

1. Audit objectives


1.1 *Why are audit objectives needed?*

Audit Objectives are broad statements developed by auditors and define intended audit accomplishments. The Performance Auditing Guidelines seek to transform the way in which Indian Audit & Accounts Department delivers its services.

1.2. *What would lead us to framing good audit objectives?*

Preliminary survey/ Pilot study: The single virtue of a preliminary survey is the perspective it provides to the team leaders of a performance audit on what direction the audit should take. The results of a preliminary survey, created by “feeling rather than thinking”, that is to say, by a well thought-process which will help in making informed decisions about the performance audit. This survey would consist of:

- making a study of a small sample of the entire programme, project, or organisation to be audited for its performance;
- selecting a small team which, having carried out local inspections for transaction audit, financial audit etc.in the earlier years, has some prior understanding of the organisation;
- deciding on the period over which the performance audit will focus, again, based on information/clues gathered from various sources, internal and external;
- deciding the nature, extent and availability of audit evidence required and how it will be collected (and);
- the approach and techniques which will be used to analyse the data;
- determining the organizational structure of the department and the central administration structure by reviewing the department’s

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- organization chart;
- developing a list of critical functions (that is, functions that would adversely affect the organisation's overall mission/objective) and internal control processes which monitor those critical functions for compliance with established standards;
 - determining key financial and administrative data relevant to the audit from various departmental reports and
 - identifying issues raised in prior audits of the department.

This will help us to decide:

- The timing of the various stages of the full review
- The resources required in terms of staffing input (both auditing and supervisory) and skills
- May redefine the risk perception and materiality, may even result in closing the audit study
- The format in which the findings and results of analysis should be reported.

1.3 *Understanding the entity*

We need to develop a thorough understanding of the entity we are about to audit.

Old Inspection Reports will give us:

1. Earlier audit coverage.
2. Errors/problems noticed.
3. Response of the audited department/company to audit observations.
4. Follow-up action

5. Outstanding matters

Administrative Reports of the Department will give us:

1. The mandate
2. The organisational structure
3. The activities undertaken
4. Targets and achievements
5. Financial and Statistical data

Government sanctions will reveal:

1. Reasons for the sanctions
2. Dates of sanction released
3. Amount of sanction involved

Memorandum signed with multilateral donor/lending agencies (IMF, World Bank, ADB etc.) will disclose

1. Amount of funding
2. Cost of funding
3. Commitment and responsibility to the lending agency
4. Term of agreement
5. Tenure and maturity date
6. Stages of project funding and implementation.

1.4 Risk assessment

1.4.1 Identifying risks:

Does the risk relate to a programme of national significance?

Does it affect :

- Health or safety
- Service delivery
- National security
- National defence
- Economic growth
- Citizens' rights

1.4.2 Where do risks arise from?

- A weak control structure
- Poor management information system
- Poor monitoring by senior staff
- Inadequate knowledge/skill of the staff

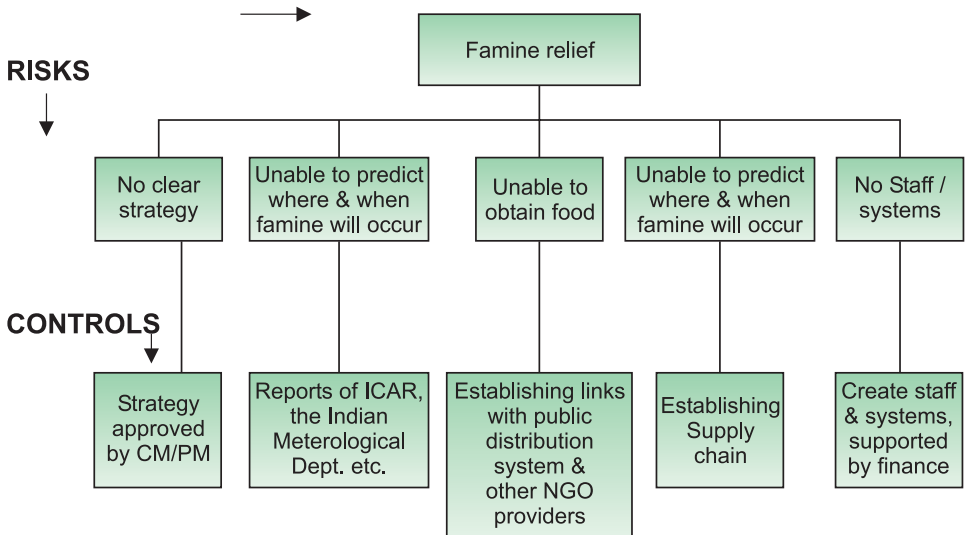
1.4.3 What are the consequences arising from the risks?

- It may affect the services delivered by that department
- It may result in failure of the programme
- It may reduce the effectiveness of the project
- it may affect the efficiency of the organisation
- It may cause loss of life
- The validity of the data may be in question making it unreliable for decision-making
- Sensitive information may be misused.
- consider the likelihood of their occurrence and

- determine the overall significance (or level) of each risk.

For example,

OBJECTIVE



1.5 Define audit objectives

What is the goal of our performance audit? To be able to express an opinion about the economy, efficiency or effectiveness of a department, a programme, or a project. Why are we conducting this performance audit? What do we wish to achieve at the end of this performance audit? What is the “focus” of our performance audit: is it outputs, or outcomes, or impact?

Step #1: Identify thrust areas

- Thrust areas should be limited in number. There could be a single thrust area. Ideally, we should not have more than two to three thrust areas.

- The interplay of the thrust area will define the subject and the scope of audit study.
- Thrust areas are identified from a risk-significance analysis.

e.g., A study may have identified procurement and inventory management as two thrust areas for the study as a result of risk analysis.

Step #2: Phrase what audit would want to comment with regard to the thrust area. This is the audit objective(s) for the thrust area.

- There could be one or more audit objective(s) for each thrust area. An attempt should be made to restrict the number of audit objectives to five at the maximum.
- In case an audit objective is too complicated/ unwieldy or there is a logical possibility of further division, we could break it up into two or more sub-objectives. We should attempt to restrict the number of sub-objectives for each audit objective to five.
- The audit objective/ sub-objective should ideally be in the form of a question regarding which audit will provide an assurance. The response to the audit objective question will essentially involve audit opinion.

e.g., Within the thrust area inventory management, we could have the following audit objectives:

- *Are the inventory management policies and procedures contemporary?*
- *Is the inventory management system efficient and suitably economical?*
- *Are the users of the system satisfied?*

We could further break up the second objective into the following logical sub-objectives as per the processes involved:

- *Are the requirements assessed efficiently?*
- *Is the procurement formalities followed adequately and done with due economy?*
- *Is the supply chain management efficient?*
- *Are the goods warehoused properly and disposed efficiently?*

Step #3: Frame the questions under each audit objective/ sub-objective.

- The questions could form a hierarchical structure, a complicated question broken down into further sub-questions. The lowest level of questions should be of a level where they cannot be further broken down. A question should not be broken down ideally into more than five sub-questions.
- There should be a logical structure in the hierarchy of questions.
- Each question should address an independent area. (*Mutually exclusive*)
- Taken together, all the questions outlined should satisfy the audit objective completely. (*Collectively exhaustive*)
- There should be direct answers possible to the lowest level questions without any interplay of opinion.

e.g., To study the audit objective 'Are the users of the system satisfied?' we could ask the following questions:

- *Were the users' demand requisitions registered timely?*
- *Were the issues satisfactory to the users?*
 - *Whether they were on time?*
 - *Whether requisite quantity was supplied?*
 - *Were the supplies of adequate quality specifications?*

- *Whether there were any significant problems faced on account of non-availability?*
 - *Whether there were any cases of major hold up due to lack of supplies?*
 - *Whether the magnitude of non-availability of supplies and quality rejections were beyond acceptable levels?*
- *Whether the service regarding replacement of supplies prompt and efficient?*
 - *Whether the replacements were timely?*
 - *Whether the replacements were satisfactory (both quality and quantity)?*

Dos:

- Do limit the number of audit objectives. There should be no more than one audit objective per thrust area and a maximum of two objectives per thrust area.
- Do ensure simplicity in writing the objectives.
- Audit objectives could begin with “whether...”, “To assess...”, “to ascertain/verify whether” etc.
- Is it clear (or obvious) which of the selected issue(s) the audit objective is intended to address?
- Does the audit objective relate well to the intended issue(s)?
- Does the audit objective describe clearly what is intended to be accomplished by the audit team or the nature of the opinion (or assurance) the team intends to provide?
- Does the audit objective relate to the nature of audit work - risk, control, governance or information?

An example of an audit objective:

Whether the organisation made a precise forecasting of the material needs to carry out scheduled repairs?

You will observe that we have included

- *an action achievement verb: “precise forecasting”*
- *a single key result to be accomplished “forecasting of the material needs”*
- *a target completion date or time period “scheduled”*
- *Specify an action which would lead to a result - forecasting of material needs which leads to timely repairs.*

Don'ts

- Don't have a large number of audit objectives
- Don't have a very complex audit objective. If necessary, it should be broken down into further sub-objectives

An example of a complex audit objective:

“Whether the organisation made a precise forecasting of the need based repair size, with adequate thought to the economics of repairs vis-à-vis fresh procurement.”

You will observe that this audit objective is trying to address too many issues. Such as

1. *a precise forecasting vis a vis the needs*
2. *the economics of repairs*
3. *fresh procurement.*

The issues of economy will actually be addressed in issue analysis when we break down the subject of Inventory Management policies & practices

with reference to (a) forecasting needs, (b) ensuring economies of repairs & (c) fresh procurement.

Placing three independent issues together will ensure neither gets covered properly!

1.6 Audit Criteria

What is a criterion?

- **Audit criteria are reasonable and attainable standards of performance against which the economy, efficiency, and effectiveness of activities can be assessed.** It is a reasonable and informed person's expectation of "what should be". It constitutes the basis on which the audited entity is evaluated.

For example, Procurement in all cases beyond Rs.1 lakh has to be made through Tender Purchase Committee (TPC)

- It is based on a key priority for implementation,

If a standard time for issue of stores from a depot is a key priority, then:

- *The standard time for receiving, sorting, vetting and registration of demands should be 3 days.*
- *The stores should be identified, picked and packed for issue within 4 days.*
- It is used to define the structure of a process that is to be measured.

Purchases beyond Rs.10 lakh require prior concurrence of Inventory and Budgetary Control Cell.

- It is a reasonable standard against which an auditor may assess the activities subject to audit.

Local units are delegated financial powers to the extent of Rs. 25 lakhs to directly purchase items from local markets.

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- It reflects a desirable control model or a good practice for the subject matter under review.

e.g., The criteria for some of the sub-questions shown in the previous paragraph could be:

- *Whether procurements were on time?*
 - *The stipulated time as per procedures manual for supplies (provided audit feels that the manual criteria is adequate as a standard)*
 - *Whether requisite quantity was supplied?*
 - *As per the quantity requisitioned.*
 - *Were the supplies of adequate quality specifications?*
 - *As per quality specifications of demand or general quality specifications as per manual.*
 - *Number of rejections within the acceptable percentage.*
- Since ideally, we will be splitting each audit objective to four levels of questions, there should be one criterion against each lowest level question.

For example, if the main question was “does the system meet the users’ needs at a reasonable cost?” then, one of the lowest level questions could be “Were a reasonable number of bids received?”

Now there has to be an audit criterion to match this question.

The audit criterion here will be the best practices adopted in contractual processes, which is that “In response to the Notice Inviting Tender there should be a minimum of five bids”.

- *Five bids here become the criterion by which the organisation is able to compare the prices available in the market for a product/service.*

- *We state a measurable and concrete number instead of saying “a high number of bids were received”.*
- Where do you get criteria from?
 - Entity’s criteria: Since access to internal data and information is easier, data might be available in a manual of practices and procedures. Some organisations also lay down targets of performance in their annual reports.
 - Discussion with entity
 - Generally accepted ‘good practice’ or comparable standards in other organisations.: For example, if we are auditing procurement, it might be useful to study practices in Canada, or Australia, or the U.K. since, for historical reasons, commonwealth nations have comparable practices.

The Public Service Commission of Canada has brought out a Report in October 2004 on the Audit of Contracting.

The Australian Department of Finance & Administration made a report on Competitive Tendering and Contracting that it carried out in 2003-2004.

These would give us insights into what are the best practices followed in other countries.

- Expert’s aid: It is useful to learn from those who are at the leading edge, however, it has to be borne in mind that the data and information should be comparable and the specialists should be able to transfer his sectoral understanding to the practitioners of performance audit.
- Other SAIs: it would be practical to utilise the audit criteria set by other SAIs, but it must be remembered that decisions taken in an audited entity are a function of that unit’s cultural, political and economic context and to that extent, we must be very

sure that the criteria can be translated usefully to the Indian setting.

- Best practices (set by professional bodies) Organizations that perform similar work or deliver similar services can also be a good source of audit criteria with reference to specific critical processes and operations.

The National Forum for Risk Management in the Public Sector in the UK, The Project Management Institute, the Australian Comcover Risk Management Performance Benchmarking have all carried out benchmarking studies in the area of risk assessment.

- **Dos**

Do make sure your criteria are:

- Specific
- Measurable/ quantitative
- Agreed with entity
- Free from auditors' bias
- Clear and understandable
- Comparable

Examples of well- drawn criteria:

- *Review of Class 'A' stores should commence on 01 November every year and be completed, including placement of demands, by 31 March of the following year (Is the criterion clear? Yes.)*
- *Time elapsed between requirement determination and demand placement is kept within prescribed limit of two months (Is it measurable? Yes.)*

- *All items in inventory are to be properly identified by the allocation of distinctive Part Numbers for effective management of inventory (Is it comparable? Yes.)*
- *According to Para 136 of Technical Instruction 040, demands for procurement of spares should be placed within two months from the date of review (Does entity agree with this criterion? Yes, since it is taken from their Manual)*

- **Don'ts**

Please make sure they are not:

- Vague
- Leading to indefinable assessments
- Influenced by the auditors' preconceptions
- Open to several interpretations
- Indistinct
- Inconsistent

Examples of poorly outlined criteria:

"The institution has a clearly stated mission and purpose with goals and priorities which are responsive to its local, national and international context and which provide for transformational issues." (Were you able to pinpoint what it is that we are trying to measure? No.)

"There are effective strategies in place for the realisation and monitoring of these goals and priorities. Human, financial and infrastructural resources are available to give effect to these goals and priorities." (Is the criterion clear? No.)

"Financial planning ensures adequate resource allocation for the development, improvement and monitoring of quality in the core activities of teaching and learning, research and community engagement." (Is it measurable? No.)

“Operational and strategic planning is being done”. (Is it comparable? No.)

1.7 Evidence

- Why is evidence needed?
 - To substantiate audit findings.
 - To gain an assurance on the accuracy and reliability of the facts learnt during audit.
- What is evidence?
 - All data one collects is not evidence.
 - Data tested against criteria is evidence.
 - Evidence is in the context of audit findings and test programme that supports it.
- Sources of evidence
 - Files, records & databases of the entity

If we are analyzing time taken to issue stores against the demands placed on a depot, then the Issue Registers & Indents Received Registers will serve as audit evidence.

File notings disclose the statement of case based on which a scheme/task was projected. They illustrate the views/outlook of officials involved. They reveal the chronology of decisions taken and the basis of decisions taken.

- Annual reports published by the entity stating its performance

In the review of inventory, annual stock verification reports will serve as evidence as they contain significant information about the progress of the project/programme selected for audit.

- Policy documents: administrative orders, policy guidelines

For example, policies, practices and procedures relating to:

- *acquisition and deployment of inventory as also the structure of supply chain;*
- *categorisation of inventory, for the purposes of generic description and control;*
- *description of role of store depots (e.g. provision of Class 'B' stores, to hold reserve stocks, to manage the repair/overhaul of equipment, disposal of unserviceable and redundant inventory).*

All these will serve as evidence.

- Studies on the entity done by professional bodies

The organization may have hired a professional body or experienced person to advise it on the best methods to be adopted for inventory management.

- Comments of the audit team on aspects they have observed (& recorded/verified personally)

Inspection reports of annual transaction audit will help identify earlier audit coverage, errors/problems noticed, response of the audited entity to audit observations, follow-up action taken by the entity and outstanding matters.

- External sources

The organization may have hired a professional body or experienced person to advise it on the best methods to be adopted for inventory management.

The source (internal or external) and nature (documentary, oral, visual) of audit evidence has considerable impact on its reliability.

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- Confirmation from third parties is more reliable than data obtained from the entity's records;
 - Evidence gathered by the performance audit team will be more reliable than that supplied by the audited entity;
 - Documentary evidence is better than oral evidence
 - Original documents are better than photocopies.
 - Audit evidence is more persuasive if it can be "triangulated". That is, if evidence from more than one sources can confirm the same findings.
 - How is evidence analysed?
 - Set Objective -> Define Criteria -> Collect & analyse evidence

- *Audit objective: "Does the system meet the users' needs at a reasonable cost?"*
- *One of the lowest level questions: "Were a reasonable number of bids received?"*
- *Audit criterion: "In response to the Notice Inviting Tender there should be a minimum of five bids".*
- *Audit evidence: (Culled from files, records & databases of the entity): indents for the system to be procured, statement of case for procurement, date of notice inviting tender, number of bids received, bid evaluation criteria laid down, bids short-listed, minutes of meeting of Price Negotiation Committee, final decisions recorded, tender award to the recommended tenderer and names of unsuccessful tenderers.*

- Evidence available from external sources & gathered from entity

Notice Inviting Tender printed in leading newspapers will serve as audit evidence.

- Test of the evidence against various criteria

If our criterion was that a minimum of five bids should be received in response to the Notice Inviting Tender, then we will have to examine contract files and tally the number of bids received.

- **Dos of the evidential process**

- Do physically examine a physical asset of the entity where evidence of completeness, validity (existence) is required.
- Do personally observe the way procedures are being performed by employees of the client entity.
- Do match the documentary evidence available with the details recorded in accounting records as confirmation of the completeness, validity or accuracy of an account balance or underlying class of transaction.

- *For example, the auditor obtains evidence relating to the validity of purchases recorded in a client's inventory records by vouching from details recorded in the inventory records (e.g. the quantity purchased) to details on suppliers' invoices. (for "validity" purposes)*
- *Or, the auditor obtains evidence relating to the completeness of a client's inventory records by tracing details on the suppliers' invoices (e.g. the quantity purchased) to the details recorded in the inventory records (for the sake of "completeness").*
- *Or, the auditor obtains evidence relating to the accuracy of a client's inventory records either by vouching from details recorded*

in the inventory records (e.g. date of purchase, unit cost) to details on the suppliers' invoices (e.g. date of purchase, unit cost) to the details recorded in the inventory records (to ensure "accuracy").

- Do confirm your data by requesting information in writing and from a third party. However, auditors consider the appropriateness of the authority of the person signing the confirmation, and where possible, the confirmee's integrity and competence.

The third-party confirmation will attest to the validity (i.e. the existence or occurrence) of an item, such as an asset, liability, transaction or economic event.

- Do try to identify and investigate the reason for any unusual or unexpected relationship between the actual and expected values.
- Do ensure that data captured is verifiable vis-à-vis audit criteria
- Do make sure it supports the findings arrived at in the reports
- Do decide what procedures you need to use to gather evidence.
- Do decide beforehand the size of the population to be examined and the sample you intend to extract from it.
- Do be clear as to the time-frames within which evidence must be collected.
- Do assure yourself of the independence of the person providing information.
- Scan analytical procedures
- Do ensure that the evidence collected through investigation by auditors is signed or stamped by the provider.
- If the auditee officers refuse to corroborate (sign or stamp) the audit evidence produced by them, do make a note in the evidence

or in the attached materials the reasons and dates of such refusal. Where reasons for refusal have no impact on the facts, the evidence will still be regarded as effective audit evidence.

- **Don'ts of the evidential process**

- Do not forget to exercise professional scepticism :

Professional skepticism is described by experts as “an attitude that applies a questioning mind to a critical assessment of evidence”. “Does this document really tell the true story of the transaction?”

- Do not let discrepancies in records catch you unawares. Conflicting or missing evidential matter should be brought to the notice of your Group Officer immediately.
- Do not forget that more evidence yields more assurance in the performance audit.
- Do not disregard the fact that absolute certainty requires convincing evidence whereas reasonable certainty requires persuasive evidence.
- Do not set needlessly high reliability goals. Use controls etc. to reduce the extent of audit tests.
- Do bear in mind the systematic sequential nature of evidence search and evaluation:

We formulate audit objectives first, define the criteria, methodically assemble evidence and finally evaluate it as per the criteria designed for our performance audit.

- Finally, do not fail to remember to test your indicators and measures against the criteria designed.

Introduction

The Performance Auditing Guidelines issued by this office constitute the authoritative basis for the conduct of Performance Auditing in the department. This includes the entire gamut of activities commencing with the formulation of strategic plans, selection of topics based on these plans, planning of individual audits, audit execution, finalization of reports and subsequent follow up. During the conference of Accountants General held in the year 2005, it was recommended that supplementary guidance was required to be issued to facilitate due implementation of Performance Auditing Guidelines when undertaking Performance Audits. It has now been decided that supplementary guidance will be issued at two levels; one will be a series of 'Supplementary Guidelines' and the other will be a series of 'Practice Guides'. This Practice Guide entitled 'Planning Individual Performance Audits' is the fourth in the series.

The Performance Audit methodology adopted by us has underlined logical flow commencing with the selection of a topic by each Performance Audit which is primarily on the basis of a risk analysis but also dependent upon other factors that go into the framing of strategic and annual audit plans. Once a topic is selected it is necessary to determine its scope not only in terms of the period and locations to be covered but also in terms of the segments of an entity or programme that we seek to cover. This is followed by framing of audit objectives, the identification of issues and the subsequent analysis of the issue leading to the framing of a study design matrix that leads to framing of questions that form the basis of the audit process as also the identification of criteria and the corresponding evidence, the identity comparison of which leads to an audit finding. This Practice Guide covers the gamut of activities from the framing of audit objectives to identification, collection and analysis of evidence. It is important to keep in mind that these Practice Guides are intended to facilitate practitioners in the field of Performance Audit and provide a framework to ensure that audits conducted across the country follow the same methodology. There is however, no substitute for initiative and it will be a test of good professional practice to ensure that while we work within the prescribed framework we do not stifle initiative and original thinking.

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