Agenda Item 6

Performance Audits

Objective of Agenda Item
To discuss a project proposal to determine whether AICPA should develop standards or guidance for conducting performance audits that converge with GAGAS.

Background
Generally Accepted Governmental Auditing Standards (GAGAS)\(^1\), often referred to as the Yellow Book, provide a framework for conducting high quality audits with competence, integrity, objectivity, and independence. These standards are for use by auditors of government entities and entities that receive government awards and audit organizations performing GAGAS audits. All audits begin with objectives, and those objectives. The types of audits that are covered by GAGAS, as defined by their objectives which determine the type of audit to be performed and the applicable standards to be followed, are financial audits, attestation engagements, and performance audits. GAGAS incorporates by reference the AICPA Statements on Auditing Standards (SAS) and Statements on Standards for Attestation Engagements (SSAE) for performing financial audits and attestation engagements, respectively, and imposes additional requirements for such engagements in accordance with GAGAS. However, for performance audits, GAGAS does not incorporate other standards by reference, but recognizes that auditors may use or may be required to use other professional standards in conjunction with GAGAS. The purpose of this project is to determine whether AICPA should develop standards or guidance for conducting performance audits that converge with GAGAS.

Requested of ASB:
The ASB is requested to consider the proposal to determine whether AICPA should develop standards or guidance for conducting performance audits that converge with GAGAS.

Additional Materials
Project Proposal – see following pages

---

\(^1\)GAO, Government Auditing Standards, GAO-12-331G (Washington, D.C.: December 2011)
Project Proposal – AICPA Standards or Guidance for Performance Audits

I. Subject

Generally Accepted Governmental Auditing Standards (GAGAS)\(^2\), often referred to as the Yellow Book, provide a framework for conducting high quality audits with competence, integrity, objectivity, and independence. These standards are for use by auditors of government entities and entities that receive government awards and audit organizations performing GAGAS audits. All audits begin with objectives, and those objectives determine the type of audit to be performed and the applicable standards to be followed. The types of audits that are covered by GAGAS, as defined by their objectives, are financial audits, attestation engagements, and performance audits. GAGAS incorporates by reference the American Institute of Certified Public Accountants (AICPA) Statements on Auditing Standards (SAS) and Statements on Standards for Attestation Engagements (SSAE) for performing financial audits and attestation engagements, respectively, and imposes additional requirements for such engagements in accordance with GAGAS. However, for performance audits, GAGAS does not incorporate other standards by reference, but recognizes that auditors may use or may be required to use other professional standards in conjunction with GAGAS. The purpose of this project is to determine whether AICPA should develop standards or guidance for conducting performance audits that converge with GAGAS.

II. Background

Over recent decades, performance audits, sometimes referred to as “value for money” audits, have become common in the public sector and have also been undertaken increasingly in the private sector. As a result, the International Auditing and Assurance Standards Board (IAASB) released an Exposure Draft of International Standard on Assurance Engagements 3000, Assurance Engagements Other Than Audits or Reviews of Historical Financial Information, in April 2011, which introduced new application and other explanatory material addressing performance audits (referred to as direct engagements by the IAASB).

Performance audits are defined as audits that provide findings or conclusions based on an evaluation of sufficient, appropriate evidence against criteria. Performance audits provide objective analysis to assist management and those charged with governance and oversight in using the information to improve program performance and operations, reduce costs, facilitate decision making by parties with responsibility to oversee or initiate corrective action, and contribute to public accountability. The term “program” is used in GAGAS to include government entities, organizations, programs, activities, and functions.

Despite certain similarities, the following characteristics of performance audits differentiate these engagements from attestation engagements:

- Performance audits do not require the auditor to obtain a written assertion or written representations from the responsible party.
- The form of audit reports prepared in connection with performance audits vary widely based on the users’ needs. However, certain reporting elements should be included in all such reports. For example, auditors should include in the report a description of the audit objectives and the scope and methodology used for addressing the audit objectives because report users need this information to understand the purpose of the audit; the nature and extent of the audit work performed, including the

Performance Audits
ASB Meeting, May 7-9, 2013

criteria used; the context and perspective regarding what is reported; and any significant limitations in
audit objectives, scope, or methodology.
• Distribution of audit reports completed in accordance with GAGAS, whether financial audits,
attestation engagements, or performance audits, depends on the relationship of the auditors to the
audited organization and the nature of the information contained in the audit report.

Performance Audit Objectives
Performance audit objectives are what the audit is intended to accomplish. They identify the audit subject
matter and performance aspects to be included, and may also include the potential findings and reporting
elements that the auditors expect to develop. Performance audit objectives can be thought of as questions
about the program that the auditors seek to answer based on evidence obtained and assessed against criteria.
Performance audit objectives vary widely and include assessments of program effectiveness, economy, and
efficiency; internal control; compliance; and prospective analyses. Audit objectives that focus on program
effectiveness typically measure the extent to which a program is achieving its goals and objectives, while audit
objectives that focus on economy and efficiency address the costs and resources used to achieve program
results. In conducting a performance audit in which the objectives focus on program effectiveness, economy,
and efficiency, the auditor might seek to answer questions such as:

• Has the program achieved its legislative, regulatory, or organizational goals?
• Does the program duplicate, overlap, or conflict with other related programs?
• Do the benefits provided by the program outweigh or justify the costs incurred to administer the
  program?

Internal control audit objectives typically relate to an assessment of one or more components of an
organization’s system of internal control and may be relevant when determining the cause of unsatisfactory
program performance. Compliance audit objectives typically relate to an assessment of compliance with
criteria established by provisions of laws, regulations, contracts, or grant agreements. Prospective analysis
audit objectives provide analysis or conclusions about information that is based on assumptions about events
that may occur in the future, along with possible actions that the entity may take in response to future events.
In conducting a performance audit that includes internal control, compliance, or prospective analysis audit
objectives, the auditor might seek to answer questions such as:

• Are managers of the program able to produce information for decision-making that is complete,
  accurate, and consistent?
• Are program benefits and services being provided to recipients in accordance with eligibility
  requirements?
• How might policy or legislative proposals impact the benefits provided by the program or the costs
  incurred to administer the program?

The objectives related to program effectiveness, economy, and efficiency; internal control; compliance; and
prospective analyses are not mutually exclusive. Thus, a performance audit may have more than one overall
objective. For example, a performance audit with an objective of determining or evaluating program
effectiveness may also involve an additional objective of evaluating internal controls to determine the reasons
for a program’s lack of effectiveness or how effectiveness can be improved. Examples of the various types of
the performance audit objectives are included in Appendix I of Government Auditing Standards, GAO-12-331G.

Performance Audit Criteria
Criteria represent the laws, regulations, contracts, grant agreements, standards, specific requirements,
measures, expected performance, defined business practices, and benchmarks against which performance is
compared or evaluated. Criteria identify the required or desired state or expectation with respect to the
program or operation. Criteria provide a context for evaluating evidence and understanding the findings,
conclusions, and recommendations included in the report. During planning, auditors should identify the potential criteria needed to evaluate matters subject to audit. Auditors should identify and use criteria that are relevant to the audit objectives and permit consistent assessment of the subject matter. Since a performance audit conducted in accordance with GAGAS requires evaluative criteria for developing the elements of a finding and drawing conclusions about program performance, the credibility of the performance audit’s conclusions relies in large part on the credibility of these criteria. Additionally, the process an auditor uses for identifying criteria tends to be iterative and ongoing throughout the engagement. Moreover, when available criteria lack objectivity or are insufficient to capture the full meaning of the questions the auditor seeks to answer, the auditor may consider the development of new criteria in order to draw valid and appropriate conclusions. However, new criteria are not usually created from scratch. They are often derived from existing criteria, general principles of social science research, or standards of professional practice. Furthermore, because developing and validating new evaluative criteria require additional time and resources, it is important to first determine whether the effort is warranted and likely to succeed. If the auditor cannot identify or develop acceptable criteria, the performance audit objectives may need to be revised or the engagement reclassified to a nonaudit service.

Level of Assurance Provided by Performance Audits

In performance audits that comply with GAGAS, auditors obtain reasonable assurance that evidence is sufficient and appropriate to support the auditors’ findings and conclusions in relation to the audit objectives. The concept of sufficient, appropriate evidence is integral to the auditors’ findings and conclusions in a performance audit, just as it is integral to the opinion resulting from a financial audit or examination-level attestation engagement. However, it is important to note that the sufficiency and appropriateness of evidence needed in a performance audit will vary based on the performance audit objectives, findings, and conclusions. Objectives for performance audits range from narrow to broad and involve varying types and quality of evidence. Auditors should identify potential sources of information that could be used as evidence and determine the amount and type of evidence needed to obtain sufficient, appropriate evidence to address the audit objectives and adequately plan audit work. In some engagements, sufficient, appropriate evidence is available, but in others, information may have limitations. Professional judgment assists auditors in determining the audit scope and methodology needed to address the audit objectives, and in evaluating whether sufficient, appropriate evidence has been obtained to address the audit objectives. If auditors believe that it is likely that sufficient, appropriate evidence will not be available, they may revise the audit objectives or modify the scope and methodology and determine alternative procedures to obtain additional evidence or other forms of evidence to address the current audit objectives. Auditors should also evaluate whether the lack of sufficient, appropriate evidence is due to internal control deficiencies or other program weaknesses, and whether the lack of sufficient, appropriate evidence could be the basis for audit findings.

In assessing the sufficiency of evidence, auditors should determine whether enough evidence has been obtained to persuade a knowledgeable person that the findings are reasonable. Sufficiency is a measure of the quantity of evidence used for addressing the audit objectives and supporting findings and conclusions. Sufficiency also depends on the appropriateness of the evidence. In assessing the overall appropriateness of evidence, auditors should assess whether the evidence is relevant, valid, and reliable. Relevance refers to the extent to which evidence has a logical relationship with, and importance to, the issue being addressed. Validity refers to the extent to which evidence is a meaningful or reasonable basis for measuring what is being evaluated. In other words, validity refers to the extent to which evidence represents what it is purported to represent. Reliability refers to the consistency of results when information is measured or tested and includes the concepts of being verifiable or supported. When assessing the sufficiency and appropriateness of evidence, auditors should evaluate the expected significance of evidence to the audit objectives, findings, and conclusions, available corroborating evidence, and the level of audit risk.

Performance Audit Reporting Requirements

Auditors should use a form of the audit report that is appropriate for its intended use and is in writing or in some other retrievable form. The users’ needs will influence the form of the audit report. Different forms of
audit reports include written reports, letters, briefing slides, or other presentation materials. The purposes of audit reports are to (1) communicate the results of audits to those charged with governance, the appropriate officials of the audited entity, and the appropriate oversight officials; (2) make the results less susceptible to misunderstanding; (3) make the results available to the public, unless specifically limited; and (4) facilitate follow-up to determine whether appropriate corrective actions have been taken. Auditors should prepare audit reports that contain (1) the objectives, scope, and methodology of the audit; (2) the audit results, including findings, conclusions, and recommendations, as appropriate; (3) a statement about the auditors’ compliance with GAGAS; (4) a summary of the views of responsible officials of the audited entity; and (5) if applicable, the nature of any confidential or sensitive information omitted. Auditors should also report deficiencies in internal control, instances of fraud, noncompliance with provisions of laws, regulations, contracts, or grant agreements, or abuse that have occurred or are likely to have occurred and are significant within the context of the audit objectives.

III. Project Objective and How it Serves the Public Interest

Project Objective
The objective of the project is to develop standards or guidance to assist auditors in conducting performance audits that converge with GAGAS.

How the Project Objective Serves the Public Interest
As described in the ASB’s Operating Procedures, standards and practice guidance enable practitioners to provide high-quality, objective audit and attestation services in an effective and efficient manner.

IV. Outline of the Project

Project Scope
To be determined.

Major Problems and Key Issues that Will be Addressed
To be determined

Impact Analysis Considerations
To be determined

V. Implications for any Specific Persons or Groups

This project will impact CPAs who perform performance audits that converge with GAGAS, including those working for governmental audit organizations. It may impact non-CPAs performing such engagements.

VI. Development Process, Project Timetable and Project Output

Development Process
A task force will be formed to study the issues and make recommendations to the ASB.

Project Timetable
To be determined.

Project Output
To be determined by the task force, whether to issue a standard, other authoritative guidance, or non-authoritative guidance.

VII. Resources Required

A project task force of up to 5 individuals.

VIII. Relevant Sources of Information that Address the Matter Being Proposed

Relevant sources of information include the following:

- Government Auditing Standards, December 2011 Revision
- IAASB Project Summary, Assurance Engagements Other than Audits or Reviews of Historical Financial Information