

OAG AUDIT STANDARD

THE AUDIT OF PERFORMANCE INDICATORS

INTRODUCTION

Under the provisions of the FAAA and as detailed in Treasurer's Instruction 904, as part of their annual reporting process, accountable officers and authorities are required to report performance indicators. Treasurer's Instruction 904 provides guidance on the types of performance indicators required to be reported by agencies. Key performance indicators of efficiency and effectiveness are subject to audit by the Auditor General who is required to provide an opinion as to whether agencies' performance indicators are relevant and appropriate having regard to their purpose and fairly represent indicated performance. Performance indicators are intended to be guides to an understanding of the performance which has been achieved. The word indicator is derived from the word indicate: to point out, to show; to give some notion of; or to give ground for inferring. Performance indicators do not, therefore, have the precision and comprehensive coverage of financial statements.

An audit of performance indicators differs from a financial attest audit in that the audit opinion not only addresses the traditional area of "fair representation" but also provides an assessment of whether or not the indicators are relevant and appropriate having regard to their purpose.

This Standard includes a definition of terms, an approach to planning, conducting and reporting on audits of performance indicators, criteria for qualified and unqualified opinions, wording of opinions and skills and competencies required to audit certain types of indicators.

DEFINITIONS

Appropriate: A dictionary definition of appropriate is 'being suitable for a particular purpose'. Treasurer's Instruction 904 defines "Appropriate" as the output measures and performance indicators that give users sufficient information to assess: the extent to which an agency has achieved a predetermined target or outcome; trends in performance over time; and performance relative to the performance of similar agencies and/or benchmarks.

To be appropriate an agency's performance indicators should enable users to assess:

- performance relative to targets or goals;
- performance relative to previous performance; and
- performance relative to the performance of similar agencies or benchmarks.

Relevant: To be relevant, the output measures and performance indicators should have a logical relationship to a user's needs and to clearly defined outputs and outcomes that communicate what is to be measured. The key words in the outputs and outcomes stated in an agency's annual Budget Statement, corporate plan, or annual report will be used when assessing the relevance of an indicator.

Key Performance Indicators: A key performance indicator is one which relates to the primary purpose of the output and/or outcome and/or agency. Key performance indicators should be high level indicators, giving an overview of the performance achieved. They should therefore relate to ends (performance with respect to the outputs and outcomes), not means (performance of the operational activities associated with the outputs and outcomes).

Efficiency Indicators: Relate resource outputs to the level of resource inputs required to produce them. Efficiency indicators should show the efficiency with which the agency produced those outputs which are directly related to the primary purpose of the output. Efficiency indicators should relate the total resources used by an agency to the outputs achieved, including overheads and administrative components; eg:

- financial resources (total cost/unit of output),
- physical resources (value of assets used per output) ,
- human resources (staff/output),
- time resources (time/output).

Effectiveness Indicators: Effectiveness indicators provide information on the extent to which outcomes have been achieved through the funding and production of agreed outputs.

An outcome is what has been brought about as a direct result of an agency's outputs.

Outcome indicators usually relate to an area over which the agency has a significant degree of control. However, many agencies (particularly central agencies and those with a policy development, coordinating or facilitating role) seek to influence a policy area over which they may not have direct control.

Workload Indicators: show the amount of work done. They are activity oriented and frequently relate to process rather than outputs. They are not considered to be key indicators of performance and, if included in the annual report, should be included in the report on operations section not as performance indicators.

Users: Defined as Parliament, those members of the public with an interest in an agency's outputs and outcomes, the media and peer organisations.

SCOPE OF AUDIT WORK

The Financial Administration and Audit Act 1985 requires the accountable officer or authority to prepare and submit performance indicators. Treasurer's Instruction 904 requires the accountable officer or authority, excluding those government enterprises in the Appendix to the Instructions, to disclose in the annual report

- (i) the government desired outcome(s) to which each output relates;
- (ii) the output measures of quantity, quality, timeliness and cost;
- (iii) key efficiency indicators for each output, relating outputs to inputs consumed; and
- (iv) key effectiveness indicators for each outcome, relating outputs to outcomes achieved.

The accountable authority of a government enterprise included in the Appendix to the Instruction is required to disclose in the annual report key efficiency and effectiveness indicators.

The Auditor General is required to audit agencies' key efficiency and effectiveness indicators and state whether in his opinion, they are relevant and appropriate having regard to their purpose and fairly represent the indicated performance.

PLANNING

The auditor should allow for two planning stages when auditing performance indicators:

- the initial planning stage when the auditor is looking at the overall planning of the audit and preparing the Audit Planning Memorandum; and
- the interim audit stage when the auditor should have received the draft performance indicators and is in a position to finalise the audit approach and the test plan.

During both planning stages and the conduct phase, auditors should continually be assessing whether or not they themselves and their assistants have the appropriate mix of skills to conduct the audit of the reported performance indicators.

Initial Planning Stage

The auditor should review the previous year's performance indicators and audit opinion and the proposed indicators for the current year, and include a section in the Audit Planning Memorandum setting out:

- what changes are proposed by the agency to its performance indicators;
- what assistance, if any, the agency has requested;
- an initial assessment as to whether the indicators are considered to be relevant and appropriate;
- an assessment of the adequacy of the underlying systems supporting the development of these indicators; and
- what skills may be required to audit the indicators.

Relevant and Appropriate

The types of issues the auditor needs to address in planning the audit of performance indicators include:

- has the agency developed outputs and outcomes that reflect the government desired outcome;
- do the key efficiency indicators for each output relate outputs to inputs consumed;
- do the key effectiveness indicators for each outcome relate outputs to the outcomes achieved;
- do these key indicators show performance of the primary purpose(s) and are they comprehensive in covering all major areas of the agency's performance; and
- do these key indicators enable users to assess performance relative to targets or goals, previous performance and similar agencies or benchmarks.

Comprehensive

The auditor needs to ensure that the key performance indicators of efficiency and effectiveness cover all of the key areas of the agency's outputs and outcomes and provide an adequate range of indicators for users to assess performance.

The indicators presented may all be relevant and appropriate to an output or outcome but may be deficient in that they are not comprehensive enough to cover all of the key areas within that output or outcome. In such a case the auditor will need to bring to the attention of the agency the areas where the indicators are considered to be deficient.

Skills and Competencies Required

Before undertaking the audit, the auditor must be confident that the skills and competence required to audit performance indicators are available.

For auditors to undertake successful audits of performance indicators, they will need to understand issues in performance measurement, derivation of performance indicators and practical development of suitable information systems. In addition, auditors should be aware of current corporate and business planning issues and related social, economic and environmental factors.

In auditing non-financial performance information auditors will be required to exercise judgement and express opinions on areas that involve disciplines other than accounting. If neither the auditor nor another person within the Office of the Auditor General has the professional skills, then the auditor will need to engage the services of a qualified or professionally recognised specialist in the relevant field, for example: valuers, engineers, actuaries or lawyers.

The specialist may be called upon to undertake the audit of particular areas of the non-financial performance information, or offer the auditor advice in relation to certain parts of the audit process, for example, to assist with the evaluation of the integrity of systems and controls that are of a technical or specialist nature, to advise on the type of audit testing the auditor should undertake, or the appropriate technical or quality standards relevant for specific performance measures.

It is essential that any expert assistance be identified at the planning stage.

When using the work of another auditor or expert, the auditor needs to consider the audit procedures required by auditing standards AUS 602 and 606.

Interim Audit Stage

The auditor should have made an initial assessment as to whether the indicators are relevant and appropriate during the initial planning stage.

This assessment should be reviewed when considering the draft performance indicators and before finalising the performance indicator test plan.

If the indicators are considered to be relevant and appropriate, it is during this stage that the auditor should determine the nature and extent of audit testing required in

order for the auditor to be satisfied that the indicators fairly represent the indicated performance.

Points to consider are:

- determination of whether the indicators are verifiable. Appropriately qualified individuals working independently should be able to arrive at essentially similar conclusions or results about the key performance indicators of efficiency and effectiveness. This means that the information upon which the indicators are based must be collected, recorded and analysed in such a way that the conclusions drawn from it can be checked;
- determination of whether the key indicators of efficiency and effectiveness are free from bias. The information used to indicate performance should be impartially gathered, analysed using techniques which are free from built in bias and impartially reported. Selective reporting or distorted presentation of information is to be avoided; and
- determination of whether the indicators are quantifiable. The indicators should show in a quantified way the extent to which outcomes have been achieved through the funding and production of agreed outputs. Extent is a relative term and requires a reference point against which comparison can be made. It should be noted that subjective or judgmental statements about performance are not quantifiable indicators.

The auditor should also see that the key indicators of efficiency and effectiveness are supported by adequate explanatory notes.

The Notes should explain the indicators' relevance to the outputs and outcomes, how the indicators have been derived, any variations in the way they have been derived (from previous indicators), why these are key indicators of performance, and how the indicator may be used to assess performance. However, the Notes should not make judgements about the indicated performance.

CONDUCTING THE FIELD AUDIT WORK

Audit Assurance

When auditing performance indicators, the auditor should apply a combination of audit techniques and tests that will provide the required level and amount of audit evidence to facilitate the forming of an opinion.

Because the information is primarily non-financial, as opposed to financial, does not in itself necessarily call for new techniques or tests to be used. The combination of various audit techniques or tests may differ when compared with those used for the audit of financial information.

Audit techniques that are able to be applied by the auditor would include:

- Compliance testing and evaluation of the systems, processes and controls that capture, record, analyse and monitor the information;
- Performing rigorous analytical procedures over the information; and
- Performing a combination of those substantive tests considered necessary to gain the required level of assurance.

As with any other aspect of auditing the auditor must exercise judgement in obtaining sufficient appropriate audit evidence to enable reasonable conclusions to be drawn.

Sources of likely audit assurance may vary according to the nature of the indicators reported. The next section sets out the evidential requirements that are likely to apply to the audit of effectiveness (outcome) and efficiency (relationship of inputs to outputs) indicators.

Evidential Requirements

Where the key performance indicators are of effectiveness (outcomes), ie. that which has been brought about as a direct result of the agencies' outputs, the auditor will primarily be concerned with testing the systems used to measure those outcomes.

Outcomes will generally be measured through surveys or databanks of factors such as satisfaction levels, use of a service (for example, patronage levels at Art Gallery), quality of a service (for example, water quality) or the number of occurrences of a specified event (for example, crime rates and clearance rates).

In such cases, the auditor will usually test the systems used to measure the outcomes, to ensure that they support the reported information. Normal audit standards and guidelines applying to reliance on financial systems will be applicable in most cases. Other sources of evidence could include statistics gathered independently (for example, by the Australian Bureau of Statistics).

Auditing the quality of a service may have two meanings or dimensions, a customer-based meaning (for example, user perceptions of water clarity and taste), and a technical meaning (for example, technical standards for water quality). Neither dimension is of itself "correct", and proper measurement of quality should include both dimensions. Entities may choose to measure and report on either or both. Auditors should assess whether entities have considered both before choosing measures, and encourage the use of both.

The judgment involved in the audit of quality is such that the auditor needs to have the expertise, knowledge and skills to undertake work in this area, and as such it is expected that the work will be performed by auditors with relevant experience. If neither the auditor nor another person within the Office of the Auditor General has the professional competence, then the auditor should engage the services of a qualified or professionally recognised specialist in the relevant field.

Where the performance indicators are of efficiency, that is the relationship of inputs to the outputs (goods and services produced), the auditor may expect to use any one or more of the full range of audit techniques and tests available.

Auditing Allocation of Costs

In auditing costs much of the substantiation will be performed as part of the financial audit. The auditor will, however, need to establish that costs have been correctly allocated to each significant output.

The full and fair allocation of costs to the outputs that incur them is one of the cornerstones of an efficient management control system. The information such systems

generate should enable entity stakeholders and management to make accurate business decisions.

The audit focus should be on the underlying assumptions and systems. Therefore the auditor should concentrate on:

- testing the reasonableness of the underlying assumptions;
- ensuring the method of allocation is reasonable and supportable; and
- ensuring there is consistency of treatment within the audit period (i.e. costs are allocated on the same basis as funds are appropriated or budgeted), and between audit periods where applicable.

Changes in Significant Indicators

Where significant indicators have changed the auditor should ensure that the change has been correctly authorised/approved.

On receipt of the first draft of the performance indicators, the auditor should check whether there have been any changes to significant performance indicators during the reporting period. Where changes are noted the auditor should ensure that the changes have been properly approved.

In addition to the changes being properly authorised, the auditor should be satisfied with the reasons for any change. The change should improve the measurement of achievement and not try to hide bad performance.

The auditor needs to be wary of unnecessary and/or unsupported changes that give the appearance of an improved result. Such changes are not acceptable.

The quality of significant performance measures is more important than their consistency from one period to another.

Consistency of measures between periods is valuable, however, in the development of performance reporting, improvement in the quality of a significant performance measure is considered to be more important than inter-period consistency.

Notes to the Performance Indicators

Where Notes are included as part of the performance indicators, the auditor will be required to form an opinion on their validity.

The auditor should form a view on the Notes, as the credibility of the audited financial and non-financial information reported in the performance indicators may be undermined by inconsistencies with the Notes. Professional judgement should be exercised as to the level of assurance required, depending upon the statements made in the Notes.

Where, in the opinion of the auditor, the Notes portray an impression that is inconsistent with, or unjustified by, information contained elsewhere in the financial statements or report on operations, the auditor should request management to justify their Notes, and reconcile the inconsistencies. Where management is unable to satisfactorily justify the Notes or reconcile the inconsistency, the auditor should ask for the commentary to be amended or removed. If this is not done, the audit opinion may need to be qualified.

Notes to the indicators should explain:

- how the indicators have been derived;
- any variations from previous indicators;
- why the indicators are considered to be relevant to the outputs and outcomes;
- why these are key indicators of performance;
- how the indicators can assist the user to assess performance; and
- any major movements in the measurement as a result of unusual events or circumstances.

REPORTING FINDINGS

The opinion expressed in the audit report should be either

- unqualified; or
- qualified.

A qualified opinion should be expressed as:

- (i) an “except for” opinion;
- (ii) an “adverse” opinion; or
- (iii) an inability to form an opinion.