Training Module Mining

Handout -1

Introduction of Performance Audit

What is performance auditing?
According to INTOSAI performance auditing is an audit of econonmy, efficiency and effectiveness with which the audited body uses its resources in carrying out its responsibilities (INTOSAI audit standards 1992).In other words, performance auditing may be defined as examining whether government Ministries are doing the right and doing this in the right and least expensive way.

Where is performance audit carried out?
Performance audit may be carried out throughout the whole public sector, central and local government, and parastatals. (Public authorities)

How is performance audit done?

- Performance audit is normally carried out by qualified and independent practitioners. In particular, they should:-
- Establish audit objectives
- Identify suitable criteria for the assessment of management performance in the areas of government activities to be audited.
- Gather the evidence necessary to asses the performance of management against those criteria.
- Conclude against established audit objectives.
- Make recommendations to management, when appropriate, to deal with significant variances between a criterion (or criteria) and performance.
- Follow – up on the recommendations.

Why do we carry out performance auditing?

- Performance audits seek to promote well managed and accountable government operations.
- There are three main reasons for carrying out performance audit, mainly

1. Accountability and democratic insight
2. Substitute for market
3. Basis for decision making

1. ACCOUNTABILITY AND DEMOCRATIC INSIGHT

Public accountability means that those put in charge of a government Programme or Ministry are held responsible for the efficient running of that Programme or Ministry.

- **Accountability**

Presupposes that there is public insight into the activities of the program or ministry.

- **Democratic insight**

Insight is facilitated by the fact that performance auditing is independent of the government Ministries whose activities are subject to the audit. In this way an independent and alternative view of the performance of the auditee is obtained. The auditor's view often stands in contrast to the picture presented by those responsible for the activities in question.

2. SUBSTITUTE FOR MARKET MECHANISM

- The private sector has an automatic system for assessing a company's success basically the market mechanism and the making of profits.
- A successful company will make a profit and stay on the market while an unsuccessful one eventually will go bankrupt and will be forced to leave the market.
- Such a mechanism does not exist in the Public Sector the most unsuccessful Health Ministry will never go bankrupt. In this sense performance auditing in the public sector may serve as a substitute for the market mechanism of the private sector.

3. BASIS FOR DECISION MAKING

- When resources are scarce, emphasis must be put on deciding which Programmes and Ministries should be given priority.
- Performance auditing may serve as a basis for decisions on future Investments and priorities.

What do we audit in performance audit - The audit object

Audit object may be:-

1. Individual government ministry.
2. All those Ministries which contribute to the fulfillment of a particular task.
3. System studies – investigating complex problems in the public sector.
4. A single activity.

Generally performance audit focuses on a particular part of a Ministry's activities - a Programme, an obligation, certain tasks or specific grants and subsidies.

Performance auditing and other assessment

- Performance auditing uses similar methods to other types of assessment activities namely:-
- Evaluations and investigations carried out by research workers or government commissions.
- Studies of rationalization, restructuring of government etc carried out by special government bodies.
- Assignments carried out by consultants.
- The auditor can make use of these assessment activities, for example to learn from the methods applied or to use the results for purposes of comparison.
- Although the performance auditor uses theories, methods etc from research, the auditor must also uses his or her own experience and common sense in the practical audit work
- A scientific approach is expected of the research worker when it comes to methodology etc. The demands placed on the performance auditor in this respect are however; rather that he should use a **systematic** and **logical approach**.
- One consequence of this is that the auditor can point to weaknesses in the system by using a limited number of cases and without having any ambition to form general conclusions from these findings.

Economy, efficiency and effectiveness

Economy

Minimizing the cost of resources for an activity having regard to appropriate quality.

- **Efficiency**
  The relationship between the output in terms of goods, services or other results and the resources use to produce them.

- **Effectiveness**
  Effects compare with goals and related to the resources used to achieve these goals.

Pre – study

- The pre study is the basis for a decision whether to start a main study or not.
- This study results in an internal pre- study memo not intended for publication.
- If the management then decides to start a main study, a work plan is prepared and decided upon.
- From practical point of view this means that the pre study memo sometimes includes a work plan for a main study, while sometimes the pre - study memo and the work plan are two different documents.
- The pre – study should normally be carried out in a short time while the main study usually lasts much longer.
- Pre study has the character of a trial and error process, where it is possible to test different ideas, alternative audit problems and methods.
- Consequently the pre – study contains elements both of expansion and narrowing down.
- The expansion element exists when the auditor is reaching for alternative audit problems and new ways of looking at those problems.
- During this phase the audit work focuses on communication and brainstorming.

The purpose of the pre – study

- Collect information to increase the auditor's knowledge of the audit area.
- Identify possible audit problems.
- Decide whether to start a main study or not.
- Plan the main study (documented in the work plan)

Main study

- The purpose of the main study is to assess the economy, efficiency and effectiveness of use of public resources and there by explain the level of performance of the organization or programme audited.
- The main study results in an audit report.
- As a general rule a complete audit project consisting of a pre – study and a main study should not exceed one year.
- However, nothing prevents the audit office from carrying out much shorter audit projects.

Work plan

- The work plan is a concrete plan for the execution of the audit project.
- It serves as the guideline according to which the project is to be pursued.

Work plan should indicate whether the audit team

- Has formulated a valid audit problem
- Will be able to verify their hypotheses and answer the questions postulated
- Has sufficient knowledge to carry out the audit using the methods described.
- Has suggested the most suitable methods for the audit.

The audit process - an overview

- The practical audit process may be divided into a number of chronological steps as indicated below:-
- Selecting the audit problem.
- Planning the audit project.
- Collecting the data.
- Analyzing data.
- Writing an audit report.
- Finalizing the audit project.

The selection of the audit problem and the planning of the audit project

This is done during the pre – study. However it must be noted that planning is an ongoing process and is therefore part of the main study as well.

Selecting the audit problem is usually done as part of the pre – study and documented in the first part of the pre – study memo

What is a problem?

From an auditor's perspective, situations or events in an organization or programmes where performance is not satisfactory may be defined as problems. These may be linked to one or more of our three concepts of economy, efficiency and effectiveness.

The three Es, economy problems are defined as the use of too many resources, efficiency problems are the operations which are not well managed.

Effectiveness problems indicate that operations do not focus on specific recipient and do not have the required effect.

Criteria for selecting an audit problem
There are a number of selection criteria which can be used to compare possible audit problems.

Relevance of the problem
- Materiality (Money involved importance for the citizens)
- Risk (Of ineffectiveness)
- Type of problem (structural, long term problem etc.)

Possibility carrying out an audit.
- Relevant audit methods applicable.
- Ressources avalable (Budget, Transport, time etc.)
- Relevant audit skills avalable.

Potential for change
- Possible solutions (Excluding allocations).
- Interest in change shown by the auditee or the government.
- The decision to select a particular audit problem is based on the auditor's description of the audit area, consideration of possible problems and analysis of the findings in the pre – study.

Planning the audit project
- Different types of planning
- Short – term or operational planning.
- Long – term or strategic planning.
- Short – term planning deals with questions such as "what are we going to do next week? Or how are we going to organize the field trip? And goes on throughout the project.
- Long – term planning takes place above all at the beginning of the project or at regular intervals and deals with strategic uses such as the choice of audit problem basic design of the projects etc.

Strategic planning
This is divided into:-
- Methodological planning.
- Administrative planning.

Methodological planning
Deals with establishing an audit design i.e. deciding on:-
- The audit scope
- Hypotheses.
- Assessment criteria
- Methods of collecting data

Audit scope

In order to focus on those aspects which are most important and also to make it possible to carry out the audit, the auditors must limit the scope of the study.

ASPECT	Examples
Audit objects	One Ministry or the whole sector.
Geographical limitation	One or more regions.
Time limitation	One or more years

Hypotheses

- Usually the auditor then proceeds to formulate hypotheses about the audit problem.
- Hypotheses are statements should be formulated so that they are:-
- Relevant (to the audit problem analysis)
- Possible to test (Are they true or false)
- Formulated in a negative way (Saying the organization is inefficient, planning does not function well etc.)

Planning the testing of hypotheses

At the planning phase, the auditor should make sure that the data collected will make it possible to test or verify the hypotheses

Assessment criteria

- The auditor has to compare the actual results of the auditee or programme with some kind of standards.

- This comparison will involve the audit problem (e.g. delay in school books etc) as well as the hypotheses.

Administrative planning

Planning procedures and routine will be presented.

Organization of the audit

- It is advised to organize performance audit projects by using teams of at least two and not more than four people.

Time – schedule

- The project should be planned using a time schedule. This makes it easier to complete the project with a reasonable time and with a specific number of days spent by the auditors.

Project budget

- The use of budget for managing a performance audit project should be linked to the way budgets are normally used at the audit office.

Monitoring the progress of the audit

- It is advisable to have regular follow – up meetings during the audit.
- Progress of the project and the resource situation.

Co – operation with the auditee

- The auditors are obliged to keep the auditee continuously informed of the progress of the project.

Collection and analysis of data and report writing

These are primary activities performed during the main study but are also components of the pre – study.
Data, information and knowledge are similar concepts linked together in a chain data this is the primary observation. Data which has been compiled is transformed into information.

The purpose of collecting data

- Data is usually collected to make it possible to describe the audit object, assess and measure output and effects and by testing hypotheses to explain performance in terms of shortcomings at the auditee.

Different types of data

- Quantitative data refers for example to numbers and numerical relations.
- Qualitative data may refer to opinions and altitudes or general observations of the conditions at a work place.

Analyzing data

One of the aspects in the audit process is to compile and analyse the data which has been collected. This is done to assess but also explain the performance of the auditee and in this way determine what has caused the identified effects. (Cause and effect analysis)

The actual approach used in the analysis depends, on the type of data that has been collected.
Quantitative analysis of statistics.
Qualitative analysis of interviews and documents.
Combination of quantitative and qualitative analysis based on all types of data.

Writing an audit report

The audit report is the most important product of the main study. An audit report is not a compiled version of internal working notes. On the contrary, the working notes made throughout the audit project must be transformed into a new form, the audit report. The report should be written using a structure that makes it easy for the reader to understand.

The audit report should be written to the specific individual or organizations which it is addressed.

What is a good report?

A good report should have the following key attributes:

Relevance

Information in the report should be relevant to the problem analyzed

Reliability

Users should be able to have confidence in the reliability and validity of reported results.

Objectivity

Information in the report should be objective.

Materiality

Importance sensitivity and resources Involved.

Comparability

Information should facilitate comparison over time.

Accessibility

Report should clearly explain how and where more detailed information may be obtained.

Understandability

An informed person who lacks detailed knowledge of government operations and the audit object should be able to understand the report.

Structure of the report

- Executive summary.
- Introduction
  - Background
  - Reasons of the audit
- Audit design
- Description of the audit object.
- Findings of the audit.
- Conclusions from the audit.
- Recommendations.
- Appendices