

# **A Brief Introduction to China's Auditing of Energy Conservation**

## **I. Overview of CNAO's audit of energy conservation**

Owing to limited domestic resources and environmental capacity, plus the impact of global energy security efforts and countermeasures against climate change, the restraint on China's resources and environment has been increasingly tightened. In order to propel society-wide energy conservation in China, improve energy utilization efficiency and economic performance, protect the environment, safeguard national economic and social development, satisfy people's needs of life, the Chinese government formulated the *Energy Conservation Law of the People's Republic of China*. The *Eleventh Five-Year Plan for National Economic and Social Development of the People's Republic of China* (2006-2010) for the first time incorporated "energy conservation & emission reduction" into its content. Thereafter, the Chinese government progressively unveiled a series of energy conservation & emission reduction policies including the *Comprehensive Work Plan on Energy Conservation and Emission Reduction in the "Twelfth Five Year Plan" Period* (2011-2015), *Opinions of the State Council on Accelerating the Development of Energy Conservation and Environmental Protection Industries* etc.

The National Audit Office of China of China (CNAO) attaches great importance to audit supervision on the protection of resources and environment. In order to perform audit supervision, it made active attempts to expand the audit scope of China's resources and environment, based on the historical background of nationwide energy conservation & emission reduction initiative which intermingle political, economic and environmental factors. Since 2008, the National Audit Office of China organized and unfolded four special audits of energy conservation & emission reduction, including two performance audits of the management and use of public funds in local governments' energy conservation & emission reduction, one audit of the implementation of energy conservation & emission reduction policies in key enterprises in electricity, steel, and cement industries, and one audit of funds under the accounting subject of "conservation and utilization of resource and energy" (hereinafter referred to as 'audit of accounting subject').

Since August 2014, CNAO has carried out a real-time audit of the implementation of

policies to ensure stable growth, boost reform, adjust structure and benefit the people, among which one of the most important audit content is to promote the implementation of policy measures for the development of energy conservation and environmental protection industries. According to decrees including the *Opinion of the State Council on Accelerating the Development of Energy Conservation and Environmental Protection Industries*, our audit projects shall mainly cover promoting high-efficiency boiler, demonstration & popularization of new energy vehicle, and upgrading of key energy-using equipment, accelerating the favorable policy for people purchasing energy conservation products, and for government procurement of for energy conservation environment-friendly products, expanding energy conservation and environmental protection service industry, Energy Performance Contracting (EPC) management, implementing environment-related fiscal & tax policy and setting up market-based financing model. In the “13th Five Year Plan” period (2016-2020), CNAO will follow requirements of the *Outline of the 13<sup>th</sup> Five-Year Plan for the National Economic and Social Development of the People's Republic of China*, propel all-round energy conservation, focus on “de-capacity” and carry out real time audit of phasing out outdated capacity policy, and special audit investigation on energy conservation & emission reduction by revolving around .

Meanwhile, China’s local audit institutions also organized and unfolded energy conservation special audit investigations. For instance, in the second half of 2014, Shanghai Municipal Audit Office organized and unfolded a special audit investigation on energy conservation of public buildings in the city. The energy conservation of public buildings is a key task in Shanghai’s energy conservation & emission reduction work. The audit investigation placed emphasis on implementation and enforcement of laws, policies and regulations concerning public building energy conservation, management of energy conservation in public buildings, management of special fund subsidy etc, involving the Municipal Housing, Urban and Rural Construction Management Committee, the Municipal Development and Reform Commission, the Municipal Government Offices Administration, the Municipal Commission of Health and Family Planning, the Municipal Tourism Administration, the Municipal Commission of Commerce, and the Municipal Commission of Education. The audit team spot checked some public building energy conservation projects in 7 downtown districts headed by Huangpu District, spot checked existing building energy conservation renovation projects completed between 2011 and 2013 totaling

3,738,100 sqm, building energy conservation projects with application of renewable energy totaling 5,224,900 sqm, which respectively accounted for 72.14% and 43.48% in completed areas; spot checked 236 building energy conservation projects receiving financial subsidy during the 3 years, which involved a total of 101,593,300 yuan subsidy fund, accounting for 76.13% in total subsidy amount (from the *Auditing Survey Results of Energy Conservation of Public Buildings in Shanghai by the Shanghai Municipal Audit Office* 2015 No. 42).

This paper will mainly introduce the above-mentioned “audits of accounting subject” in energy conservation & utilization category organized and unfolded by CNAO.

## **II. Audit background and auditing program**

In order to further the audit of execution of central financial budget, propel rational practice and standard financial management, promote effective implementation of proactive fiscal policies, standardize distribution management of special transfer payment, CNAO tried to combine “audits of accounting subject” with audits of budget execution\ and special funds for energy conservation and utilization. The audit covered two years’ funds subject to budget arrangement and transfer payment by central government in energy conservation & utilization category in 18 provinces. These funds mainly focused on the policy targets of propelling energy conservation and consumption reduction in industrial and construction fields, accelerating the favorable policy for people purchasing energy conservation products, supporting development of renewable energy, improving integrated utilization of waste & discarded resources. Through this innovative auditing model, we intended to accomplish overall evaluation of the performance of special funds and policies for energy conservation & utilization, and meanwhile the auditing outcomes can also serve the purpose of central budget execution audit. The audited entities involved ministries including the Ministry of Finance, the National Development and Reform Commission, the Ministry of Industry and Information Technology, the Ministry of Housing and Urban-Rural Development, the National Energy Administration and 18 provincial people’s governments and relevant departments, as well as key enterprises and project units involved in the “audits of accounting subject”.

Main contents of the “audits of accounting subject” audit include: Budget arrangements of “audits of accounting subject” in energy conservation & utilization category arranged by the central budget, fund allocation and fund management and

usage, construction of energy conservation & utilization projects and fulfillment of policy targets, truthfulness and completeness of final accounts.

Major foundations of this audit are based on policies, laws and regulations including the *Audit Law of the People's Republic of China*, *Energy Conservation Law of the People's Republic of China*, the *Comprehensive Work Plan on Energy Conservation and Emission Reduction in the "Twelfth Five Year Plan" Period* and administrative regulations of relevant departments.

### **III. Audit methodology and problems identified**

By combining financial audit and performance audit, the “audits of accounting subject” solves problems in past audits where only a small quantity of samples get spot checked due to scattered organization, limited labor and time, in order to reflect and estimate the overall situation. Detailed practices in this audit are as follows:

Firstly, it clarified the guideline and methodology for work, which laid down important foundation for accomplishing targets. IT application has facilitated full coverage of fund allocation. All audit teams were requested to invest sufficient auditing strength to guarantee an average 60% of spot-checking. “eEasy-to-fill, energy-based, quick-to-consolidate” auditing work forms have been designed, and audit subject matters listed in each special fund must follow operation guidance.

Secondly, it set up cross-department joint work group, which provided organizational guarantee for project execution. More than a dozen staff from the Department of Resources and Environment Protection Audit, the Department of Finance Audit, the Department of Administration Affairs Audit, the Department of Fixed Assets Investment Audit, and the IT Center of the National Audit Office of China formed the temporary work group, which was mainly responsible for compiling audit work plan, worksheet and audit report outline, assembling & releasing work updates, coordinating audit in ministries, answering questions from field audit teams, consolidating electronic data and analyzing data, compiling & distributing audit circulars, and consolidating & drafting audit report etc.

Thirdly, it explored the application of IT audit for fiscal fund, so as to provide technical support to ensure the full coverage of fund allocation. Before the “audit of accounting subject” began, several senior auditors were dispatched to public financial departments of some provinces, cities and counties to perform special survey, and compiled the draft of standard data table. During the audit, considering the fact that

the budget management systems, accounting systems and payment systems adopted by financial departments in various regions were developed by different software developers, survey forms and trial forms were later distributed, so that all audit teams can put forward opinions for improvement and amendment based on actual conditions in different regions, which were discussed and amended by auditors to develop a template of standard form. All auditing teams finally finished filling standard forms. The “audit of accounting subject” discovered that, some entities of energy conservation utilization projects fabricated fake application materials to fraudulently acquire and swindle relevant fund; some entities misappropriated or diverted relevant fund for production and operation, or for paying expenditure. Due to lenient approval by competent departments, and non performance of responsibility by third party auditing institutions, some entities illegally obtained relevant fund through applying for big project but building small project, and repeated applications. The audit also revealed that some entities failed to meet the expected policy targets.

#### **IV. Audit impact and rectification**

After problems discovered by the “audit of accounting subject” were pointed out, some local departments and project entities have returned some of the misappropriated or diverted fund to the original fund channel, or recover some fund that were fraudulently acquired or swindled. The audit also transferred clues to a number of cases to the judicial organs.

Based on this audit, CNAO analyzed a number of existing problems in the current industrial policies for energy conservation with financially support, and drafted audit circulars, which received concern from relevant departments, generating concrete results.

#### **V. Challenges and difficulties**

Because of contradictions between workload, time and labor, the “audit of accounting subject” in energy conservation & utilization category lacks in depth and breadth. This audit only used audit resources of CNAO and its regional offices, and did not engage local audit offices. compared to , The audit resources did not match the total fund size and the total workload. Owing to limited labor and time, although the quantity of audit extensions met the requirements set in the audit program, the audit quality still needs improvement. Specifically speaking, analysis and study on some

systemic issues lack in depth.

The complexity in software usage in the public financial sector also increases the difficulty of the IT application during auditing. To achieve full coverage of auditing in the allocation step, ICT support was indispensable. Yet IT audit depends on the degree and condition of IT application in the audited entities. IT auditing was rather difficult given the fact that the types and versions of backend databases of the budget indicator management systems are different, and that the information systems are not inter-connected for information sharing.