information leakage and loss of independence.

#### **4.1.3. Working Ability of Foreign Workers**

On the one hand, due to the emphasis of national audit on budget audit, the lack or inadequacy of internal control system, and the difference of business processes between government agencies and external enterprises, the authenticity and reliability of some financial information are insufficient. On the other hand, some outsourcers' professional knowledge level and professional competence may also be lacking, and the lack of sufficient national audit experience may lead to professional judgment bias, which in turn will affect the depth and breadth of audit work. In addition, CPA audit is quite different from government audit. The former is more inclined to the audit of financial behavior, while the latter focuses on the audit of ruling behavior and ability and involves many departments and industries, which may lead to the relative lack of experience of CPA and affect the control system of audit quality.

### **4.2. Risk to Staff**

#### **4.2.1. Lack of Effective Restriction Mechanism**

Social audit organizations are usually companies with independent legal personality, which not only ensures a certain degree of independence, but also means that it is difficult to directly and

effectively supervise and restrict them. However, the behavior of purchasing external services is only based on the written cooperative relationship, and there is no subordinate relationship, which may cause external personnel to disobey the administrative orders of audit institutions. In addition, if there are flaws in the work of social auditors, it will be difficult for audit institutions to directly impose effective penalties, and it will be even more difficult to effectively supervise and manage the whole business process. All these may lead to risks to the quality of work.

#### **4.2.2. Budget Limits for Purchasing Services**

According to the 2019 final accounts report of the National Audit Office, the expenditure earmarked for hiring experts in related fields in that year to assist in completing the audit task was 28,220,600 yuan; In 2018, this part of the expenditure was 29,906,700 yuan; In 2017, it was 27,921,400 yuan. In the 2020 budget report, it is clearly proposed to reduce this part of the funds, implement the requirements of the party and the central government to "live a tight life" and reduce general expenditures. This will undoubtedly become one of the limiting factors for audit institutions to purchase external services: on the one hand, the budget reduction may lead to the purchase of social audit services not being included in the budget arrangement, making the purchase behavior lose the source of funds, and even slowing down the project progress; On the other hand, the reduction of budget may also affect the frequency and depth of audit work and increase the risk of audit quality.

### **4.3. Risks of Contractual Relationship**

#### **4.3.1. Legal and Regulatory Risks**

Because China's construction of "integration of three trials" is still in the initial stage and lacks relevant experience, the relevant laws and regulations are still not perfect and there are no standards to follow. At present, there are some clear policy documents to support purchasing behavior, but there are no standards to clearly divide the types and scope of outsourcing business, and no guidance to the form of outsourcing, let alone to the outsourcing process and follow-up supervision and management. However, due to regional differences and uneven development level of audit technology, there is a lack of unified management and standards for government audit purchasing services. Therefore, the implementation details of purchasing behavior can be described as random. These great uncertainties will not only lead to all kinds of risks in the purchasing process of government agencies, but also hinder and restrict the social auditors in implementing the project process. In addition, the imperfection of laws and regulations also leads to a series of problems, such as difficulty in determining responsibility for follow-up problems, difficulty in finding responsibility for violations, etc.

#### **4.3.2. Risk of Contract**

Generally speaking, accounting firms will have their own contract templates to protect their rights and interests to the greatest extent and in the widest range. However, as the government audit outsourcing is a new type of business which is still in the exploratory stage, it is difficult to give a unified model for the contract of this kind of business, and various clauses still need to be improved. In addition, different from ordinary business cooperation, the particularity of government audit business projects makes it difficult to apply the traditional contract template, and the risks of contract terms are also difficult to predict, and the standard of responsibility division is unprecedented. However, if the ambiguity in the process of establishing the contractual relationship leads to disputes, it will affect the efficiency of audit work, and even lead to subsequent disputes such as expenses and responsibilities.

#### **4.3.3. Risk of Bidding**

In the process of outsourcing, government agencies usually choose partners by bidding. In this process, it is hard to avoid "rent-seeking risk": some government employees may engage in

corruption for their own benefit, interfere in the bidding process, affect the fairness and impartiality of bidding, and pose a threat to the quality of audit business. In addition, there may be the risk that social audit organizations will not only collect service fees from government agencies, but also seek profits with audited units, which will lead to false audit results.

## **5. Suggestions on National Audit Purchasing Social Audit Services**

### **5.1. Suggestions about the Staff**

#### **5.1.1. Narrow the Scope of Outsourcing Business**

First of all, when purchasing audit services, we should not only analyze from the perspective of cost-effectiveness, but also comprehensively measure whether the audit business is suitable for outsourcing, such as choosing the business with low information risk and single industry. Secondly, audit institutions should also strengthen the training of internal auditors, encourage staff to receive continuing education and understand information technology, so as to cultivate auditors with both professional ability and knowledge level, and build a compound talent echelon to improve audit efficiency at the source and avoid purchasing external services. Finally, audit institutions can also choose to cooperate with universities and local units to broaden the choice of seeking external help, which is also conducive to reducing expenditure.

#### **5.1.2. Improve the Communication and Supervision System in the Implementation Process**

For externally hired CPAs, the early government audit institutions can enhance communication through standardized short-term training system, bilateral auditors' exchange meetings and other forms, and help CPAs understand the business nature and characteristics of audited units and government agencies. It's best to work out a quality control system and reach a consensus on the terms of the contract in the preparation stage, so as to lay a benchmark recognized by both parties for the audit work. In the implementation stage of the work, timely communication should be conducted on a regular basis based on the progress of the work, and on-site supervision and guidance should be strengthened. It is best for government auditors to participate in the work of the project team in the whole process. In the reporting stage, the relevant personnel of the audit institutions should review the audit work and timely communicate with the outsourcing project team on the audit results, and set up a performance evaluation system according to specific indicators, which can be used as the evaluation standard for the quality of each outsourcing business.

#### **5.1.3. Strengthen the Screening of Accounting Firms**

On the one hand, before purchasing services, audit institutions should conduct a comprehensive and detailed review process for alternative firms, and consider various indicators to select the best partner. On the other hand, government agencies can provide a platform to promote the daily communication of auditors, and integrate the information of auditors in various industries to form a reserve talent pool. It not only helps to select auditors when seeking external services, but also helps practitioners to learn from each other and improve the overall level of the audit industry. In addition, for the work items that are different between CPA audit and government audit, when selecting partners, you can give priority to CPA with relevant experience background, or establish long-term cooperative relationship to train CPA in government audit business, so as to improve auditors' professional competence.

### **5.2. Suggestions on the Quality of Work**

#### **5.2.1. Strengthen the Restriction Mechanism**

As the Chinese government mainly adopts cash basis accounting, it can agree to settle the expenses after the project is completed when purchasing services, and make use of the time

difference of fund payment to achieve the purpose of restriction. On the one hand, the National Audit Office should strengthen the supervision of social audit organizations in conjunction with the Ministry of Finance and relevant regulatory authorities, and punish irregularities such as leaks and concealment in the course of audit business execution, so that audit institutions have direct binding force on outsourcing organizations. On the other hand, the Institute of Certified Public Accountants should also strengthen the supervision of CPA's practice, fill the loopholes in the system with written regulations, and assist the lack of supervision with public supervision. Finally, the information about government audit outsourcing projects should be published on the official platform as much as possible, and supervised by the public, to regulate the practice behavior of certified public accountants.

### **5.2.2. Minimize Transaction Costs**

In the 2020 budget report published by the National Audit Office, it is clearly proposed to reduce this part of the funds, implement the requirements of the party and the central government to "live too hard" and reduce general expenditures. Therefore, before purchasing, the government should investigate the market-related business expenses in advance and make budget arrangements. At the same time, different budget standards should be made according to different levels and technologies of purchasing services to avoid the risk of insufficient funds. On the other hand, regular training can be given to the staff in order to improve the competence of audit institutions, which can not only improve the quality of internal work, but also help to get rid of the dependence on outsourcing.

## **5.3. Suggestions on Contractual Relationship**

### **5.3.1. Legal and Regulatory Risks**

Although there are some laws and regulations that support the outsourcing of government audit, there is still a lack of a unified rules and regulations to clearly define each link in the outsourcing process. However, the lack of uniform regulations will increase the "outsourcing chaos" caused by factors such as regional differences and business development level. Therefore, the National Audit Office and relevant departments should issue a unified and universal law and regulation, which can provide a guiding reference for local audit institutions to purchase services. In addition, local authorities should also issue opinions on the implementation of purchasing behavior, and improve supporting measures, so as to improve the standardization of purchasing business and realize experience sharing in the industry.

### **5.3.2. Risk of Contract**

The Australian Audit Office began to outsource audit projects in the early 1980s. Up to now, more than half of the audit projects of the Australian Audit Office have been completed through outsourcing. According to ANAO's disclosure, the Australian Audit Office has established a strict quality control system according to the outsourcing contract management cycle. Such a system also enlightens us that the potential risks of outsourcing contracts can be avoided through the following countermeasures: firstly, the responsibilities division and confidentiality system should be clearly defined in the contract, and a consensus should be reached on the corresponding supervision and checks and balances system; Secondly, we should draw up standardized contract templates applicable to more situations as soon as possible and adjust the details of clauses in time to avoid unexpected risks; Finally, while auditing the quality of audit projects, we should also pay attention to outsourcing business quality control activities, and regularly select outsourced audit projects for review.

### **5.3.3. The Risk of Bidding**

First of all, the details of all business dispatch, such as information of appointing certified public accountants, details of expenses, etc., should be specified in the bidding documents; Secondly, the bidding process should ensure fairness, justice and transparency, and the contract should



be signed in time after the winning result is determined; Finally, we should give full play to the supervision of the public, and make the bidding, bidding, bid evaluation, business process and even the later assessment system of business outsourcing properly disclosed to the public through the public platform, so as to avoid abuse of power, internal and external collusion and other behaviors that affect the authenticity and fairness of audit work, and make the risks transparent.

## 6. Conclusion

Under the background of rapid economic development, audit, as one of the main governance mechanisms of modern countries, plays an important role in politics and law. However, in the face of the inevitable disparity between resources and business, and the difference between expectations and manpower, rational use of business outsourcing rights is not only conducive to the synergy of the "integration of three audits", but also conducive to building a shared platform for auditing information exchange and macroeconomic management, and it is also a good opportunity to integrate resources as a whole and meet the challenges of transformation. This paper focuses on the national audit's purchase of social audit services, analyzes the feasibility, and summarizes the risks of purchasing business processes and the corresponding countermeasures. Audit institutions shoulder the heavy responsibility of supervising and managing the use of state budget funds, and outsourcing management will be an effective means for audit institutions to meet challenges. Therefore, more practice and research are needed.

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