A step by step guide to Performance Audit

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This article explores the principles of a performance audit. I start by exploring the meaning and objectives of a performance audit then go into the nitty-gritty of getting one done.

What is a performance audit?

A performance audit is an unbiased, objective, and trustworthy investigation of whether business systems, operations, programs, activities, or organizations are running in line with economic principles and whether there is an opportunity for development in terms of efficiency and effectiveness.

Performance auditing aims to give new information, analysis, or insights and, where applicable, improvement recommendations.

- Providing new analytical insights (broader or deeper analysis or new perspectives);
- Making existing information more accessible to various stakeholders;
- Providing an independent and authoritative view or conclusion based on audit evidence; and
- Providing recommendations based on an analysis of audit findings

Objectives of a performance audit

- The primary goal of performance auditing is to promote cost-effective, operative, and efficient governance, and it also adds to openness and accountability.
- Performance auditing encourages responsibility by supporting people in charge of governance and supervision in improving their performance. It accomplishes this by analyzing whether policy, legislative, and executive choices are made and implemented efficiently and effectively.

Parties to a performance audit

1. Auditors typically have much leeway regarding the subject matter and determining criteria, which impacts who the responsible parties and intended users are. While auditors can make suggestions, they must be careful not to take on the parties' obligations in charge. In most performance audits, auditors operate as part of a team with various abilities that complement

each other.
2. Several persons or entities may share the position of the responsible party, each having accountability for a distinct portion of the subject matter. Some parties may be to blame for the difficulties that have arisen as a result of their conduct. Others might be able to make improvements in response to a performance audit's suggestions. Others may be in charge of supplying information or proof to the auditor.
3. The individuals for whom the auditor creates the performance audit report are the intended users. Among the planned users are the legislature, government agencies, and the general public. An intended user can also be a responsible party, although it is rarely the sole one.

Economy, efficiency, and effectiveness

The following are definitions of the principles of economy, efficiency, and effectiveness, which are the components of a performance audit:

- The idea of economy entails lowering resource costs as much as possible. The resources employed should be accessible on schedule, in sufficient quantity and quality, and reasonable.
- The efficiency concept entails making the most out of limited resources. It is concerned with the link between the resources used and the amount, quality, and timeliness of the products delivered.
- The concept of effectiveness is concerned with getting the desired results and reaching the established objectives.

Performance audits frequently include an examination of the circumstances that must be met to maintain the principles of economy, efficiency, and effectiveness. These circumstances might consist of effective management policies and processes that ensure that services are delivered correctly and on schedule. The influence of the regulatory or institutional framework on the audited entity's performance should be considered where relevant.

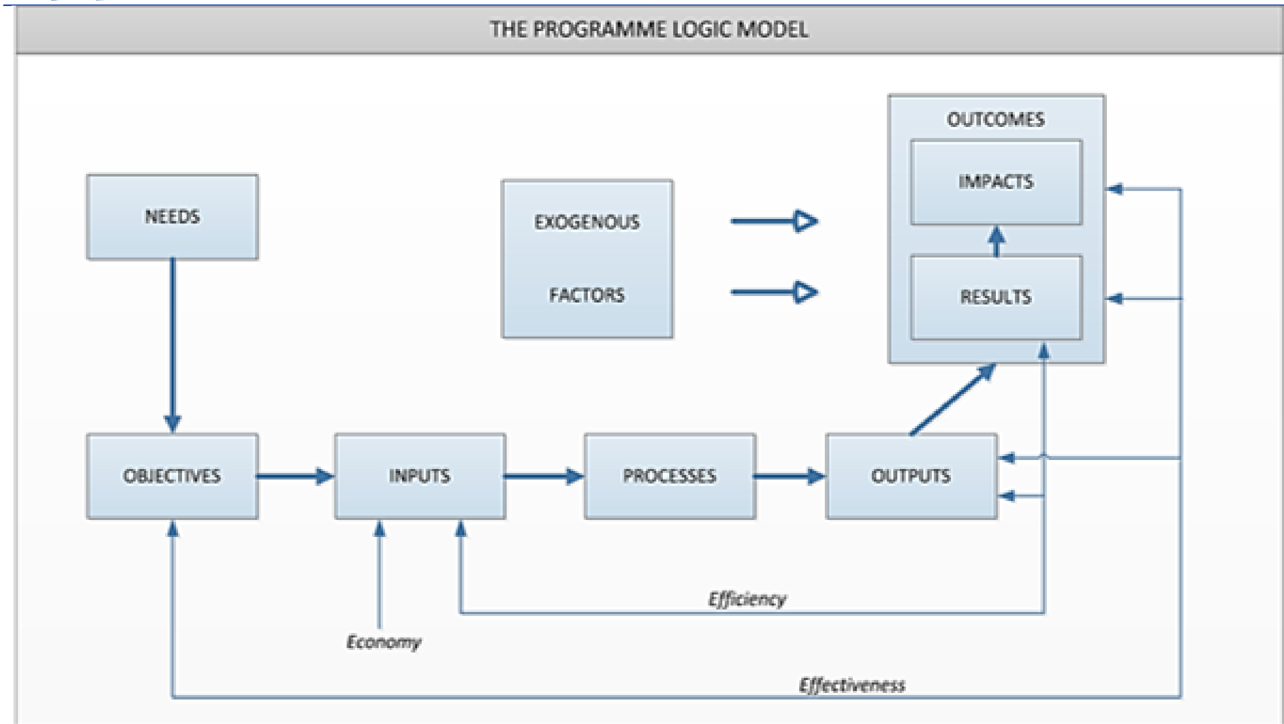
Applying the 3 e's

A public intervention, regardless of its form (policy, program, measure, or project), can be analyzed as a collection of financial, organizational, and human resources mobilized to achieve an objective or set of objectives in a given period, to solve or overcome a problem or difficulty affecting targeted groups.

The use of logic models can assist the audit team in identifying and defining the relationship between the intervention's socio-economic needs and its objectives, inputs, processes, outputs, and outcomes, which include results (immediate changes that occur for direct addressees after they complete a public intervention) and impacts (longer-term effects of the intervention).

In theory, performance audits should examine all components and linkages in such models by concentrating on the three "e's": economy, efficiency, and effectiveness.

An example of a Program Logic Model is illustrated in the diagram below:



Source:https://www.eca.europa.eu/Lists/ecadocuments/PERF_AUDIT_MANUAL/PERF_AUDIT_MANUAL_EN.PDF

Economy

When an organization or activity might drastically cut the costs of inputs for a given level of outputs or results, economic issues arise. The following are some examples of general dangers in this area:

- Waste, i.e., Obtaining resources that are used but could have been obtained at a lower cost;
- Overpaying, i.e., Obtaining resources that are used but could have been obtained at a lower price; and
- Gold-plating, i.e. Obtaining a higher quality of input than that required to achieve the desired outputs or results.

As a result, an economic audit is concerned with establishing if the most suitable and low-cost inputs are used to meet the set goals. It will examine whether:

- The audited entity obtains the appropriate type, quality, and quantity of resources at the lowest possible cost;
- The audited entity manages its resources to reduce overall expenditure; and
- The intervention could have been designed or implemented more cost-effectively.

Efficiency

Efficiency issues arise when an entity or action could boost the quantity or quality of outputs or results while using fewer resources.

General risks in this area include:

- Leakages, i.e., Resources used do not result in desired outputs;
- Non-optimal input/output ratios (e.g. Low labor efficiency ratios);
- Slow intervention implementation; and
- Failure to identify and control externalities, i.e., Costs imposed on individuals or entities outside the intervention's or organization's boundaries.

As a result, an efficiency audit determines if the resources used and the outputs or outcomes generated are in the best possible connection. The critical question is whether outputs or results have been maximized in terms of quantity, quality, and timing for the level of resources available. Efficiency is closely related to the concept of "productivity," and the critical question is whether outputs or results have been maximized in terms of quantity, quality, and timing for the level of resources available. The audit will look into things like whether:

- Outputs or results were produced at a reasonable cost; and
- If there were any avoidable bottlenecks or needless overlapping.

When the audit goal of efficiency addresses outputs, the auditor is frequently led to investigate how an organization converts inputs into outputs. Calculating unit costs of results produced (e.g., the average cost per hour of training) or labor efficiency ratios (e.g., number of subsidy applications processed per day) and comparing them to accepted criteria derived from similar organizations, previous periods, or standards that the audited entity has explicitly adopted can be part of the assessment.

When the audit aim of efficiency includes results, economic techniques are usually required to analyze an audited entity's, operation's, or program's capacity or potential to produce particular results at a specific cost. Cost-effectiveness analysis, for example, can be used to link the net effects of an intervention to the financial inputs required to produce those effects; the judgment criteria could, for example, be the cost per unit of the result produced (e.g., cost per job created), which is then compared to the price per unit of impact produced by other interventions chosen as benchmarks. Depending on the audit technique, the auditors will either check the accuracy of the examined body's analysis or undertake the research themselves.

Effectiveness

When an organization or activity fails to achieve the intended outputs, outcomes, or consequences, it is ineffective. General risks in this area include:

- Poor policy design, such as an insufficient assessment of needs, unclear or incoherent objectives, adequate means of intervention, or impracticability of implementation; and
- Management failures, such as goals not being met or management not prioritizing goal achievement.

As a result, an effectiveness audit is concerned with determining the extent to which particular sorts of objectives have been met:

- Operational purposes: the audit analyzes the area to which the anticipated outputs have been generated, and it usually entails a review of the internal operations of the organizations responsible for the intervention's execution;
- Immediate objectives: the audit determines whether the intervention had clear and positive results for direct addressees at the conclusion of their participation. It usually entails looking at monitoring data produced by implementing organizations and gathering information from direct addressees.
- Intermediate and global objectives: the study goes beyond the audited entity's borders and attempts to quantify the effects of government involvement. This necessitates that the audited account for exogenous influences and offer proof that the results are seen are the result of the public action in question rather than the result of such factors.

As a result, the effectiveness audit will focus on outputs, outcomes, or impacts:

- Assessing the effect of an intervention, that is, the amount to which the intervention's global and even intermediate objectives have been met may be highly challenging. The problem occurs because the goals are sometimes stated in such broad terms that they are unable to be linked to quantitative indicators, making the amount of their success impossible to assess. Similarly, when the audit goals are more clearly defined, gathering and analyzing the relevant audit evidence might demand disproportionate audit resources if this information is not easily available inside the examined business.
- Assessing the outputs or results of an intervention, i.e., the amount to which operational or immediate objectives have been met, is frequently a more achievable audit aim. This is likely to provide a clear and suitable reference basis for assessing effectiveness, provided that the objectives are "SMART" - specific, measurable, achievable, relevant, and timely - per the Commission's performance and risk management approach, and that performance indicators monitor their achievement.

Planning, inspection, and reporting are the three stages of the performance audit process. They can further be broken down into the following steps:

Step 1: appoint an auditor

The major goal of this stage is to ensure that there are no obstacles to the assignment starting. As part of this step, the following processes are carried out:

- Ensure that client due diligence.
- Examine whether the assignment has any ethical challenges, and if so, whether there are any protections that can be implemented to allow the engagement to continue.
- Has sufficient acceptable proof been gathered about the opening balances if a different auditor was in place the previous year? In such cases, the existing auditor's professional approval should

be sought.

- An engagement letter is written and signed.

Step 2: risk analysis

This stage entails gathering information about the organization from multiple sources to determine the overall audit risk. This stage entails:

- A look back at the concerns that have arisen in recent years.
- An examination of the company's permanent audit file and any pertinent communication from the previous year.
- Discussions with management about any relevant concerns that arose over the year.
- To prepare a preliminary analytical review, a review of draft performance information is conducted.
- An examination of the company's internal controls.

Audit questions should be developed by identifying potential threats to attaining economy, efficiency, and effectiveness. Each concept is fundamentally equal in value. The precise priority will be determined on a case-by-case basis; nonetheless, auditors are advised to include the efficacy in their study wherever possible. A performance audit is not intended to cover a simultaneous and comprehensive examination of all aspects of the economy, efficiency, and effectiveness and should not aim to do so. Based on the considerable potential hazards identified, it will instead analyze particular concerns relating to economics, efficiency, or effectiveness, or a combination thereof.

Step 3: approach to the audit

Following on from step 2, a description of the significant audit risks and how they influence the audit's intended strategy should be provided. The overall risk (including the possibility of fraud) should be categorized as low, medium, or high.

Step 4 – administration

For the task, a suitable staffing strategy should be put in place (with appropriate skillsets and experience assigned to the team). The client should be given a deadline for the job's completion.

Step 5: briefing of the audit team

A team meeting lays out the audit strategy, the significant risk areas, and how these risks will be addressed, as well as each team member's role in the project.

Step 6: client support

Consider whether you can provide any relevant advice to the customer about any of the issues you've discovered.

Step 7: communication with the client

Any modifications in the nature or scope of the assignment should be communicated to the customer. Additionally, the audit team's information is conveyed to and agreed upon with the customer.

The overall process should follow the SMARTEST approach.

The auditor should ensure that:

- **S**ound judgment is exercised throughout the audit process.
- **M**ethodologies are appropriate and combined to capture a range of data.
- **A**udit question(s) is set, which can be concluded against.
- **R**isks to delivering the audit report are analyzed and managed.
- **T**ools are employed to help achieve the successful delivery of the audit.
- **E**vidence is sufficient, relevant, and reliable to support the audit findings.
- **S**ignificant/substantive conclusions and recommendations to the final report are considered from the planning phase onwards.
- **T**ransparency - a 'no surprises approach' - is adopted with the auditee.

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