Preliminary draft for discussion only
(Do not quote without permission)
October 15, 2016

DISCUSSION PAPER # 2

BHARTI INSTITUTE OF PUBLIC POLICY
INDIAN SCHOOL OF BUSINESS (ISB)

AUDITING THE AUDITORS: EVALUATING THE METHODOLOGY OF PERFORMANCE AUDITS

by

Prajapati Trivedi

Senior Fellow Governance
Bharti Institute of Public Policy and
Adjunct Professor of Public Policy
Indian School of Business

and

Visiting Economics Faculty
Harvard Kennedy School of Government
Harvard University

AUDITING THE AUDITORS:
EVALUATING THE METHODOLOGY OF PERFORMANCE AUDITS[1]

by

Prajapati Trivedi

ABSTRACT

It is hard to deny that last two decades have witnessed an 'audit explosion.' Increasingly, Supreme Audit Institutions in most counties are allocating greater share of their resources on Performance Auditing of government entities. However, this paper finds that serious academic work examining the methodological foundations of Performance Auditing is conspicuous by its absence in the extant literature on Performance Auditing. Much of the literature on the subject comes from various Supreme Audit Institutions. Academics have either only elaborated on the methodology adopted by these Supreme Audit Institutions or taken issue with the magnitude and direction of the impact of Performance Audit on the performance of government entities. This paper seeks to fill an important void in the literature and argues that the current methodology of performance auditing is fundamentally flawed. Using the well-established principles in financial auditing, it points to the necessity for the existence of a 'performance statement' before a Performance Audit can be undertaken. The current practice of auditors making this statement ex-post violates a well-established norm – the creator of a performance statement cannot be the auditor of the same statement. The paper then goes on to suggest a methodology for developing performance statements and auditing them.

[1] An earlier version of this paper was presented at a workshop on 'Performance Auditing: Challenges and Opportunities,' organized by the Word Bank for Supreme Audit Institutions in Asia Region in Thimpu, Bhutan, on June 5-6, 2012. I am grateful to participants and resource persons in this workshop for their comments. I am particularly grateful to Mr. Vinod Rai, former Comptroller and Auditor General of India for his encouragement to further pursue the main ideas contained in this paper. Remaining errors of omission and commission are entirely mine.

1. INTRODUCTION

It is impossible to have good governance, let alone a viable democracy, without a Supreme Audit Institution (SAI). In Commonwealth countries this institution is generally referred to as the Comptroller and Auditor General (CAG) of the country. In most countries they have the status of a constitutional body such the Supreme Court of the country. They are at par with executive and hence, once appointed, the executive does not have the power to remove a CAG in most countries. The CAG in India is ranked 9th and enjoys the same status as a judge of Supreme Court of India in Indian order of precedence. To insure independence, SAIs follow a peer review system and the accounts and activities of a country's SAI are usually audited by another member of the International Organization of Supreme Audit Institutions (INTOSAI).

Founded in 1953, INTOSAI is an autonomous, independent and non-political organisation with 191 countries as its members. According to its website (www.intosai.org), INTOSAI provides an institutionalised framework for supreme audit institutions to promote development and transfer of knowledge, improve government auditing worldwide and enhance professional capacities, standing and influence of member SAIs in their respective countries. In keeping with INTOSAI's motto, *'Experientia mutua omnibus prodest'*, the exchange of experience among INTOSAI members and the findings and insights which result, are a guarantee that the profession of government auditing continuously progresses with new developments.

In the case of India, Article 148 of the Indian Constitution outlines the rights and privileges of the Comptroller General of India as follows:

> *There shall be a Comptroller and Auditor-General of India who shall be appointed by the President by warrant under his hand and seal and shall only be removed from office in like manner and on like grounds as a Judge of the Supreme Court.*
> *Every person appointed to be the Comptroller and Auditor-General of India shall, before he enters upon his office, make and subscribe before the President or some person appointed in that behalf by him, an oath or affirmation according to the form set out for the purpose in the Third Schedule.*
> *The salary and other conditions of service of the Comptroller and Auditor-General shall be such as may be determined by Parliament by law and, until they are so determined, shall be as specified in the Second Schedule: Provided that neither the salary of a Comptroller and Auditor-General nor his rights in respect of leave of absence, pension or age of retirement shall be varied to his disadvantage after his appointment.*
> *The Comptroller and Auditor-General shall not be eligible for further office either under the Government of India or under the Government of any State after he has ceased to hold his office.*
> *Subject to the provisions of this Constitution and of any law made by parliament, the conditions of service of persons serving in the Indian Audit and Accounts Department and the administrative powers of the Comptroller and Auditor-General shall be such as may be prescribed by rules made by the President after consultation with the Comptroller and Auditor-General.*
> *The administrative expenses of the office of the Comptroller and Auditor-General including all salaries, allowances and pensions payable to or in respect of persons serving in that office, shall be charged upon the Consolidated Fund of*

India.

All SAIs primarily undertake following three types of audits.[2]

1. Compliance audit
2. Financial Audit
3. Performance Audit

Compliance Audit

Tests for assuring compliance to laws, regulations and rules. It provides:

1. Attestation (opinion on) of financial accountability;
2. Existence and control for safeguarding of assets;
3. Evaluation of financial records;
4. Audit of financial systems;
5. Audit of internal control for safeguarding assets and completeness and accuracy of accounts
6. Audit of propriety of administrative decisions;

Financial Audit

Financial statements are prepared by undertakings run by various departments, statutory corporations, government companies and other autonomous bodies and authorities. SAIs certify how far the accounts are "true and fair" i.e., whether the financial statements (accounts) are properly prepared, complete in all respects and are presented with adequate disclosures. In most cases, SAI financial audit is a "supplementary audit" with the primary auditor usually being a chartered accountant. SAIs also audit and certify the annual accounts of the Central and State governments. More on this later in the paper.

Performance Audit

Performance audits seek to establish at what cost and to what degree the policies, programmes and projects are working. Performance audit, apart from asking whether things are being done in the right way, goes a step further and analyses whether the right things are being done. In addition to all the financial audit checks, the Performance Audit seeks to assess whether a programme, scheme or activity deploys sound means to achieve its intended socio-economic objectives. This type of audit is the focus of this paper and we will elaborate on this definition later in the paper.

In most member counties the importance of Performance Audits has grown exponentially. Today, almost 50 % of the budget of CAG in India is spent on Performance Audits. Reports and findings of these audits have had a devastating impact on governments, including their eventual fall from power. Thus the methodology of 'Performance Audits' is of paramount importance for the functioning of democracy. Unlike compliance audit and financial audit, there is no general agreement on the methodology for conducting a Performance Audit.

[2] Comptroller and Auditor General of India website (www.cag.gov.in)

This paper argues that methodology of Performance Audit used by CAG India is flawed. It is probably true of most SAIs as their methodologies are also inspired by the guidelines and methodology proposed by INTOSAI, which, as the paper will argue, is also equally flawed. Indeed, the genesis of the problem can be traced back to the fuzziness of the 162 pages of INTOSAI guidelines on Performance Auditing. To illustrate, on page 32 of these Guidelines[3], INTOSAI argues:

> *"Performance auditing should not be streamlined. Advanced performance auditing is complex investigatory work that requires flexibility, imagination and high levels of analytical skills. Streamlined procedures, methods and standards may in fact hamper the functioning and the progress of performance auditing. Consequently, standards – as well as quality assurance systems – that are too detailed should be avoided. Progress and practices must be built on learning from experience."*

This loose formulation of the guidelines has given intellectual licenses to member SAIs do almost anything in the name of Performance Auditing. Thus, while there is a great deal of uniformity in approaches and methods used for Financial Auditing among SAIs, Performance Auditing has spawned a plethora of approaches, most of them, as this paper will show, are hard to defend as consistent with the existing body of knowledge and best practice developed by performance evaluation professionals.

The rest of this paper is divided into six sections. In section two that follows we start with a review of the relevant literature to see how this issue has been dealt by others and identify the gaps that need to be filled and the gaps that this paper seeks to fill. Third section examines the various definitions of the term 'performance' and develops a taxonomy to classify various methodologies and approaches to performance evaluation. Fourth section takes an in-depth look at the term 'audit' and tries to delineate the most appropriate definition of audit for our context. It goes on to develop a more robust and meaningful definition of performance audit and evaluates current practice in 'performance auditing' against this definition. Based on this definition, Section five proposes a new methodology for undertaking performance audits. Followed by suggestions for new approach to performance auditing in Section six.

2. Literature Review

The available literature on Performance Auditing can be divided into four broad categories. First, group of papers and studies come from the various Supreme Audit Institutions themselves. Second group consists of literature that simply expands the work of Supreme Audit Institutions by explaining it more eloquently in books and monographs. Third, group consists of modest amount of academic work on the impact of Performance Auditing. Fourth group of studies come from academics who highlight the weaknesses and unintended negative consequences of Performance Auditing. Fifth Group of studies try to find a middle ground and reconcile the negative views held by some leading academics and the views of auditors on accountability, performance and performance auditing.

This review literature exposes a gaping void of studies that have examined the methodological weaknesses of Performance Auditing and suggested ways to improve it. Most of them take the methodology as given. As we will demonstrate, this papers fills this void

[3] INTOSAI. *Performance Audit Guidelines: ISSAI 3000 – 3100*, INTOSAI Secretariat, Vienna, July 2004 (www.intosai.org).

and represents a departure from previous work in this area. Before doing so, we explain various groups of studies mentioned above.

The first group of papers and studies come from the various Supreme Audit Institutions themselves and consists mostly of guidelines, manuals, reports and self-serving impact studies of their own performance. There is no doubt that the intentions of SAIs are good. They do intend their work to improve the performance of the agencies they audit. We can also give them the benefit of doubt and assume that by 'improved performance' they do mean more than merely compliance with rules or following proper process and procedure. Auditors, in fact, believe that the 'performance improvement' they seek will occur as a result of improved accountability resulting from performance audits. Unfortunately, very little rigorous academic work has been done to establish this causality. Instead what we have is statements from SAIs attesting to this fact.

For example, David Walker, a former Comptroller General of the United States and head of GAO claimed: 'We're in the business of helping government work better and holding it accountable to the American people. To this end, GAO provides Congress with oversight of agency operations, insight into ways to improve government and foresight about future challenges' (Walker 2005).

According to Office of the Auditor General of Canada: 'The Auditor General's performance audit reports contain recommendations that can serve as a springboard to lasting and positive change in the way government functions. Follow-up audits may be conducted to determine whether the government has made satisfactory progress in implementing the Office's recommendations' (Office of the Auditor General of Canada, 2010).

Second group consists of literature that simply expands the work of Supreme Audit Institutions by explaining it more eloquently in textbooks and monographs such as Brown and Gallagher (1982) and Raaum and Morgan, Stephen. (2009). These textbooks simply base most of their work on the publications of SAIs.

As Loocke and Put (2011), the third group of studies consisting of scholarly work directly examining the impact of performance auditing is rather small in size. In an article published in the Israeli journal *Studies in State Audit* entitled 'Are the Watchdogs Really Watching? Assessment of Audit Institutions in the Fifty United States of America,' Friedberg and Lutrin (Friedberg and Lutrin, 2004, 115) report conducting a systematic search for academic articles on public auditing in the United States and finding only two such articles: Wheat's 'The Activist Auditor: A New Player in State and Local Politics' and Baber's 'Another Look at Auditing by State Governments' (Wheat, 1991; Baber, 1995).

According to Funkhouser (2011), in addition to these articles, two Ph.D. dissertations, *The Spread of Performance Auditing Among American Cities* (Funkhouser, 2000) and *National Systems for Accountability, Transparency, and Oversight of Economic Activities* (Zacchea, 2001), can be added to that total. To these, one can add a small number of further studies in Canada (for example, Morin, 2001) and others from Europe and Australia. However, only two of the United States studies, those by Funkhouser and by Wheat, focus specifically on performance auditing. This is surprising given the rapid increase in the amount of performance auditing that appears to be occurring worldwide.

Fourth group of studies come from academics who highlight the weaknesses and unintended negative consequences of Performance Auditing consists authors such as Behn (2001) and Dubnick (2005). As has been observed elsewhere (Funkhouser, 2008), despite its connections with 'new public management', leading public management thinkers and practitioners have generally ignored performance audit. Where they have commented, their views have tended to be negative and they have 'employed a range of arguments, from democratic theory to extensive empirical evi- dence, to persuade us that performance auditing's impact on public organi- zations is at best benign, and at worst malevolent' (Funkhouser, 2008).

In *Rethinking Democratic Accountability* (2001) Robert Behn offers a scathing denunciation of performance auditing. In a section entitled 'The Bane of Performance Auditing,' he writes:

> *The problem with performance auditing is that auditors believe that theirs is the only profession that is capable, authorized, or entitled to do it. And if the auditors manage to convert their version of 'performance auditing' into the primary vehicle for creating accountability for performance, performance accountability will become compliance accountability. If this happens, accountability will come to mean nothing more than whether the agency – the performance auditee – has complied with the performance auditor's definition of performance. And for the performance auditor to do its audit, it will have to establish some rules, regulations, standards or other criteria so that it can audit the agency's records and behavior to determine whether it has indeed complied with the performance criteria. (Behn, 2001, 203)*

Behn goes on to argue that whatever areas auditors expand into they will always audit, modifying their practices only slightly, with their focus still on compliance. In addition, Behn has at least three other major criticisms of 'institutions of accountability', of which auditors and performance auditing are a part. He argues that they are nitpicking, often pouncing on small errors, hierarchical and punishing, and ultimately they undermine the public trust needed to allow government to function well. As a result, 'we ought not to even use the phrase "performance audit," lest we give the auditors the excuse to assert a unique, professional claim to the task of creating performance accountability'. (Behn, 2001, 202–03)[4]

The fifth group of studies is best represented by Funkhouser (2011). Who says the real benefit of Performance Auditing comes from promotion of (a) Public dialogue, (b) organizational learning, and (c) increased political responsiveness.

None of these studies have examined the methodological weaknesses of Performance Auditing and suggested ways to improve it. Most of them take the methodology as given and critique it (Behn 2001). As mentioned earlier, this papers represents a departure from studies examined above and fills a conspicuous void in the literature.

3. MEANING OF THE TERM 'PERFORMANCE'

[4] See Funkhouser (2011) for further details.

Various evaluation approaches available for our consideration in this context can be classified along three broad dimensions:

a. Ex-post versus Ex-ante Evaluation
b. Managerial versus Agency Evaluation
c. Comprehensive versus Partial Evaluation

In what follows we explain these three dimensions before we use them to develop a taxonomy to contextualize current approach to Performance Audit recommended by INTOSAI and used by its members, including India.

3.1. Ex-post versus Ex-ante Evaluation

An *ex-ante* evaluation exercise is:

- based on a comparison of achievements (actual results) against targets agreed at the beginning of the evaluation cycle.
- typically involves a formal agreement at the beginning of the evaluation cycle
- commonly used in most professionally run organizations

An *ex-post* evaluation exercise is:

- based on selection of criteria by the evaluator at the end of the evaluation cycle
- typically undertaken by researchers
- useful for future projects
- more comprehensive

3.2 Managerial versus Agency Evaluation

Evaluation of an agency (or organization) is based on observed results delivered by the agency.
Evaluation of the management of the agency may be calculated by adjusting ‘agency evaluation’ for factors beyond the control of the ‘management (government officials).’

The following equation depicts the heuristic relationship between the two concepts:

Agency Evaluation	≡	**Evaluation of Management**	±	**Exogenous Factor**

To illustrate this heuristic relationship. Let us take a situation in which a government hospital (agency) was expected to provide 100,000 extra hospital beds. However, there was a sudden and unexpected (unknown, unknown) budget cut. The impact of the budget cuts was a reduction in 175, 000 hospital beds. Yet, the hospital (agency) managed to increase the number of hospital beds by 75,000 through better resource management. As illustrated in the figure below, the net impact was still a decline in hospital beds by 100,000. In this case *Agency Evaluation* would be -100,000 but *Management Evaluation* would be +75,000.

Agency Evaluation	≡	**Evaluation of Management**	±	**Exogenous Factor**
(-) 100,000 hospital beds	≡	(+) 75,000 hospital beds	±	(-) 175,000 hospital beds

In other words, while Agency's performance looks bad (loss of 100,000 beds), Managerial Performance should be deemed to be positive (a contribution of 75,000 beds under adverse circumstances).

3.3 Comprehensive versus Partial Evaluation

A Government Agency (Ministry, Department, Attached and Subordinate Bodies) performs a multiplicity of tasks. These tasks could include policies, programs, projects, schemes, and so on. There are evaluation exercises that do a holistic evaluation of all objectives, actions and activities undertaken by the Government Agency (Trivedi, 2003). Unlike these Comprehensive Evaluation exercises, there are others that evaluations that focus on a specific aspect of Agency Performance. The latter approaches fall under the Partial Evaluation category.
When we depict all three dimension on a two-dimensional diagram, we get the following eight major types of evaluation approaches:

Figure 1: Taxonomy of Performance Evaluation Approaches

		Managerial Evaluation	**Agency Evaluation**
Ex-ante Evaluation	**Comprehensive**	Cell # 1	Cell # 2
	Partial	Cell # 3	Cell # 4
Ex-post Evaluation	**Comprehensive**	Cell # 5	Cell # 6
	Partial	Cell # 7	Cell # 8 **Performance Audit**

As we shall see from the following statements from the 'Guidelines for Performance Audits' published by Comptroller And Auditor General of India, Performance Audits as designed and implemented according to these Guidelines fall in Cell # 8. Performance Audits, according to CAG Guidelines, focus on selective aspects of organization's performance, deal with ex-post judgements, and deal with agency's performance.

For example, according to the Section 1.32 of the extant CAG guidelines for Performance Audit in 2013:

> *Given the size, complexity and diversity of entity operations, it is generally not practicable to attempt assessment of the overall performance of departments or entities. Consequently, performance audits are usually directed towards specific functions, ...*

According to Regulation 68 of the Regulations on Audit and Accounts 2007:

> *"Performance audit is an independent assessment or examination of the extent to which an organisation, programme or scheme operates economically, efficiently and effectively."*

According to Para 1.1 of the CAG Guidelines on Performance Audit (2014):

> *The subject matter of a performance audit need not be limited to specific programmes, entities or funds but can include activities (with their outputs, outcomes and impacts) or existing situations (including causes and consequences). The subject matter is determined by the objective and formulated in the audit questions.*

The above quotes are enough to give us a good idea of the general methodology of the Performance Audit. This methodology will be critically analyzed after a quick examination of the meaning of the term 'audit.'

4. Meaning of the term 'Audit'

All SAIs undertake financial audits in addition to performance audits. The goals, objectives and procedures for doing so are relatively much better understood and there is a much greater degree of uniformity in the design and implementation methodologies in this area.

Thus the search for a good definition of the term 'Performance Audit' naturally leads us to the definition of 'financial audit.' The textbook definition of Financial Audit is as follows:

1. *A **financial audit**, or more accurately, an **audit of financial statements**, is the verification of the **financial** statements of a legal entity, with a view to express an audit opinion.*
2. *The audit opinion is intended to provide reasonable assurance that the **financial** statements are presented fairly, in all material respects, and/or give a true and fair view in accordance with the **financial reporting framework**.*
3. *The purpose of an audit is to enhance the degree of confidence of intended users in the **financial** statements.*

It stands to reason that the definition of Performance Audit should be along the same lines. This paper proposes the following definition for Performance Audit consistent with the above definition of Financial Audit.

1. *A **performance audit**, or more accurately, an **audit of performance statements**, is the verification of the **performance statements** of a legal entity, with a view to express an audit opinion.*
2. *The audit opinion is intended to provide reasonable assurance that the **performance statements** are presented fairly, in all material respects, and/or give a true and fair view in accordance with the **performance reporting framework.***
3. *The purpose of an audit is to enhance the degree of confidence of intended users in the performance statements.*

It is rare for the Private Sector to have a performance audit in addition to a financial audit because the financial statements are also the performance statements for private sector entities.

If we accept the above definition of Performance Auditing, then flaws of the current Performance Audit methodology used by the CAG in India and recommended by INTOSAI become obvious.

First, it is clear from the above definition that a Performance Audit presupposes the existence of 'Performance Statements.' The current approach to Performance Auditing recommends that auditors should first create the Performance Statement and then audit it. That is equivalent to saying that a Financial Auditor should first makes the statement and then audit the same statement. At the very least there is a conflict of interest involved. A core principle of auditing is that one cannot do self-auditing—one cannot audit what one has created. No one would accept the validity of financial statements that are audited by the same chartered accountant that created these financial statements in the first place. It is indeed bewildering that how this simple, common sense rule has been blatantly disregarded in the prevailing INTOSAI inspired Performance Audit Methodologies.

Another way to visualize this rather absurd approach is to imagine an auditor arrives at a private sector company to audit and the company gives the auditor many mountains of raw financial data to audit. In private sector the auditor would not accept the task and ask the company to call them back when the accounts are ready. However, the extant Performance Auditing Methodology recommends the auditor should undertake this task.

Second fundamental problem with INTOSAI inspired methodologies is the subjectivity that inevitably creeps in when performance audit is done based on the basis of goals, objectives and targets created after the fact. As any professional evaluator will tell you, it is hard enough to design ex-ante systems, when creating them ex-post they are susceptible to allegations of witch-hunt and political manipulation, among other subjective influences. There are plenty of examples of such Performance Audits that have led to the downfall of democratically elected governments. It was alleged that the fate of these governments depended on the assumptions made by auditors after the fact.

In view of the two fatal flaws mentioned above, most professional evaluators would consider current Performance Audit methodologies as a voodoo science. The other problems bedevilling the currently methodology seem so insignificant in comparison that it is not worth spending time on them. They are like arranging the chairs on the deck of the Titanic. Hence, we now move on to finding a solution to this problem.

5. PROPOSED NEW METHODOLOGY FOR PERFORMANCE AUDITS

The proposed new methodology for Performance Auditing is based on the definition mentioned in the previous section. It requires following three things:

a. A Performance Reporting Framework
b. A Performance Statement
c. An agreement on what and how to audit the Performance Statement.

The rich outpouring of literature on New Public Management (NPM) provides a fertile territory for answers to the above questions and there is no need to re-invent the wheel.

The current best practice in this area is represented by Performance Agreement between the head of the Government agency and her superior. A Performance Agreement (PA) provides a summary of the most important results that a department/ministry expects to achieve during the financial year. This document has two main purposes: (a) move the focus of the department from process-orientation to result-orientation, and (b) provide an objective and fair basis to evaluate department's overall performance at the end of the year. Thus, a wellcrafted Performance Agreement represent a necessary condition for Performance Audits. We now explain the best-practice methodology for designing effective Performance Agreements.[5]

4.1 Format of Performance Agreement

A Performance Agreement (PA) is essentially a record of understanding between a Minister representing the people's mandate, and the Secretary of a Department responsible for implementing this mandate. This document contains not only the agreed objectives, policies, programs and projects but also success indicators and targets to measure progress in implementing them. To ensure the successful implementation of agreed actions, PA may also include necessary operational autonomy.

The PA seeks to address three basic questions: (a) What are ministry's/department's main objectives for the year? (b) What actions are proposed by the department to achieve these objectives? (c) How would someone know at the end of the year the degree of progress made in implementing these actions? That is, what are the relevant success indicators and their targets which can be monitored?

The PA should contain the following six sections:

Section 1	Ministry's / department's Vision, Mission, Objectives and Functions.
Section 2	*Inter se* priorities among key objectives, success indicators and targets.
Section 3	Trend values of the success indicators.
Section 4	Description and definition of success indicators and proposed measurement methodology.
Section 5	Specific performance requirements from other departments that are critical for delivering agreed results.
Section 6	Outcome / Impact of activities of department/ministry

Section 1: Ministry's / Department's Vision, Mission, Objectives and Functions

This section provides the context and the background for the Performance Agreement (PA). Creating a Vision and Mission for a department is a significant enterprise. Ideally, Vision and Mission should be a by-product of the strategic planning exercise undertaken by the department. Both concepts are interrelated and much has been written about them in the management literature. Here we will provide some working guidelines to write this section of the PA.

Vision:

Vision is an idealized state for the department. It is the big picture of what the leadership wants the department to look like in the future.

Vision is a symbol, and a cause to which we want to bond the stakeholders, (mostly employees and sometime other stake-holders). As they say, the people work best, when they are working for a cause, than for a goal. Vision provides them that cause.

---

[5] For more detailed explanation of this concept, please see Trivedi (2013).

Vision is a long-term statement and typically generic and grand. Therefore a vision statement does not change from year to year unless the department is dramatically restructured and is expected to undertake very different tasks in the future.

Mission:

The department's M*ission* is the nuts and bolts of the vision. Mission is the who, what and why of the department's existence.

We strongly recommend that mission should follow the vision. This is because the purpose of the organization could change to achieve their vision. The vision represents the big picture and the mission represents the necessary work.

Mission of the department is the purpose for which the department exists. It is in one way the road to achieve the vision.

Objectives:

Objectives represent the developmental requirements to be achieved by the department in a particular sector by a selected set of policies and programmes over a specific period of time (short-medium-long). For example, objectives of the Ministry of Health & Family Welfare could include: (a) reducing the rate of infant mortality for children below five years; and (b) reducing the rate of maternity death by (30%) by the end of the development plan.

Objectives could be of two types: (a) Outcome Objectives address ends to achieve, and (b) Process Objectives specify the means to achieve the objectives. As far as possible, the department should focus on Outcome Objectives.[6]

Objectives should be directly related to attainment and support of the relevant national objectives stated in the relevant Five Year Plan, National Flagship Schemes, Outcome Budget and relevant sector and departmental priorities and strategies, President's Address, the manifesto, and announcement/agenda as spelt out by the Government from time to time.

Objectives should be linked and derived from the Departmental Vision and Mission statements and should remain stable over time. Objectives cannot be added or deleted without a rigorous evidence-based justification. In particular, a department should not delete an objective simply because it is hard to achieve. Nor, can it add an objective simply because it is easy to achieve. There must be a logical connection between Vision, Mission and Objectives.

Section 2: *Inter se* priorities among key objectives, success indicators and targets.

The heart of the Section 2 of the PA document consists of the Table 1 given below. In what follows we describe the guidelines for each column of this Table.

---

1 Often a distinction is also made between "Goals" and "Objectives". The former is supposed to be more general and latter more specific and measurable. The Vision and Mission statement are expected to capture the general direction and future expected outcomes for the department. Hence, only the inclusion of objectives in Section 1 is required. See also Figure 3 on page 11.

Column 1: Select Key Departmental Objectives

From the list of all objectives, select those key objectives that would be the focus for the current PA. It is important to be selective and focus on the most important and relevant objectives only.

Column 2: Assign Relative Weights to Objectives

Objectives in the PA should be ranked in a descending order of priority according to the degree of significance and specific weights should be attached to these objectives. The Minister in-charge will decide the *inter se* priorities among departmental objectives and all weights must add to 100%.

Table 1: Stylized Format of the Performance Agreement (PA)

Column 1	Column 2	Column 3	Column 4		Column 5	Column 6				
						Target / Criteria Value				
Objective	Weight of Objective	Actions	Success Indicator	Unit	Weight of Success Indicator	Excellent	Very Good	Good	Fair	Poor
						100%	90%	80%	70%	60%
Objective 1		Action 1								
		Action 2								
		Action 3								
Objective 2		Action 1								
		Action 2								
		Action 3								
Objective 3		Action 1								
		Action 2								
		Action 3								

Column 3: Specify Means (Actions) for Achieving Departmental Objectives

For each objective, the department must specify the required policies, programmes, schemes and projects. Often, an objective has one or more policies associated with it. Objective represents the desired "end" and associated policies, programs and projects represent the desired "means" and actions to be taken to achieve the objective. The latter are listed as "actions" under each objective.

Column 4: Specify Success Indicators and Units

For each of the "action" specified in Column 3, the department must specify one or more "success indicators." They are also known as "Key Performance Indicators (KPIs)" or "Key Result Indicators (KRIs)." A success indicator provides a means to evaluate progress in implementing the policy, programme, scheme or project. Sometimes more than one success indicator may be required to tell the entire story.

Success indicators are important management tools for driving improvements in departmental performance. They should represent the main business of the organization and should also aid accountability. If there are multiple actions associated with an objective, the weight assigned to a particular objective should be spread across the relevant success indicators.

Success indicators should consider both qualitative and quantitative aspects of departmental performance. In selecting success indicators, any duplication should be avoided. For example, the usual chain for delivering results and performance is depicted in Figure 1. An example of this results chain is depicted in Figure 2.

If we use Outcome (increased literacy) as a success indicator, then it would be duplicative to also use inputs and activities as additional success indicators.

Ideally, one should have success indicators that measure Outcomes and Impacts. However, sometimes due to lack of data one is able to only measure activities or output.

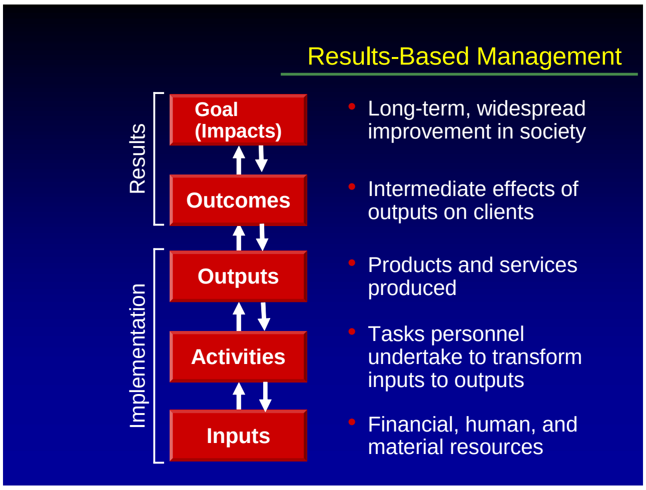


Figure 1: Typical Results Chain

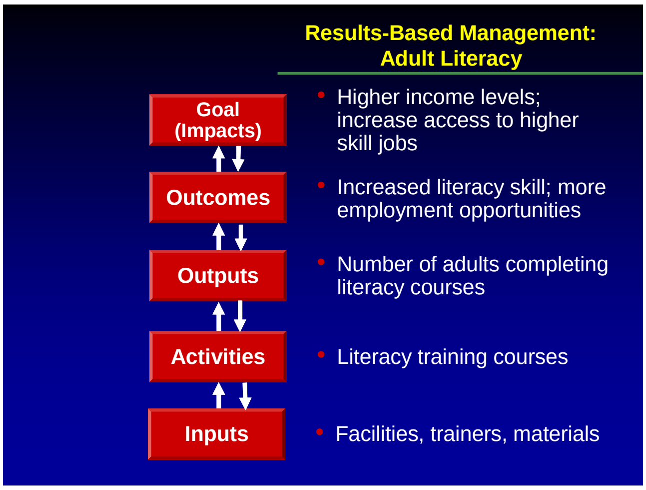


Figure 2: An Example of Results Chain

Column 5: Assign relative Weights to Success Indicators

If we have more than one action associated with an objective, each action should have one or more success indicators to measure progress in implementing these actions. In this case we will need to split the weight for the objective among various success indicators associated with the objective.

Column 6: Specify Targets/Criteria value for Success Indicators

The next step is to choose a target for each success indicator. Targets are tools for driving performance improvements. Target levels should, therefore, contain an element of stretch and ambition. However, they must also be achievable. It is possible that targets for radical improvement may generate a level of discomfort associated with change, but excessively demanding or unrealistic targets may have a longer-term demoralizing effect.

The target should be presented as per the five-point scale given below:

Excellent	Very Good	Good	Fair	Poor
100 %	90%	80%	70 %	60 %

It is expected that, in general, budgetary targets would be placed at 90% (Very Good) column. There are only two exceptions: (a) When the budget requires a very precise quantity to be delivered. For example, if the budget provides money for one bridge to be built, clearly we cannot expect the department to build two bridges or 1.25 of a bridge.(b) When there is a legal mandate for a certain target and any deviation may be considered a legal breach. In these cases, and only in these cases, the targets can be placed under 100 %. For any performance below 60%, the department would get a score of 0 in the relevant success indicator.

Section 3: Trend values of the success indicators

For every success indicator and the corresponding target, PA must provide actual values for the past two years and also projected values for two years in the future. The inclusion of actual values for the past two years vis-a-vis the projected values for the next two years will help in assessing the target value for the current year.

Table 2: Trend Values for Success Indicators

Objective	Actions	Success Indicator	Unit	Actual Value for FY 12/13	Actual Value for FY 13/14 (anticipated)	Target Value for FY 14/15	Projected Value for FY 15/16	Projected Value for FY 16/17
Objective 1	Action 1							
	Action 2							
	Action 3							
Objective 2	Action 1							
	Action 2							
	Action 3							
Objective 3	Action 1							
	Action 2							
	Action 3							

If an action is being initiated in the current year, then no values would be listed in the previous year column. Also, in case an action is going to be completed in the current year, then no values would be listed in the next 2 years. Kindly do not copy Section 2 figures here and care should be taken that the date values are for the relevant year listed in the column.

Section 4: Description and definition of success indicators and proposed measurement methodology.

PA must contain a section giving detailed definitions of various success indicators and the proposed measurement methodology. Abbreviation/acronyms and other details of the relevant scheme may be listed in this section. Wherever possible, the rationale for using the proposed success indicators may be provided as per the new format recently incorporated in the RFMS.

Departments should specify in Section 4 of the PA, the basis on which they have set the targets. The projected Trend Values also need to be specified preferably in section 4. Supporting documents should be uploaded for each indicator regarding Targets and projected trend values

SI. No.	Success Indicator	Description	Definition	Measurement	General Comments

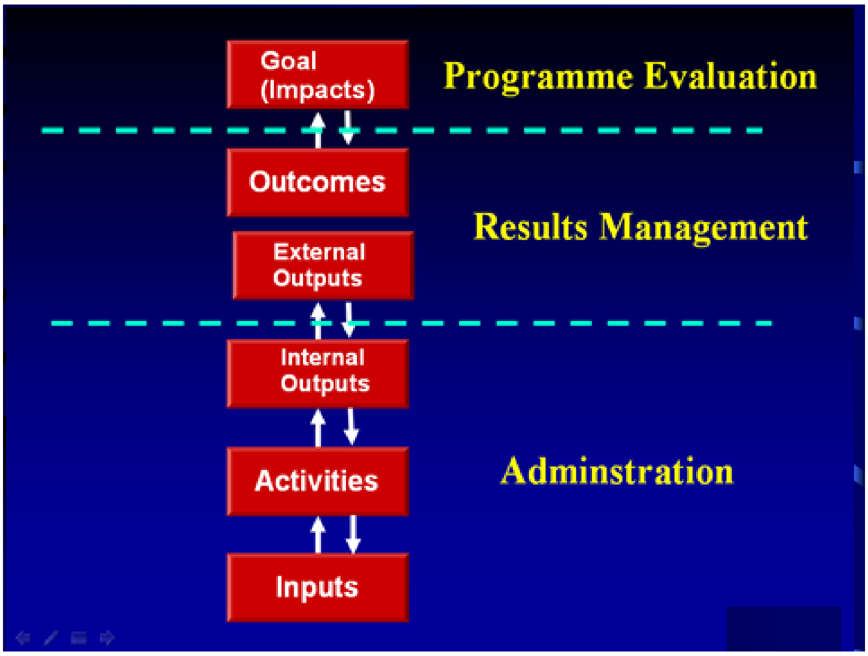
Section 5 Specific performance requirements from other departments that are critical for delivering agreed results.

This section should contain expectations from other departments that impact the department's performance and are critical for achievement of the selected Success Indicator. However, names of those departments only need to be incorporated where dependency is more than 20%. These expectations should be mentioned in quantifiable, specific, and measurable terms. While listing expectations, care should be taken while recording as this would be communicated to the relevant Ministry/Department and should not be vague or general in nature. This should be given as per the new format incorporated in the RFMS.

Location Type	State	Organization Type	Organization Name	Relevant Success Indicator	What is your requirement from this organization	Justification for this requirement	Please quantify your requirement from this Organization	What happens if your requirement is not met

It is important to note that this section is not meant to provide alibi for potential shortfalls in targets. Therefore, it is recommended that only a handful of key dependencies, perhaps not more than 5 or 6, should be mentioned in this section. The essence of management is to deliver results that are outside the boundary of direct control. Figure 4 on the next page illustrates the difference between administration and management.

Figure 4: Administration versus Management



Outcome / Impact of activities of department/ministry.

Section 6

This section should contain the broad outcomes and the expected impact the department/ministry has on national welfare. It should capture the very purpose for which the department/ministry exists.

This section is included for information only and to keep reminding us about not only the purpose of the existence of the department/ministry but also the rationale for undertaking the PA exercise. However, the evaluation will be done against the targets mentioned in Section 2. The whole point of PA is to ensure that the department/ministry serves the purpose for which they were created in the first place. Like, Vision and Mission, Outcomes do not (and should not) change from year to year.

Table 3: Outcome / Impact of activities of department/ ministry

S. No	Outcome / Impact	Jointly responsible for influencing this outcome / impact with the following organisation (s) / departments/ministry(ies)	Success Indicator (s)	Unit	2012-2013	2013-2014	2014-2015	2015-2016	2016-2017

4.2 Evaluation Methodology

At the end of the year, we look at the achievements of the government department, compare them with the targets, and determine the composite score. Table 4 provides an example from the health sector. For simplicity, we have taken only one objective to illustrate the evaluation methodology.

The Raw Score for Achievement in Column 6 of Table 4 is obtained by comparing the achievement with the agreed target values. For example, the achievement for first success indicator (% increase in primary health care centers) is 15 %. This achievement is between 80 % (Good) and 70 % (Fair) and hence the "Raw Score is 75%."

The Weighted Raw Score for Achievement in Column 6 is obtained by multiplying the Raw Score with the relative weights. Thus for the first success indicator, the Weighted Raw Score is obtained by multiplying 75% by 0.50. This gives us a weighted raw score of 37.5%

Finally, the Composite Score is calculated by adding up all the Weighted Raw Scores for achievements. In Table 4, the Composite Score is calculated to be 84.5%.

The Composite score shows the degree to which the government department in question was able to meet its objectives. The fact that it got a score of 84.5 % in our hypothetical example implies that the department's performance vis-à-vis this objective was rated as "Very Good."

The methodology outlined above is transcendental in its application. Various Government departments will have a diverse set of objectives and corresponding success indicators. Yet, at the end of the year every department will be able to compute its Composite Score for the past year. This Composite Score will reflect the degree to which the department was able to achieve the promised results.

Departmental Rating	Value of Composite Score
Excellent =	100% - 96%
Very Good =	95% - 86%
Good =	85 – 76%
Fair =	75% - 66%
Poor =	65% and below

6. What to Audit?

It is clear that we need the existence of a Performance Statement (Performance Agreement) before a meaningful Performance Audit can be undertaken. This is a simple proposition at its core. It argues that if you do not have a performance management system then there is no need to go through the motions of a Performance Audit. Lack of a performance statement suggests that the government really does not care about performance or anything goes. In either case, it is meaningless to undertake performance audit. If there is any evidence good performance, it is only by chance and not by design.

This proposal for designing Performance Agreements is not academic proposal. As depicted in Trivedi (2016), Performance Agreements are at the core of New Public Management and gaining wide currency. They are known by different names and the technology of designing and implementing them has been mastered by many countries. In India, they are known as Results-Framework Documents (RFD), and extensive implementation experience exists in this regard.

Once the existence of a Performance Statement has been confirmed, following illustrative list of questions become relevant. This paper does not intend to delve deeper into these interesting and highly relevant questions. That is a task for another day.

	Relevant Audit Questions	Details / Rationale
1	Are the Objectives of the government department consistent with the mandate and have been approved?	Often departments chose those objectives that are easy to achieve and ignore the difficult ones.
2	Have these objectives changed from last year? What was the reason for the change? Have the changes been approved?	Departments cannot change objectives from one year to another to suit their convenience. There must be a good reason for doing so.
2	Are the priorities consistent with government policies and have been approved?	Government department attach higher priorities to easily achieved targets and vice versa.
3	Has the government department chosen appropriate success indicators?	Are the success indictors SMART – Specific, Measurable, Achievable, Realistic, Time Bound
4	Are the targets consistent with the other government documents?	It is natural for government department to suggest soft targets. The performance auditors have to be vigilant.
5	Is the correct format and methodology have been used to design Performance Agreement.	

This is an illustrative list to indicate the types of questions that may be relevant in the context of the new methodology for Performance Audit. Further work is required to develop this into a full blown methodology. That, alas, lies outside the scope of this paper.

Table 4: Example of Performance Evaluation at the End of the Year

Column 1	Column 2	Column 3			Column 4	Column 5					Column 6		
Objective	Action	Criteria / Success Indicators		Unit	Weight	Target / Criteria Values					Achievement	Raw Score	Weighted Raw Score
						Excellent	Very Good	Good	Fair	Poor			
						100%	90%	80%	70%	60%			
Better Rural Health	Improve Access to Primary Health Care	1	% Increase in number of primary health care centers	%	.50	30	25	20	10	5	15	75%	37.5%
		2	% Increase in number of people with access to a primary health center within 20 KMs	%	.30	20	18	16	14	12	18	90%	27%
		3	Number of hospitals with ISO 9000 certification by December 31, 2009	%	.20	500	450	400	300	250	600	100%	20%
												Composite Score =	**84.5%**

REFERENCES

Azuma, Nobuo. "Performance Measurement of Supreme Audit Institutions, "*Government Auditing Review* 11 (2004): 65-94.

Baber, W.R. (1995), ‘Another look at auditing by state governments’, *Journal of Public Budgeting and Financial Management,* **2**, 22–41.

Behn, Robert (2001), *Rethinking Democratic Accountability,* Washington: Brookings Institution Press.

Bouckaert, Geert, and John Halligan. *Managing performance: International comparisons*. Routledge, 2007.

Brown, Richard E. and Gallagher, Thomas, P. (1982). Auditing Performance in Government: Concepts and Cases, John Wiley & Sons Inc., NY, USA.

Davis, Dwight F. "Do you want a performance audit or a program evaluation, "*Public Administration Review* 50.1 (1990): 35-41.

Friedberg, Asher and Carl Lutrin (2004), ‘Are the watchdogs really watching? Assessment of the audit institutions in the fifty United States of America’, *Iyunim, Studies in State Audit,* **60**, 91–119.

Funkhouser, Mark (2000), *The Spread of Performance Auditing Among American Cities,* Kansas City: University of Missouri.

---. (2002), ‘Auditing in America’s big cities’, *Journal of Government Financial Management,* **51** (2), 20–25.

---. (2003)‘Governance and auditing’, *Local Government Auditing Quarterly,* **17** (1), 3–4, available at http://www.nalga.org/qrtly/articles.html.

---. (2008), *Honest, Competent Government: The Promise of performance Auditing*, Altamonte Springs: The Institute of Internal Auditors Research Foundation.

---. (2011). 10. Accountability, performance and performance auditing: reconciling the views of scholars and auditors. Performance auditing: Contributing to accountability in democratic government, 209.

INTOSAI. *Performance Audit Guidelines: ISSAI 3000 – 3100,* INTOSAI Secretariat, Vienna, July 2004.

Lonsdale, Jeremy, Wilkins, Peter, and Ling, Tom. (2011). Performance Auditing: Contributing to Accountability in Democratic Government, Edward Elgar Publishing, Northampton, Massachusetts, USA.

Morin, D. (2001), ‘Influence of value for money audit on public administrations: looking beyond appearances’, *Financial Accountability and Management*, **17** (2), 99–118.

Office of the Auditor General of Canada (2010), ‘Performance audits’, available at www.oag-bvg.gc.ca/internet/English/au_fs_e_9365.html (last accessed 20 April 2010).

Raaum, Ronell, and Morgan, Stephen. (2009). 2nd Ed. Performance Auditing: A Measurement Approach, Institute of Internal Auditors, USA

Trivedi, Prajapati. (2016). Performance Management and Accountability for Effective implementation of SDGs, Discussion Paper # 1, Discussion Paper Series, Bharti Institute of Public Policy, Indian School of Business, Mohali, India

---. (2013) Performance Management and Evaluation System (PMES). *Proceedings of the Global Roundtable on Government Performance Management*, United Nations Development Programme, New York, USA

---. (2003). Performance Agreements in US government: Lessons for developing countries. *Economic and Political Weekly*, 4859-4864.

---. (1994). Improving Government Performance: What Gets Measured, Gets Done. *Economic and Political Weekly*, M109-M114.

Van Loocke, Eddy, and Vital Put. "The impact of performance audits: a review of the existing evidence." Performance auditing: Contributing to accountability in democratic government (2011): 175-208.

Walker, David M. (2005), ‘Transforming government to thrive, not just survive, in changing times’, Address to the Diamond Cluster Exchange, Kiawah Island, South Carolina, September 19, 2005.

Wheat, E. (1991), ‘The activist auditor: a new player in state and local politics’, *Public Administration Review*, **51** (5), 385–392.

Zacchea, Nicholas (2001), *National Systems for Accountability, Transparency and Oversight of Economic Activities*, International Independent University of Muldovia.