



**Pakistan Institute
of Public Finance Accountants**

Model Solutions

**Performance Auditing
(Application)
AGP | PG | Public Sector
Winter Exam-2023**

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Q.1. (Rule 3.1 Performance Audit Guidelines)

As stated in AS 3.0.1: 'The purpose of field standards is to establish the criteria or overall framework for the purposeful, systematic and balanced steps or actions that the auditor has to follow.' The field standards establish the framework for planning, conducting and managing audit work (AS 3.0.2).

The performance audit cycle covers several steps. Broadly speaking, it comprises the planning process, the execution process and the follow-up process. The planning process is often divided into different stages. The first stage is strategic planning, where potential themes and topics are analyzed. Once a topic has been selected for performance audit, a pre-study – resulting in a work plan for the main study – may be undertaken to gather information in order to be able to design a proposal for the main study. Throughout the main study, the emphasis should be on the production of a final report to be considered by the government, the legislature, the executive bodies concerned, and the public. The report-writing process should, based on experience, be viewed as a continuous one of formulating, testing and revising ideas about the topic. Issues, such as the expected impact and value of the audit, should be considered throughout the audit. By setting deadlines for the writing process timely reporting may be enhanced.

Follow-up procedures identify and document audit impact and the progress made in implementing audit recommendations. Such processes are vital to provide feedback to the SAI and the legislature. (AS 2.2.5-6)

The performance audit cycle involves several steps: strategic planning, preparation work, the main study and follow-up activities.

Total Marks 08

Q.2. Rule 6.3 Performance Audit Book- 2

6.3 Identifying Key Activities, Systems & Controls

This is an important process and requires professional judgment. Key management systems and controls are those that are crucial to the organizations' operations and the attainment of its objectives. A serious weakness in any one of them could adversely affect successful implementation. The key systems would normally include areas such as finance, personnel and other administrative activities. One way to go about this is to prepare two separate lists:

- one, a list of the main activities that contribute directly to achieving the outputs (e.g. digging of canals, organizing users groups, training); and
- second, a list of those activities which provide essential support (e.g. finance, personnel, travel etc.). With respect to the first category
- determine how crucial each is to achieve the objectives of the entity and list those in order of importance;
- assess which of those may be more vulnerable; i.e. where one would expect weaknesses or short-comings.

With respect to the second category, i.e. support activities, the priorities for audit may be guided by an assessment of risk and exposure as well as the potential for economies and improvements in efficiency. The size of expenditure, how extensive is the operation, its nature and complexity, a general experience of where things can go wrong, the nature of controls, the systems of monitoring and accountability reporting and other similar factors need to be taken into account in identifying the key areas.

Total Marks 12

Q.3. (5.3 Performance Audit Guidelines)

5.3 What characterizes a good and usable performance audit report?

Good performance audit reports should add value to the stakeholders and meet the objectives set. They should provide accessible, concise, and up-to-date information, which the government,



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parliament, auditee, and other stakeholders can use to improve the economy, efficiency, and effectiveness of the public sector: i.e. the report should contribute to better knowledge and adequate improvements.⁶⁰ Good performance audit reports should be reader-based and well structured, and the language should not be ambiguous. They should present findings objectively and fairly (AS 4.0.7). This requires that:

- there are separate presentations of findings and conclusions;
- facts are presented and interpreted in neutral terms;
- different perspectives and viewpoints are represented;
- all relevant findings, arguments, and evidence are included; and
- reports are constructive, and positive conclusions are presented.

In a wider sense – and to sum up – the quality of a performance audit may be assessed by means of specific criteria, including those considered below:

Materiality, relevance and objectivity The topics dealt with should be material. The information given should be relevant to the topic; the audit question or the problem studied. Objectivity can be defined as ‘impartiality, balance and neutrality’. When making decisions about scope, audit evidence, significance of observations, and conclusions, the auditor must have an unbiased point of view and an objective state of mind. The audit design should ensure that the selection of facts to be investigated and presented in the report is balanced and unprejudiced. The findings should be influenced by evidence obtained and assembled in accordance with relevant audit standards. Facts must not be suppressed, and the auditor must not exaggerate minor shortcomings. **Explanations** – especially from the auditee(s) – must always be sought and critically evaluated (AS 1.0.9, 2.2.40, 3.5.4, 4.0.7, and 4.0.24-26). **Reliability, validity and consistency** Users should be able to trust the reliability and validity of reported results. The data collection methods should be valid and reliable. The audit design should be such that conclusions arise from the findings and the analysis, based on verified facts and other information from various sources. All the documents in the process must be well balanced in their perspectives and judgments (AS 2.2.36, 2.2.39, 3.2.3, 3.4.5, 3.5.2, 4.0.8, and 4.0.22-25). **Transparency, usability and timeliness** A SAI must not be forced to withhold findings and should, within its legal mandate, be free to decide what to publish and how. The report should provide accessible, concise and up-to-date information, which the government, parliament, and government entities can use to improve the way they function, i.e. the information provided should add value. The audit questions should be answered. The points on which the SAI expects action to be taken, and by whom, should be clearly stated. Being timely requires that the report should be issued on time in order to make the information available for timely use by management, government, legislative officials and other interested parties (AS 2.2.10-11, 3.1.1, 4.0.4-5, 4.0.7-8 and 4.0.21-22). Good performance audit reports add value to the stakeholders and meet the objectives set. They contribute to better knowledge and highlight improvements needed. They are reader-based and well structured, and the language is not ambiguous. Findings are presented objectively and fairly. There are separate presentations of findings and conclusions, and facts are presented and interpreted in neutral terms. Different perspectives and viewpoints are represented, all relevant findings, arguments and evidences are included, and the reports are constructive; i.e. positive conclusions are presented.

Total Marks 10

Q.4. Ref: Rule 6.7 The Feasibility of Audit -Performance Audit Book- 2

6.7 The Feasibility of Audit

By now the auditor can answer the question whether it would be feasible to undertake a performance audit. Feasible according to the Concise Oxford Dictionary means "practicable, possible, manageable, convenient, serviceable, plausible". There is no point in undertaking an audit which is not likely to produce meaningful and credible results in a cost-effective manner.

A proposed performance audit may sometimes not be feasible for reasons such as:

- non-availability of data;
- improper timing: e.g., the audit being planned at a time when management is likely to be genuinely preoccupied' with unavoidable tasks of higher priorities; e.g. Board meetings, crises management, inspections by donor agencies etc;
- difficulty in getting access to project sites: e.g. a project site may not be easily accessible due to floods, or snow or general in-security etc;



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- the audit is not expected to be cost-effective, i.e. the cost of carrying out an audit is more than the benefits expected from it;
- financial audit has covered most of the ground or a comprehensive evaluation has already been completed;
- the preliminary survey indicates that the internal controls are working satisfactorily and the entity is achieving its objectives.

In the light of a realistic assessment of the preliminary information and other relevant factors, some of which were discussed above by way of illustration, an auditor should be able to, determine whether an audit would be feasible or not. If not, he would record his reasons to that effect and submit the case to his superiors to enable them to take a decision. In case the audit is considered feasible, which would mostly be the case, we move to the next stage.

Total Marks 10

Q.5. Ref: Rule 6.4 Performance Audit Book- 2

6.4 Determining the Audit Approach

The auditor should at this stage be in a position to determine what audit approach would be the most suitable and fruitful for this assignment.

For the purposes of determining audit approaches, techniques, and methodology the guidelines for performance audit have been divided into two broad categories:

- audit of projects, Book 3, and
- audit of programmes, Book 4.

In determining the audit approach an auditor tries to answer two sets of questions in relation to the specific entity which is to be audited:

- questions relating to methodology of audit; and
- those relating to logistics.

The following are some questions relating to methodology:

- What will be the main objectives of audit?
- What will be the main lines of enquiry and the audit focus?
- What audit criteria are available? What more will have to be developed in consultation with management?
- What methods/techniques will be used? Discount cash flows? Output-budgeting? Others?
- What sampling method will be used?
- Do we undertake financial audit simultaneously; if so to what extent?
- Other.

The second set relating to logistics includes questions like:

- On what locations (headquarters, branches, project sites) will audit be conducted?
- Where to begin, what to take next' and next?
- What site visits? when? with whom

What is to be the composition of the audit party and how would work generally be divided among members, and supervised; etc.

It must be emphasised that the audit steps, and the considerations that bear on them, are not in the nature of neatly divided compartments, each to be considered separately, exclusively, and completely, one at a time. As we have noted in several other places these guidelines the issues overlap, interact, and mutually affect each other. The audit planning process is iterative, i.e. the circle is often repeated several times in the light of information and needs of the next steps.

The fundamental question as to what audit approach should be taken in audit is answered in Books 3 and 4. In the light of these guidelines an auditor would have to figure out specific details/steps appropriate to the entity to be audited. Performance audit requires creative thinking and seasoned judgement. There are no ready-made answers, standard audit programmes, or universally applicable check-lists in performance auditing. The guidelines here are to stimulate thinking, arouse questions and encourage a methodical approach.

Total Marks 10



Q.6. Ref: Rule 13.3 Performance Audit Book- 2

13.3 Techniques Used in Data Analysis

There is a large variety of techniques available to an auditor for analysis:

discounting cash flow techniques like the net present value (NPV), internal rate of return (IRR), sensitivity analysis; output budgeting; various forms of cost analysis and cost-benefit ratios; financial analysis and ratios; statistical techniques like averages, means, mode, standard deviations, time-series analysis, or correlation and regression analysis. Auditors usually prefer techniques which 'give them results/measures which are quantitative; figures are more credible than adjectives;

- aggregate; figures that sum up say costs, benefits or costs and benefits both, or sum up losses, or wastage etc. Net present value (NPV), cost benefit ratios, cost per unit are measures of this type;
- amenable to comparison; again NPV, IRR, cost per, unit, output per man-hour, percentages etc. are measures of this type;
- relatively simple to understand by the users of the report.

13.4 Some Elements of Data Analysis

Data analysis undertaken by auditors in their work generally includes some of the following elements:

- a detailed examination of observed facts to determine whether evidence proves or disproves an assumption which the auditor set out to test. For example, in a preliminary survey the auditor may have gathered some evidence to indicate that the management reporting system did not reflect the state of affairs correctly. He would, in his data collection and its subsequent analysis, try to form a judgement whether there was sufficient evidence to prove the assumption;
- a judgement on the results of tests carried out on key systems and controls to determine whether the deviations from standard/or norm are within acceptable limits or indicate weaknesses worth reporting;
- relating data from different sources or of different nature to test if conclusions drawn from one set of observations hold good in the light of this additional information, which may sometimes be only indirectly related. For example, an auditor examining a child immunization programme finds highly impressive figures of immunizations carried out. He might want to relate these results to the overall consumption of the vaccines in the area or the infant mortality rates coming out of a post-implementation survey.
- link various aspects of an audit observation in a logical sequence and relationship to enable conclusions to be drawn. An auditor observes delays in the completion of a project; he would, among other things, examine the effect of delays on costs and benefits; and the extent of it; he would, then, evaluate the overall profitability of the project in the light of actuals as compared to estimates.
- the identification of significant trends. In the course of detailed review an auditor may come across several instances, which seen together and in relation to each other, may point to a significant trend which may merit reporting;
- comparisons of various kinds to provide a meaningful perspective to conclusions. Comparisons can be of various kinds: comparisons of the actual with what was planned or estimated; comparison of management performance or costs with similar or comparable undertakings elsewhere; comparison with generally accepted standards;
- examination of the causes of significant effects to help management take corrective action;
- assessment of the consequences of events. When an auditor finds a situation which is not satisfactory he not only tries to ascertain the causes that led to this situation, he also tries to assess what consequences it will have if corrective action is not taken. This involves considerations of materiality, with a view to underlining the need for follow up action.
- organization of the supporting evidence and -argument in a manner which is coherent, brief, and effective so that it makes sense to the reader and convinces him of its credibility.



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Q.7. Ref: Rule 7.3 to 7.8 Performance Audit Book- 2

7.3 Criteria in Performance Auditing

The situation is not alike for performance auditing. Firstly, it is a nascent discipline and its scope and methodology vary from country to country. Secondly, it does not have the backing of a long-drawn history of academic work.

7.4 Types of Criteria in Performance Auditing

There are two types of criteria in performance auditing:

- a) General criteria
- b) Specific criteria

See Figure 7.1

7.4.1 General criteria

The general criteria are derived from common sense or general rationality. For example, the procedures in an organization may be too cumbersome to be effective. Even a general review of its procedures may suggest potential areas for simplification. Another example could be ineffective span of control for some supervisors. A general review will suggest need for re-distribution of work.

In most of the cases, however, the general criteria are derived from generally accepted management practices. For example, bulk purchases are more economical than piecemeal purchases. Another example could be that separation of indenting, purchasing and payment functions leads to greater efficiency. The knowledge of generally accepted management practices (GAMP) is obtained either by formal education and training in management sciences or by on-the-job work in a well-run organization. The professional bodies also lay down performance or practice norms for its members. For example, doctors, lawyers, teachers, accountants and scientists' organizations prescribe acceptable standards of conduct and efficiency. There can be operational standards laid down by various specialists. For example, in education, a standard prescribed by specialist could be in terms of a minimum number of years experience, in teaching and research before a certain job can be manned by a person. Thus the auditors would need to acquaint themselves with generally accepted management practices of different areas. These practices can be adopted as general audit criteria for an audit assignment.

7.6 How to Determine the Criteria

There are no hard and fast rules to determine the audit criteria. Some of the tips are as follows:

The auditors should try to visualize various segments of the programme into project, or tasks. Each project or task normally passes through such phases as feasibility, planning, financing, execution, operation and evaluation. Audit criteria are often stated in the form of desirable activities and are stated in the verbal form of 'should'. The audit criteria can also be laid down in the form of main criterion and sub-criteria. The main criterion could lay down the general principle while the sub-criteria could be the detailed activities expected of the management. For example, in the case of audit criteria for the use of an equipment, the main and sub-criteria could be as below:

Main Criterion

The equipment should be optimally used.

Sub-Criteria

- i) The management should lay down utilization time and productivity of the equipment.
- ii) The utilization and productivity of the equipment should be recorded and monitored.
- iii) The management should take remedial action where the productivity is below (say) 80% of the standard



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7.8 Some Generally Applicable Audit Criteria

In this section we shall list some generally applicable criteria. But the auditors should use them with care. They should adapt these criteria for each specific situation.

- The objectives of the management should be:
 - Attainable
 - Quantifiable
 - Specific about quality, time and cost
 - Appropriate to the overall charter of the organization
 - Understood by all concerned
- The management should have clearly stated plan to achieve the objectives. The plan should specify steps, procedures and resources. It should provide for appraisal of alternatives.
- The auditee should have a system in place to monitor the work processes and review of the progress.
- All decisions should be based on a rational analysis and by persons qualified to take the decision.
- The analysis should cover all possible alternatives for achieving an objective.
- The management should consciously perceive the need for a project, function, or activity. The need should be translated into requirement. The requirement should be met in the most economical and efficient manner.
- There should be a reliable system of internal controls in place.
- The management should comply with various rules and procedures.
- Each project should have an intended product and the management should clearly specify it.
- The management should have a system in place to see that:
 - the resource-use is cost-effective
 - waste and duplication is avoided
 - resource-use is planned, managed and controlled.
- The management should determine standards of its own performance. The standards of performance could be about:
 - operations, for example number of telephone connections granted in a given period-quality of for example. response time in service dealing with an application
 - productivity - for example, processing of a given number of pension cases in a given period by each person
 - utilization - for example, occupancy rates for beds in a hospital • idle time - permissible limits for equipment and staff.
- The management should lay down performance standards after:
 - considering all the relevant factors
 - cost of performance
 - reviewing them periodically in the light of real life experience.
- The management should take remedial action in case variance is noted against the expected standard.
- There should be a system in place to review various processes, methods and products of the organization
- There should be evidence for the efforts made by the management to improve its internal efficiency and economy in resource acquisition.

Total Marks 10

Q.8. Rule 17.2 Performance Audit Guidelines Book- 2

17.2 Extracts, relating to Performance Auditing, from Reporting Standards in Government Auditing Prescribed by the INTOSAI

137. It is not practical to lay down a rule for reporting on every special situation. This standard is to assist and not to supersede the prudent judgement of the auditor in making an opinion or report.

138. The expression "reporting" embraces both the auditor's opinion and other remarks on a set of financial statements as a result of a regularity (financial) audit and the auditor's report on completion of a performance auditing.



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140. In a performance audit, the auditor reports on the economy and efficiency with which resources are acquired and used, and the effectiveness with which objectives are met. Such reports may vary considerably in scope and nature, for example covering whether resources have been applied in a sound manner, commenting on the impact of policies and programmes and recommending changes designed to result in improvements

142. For ease of reference in this chapter, the -word "opinion" is used to mean the auditor's conclusions as a result of a regularity (financial) audit, .. ; the word "report" is used to mean the auditor's conclusions following a performance audit, as described in paragraph 140.

143. The reporting standard is At the end of each audit the auditor should prepare a written opinion or report, as appropriate, setting out the findings in an appropriate form, its content should be easy to understand and free from vagueness or ambiguity, include only information which is supported by competent and relevant audit evidence, and be independent, objective, fair and constructive.

The following paragraphs explain reporting as an auditing standard Paragraph 144 relates both to opinions and reports..... and paragraphs 155-160 to reports.

144. The form and content of all audit opinions and reports are founded on the following general principles

- (a)Title. The opinion or report should be preceded by a suitable title or heading, helping the reader to distinguish it from statements and information issued by others Signature and date. The opinion or report should be properly signed.
- (c) Objectives and scope. The opinion or report should include reference to the objectives and scope of the audit.

This information establishes the purpose and boundaries of the audit.

- (d)Completeness. Opinions should be appended to and published with the financial statements to which they relate but performance reports may be free standing.
- (e)
- (f)Identification of subject matter. The.....report should identify.....the area.....to which it relates.

This includes information such as the name of the audited entity, the date and period covered, and the subject matter that has been audited.

- h) Compliance with standards. Audit opinions and reports should indicate the auditing standards or practices followed in conducting the audit, thus providing the reader with an assurance that the audit has been carried out in accordance with generally accepted procedures.
- i) Timeliness. The audit opinion or report should be available promptly to be of greatest use to readers and users, particularly those who have to take necessary action.

155. In contrast to regularity audit, which is subject to fairly specific requirements and expectations, performance audit is wide-ranging in nature and is more open to judgement and interpretation; coverage is also more selective and may be carried out over a cycle of several years, rather than in one financial period; and it does not normally relate to particular financial or other statements. As a consequence performance audit reports are varied and contain more discussion and reasoned argument.

156. The performance audit report should state clearly the objectives and scope of the audit. Reports may include criticism (for example where, in the public interest or on grounds of public accountability, matters of serious waste, extravagance or inefficiency are drawn to attention) or may make no significant criticism but give independent information, advice or assurance as to whether and to what extent economy, efficiency and effectiveness are being or have been achieved.

157. The auditor is not normally expected to provide an overall opinion on the achievement of economy, efficiency and effectiveness by an audited entity in the same way as the opinion on financial statements. Where the nature of the audit allows this to be done in relation to specific



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areas of an entity's activities, the auditor should provide a report which describes the circumstances and arrives at a specific conclusion rather than a standardized statement. Where the audit is confined to consideration of whether sufficient Controls exist to secure economy, efficiency and effectiveness, the facts are generally agreed with the audited entity in order to ensure that they are complete, accurate and fairly presented in the audit report. There may also be a need to include the audited entity's

158. Auditors should recognize that their judgements are being applied to actions resulting from past management decisions. Care should therefore be exercised in making such judgements and the report should indicate the nature and extent of information reasonably available (or which ought to have been available) to the audited entity at the time the decisions were taken. By stating clearly the scope, objectives and findings of the audit, the report demonstrates to the reader that the auditor is being fair. Fairness also implies the presentation of weaknesses or critical findings in such a way as to encourage correction, and to improve systems and guidance within the audited entity. Accordingly the facts are generally agreed with the audited entity in order to ensure that they are complete, accurate and fairly include the audited entity's responses to the matters raised, either verbatim or in summary, especially where the SAI presents its own views or recommendations.

159. Performance reports should not concentrate solely on criticism of the past but should be constructive. The auditor's conclusions and recommendations are an important aspect of the audit and, where appropriate, are written as a guide for action. Generally these recommendations suggest what improvements are needed rather than how to achieve them, though circumstances sometimes arise which warrant a specific recommendation, for example to correct a defect in the law in order to bring about an administrative improvement.

160. In formulating and following up recommendations, the auditor should maintain objectivity and independence and thus focus on whether identified weaknesses are corrected rather than on whether specific recommendations are adopted.

161. In formulating the audit opinion or report, the auditor should have regard to the materiality of the matter in the context of the financial statements (regularity (financial) audit) or the nature of the audited entity or activity (performance audit).

163. In the case of performance audits that judgement will be more subjective as the report does not relate so directly to financial or other statements. Consequently the auditor may find that materiality by nature or by context are more important considerations than materiality by amount.

Total Marks 10
