

# POSITIONINGS AND DELIMITATIONS CONCERNING THE PERFORMANCE AUDIT

Theoretical  
articles

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## Abstract

*The objectives of the present research are related to the approaches concerning the “performance audit” concept in the specialized literature and practice as well as the clear delimitation of this concept of financial audit and internal audit. For a clear emphasis of the objectives and principles of the performance audit, I highlighted the similarities and differences among the three types of audit by means of several criteria such as: audit standards, audited subjects, nature of the audit evidence, manners of assessment. Within this basically predominant research, I used several research methods and techniques such as: the critical analysis of the bibliographic sources concerning the performance audit, the documentation related to the international audit standards, comparative studies.*

## Introduction

Performance audit plays a crucial role in guaranteeing reliable, transparent and comparable information, on the use of public money. The economic and financial realities conformed that public money management in compliance with the provisions of the law is not a sufficient condition because it must be used economically, efficiently and effectively.

No economy can be efficient unless the conditions are created for making the use of public money efficient and effective. In our country, the performance audit, erroneously viewed for a long time just as a form of financial control, should lead to limiting the waste of resources and the possibilities of fraud, detecting abnormalities and deficiencies in good time. Obviously, the performance audit, which has a clear public interest mission, has undergone various periods of identity and social credibility crisis.

In this context, auditors' competences and the ethical behaviour were engaged in a process of reform that was focused both on the legal framework and on the normative one of this profession.

Performance audit, as a distinctive activity, emerged between 1960 and 1970 when the developed industrialized countries set criteria and indicators for the measurement of the government performance.

### 1. Performance audit in the specialized literature and practice

At international level, there is no unitary name related to the concept of *performance audit*. The notion of "performance audit" is used in different versions by international organisations. Although the approaches related to the performance audit are relatively heterogeneous, its defining principles are the same, i.e. this audit combines the rigour of the conformity audit and that of the financial certification audit with the basic audit principle, namely adding value and providing credibility, under conditions of the auditor's independence and objectivity.

*Performance audit* is a synonym of the syntagm "*Value for money*" and of "*Management audit*", according to the terminology issued by the the International Organisation of Supreme Audit Institutions .

Performance audit is defined as "*Performance audit*" means an objective and systematic assessment of a state agency or any of its programs, functions, or activities, in order to provide information to improve public accountability and facilitate decision-making by managers in relation to the supervision and initiation of the required corrective actions" . Besides the cost-effectiveness and the efficiency, performance auditing also includes the *Programme*

*audit*, which comprises the assessment of the extent to which the desired results are achieved, and if the entity has complied with the law and the significant regulations applicable to the programmes in question.

Performance auditing aims verifying if "*the public money was well*.(Nicolescu O., Zecheru V.,2003) Performance audit is defined as an audit of the efficiency and effectiveness of the government policy in using public money. Consequently, performance audit examines the measures taken by the audited entities for the compliance with the principles of cost-effectiveness and efficacy, and the results obtained in achieving performance indicators. The specialised literature mentions the *comprehensive audit or the full audit*, which is made when the conformity audit and the financial certification audit are combined with the performance audit. (Ghi M., Sprâncean M., 2006).This approach assesses if "the activity led to the scheduled results", hence the name of "*result audit*".

*The performance audit consists of economicity, efficiency and efficacy ("the 3 Es")* and covers: economic and administrative activities aiming management principles and practices; the efficiency of human and financial resources, including the examination of information systems on the performance indicators and the procedures followed by the audited entities; the efficiency and performance in relation to the achievement of the objectives of the audited entity, and the actual impact of the activities compared to the intended impact

Measuring performance from the perspective of the "3Es" is a need for managers at all levels, in order to have a clear image of their objectives and consists of evaluating the results in relation to the objectives in question (Boulescu M.,Ghi M., Mare V.,2002) . The following definitions for the "3Es" result from the specialized literature:

a) *Economicity* is defined as *minimizing the cost of the resources used for an activity, while observing the scheduled quality requirements*. It entails assessing the good management of public money based on accepted and legislated criteria.

b) *Efficiency* means "*a relationship between results, in the form of goods and services, and the resources used to make them*". Efficiency is closely related to the concepts of cost-effectiveness and productivity.

Efficiency can be expressed as the ratio between the effort (resources spent) and effect (results obtained), and in this case the examined activity can be assessed as favourable if the result of the ratio is lower than the planned one or decreases in dynamics.

c) *Efficacy* is represented by *the extent to which the objectives have been achieved, and the relationship between the indented impact and the*

**actual impact of an activity.** It can be expressed as a ratio between the recorded results and the planned ones:

The situation is viewed as favourable when the result is greater than or equal to one. The efficacy audit assesses how measures taken by the audited entity contributed to the achievement of the objectives and can be understood as follows:

- *in a narrow sense*, when only the management and the internal operations of the audited entity are examined;

- *in a broad sense*, when the examination exceeds the limits of the entity and when, for evaluation, the auditor also takes into account the impact of other external factors.

A performance audit does not necessarily imply the approach of the “3Es” at the same time. This will be established by the audit objectives that will be set, namely which of the three concepts will be examined.

Even if a certain performance audit does not necessarily aim at reaching conclusions related to all the three aspects, it is better not to examine economicity separately from efficiency, without a brief consideration of efficacy. And vice versa, in an efficacy audit, the auditor takes into account economicity and efficiency aspects.

A specific aspect of the efficiency and efficacy aspect is *the analysis of the unintended results*, especially if they are negative. For example, the analysis of the secondary effects of an economic development programme on the environment. (Popa ., Ionescu C.,2005)

Based on the aspects presented above we can say that the main objective of the performance audit is to evaluate how public institutions and economic entities that use public funds comply with the principles of economicity, efficiency and efficacy and, on this basis, to provide the parliament with impartial and independent information, and the audited entities with recommendations on the ways and means of increasing performance in relation to the allocation and spending of public money.

The principles of the performance audit incorporate the basic qualities and features that should determine and guide the activity of the audit, namely:

**a) Responsibility.** It is an active principle according to which the auditors’ activity is performed objectively, by taking responsibility for own work;

**b) Integrity.** Under this principle, the auditors’ activity is performed sincerely, correctly, honestly, and in good faith;

**c) Objectivity and independence** are two principles that imply each other and according to which, auditors, in their activities, keep their independence in relation to the executive power (the government), the political parties and various pressure groups;

**d) Value added.** Under this principle, performance audit supplies the parliament and the audited entities with information and solutions for the cost reduction and the achievement of the planned results;

**e) Competence.** It is a principle that requires auditors to have special professionalism, namely appropriate experience and skills;

**f) Rigour.** This principle implies that audit performance approaches the examinations thoroughly, scientifically evaluates the information underlying the findings and conclusions, so that the audit evidence administered should be complete, clear and reliable;

**g) Perseverance** requires that the auditor should not deviate from obtaining and analysing the audit evidence for the substantiation of conclusions, even if sometimes the audited entities are not cooperating;

**h) Clarity of communication.** Under this principle, the audit reports must be objective, well-balanced, clear and persuasive.

## 2. Performance audit versus financial audit

INTOSAI Auditing Standards provide that: *“unlike the compliance audit that is a financial audit and it is subject to quite clear regulations and requirements, performance audit is, in terms of nature, a large-scale audit and much more open to judgements and interpretations, and its covering is more selective and can be performed on a cycle on a few years, rather than a limited period and is not necessarily related to a balance sheet or another document. Consequently, performance audit reports are much more varied and comprise more comments and reasonable arguments”.* (Nobuo A.,2008) There are similarities and differences between the performance and the financial audit. They can be grouped according to:

**a) The auditing standards.** The international standards regulating compliance audit are largely applicable in the case of performance audit. Especially the following standard provisions are also applicable to the performance audit:

- the audit evidence and the auditor’s approach;
- the assessment of the accounting and internal control systems;
- the audit planning;
- the audit documentation;
- the audit quality assurance.

The major differences occurring in the application of the following provisions of the standards:

- reporting;
- the procedures for obtaining the audit evidence;
- planning by preliminary study.

**b) Selecting the audited subjects and the preliminary study.** In the compliance audit (the financial audit), the audited subject is generally defined by the regulations of the laws in force. In

the performance audit, the selection is much wider and is made by applying some criteria and based on a preliminary study, due to the more diversified nature of the fields (entities, programmes, activities, etc.) and to the wider opportunity to have judgements and interpretations.

**c) Evaluation criteria.** The financial audit examines operations that are defined as being “correct” or “incorrect”, “legal” or “illegal” – as defined by the law. The evaluation criteria used by the auditor to express the final opinion are relatively closed and, usually, predefined, for example the legislation governing the audited entity.

In the performance audit, the selection of the criteria is much wider and it is the exclusive attribute of the auditor, the “3Es” must be interpreted in relation to the audited subject, and the applicable criteria vary from one audit to another.

**d) Nature of the audit evidence.** While in the case of the financial audit the auditor aims at obtaining conclusive evidence (“yes/no”, “correct /incorrect”, “legal /illegal”), performance audit typically operates with persuasive audit evidence (“supporting points for the conclusion that...”).

Consequently, the auditor chooses the auditing methodology in such a way as to obtain such evidence. In practice, he often tries to obtain the audit evidence from various sources, even by using different audit techniques and procedures, so that, if all the evidence leads to the same conclusion, the audit report will be more convincing. Within the audit, it is useful to discuss with the entity management beforehand about the data analysis and interpretation techniques, with the purpose of reducing the risk of subsequent misunderstanding and to speed up the reporting process. At the same time, this allows the auditor to identify the potential subsequent disagreement areas and to plan to obtain additional evidence, as the case may be.

**e) Audit approach.** The financial audit, as well as the performance one, should be well structured on performed stages, in a logical sequence, namely: selecting the subjects that will be the object of the audit, the key issues and the main audit criteria, scheduling the audit, performing the audit, reporting and monitoring the conclusions of the report. The audit should include:

- the thorough examination of the internal control systems of the audited entity, created by it in order to provide the economicity, efficiency and efficacy of the operations carried out. The purpose of this examination is to enable the auditor to identify the fields where improvement actions are required;

- substance examinations from the perspective of the “3Es” within the entity (on activities, programmes and functions).

In the financial audit, the auditor may choose between adopting a systems-based approach (SBA) or a substantive procedures approach (vouching approach or direct verification approach) (SPA). In the performance audit, the auditor adopts a mixed approach that enables him not only to identify the weaknesses of the quality activities, but also the causes that generate them, and on this basis to formulate proposals and recommendations.

A peculiarity of the audit performance is that, if the internal control is very developed and the legislation requires ministries and other economic agents to have their own performance assessment policies and programmes (including and especially through the internal audit), the auditor may choose to limit himself to a form of **meta-evaluation (an evaluation of the evaluations)**. Anyway, such evaluation is possible only when the auditor has obtained audit evidence to supply the certainty that the internal control systems carry out accounting assessments. The external performance audit focuses the compliance with the principles of economicity, efficiency and effectiveness in the activity carried out by a public institution.

### **3. The internal performance audit versus the external performance audit**

According to the definition given by The Institute of Internal Auditors “*is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations*”

The internal audit helps this organization to achieve its objectives by evaluation, from a systemic and methodical perspective, its risk management, control and company management procedures, making proposals to consolidate their efficacy”. This form of audit, organized within the audited entity (organization) is in fact, an independent activity for objective and consultative assurance, meant to lead to the improvement of a body which it supports in the achievement of its objectives, by a systemic and orderly approach of the assessment and enhancement of the efficacy of the risk management, control and management processes.

The internal performance audit consists of performing verifications, inspections and analyses of the own internal control system, in order to have an objective assessment of the extent to which it ensures the achievement of the objectives of the public institution and the economical, effective and efficient use of the resources and in order to report to the management the findings, the weaknesses identified and the measures proposed to correct the deficiencies and to improve the internal control system performance.

The external auditing of public institutions is organised and operates in our country, as well as in the European Union and in the member countries, through the system of the Romanian Court

Accounts, subordinated to the Parliament and recognized as a supreme audit institution, including at international level.

In compliance with the provisions of the law, the Court of Accounts exercises control over the manner of forming, managing and using the financial resources of the state and of the public sector, its main specific activities being the control and the external public audit. The external public audit includes the financial audit and the performance audit.

The Court of Accounts carries out the performance audit related to the use of the financial resources of the state and of the public sector, making an independent evaluation of the economicity, efficiency and efficacy of a public entity, a programme, a project, a process or an activity in using the public resources allocated for the achievement of the objectives. The performance audit supplies relevant information for the Parliament, the Government, the audited entities and other concerned institutions, with the purpose of improving the use of public funds, through the findings and recommendations made in its reports by the Court of Accounts and aims at decreasing resources and/or increasing results. The performance audit carried out by the Court of Accounts is exercised on the management of the general consolidated budget, and on any public funds.

Starting from the reality that the common aim of both the internal public audit, and the external public audit is the good management of the establishment and use of public funds, whether various auditing methodologies are used, mutual support is required, as a condition of the efficiency of the activity. Following their evolution, most often than not, the intersection of the internal audit missions with the external ones was beneficial for both, and they completed each other at informal level or contributed to the implementation of each other's recommendations.

Given the common purpose, the two types of audit must be on a complementarity, both the Romanian Court of Accounts, as supreme auditing institution, and the Ministry of Public Finance through the Central Harmonizing Unit for the Internal Public Audit (UCAAPI), as specialized body of the central public administration that prepares, leads and applies a unitary strategy in the internal audit.

*The external public audit of the performance of using public financial resources* is characterised by the following aspects:

- assessing and promoting economicity, efficiency and effectiveness in the public sector is the main objective of the performance audit and consequently these concepts for the theoretical basis of the performance audit.

- this category of audit is oriented towards the quality side of spending public money, by examining the economicity of public procurement, the efficiency of using public resources and the efficacy of the governmental actions.

-performance audit is, according to the INTOSAI international auditing standards, an independent assessment or examination of the extent to which an activity, a programme or an institution operates efficiently and effectively, in compliance with the economicity.

The purpose of the performance audit is to provide relevant information concerning the manner of implementation and the consequences of public activities.

#### **4. Performance audit stages**

Performance audit is a laborious process, which in compliance with the good practice in the field, is carried out in a cycle that includes several distinctive stages.

##### **4.1. Strategic planning of performance audit**

The strategic planning is the first stage of performance audit, whose finality is the selection of the subjects to be examined. Usually, Supreme Audit Institutions (SAI), who examine the performance in the management of public funds, base their strategy on a staggered plan of at least 5 years that is continuously improved, as it is carried out. This plan must be flexible in relation to the adoption of new audit subjects, as a result of new press articles, debates in the parliament or changes in the government's economic policies.

The basic objective of the strategic planning is to create a well-balanced portfolio of performance audit studies that should lead to saving public money. (Mitroi F.1999).

The strategy planning is needed, because:

- it provides a correct planning of the audit mission and of the audition of the major concern areas;
- provides the establishment of the audition priorities;
- streamlines each audit study (report);
- provides a responsibility framework for the monitoring and review of the performance of the audited entities.

##### **4.2 Plans the performance audit mission**

The purpose of this stage is to prepare a *preliminary report* or a *preliminary study* that should confirm if it is justified to audit an entity and should be the main planning document of the audit mission.

*The audit mission planning* is based on at least three basic elements, namely:

- a) *the characteristics of the field to be audited;*
- b) *deciding the procedures and techniques to be used;*
- c) *the resources required to carry out the audit.*

Generally, a good preliminary report is characterised by a reasonable level of confidence of the findings, the identification of high-risk points.

**The preliminary report is an internal document of the auditor**, which is not official in nature, based on which decision factors of the audit institutions (in Romania, the plenum of the Court of Accounts) of public finance, decide whether the audit will be done or not. Its purpose is to obtain the support of the audited institution too, through the presentation by the auditors of the problems and methods approached. Moreover, the preliminary study also includes a point of view of the management of the entity in relation to the aspects presented by the auditor.

In the selection of the assessment criteria, the auditor must make sure that they are relevant, reasonable and tangible.

Due to the fact that entities attach special importance to what they measure, in other words they value their own results, the auditor should be very prudent if he selects as assessment criteria in the audit the ones used by the audited entity itself.

The proposed result of the performance audit must be reviewed in terms of “utility” and “feasibility”, together with the resource budget allocated to the audit, and these factors enable the auditor to carry out an overall assessment of the potential value added that will be created by auditing;

#### **4.3. The auditing**

The purpose of this stage is to answer the problems set in the preliminary report and includes the following stages:

##### **a) Collecting and analysing the audit evidence.**

The evidence necessary for the audit is still in the planning stage of the audit mission, through the preliminary study. In this phase, the auditor seeks to collect this evidence and to analyse it, because it will be the basis of the audit report.

Observation is known to be a highly valid examination technique; more specifically it is focused on what is real. However, compared to other techniques, observation is weaker in relation to the credibility of the audit evidence, because the observation of the same event is different from one observer to another. The main strength of the observational technique is that, by using it, detailed information is obtained concerning the actual, real way of manifestation of phenomena and processes.

**b) Informing the audited entity.** Throughout the examination, the auditor focuses:

- the existence of the conformation of the audited entity, that the audit continues, as a result of the preliminary study, and a common analysis of the purposes of the cooperation and the current stage;
- organizing a regular meeting with the audited entity and with other stakeholders for a briefing on the progress made;
- explaining the procedures and techniques used in the audit study, in order to make sure that both the

audited entity and other institutions or entities understand what is examined, and especially how the examination is carried out .

**c) The management of the audit (study) report project.**

#### **4.4. Drafting the performance audit report**

Internationally, performance audit reports are means that provide parliaments with independent information, solutions and assurance related to how departments, governmental agencies, and other economic entities funded from public budgets have observed the principles of economicity, efficiency and efficacy. This is why it is very important that these reports should convey messages clearly and should inspire trust. They are also useful for the audited entities, because they support them in implementing the proposals formulated in the performance audit. Besides this, reports are available to the media and the public.

The reports should be drafted in such a way as to be understood by the readers who do not have specialized knowledge in the audited field. The structure of the report, more specifically the sequence of the questions, answers and conclusions presented must thus be characterised by logic and clarity.

#### **4.5. Clarifying and agreeing on the performance audit report**

In some countries there are regulations providing that the performance audit reports presented to the parliament must have the approval of the audited entity through an account officer or an authorizing officer.

The purpose of this provision is to avoid a situation when a parliamentary arbitration would be required between the Supreme Audit Institution (SAI) and the audited entity, when the latter has reservations related to the data presented in the audit report, on the manner of presentation or does not accept the conclusions of the report. Consequently, an agreement is made with the audited entity, in relation to the data presented in the report.

If there are different opinions that could not be resolved during this reconciliation, they should be explained in the report, with clearly defined motivations.

#### **4.6 Publication of the performance audit report**

In relation to the publication of the performance audit report, “**the good practices in the field**” require the preparation of a *publishing plan*, which includes:

- *the recipients of the report.* These can be, as appropriate: the Official Journal, the Parliament – the specialized Commissions or Committees, the Prime minister, the Minister of Finance, the audited entity, third stakeholders, the audit team, the archive, the library, etc;
- *press conferences* allowing for:
- the supply of information that should allow for the publication of articles in the press, showing that

the supreme audit institution has independence, authority and credibility;

- avoiding the publication of articles in the press suggesting the potential cover-up of the facts.

#### **4.7. Sending the audit report to the legislative power**

In some countries audit reports are sent to specialized (budget, finance) parliamentary commissions which have the obligation to put them to good use; in other countries parliamentary structures are created whose main activity is to analyze and put to good use performance audit reports.

- For example, in the *United Kingdom of Great Britain and Northern Ireland* there is a *Public Accounts Committee* that receives, after publication, all the reports prepared by the *National Audit Office (NAO)* and selects, from among them, those that are to be subject to hearing. The National Audit Office presents to the Public Accounts Committee written or verbal information before every hearing. Account officers (authorizing officers) take part into the hearings of the audited entities. After the analysis of the report and the completion of the hearings, the Public Accounts Committee prepares its own report with conclusions and recommendations.

#### **4.8. The answer of the governmental factors**

The practice of the countries with tradition in the performance audit required that the parliamentary report prepared by the specialized commission or the Public Accounts Committee be forwarded to the Ministry of Finance, which, in cooperation with the audited entities, prepares and sends the answer to the parliament, in the form of “minutes” in which each recommendation is presented, the framework of this recommendation is described, and the progress or the future measures taken for the compliance with the recommendations are communicated, and in the case of unaccepted recommendations a point of view thereon is presented.

Consequently, the recommendations of the parliamentary structures involve actions and interventions that should be implemented in the activity of the audited entities.

Although in some countries, in the legislation, the obligation to comply with the recommendations is not stipulated, by consensus, and customarily, they are implemented.

#### **4.9. Follow-up of the impact of the performance audit report**

Annually, the supreme audit makes a review of how recommendations are implemented, and for this purpose the audited entities are contacted and discussions are held with the key persons with responsibilities in implementing recommendations. After this review an assessment of the impact of the recommendations is made.

In practice the following types of impacts can be distinguished:

- *the quantifiable financial impact*, which consists of making savings as a result of the economicity and efficiency increase;

- *the quantifiable non-financial impact*, consisting in the performance improvement in areas such as health, education, etc. For example, the organizational problems related to the reduction of the waiting time at a hospital or for other services of the public institutions;

- *the quality impact*, involving improvements in the resource management;

- *the loss impact*, showing which are the consequences of the failure to implement the recommendations.

The follow-up and measurement of the impact aim at:

- determining the size of the performance audit performed by SAI;

- quantifying the value added (obtained in addition), as a result of the audit

#### **Conclusions**

Performance audit analyses how well the government has managed public resources and supports entities in assessing the following activities: reducing costs and making financial savings, improving the quality of the public services, strengthening the healthy management of the administrative and organizational processes, reaching the planned target objectives, with costs as low as possible.

In the first stage, performance was examined in terms of economicity in relation to making public spending (inputs), monitoring one object at several governmental departments, namely: the procurement of goods, traveling expenses, staff expenses, etc.

In the second stage, performance audit was also focused on the efficiency of the governmental policies (outputs), monitoring the ratio between inputs and outputs.

Currently, analyzing the relationship created between the result and the intended impact, performance audit also monitors the efficacy of the governmental actions. It is in fact an approach by which the audit shifts from the processes to their results.

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