

Determining Criteria in Performance Auditing

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Abstract

Performance auditing is an orderly and effective systematic assessment process of effectiveness, efficiency and economy of organization functions, also to report the result of assessment along with practical suggestions to competent and authorized people to improve the operations. As this kind of audit is carried out with a far wide-range scope than other kinds of audits, auditors face with more challenges which their solution needs high knowledge and experience. In the meantime, determining assessment criteria (standards) is very important as the central core of the whole auditing process. The purpose of this article is to help auditors choosing the desirable criteria for this sort of audit.

Keywords: Auditing criteria, Performance Auditing, Performance assessment

1. Introduction

Using performance auditing is common like other kinds of auditing in most of the countries. However, performance auditing is different from other audits and focuses on operation of organizations, projects or their plans and systems. Performance auditing is usually considered as a tool for improving efficiency and effectiveness of the organization (Tillema and Terbogt, 2010)

Therefore, performance auditing is a useful tool to improve several organizational systems and to guide them towards objectives. Study of reasons for the increasing demand of performance auditing services shows that, the issue of guiding managers towards paying more attention to observe economy, efficiency, and effectiveness of economic units has provided a suitable ground for doing this kind of auditing. Also in Iran based on the article 82 of the fifth development plan of the country, all state firms subject to article 41 of country services management law -which their list is determined by the government- and also all the firms accepted in stock exchange are bound

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(since the second year of the plan and at least once by the end of the plan) to perform performance auditing in order to increase economy, efficiency, and effectiveness of firms and also increase in the reliability of financial reports (Haidarinejad and Shekarbeygi, 2012).

In this regard, setting audit criteria is one of the most important and key issues in the subject of performance auditing. As performance auditing has a wide-range operational scope and its methods and procedures are different in different countries, finding common criteria which can be used in all subjects is rather impossible. Therefore, performance auditors should design native audit criteria in their auditing (Asadi et al, 2012).

In this article, after defining criteria, its difference between performance and financial auditing has been explained. Then the sources of the audit criteria and how to determine them are being discussed. In conclusion, the existing challenges and some solutions for expansion and improvement of these standards are shown.

2. Definition of Criterion

There are different definitions of standards in auditing: criteria are a set of benchmarks which auditors compare their findings with them in order to arrive at a fair conclusion. Put differently, there are standards which a manager of any economic unit could really and objectively expect to reach those (Banifateme, 2004). Auditing criteria could be regarded as some reasonable and attainable standards which could be utilized for assessment of economy, efficiency, and effectiveness of the operation. These criteria are some desirable controlling model for the subject being studied. They show the proper method i.e. expectations of an informed and reasonable man about what must exist (Rahimiyan, 2009).

Criterion means law, standard and the like, which provides the ability for judgment about something. Therefore, audit criteria are a set of logical and accessible standards which are used as some benchmarks for assessing the performance of the main subject (Asadi et al, 2012). Based on these definitions, audit criteria are a set of logical and attainable standards that could be applied for assessment of the functioning of the main subject (Elhami, 2007).

2.1 Criteria In Financial Auditing

In financial auditing, auditors use mostly accepted standards and principles of accounting as the criteria. These accepted financial standards and principles have been deduced after several years of

academic and professional endeavor. As a result, the financial auditing as a stable system grows and its execution is fairly similar all over the world (Banifateme, 2004). For instance, it is explicitly stated in auditing standards of the country that the purpose of financial auditing is to find out whether these financial statements are prepared based on the auditing standards.

2.2 Criteria In Performance Auditing

Criteria for performance auditing are different from financial auditing. First of all, this sort of auditing is a new task and its methods, order, and scope are different from one country to another. Secondly, it does not have a long time scientific study behind it and most scientific studies about it date back to one or one and a half decades ago which have been done by a few people or institutes. Thirdly, performance auditing deals with assessing all activities of management which involve wide-range operations and mostly nonfinancial activities. The scope of this audit includes the integrity in performing the work, competency of information device, efficiency of operations, and effectiveness of different decisions and as a result there are no common criteria accepted by everyone for such a vast, different, and subtle functions. Therefore, domain of performance auditors is more complicated than financial auditors' (Elhami, 2007).

This issue could result in some problems with the audited unit. For example, if auditors use their own criteria in auditing a unit which were not approved by that unit, it could lead to a conflict between two sides and even issuing audit reports would become unreliable (Banifateme, 2004).

2.3 Definition Of Performance Auditing Criteria

Based on INTOSAI'S implementation Guideline for Performance auditing (2004), criteria for performance auditing are defined as follows:

“A set of reasonable and attainable performance standards that economy, efficiency, and effectiveness of operations could be assessed with them” Audit criteria could provide the possibility of creating audit findings (Intosaai's, 2004). In other words, audit criteria are those standards that determine whether a program has been implemented at a suitable level or better. In this kind of audit, general concepts such as economy, efficiency, and effectiveness need to be interpreted with respect to the main subject. There are no accepted common criteria about performance auditing yet and auditors in each auditing mission have compiled special criteria about that and this issue could sometimes result in disagreement with the unit which is being

audited (Elhami, 2007). This disagreement in using criteria could raise serious disagreement between performance auditors and managers of audited units and affects the auditing report.

This situation could get worse when the auditors have no interest in reaching agreement with opinions of managers. If this problem cannot be solved by explaining the situation during different stages of auditing, then auditors have to stop their operation, or if it is not possible due to some legal mandates, continue their auditing and mention their disagreement with the audited unit in their report (Banifateme, 2004).

2.4 Different Kinds Of Criteria

1-Intra-organizational criteria

2-Extra-organizational criteria

1 - Intra-organizational Criteria: Includes organizational policies, rules and regulations, contracts, funding obligation, organizational plans, operational aims and objectives, budgets, organizational charts, and detailed plans.

2 - Extra-organizational Criteria: these criteria are usually compiled by the performance auditor with coordination of the management. These criteria include performance of similar organizations, statistics related to the industry and performance of the client in the past and present, analysis or special examination, engineering standards, audit judgment, suitable operating methods, and desirable commercial custom (Banifateme, 2004).

2.5 Different Criteria In Performance Auditing

A) General Criteria

B) Specific Criteria

A) General Criteria: General Criteria are about expression and general explanation of reliable and accepted performances. General criteria are usually derived from common sense and proper judgment. Auditors should be aware and familiarize themselves to general methods accepted by management in different subject areas. These methods could be used as general audit criteria for an auditing mission (Elhami, 2007). According to accepted state standards that are compiled by the U.S. Government Accountability Office some examples of these criteria stated for the public sector are as follows:

- Expectations or stipulated objectives by the rules and regulations set by the management
- Technical standards and norms

- Performance of previous years
- Comments of experts
- Performance of other similar economic units
- Performance in the private sector (Asadi. 2012).

B) Specific Criteria: Specific criteria are closely related to rules, goals, programs, controls, and systems of the unit under auditing. Specific criteria are usually inferred from determined goals of a project or specific program and its standards and specific methods. In this area, auditors face with serious problems and these goals usually do not have any measurable criteria and hence, seriously challenging auditors (Mehdikho and Azdaryani. 2009).

2.6 Features Of A Suitable Criterion

According to fundamental standards of performance auditing, auditors must determine suitable criteria which answer to audit questions and are related to principles of economy, efficiency, and effectiveness. Criteria are those benchmarks which are used in the assessment of the main subject. Criteria of performance auditing, are reasonable and specific standards of performance auditing that based on them, economy, efficiency, and effectiveness could be examined and assessed. In this regard, features of suitable performance audit criteria could be given:

Reliability: In case of applying by other auditors, the same results could be achieved.

Unbiased, neutrality: must be unbiased towards managers or auditors.

Usefulness: their findings and results must be in conformity with information requirements of users.

Understandable: have clear and obvious explanation and no alternative interpretation

Comparability: conformity with other used criteria in similar organizations or projects.

Completeness: expansion in line with performance assessment in different conditions.

Acceptability: acceptable by audited unit, legislator, and public users (Guideline Intosai's, 2004).

2.7 Sources Of Audit Criteria

Audit criteria could be extracted from different sources, however auditors' judgment has a key role in identification of related and accepted sources. In order to create mandatory criteria about primary principles of any audit, audit board should examine sources of existing standards as follows:

- Rules, regulations, and bylaws ruling over the operations of audited unit
- Decisions made by an executor or a legislator
- Criteria employed in similar auditing or organizations
- Administrative organizations (inside or outside of governmental organizations or even country) which have the same operations
- Professional standards and experiences
- General management and texts on the main subject
- Standards set by international figures
- Surveys carried out by independent professional experts who possess enough knowledge and
- New or old scientific knowledge and other related data (Asadi. 2012).

In using these resources, their relation with audited unit, objectivity, and also their history and context of audited unit and local conditions must be considered.

2.8 Functions Of Criteria In Performance Auditing

Criteria could take a series of key roles in carrying out performance auditing, including:

- Presentation of a base for relations between auditing system
- Presentation of a base for relations between auditing management
- A base for collecting data and providing methods for collecting auditing evidences and
- Providing a base for audit findings and acceleration in providing forms and structures to audit observations (Guideline Intosai's, 2004).

Generally, criteria in any audit are based on special laws, regulations, and accepted assessment standards (or other executable standards) related to the topic. In case of need, other sources of information are used for extraction of criteria. In summary, criteria of performance auditing in any project are compiled and designed in compliance with its auditing plan (Department Of Taxation Division of Assessment Standards 1550 College Parkway,2010).

2.9 Determining Criteria

Audit criteria should be compiled totally reasonable and purposeful which requires observing logic and proper wisdom.

First of all, auditors should have these qualifications:

- Have a general understanding of auditing and be familiar with related rules and documents , like the latest studies and audits which have been carried out;
- Have an enough knowledge about justified reasons and the principle rules of the main subject or state project which is audited and qualified by the government or legislator;
- Have a good and reasonable knowledge and understanding about expectations of main shareholders and also be aware of the main expertise of the organization;
- Have a general knowledge and practical experience about other similar state activities or projects (Asadi et al, 2012).

Besides mentioned qualifications, the collaboration of the management team of audited unit with auditor's team in determining criteria is helpful and could be helpful in expansion of suitable criteria.

2.10 The Challenges Of Determining Audit Criteria

Regarding the specific features of performance auditing, including challenging nature of auditing objectives and due to the key role of criteria in performance auditing, audit criteria should be chosen in a way that guaranties the quality, independence and neutrality of the reports. Careless determination of criteria could lead to incorrect results and faces the presentation of the reports and their acceptance with serious challenges. However, due to wide-range scope of auditing and different audited subjects in performance auditing, doing each audit requires determining specific criteria. Also due to lack of accepted criteria for different subjects, in a lot of cases, determining the criteria is carried out based on the judgment of the auditor (Favchi, 2008).

Besides, there are other existing problems such as lack of strategic planning of economic units, lack of suitable performance information, lack of execution of performance based budgeting, acceptance of determined criteria by management, and inaccessibility of performance auditing

criteria (Rahimiyan, 2009). Reider believes that in case of absence of effective standards or criteria, the following three solutions could be applied:

- a) Comparative analysis of the performance with the previous performance or execution of similar units.
 - b) Using alternative standards of other organizations like production units, hospitals, and banks with similar and comparative measures for performance appraisal.
 - c) Test of performance logicity by using previous experiences in performance auditing by auditors (Reider, 2007).
- a. However, if performance auditing uses determined criteria coordinated with management, there will be fewer problems when the results come up. And if it uses new and different methods for performance auditing, then there might be some challenges between management and auditing findings. Without a doubt, using assessment criteria must be based on accepted, reliable, and right information. Otherwise, reliability of the auditing will be questioned (Hasas, 2004).

2.11 Some Suggestions For Expansion Of Criteria

- Auditors must try to think about several suitable plans about projects or tasks. To implement a project it is necessary to pass several stages such as feasibility, designing, funding, confirmation, implementing, and assessing. The question is what a logical manager does and controls in every stage.
- Auditors must examine controls, standards, or objectives adopted by the managers of the organizations, parliament, or central organization. As if the own standards of the audited unit are realized satisfactory, they can be applied as a criterion.
- In case of absence of suitable standards for measurement or judgment about the conformity of the operation with the objectives of auditing in the unit which is being audited, these criteria could be found from other sources like, rules, regulations, and standards issued by professional associations or experts in this field. And if the above mentioned sources are not available, they can rely on performance information of other organizations, private or state-run, which have similar operations, as the best methods are created from comparative assessment and consultation. Also the standards are expanded through analysis of tasks and operation by auditors.
- Another method is to use accounting standards and statistical methods to analysis the past information of the organization and providing the sought after criteria by auditors (Mehdikho and Azdaryani. 2009).

- And finally, auditors sometimes find their audit criteria through the wishes of the clients who use the organization services. This could be done by personal interview or filling questioners by clients in private or public. These questioners usually ask about expectations about the functioning level of the state unit which is being audited (Elhami, 2007).

3. Conclusion

Performance auditing and its related services are tools that developed with the objective of helping managers to guide and lead their organizations, in order to assess the economy, efficiency, and effectiveness of the economic unit and provides practical suggestions for managers to help running their units and includes quality assessment of the means at managers disposal. Regarding the specific features of performance auditing, including challenging nature of auditing objectives and due to the key role of the criteria in performance auditing, audit criteria should be chosen in a way that guaranties the quality, independence and neutrality of the reports. However, there are no common criteria accepted by everyone. Although organizations have some intra-organizational criteria such as organizational policies, rules and regulations, contracts and funding obligations, organizational plans, operational aims and objectives, budgets, organizational charts, and detailed plans , specific criteria must be compiled by performance auditing which complement above mentioned criteria. Of course agreement with the manager of the unit which is audited could pave the way of performance auditing and be one of necessities in determining performance criteria by performance auditing. Because disagreement between the units being audited and the auditing team could result in major conflicts and influences the audit report. Based on INTOSAI'S Guidelines, the features of desirable criteria for Performance Auditing are reliability, neutrality, usefulness, completeness, and acceptability. Criteria with these features could be extracted from sources like, rules, regulations and bylaws ruling over the unit being audited, decisions made by legislators, criteria used in similar audits, international and professional standards, and studies carried out by professional independent experts who have the knowledge in the related fields. In utilizing these resources, their relation to the unit being audited, objectivity, and also their history and context of the unit under auditing and local conditions must be studied. However, due to wide-ranging scope of auditing and the variety of audited subjects in performance auditing, doing each audit requires determining specific criteria. Meanwhile, in case of absence of accepted criteria for different subjects and fields, in a lot of cases, determining the criteria is carried out based on the judgment of the auditors. Regarding the mentioned problems, each one of the indexes of economy, efficiency, and effectiveness can be assessed and measured by certain criteria. The experience of different countries indicates success in this area.

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