A reflection on how far performance auditing has come from its roots in the 1970s to where we are today and where we are heading

"The notion of performance is seen as fundamental to the modern state. This has led to significant reforms within government…These developments are based around the notion that, as the state is responsible for such a large array of services and regulatory tasks, it must quantify its promises and measure its actions in ways that allow citizens, managers and politicians to make meaningful decisions about increasingly complex state activities."

OECD, *Measuring Government Activity*, 2009

Performance accountability is about a proper relationship between public sector entities' governance and the use and management of public resources, so that the Parliament can enforce responsibility for performance. Performance improvement is concerned with achieving desired changes in the efficiency, economy and effectiveness of public administration. Accountability is essential to democratic governance and central to the Australian National Audit Office (ANAO) purpose: "to improve public sector performance and support transparency in the Australian Government sector through independent reporting to Parliament, the executive and the public".

A key role of an audit office in the public sector is to advise Parliament about whether public money is being well spent and delivers value for money. This is achieved through providing assurance over how public money has been spent (processes are well defined—appropriate and proportionate with respect to quantity and quality—efficient and implemented and operating as expected), and the adequacy of the decision-making and management that underpins such spending (there is a sound strategy and objectives that are effectively executed—work is well planned, resources well managed, and performance is measured to establish if desired outcomes are achieved).

In a performance audit, the auditor's objective is to express an opinion whether, in all material respects, the operations of government administration has been carried out economically, efficiently, effectively, in compliance with legislation and accompanying instruments and to recommend ways in which the operations may be improved.

- Economy means the acquisition of the appropriate quality and quantity of resources at the appropriate times and at the lowest cost.
- Efficiency means the use of resources such that output is optimised for any given set of resource inputs, or input is minimised for any given quantity and quality of output.
- Effectiveness means the achievement of the objectives or other intended effects of activities at a program or entity level.[1]

In practice, effectiveness relates to whether:

  - the best value for money strategy is chosen;
  - that strategy is well implemented; and

[1] Standard on Assurance Engagements ASAE 3500, *Performance Engagements,* p.15.

- that it achieves the desired outcome.

In a financial statement audit, the financial reporting framework is well defined by statements of accounting concepts and accounting standards. Comparatively, for a performance audit the public sector performance management framework is still maturing and has been more broadly defined and poorly implemented.

Since the 1970s the public sector has moved away from a focus of reporting performance largely based on inputs to models which aim to provide a clearer picture of what public sector entities achieve (outcomes) for their expenditure on inputs. Performance measurement and reporting regimes first became a feature of the framework in the mid-1980s. The ANAO performance audit function has evolved alongside a developing public sector performance management framework and in response to the changing expectation of government and Parliament. The Australian Government performance management framework and the resource management framework more generally, continues to be refined and implemented with the introduction of the *Public Governance, Performance and Accountability Act 2013.*

Historically ANAO performance audits have overwhelmingly focused on examining the effectiveness of public administration and particularly effectiveness in terms of whether a strategy is well implemented. This is due in part to audit methodology and standards that include using identified criteria to evaluate or measure the performance of an activity to be able to make assertions concerning the performance of that activity. The performance audit practitioner must gather sufficient appropriate evidence about these assertions to provide a basis for expressing a conclusion. On this basis, performance audit depends crucially on the comparison of actual results or management processes against some framework or standard. Difficulties arise in assessing results where the performance management framework is absent, performance indicators have not been well defined and robust performance information and data is not collected and monitored. This has resulted in greater reliance on evaluating processes—as this provides a stronger basis for a defensible performance audit conclusion.

Despite the ANAO's experience with a slow start in developing a performance audit practice, performance audits are now a well-established function and tend to be the higher profile ANAO product.

The Development of Performance Audit in ANAO

Up until the 1970s, public sector administration was mainly concerned with issues of financial inputs, accuracy and compliance with the relevant laws and regulations. The main task of the then Australian Audit Office (AAO) was to undertake financial statement audits that concentrated on confirming information in the financial statements. During the 1970s and 1980s the public sector changed substantially, becoming more focused on concepts of efficiency and value for money.

The Royal Commission on Australian Government Administration (Coombs) inquiry was the first large scale inquiry into the Public Service since the 1920s. The 1976 Coombs report called for departmental managers to be given clearer responsibility for their managerial functions and greater freedom and discretion to perform them. Under this model it was important that the quality of departmental managers' performance be subject to critical review and the report recommended that the responsibility for efficiency (performance) auditing should be given to the Auditor-General. Subsequently in 1979, the *Audit Act 1901* was amended to give the Auditor-General the authority to conduct efficiency audits. At the time, efficiency audits were defined as an examination of the (1) functions performed and the operations carried out, or (2) the procedures that are followed, for the purpose of forming an opinion concerning (a) the extent to which those operations are being carried out in an economical and efficient manner and (b) an evaluation of the adequacy of the procedures.

Performance auditing had a tentative start with the tabling of the first efficiency audits in 1980. A number of early audits drew criticisms from the two Parliamentary Review Committees, the then Joint Committee of Public Accounts (JCPA) and the House of Representative Standing Committee on Expenditure (HRSCE). The first efficiency audit of the Department of Administrative Services' Australian Property Function was conducted between 1978 and 1980, after the Secretary of the Department invited the AAO to conduct the audit prior to the amendments to the legislation. Criticisms from the Parliamentary Review Committees included the staff expertise to conduct the audits and the stage at which a program or process was audited. The Committee considered that a program should be firmly established before it was subject to an audit.

Extract from HRSCE Review of the Auditor-General's Efficiency Audit Report; Department of Administrative Services—Australian Property Function

> First, the Committee is disappointed at the level at which, generally speaking, audit findings are pitched. There is a dearth of suggestions for specific courses of action. Some of the findings stop at the early stage of problem identification. The findings on rationalisation and disposal are two examples that fall into the above category. There are, of course, further stages of analysis which, based on precise identification of the problem, examine alternative ways of solving the problem and choose from such alternatives. This tendency to expose the problem and go no further then leaves additional work for others. Considering the time taken on each efficiency audit and the primary focus of such audits, that is, making the public sector more accountable to the Parliament for efficient administration, the Committee finds that the tendency within the broad theme to identify problems and do only that, is a disappointing feature of the first efficiency audit report.

At least half of the 24 efficiency audits tabled in the 1979-85 period examined both effectiveness and efficiency. Of the remaining audits a large proportion examined effectiveness and a small proportion were compliance focused. These early audits included efficiency in their objective, and made findings related to whether the program resource/ inputs were sufficient to achieve the intended outcomes, or whether the systems implemented could adequately assess or track the efficiency of specific programs. An example of an early efficiency audit which set out to examine both efficiency and effectiveness is the report *Department of Territories— A.C.T Internal Omnibus Network (ACTION)* (1985). The audit made conclusions and recommendations drawing attention to the fact that it was not possible to evaluate aspects of efficiency as there was insufficient data to draw on, as shown in the extract below:

Extract from Department of Territories— A.C.T Internal Omnibus Network (ACTION) (1985)

> The total bill for repairs and maintenance activity for 1983-84 was $5,347,600 (20.6% of total expenditure). As noted earlier, detailed cost data on the repairs and maintenance of buses is inadequate. One implication is that it is not possible for ACTION to closely compare the costs of replacing and refurbishing buses. Further it is not possible to effectively evaluate the performance of current bus types and models and thus provide assurance as to the quality of decisions on replacements and additions to the fleet. Audit recommends the collection and analysis of the data required.

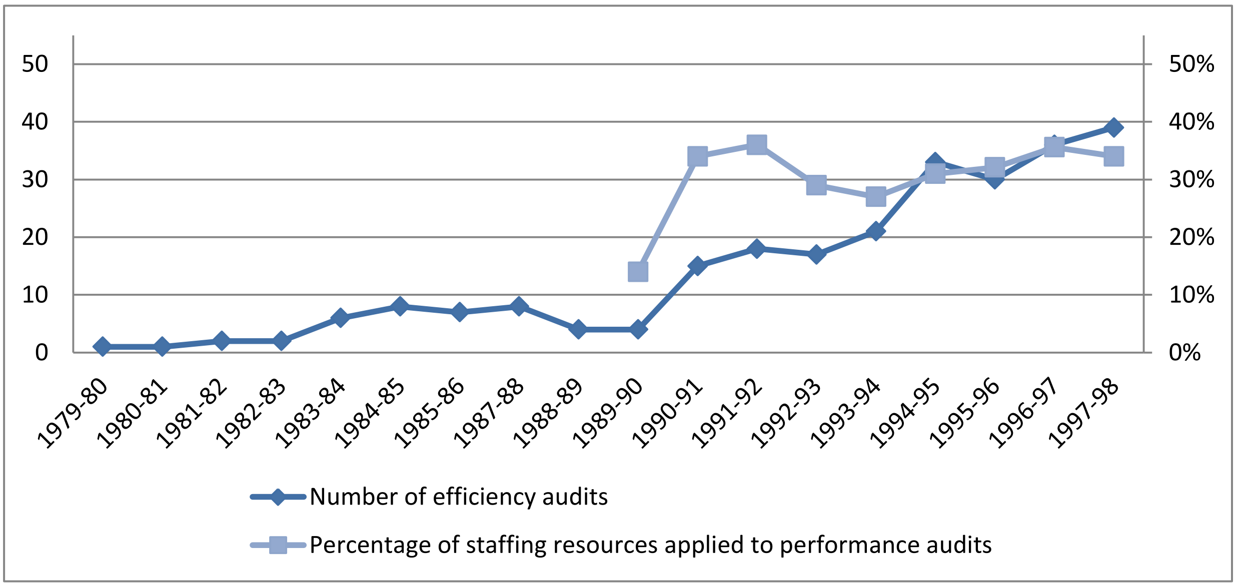
The 1983 Government White Paper *Reforming the Australian Public Service* noted the need for a complete overhaul of public service practice—a shift in management emphasis from 'compliance' to a greater degree of performance control. A key initiative that followed was the introduction of program budgeting, requiring the specification of program objectives and targets. This became the basis for the preparation of all portfolio budgets by the government, and for subsequent annual reporting by agencies.

The White Paper informed the *Public Service Reform Act 1984*. Central to the reforms was the implementation of the Financial Management Improvement Program (FMIP) with the objective to improve the performance of the public sector. The program aimed to help managers to focus on managing results, rather than directing their efforts solely to inputs and processes, freeing resources to focus on obtaining greater resource efficiency and effectiveness. Underpinning FMIP were the principles of management devolution, improved corporate and business planning, increased public accountability and increased emphasis on evaluation of effective performance. Principles which broadly underpin the reform initiatives over the next 30 years.

At the time the public sector performance management framework was shifting towards a more performance oriented public service, the AAO diverted resources from the function, shutting down the Efficiency Audit Division in 1984, and moving it within the Financial Audit Division. This change was made in response to the criticisms of efficiency audits by the HRSCE and the increase and escalation in entity disputes with efficiency audit findings. The AAO sought to re-establish good will and credibility by intentionally removing the perceived differences between efficiency audits and the established practice in financial audit.

In the late 1980s and early 1990s accrual accounting was implemented, increasing the amount of financial assurance audit work completed by the AAO. This also resulted in the AAO prioritising financial over efficiency auditing. A 1989 JCPA review *The Auditor General: Ally of the People and the Parliament : reform of the Australian Audit Office* highlighted that resources for efficiency audits were around half what they were when first introduced, and one of the review recommendations was that this function receive a separate budget to the financial audit division to ensure its sustainability. As seen in the graph below, following the JCPA review the percentage of total staffing resourcing for performance audit increased from 14 per cent in 1989-90 to 34 per cent in 1990-91. The number of performance audits completed each year was commensurate with the additional resourcing.

Efficiency audits carried out under Division 2 of the Audit Act 1901 (1979-97)



By the 1990s performance audit was embedded as an established practice, and was recognised by the JCPA and successive reviews as an important function of the ANAO. In 1992 the Australian Auditing Standards Board issued the *Statement of Auditing Practice No.33* entitled Performance Auditing. While the statement was broad in comparison to financial auditing standards, it established an Australian wide framework for conducting performance audits. In the same year the ANAO functionally separated performance audit from financial audit again, forming the Performance Audit Business Unit, and undertook to increase resourcing to the function to be equal to 50 per cent by 1995. The ANAO adopted three strategies to improve the effectiveness of performance auditing during this period: improving audit planning processes; selecting appropriate personnel with relevant skills; and documenting better practice guidance.

The 1989 JCPA review had also recommended a number of changes to the *Audit Act 1901* which resulted in the passage of the *Auditor-General Act 1997* which strengthened the independence of the Auditor-General by:

- stating unequivocally that the Auditor-General is an independent officer of the Parliament;
- providing for the JCPA to veto the person proposed by the Government to be appointed the Auditor-General; and
- implementing a 10 year, non-renewable, term of appointment.

The ANAO started producing better practice guidance (BPG) in the 1990s which aimed at making tangible improvements across the public sector by providing managers with insights and practical guidance on better practice in areas central to sound public administration. As entities were still developing their internal performance management frameworks the ANAO considered BPGs to be a standard setting exercise providing a framework against which future audits could assess entity performance.

The next key phase in performance management reform was the introduction of accrual accounting, accrual budgeting and effectiveness indicators, which provided the opportunity for concepts of efficiency to be assessed properly for the first time. The *Financial Management and Accountability Act 1997* accompanied by the *Auditor-General Act 1997*, introduced a new framework for the management of public money and public property. The Outcomes and Outputs Framework was introduced in 1999-2000 as a Commonwealth budget process which required entities to include outcomes by output groups and specify targets for each group. The broad purpose of the framework was to answer the questions:

- what does Government want to achieve (outcomes)
- how does it reach those achievements (outputs)
- how does it know it is succeeding (indicators).

A number of revisions were made to the budget and reporting framework in 2009-10. This framework increased the emphasis on performance management, measurement and reporting, including aligning budget reporting with annual reporting. Just prior to the revisions to the framework, the Standard on Assurance Engagements ASAE 3500 *Performance Engagements* was introduced by the Auditing and Assurance Standards Board (AuASB). This was a significant milestone in the evolution of performance auditing, combining and replacing two earlier standards and providing the rigour of contemporary developments in auditing by introducing terminology to outline mandatory requirements and explanatory paragraphs which provide guidance and illustrative examples to assist in fulfilling the mandatory requirements.

In 2009, the Joint Committee of Public Accounts and Audit (JCPAA) conducted an inquiry into the *Auditor-General Act 1997* to assess whether the provisions remained adequate in the modern public sector environment, and against the revisions made to the budget and reporting framework. The inquiry informed amendments to the Act which were introduced in 2011, relating to:

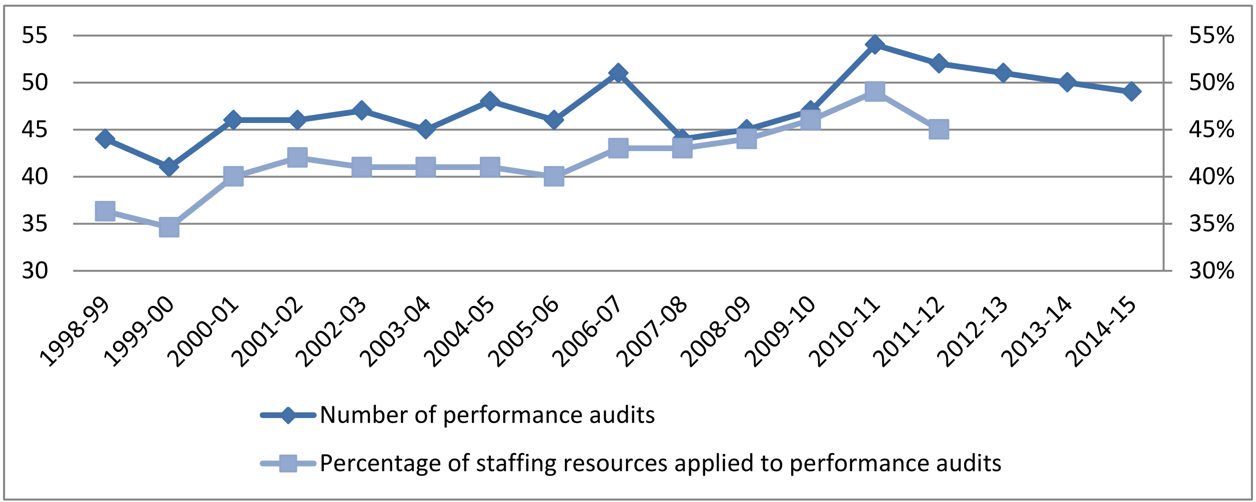
- audits of entities performance measures
- audits of Commonwealth Partners including state, territory and other non-Commonwealth entities in receipt of funds for a Commonwealth purpose.

Throughout the 2000's a range of audits conducted by the ANAO highlighted where entities' performance information could be improved in line with the framework. The ANAO's 2006-07 performance audit of the outcomes and outputs framework concluded that the development of comprehensive, relevant and informative performance indicators is still a challenge for entities and that many performance indicators did not enable an assessment to be made as to whether the desired results are achieved as the indicators did not incorporate targets, benchmarks or other details of the extent of achievement expected. More recently the ANAO's 2011-12 performance audit of the *Development and Implementation of Key Performance Indicators to Support the Outcomes and Programs Framework*, which reviewed performance information for 89 programs across 50 entities, concluded that: "While the Outcomes and Programs Framework is in its third year… many entities continue to find it challenging to develop and implement KPIs; in particular, effectiveness KPIs that provide quantitative and measurable information, allowing for an informed and comprehensive assessment and reporting of achievement against stated objectives".

It remains an important role of the ANAO to have a voice in the development, implementation and operation of an effective performance framework to enable the ANAO to fulfil the full breadth of our mandate and provide the Parliament with confidence that we are reporting on whether public funds are being spent economically, efficiently and effectively and that the public service is being well administered.

As seen in the graph below, the ANAO's performance audit function has remained relatively stable between 1998-99 through to 2014-15, in terms of the number of performance audits conducted (ranging from 41 to 54) and the percentage of staffing resources applied to performance audits.

Performance audits carried out under *Auditor-General Act 1997* (1998-2015)



2010s to present—what do we look like now?

Despite over three decades of change in public sector performance management frameworks aimed at focussing the sector on achieving outcomes in an efficient and effective manner, the majority of performance audits conducted by the ANAO remain focused on examining effectiveness in terms of whether a strategy is well implemented. The ANAO recently examined 277 of its performance audits tabled between 2010-11 and February 2016 for whether the objective or criteria allowed for an assessment of effectiveness, efficiency, and/or economy, and found the predominant focus of audits tabled during this period was effectiveness. These 'effectiveness' audits examined entities' existing program strategies, and assessed the extent to which programs were implemented as intended. There was less focus on whether the strategies themselves had been effective in achieving the desired outcome.

The underlying reason for this is a combination of the interpretation of the requirements of the performance auditing standards and the quality of performance information. The performance audit standards require the use of identified criteria to assess the economy, efficiency or effectiveness of an activity. The criteria used by public sector performance auditors therefore generally reflect developments in the performance management frameworks as 'criteria' in the context of a performance audit means reasonable and acceptable standards of performance against which the activity may be assessed. To assess performance against the criteria requires robust information and data about entity inputs, outputs, processes and results. In the absence of quality information and data the auditor is not able to establish sufficient and appropriate evidence (where sufficiency is the measure of the quantity of evidence and appropriateness is the measure of the quality of evidence; that is, its relevance and its reliability) to conclude on economy, efficiency and outcome effectiveness.

Despite the predominant focus on effectiveness in ANAO audits, there are examples of where the ANAO has applied practical methodologies to examine efficiency. In ANAO Report No. 7 2014-15 *Administration of Contact Centres,* the ANAO used Dimension Data's *2013-14 Global Contact Centre Benchmarking Report*, and spoke with representatives from centres operated by other government agencies and the private sector, to measure how the Australian Taxation Office's (ATO) performance compared. For example, to assess the appropriateness of the coverage of the ATO's quality assurance (QA) of calls the ANAO compared the numbers of calls selected by the ATO for QA review for each assessor with two government and two large private sector contact centres, and with comparable information in the global benchmarking report.

Extract from ANAO Report No. 7 2014-15 Administration of Contact Centres

In comparison to the other organisations listed in Table 3.4, the ATO reviewed the lowest number of calls per CSR each month. It is also reviewed considerably fewer calls per CSR than the average globally in 2013–14 (10.2 for experienced agents and 18.7 for new agents). There may, therefore, be merit in the ATO examining the number of calls reviewed each month to satisfy itself that it is obtaining adequate assurance on the manner in which calls are handled. In considering increasing the number of calls reviewed, the ATO would also have to bear in mind the cost of undertaking the additional reviews and the likely benefits to call handling quality.

Another example is ANAO Report No. 19 2013-14 *Management of Complaints and Other Feedback*. The audit objective was to assess the effectiveness of the ATO's complaints and other feedback management systems in supporting service delivery. One audit criterion was whether the ATO effectively analysed complaints and other feedback to inform service delivery. As the ATO did not collect data on the cost of managing complaints, to assess the efficiency of complaints management the ANAO developed and applied its own cost assessment framework. Based on data provided by ATO business and service lines, the ANAO estimated that the average total unit staff cost per complaint was $611 in 2012–13, and cost $382 per complaint when staff support costs such as analysis, coordination, reporting and quality assurance were not included.

Extract from ANAO Report No.19 2013-14 Management of Complaints and Other Feedback

Avoiding spikes in complaint numbers, or better still reducing the total number of complaints, requires the ATO to proactively address issues that can give rise to complaints. In addition to declining client satisfaction, increases in complaint numbers are costly to manage. In the absence of ATO analysis, the ANAO estimated that, if the number of complaints in that year had been the same as in 2010–11, the ATO would have incurred additional employee costs in the order of $8 million to manage the workload. Accordingly, it is important that the ATO puts in place strategies to minimise complaints occurring in the first place, particularly when major business and process changes are being implemented and for the annual tax time.

The Australian Public Service is currently in the process of implementing a new resource management framework. The *Public Governance, Performance and Accountability Act 2013* (the PGPA Act) was introduced in 2013 with the aim of requiring Commonwealth entities to: meet high standards of governance, performance and public accountability; provide meaningful information to the Parliament and the public; use and manage public resources properly; and work cooperatively with others to achieve common objectives

The Department of Finance has emphasised that the reform program underpinned by the Act is based on the following principles:

- Government should operate as a coherent whole
- a uniform set of duties should apply to all resources handled by Commonwealth entities
- performance of the public sector is more than financial
- engaging with risk is a necessary step in improving performance
- the resource management framework should support the legitimate requirements of the Government and the Parliament in discharging their respective responsibilities.

The PGPA Act established the basis for developing a resource and risk management framework to meet the needs of modern government, by improving the quality of planning, performance information, evaluation and reporting within government to enhance accountability.

Performance audit in the future

The ANAO will continue to adapt to changes in the public sector, including the evolving delivery of government services which is shaped by various drivers. One of these drivers is the performance management framework and how it will shape the focus of our business, including the development of the audit program. Success in delivering the ANAO mandate extends beyond evaluating implementation effectiveness in performance audits, to evaluating outcome effectiveness as well as strategy development, economy and efficiency. History tells us that the quality of performance information will be key to the ability to do this.

However, the ANAO should not be a passive recipient of what information is available. The ANAO is playing an important role in advising Parliament, through the JCPAA, on the implementation of the more recent reforms to the performance management framework with the introduction of the PGPA Act. One aspect of this role includes undertaking performance audits on the implementation of the new framework. The focus here should not be critiquing the quality of central agency guidance, but rather assessing the commitment of entity leadership to implementing appropriate strategies to meet their obligations to the Parliament. These include transparency and accountability in entity operations. Another aspect is the use of the mandate to conduct audits of the appropriateness of the performance measures (however described). The ANAO should focus on performance information to encourage improvement in the quality of performance information under the new framework. Such audits should become a regular element of the ANAO work program.

The extension of the performance audit work program to more regularly examine the full spectrum of effectiveness, efficiency and economy, should not wait on the improvement of performance information. The ANAO needs to be innovative in the application of its audit methodology and how it assesses entities' performance, whilst still meeting the requirements of the performance audit standards. For example, in the absence of quality published information and targets, entity performance can be assessed using other information by taking a practical, rather than a technical purist, approach. It is better to include some analysis about the costs and outputs of a program than to leave aside considerations of economy and efficiency altogether.

In the absence of good quality performance information and data an entity's performance can be assessed using proxy indicators, trends, benchmarks and the existence or not of competitive procurement. Questions that are reasonable for the performance auditor to ask include:

- Have inputs been procured through competitive processes and if not how do their costs compare with other entities (benchmarking) (economy);
- How does cost growth compare with relevant index benchmarks (economy);
- What has been the trend cost of output and does this provide any insights into efficiency and can changes in quality explain some of this (efficiency);
- During program design what delivery option analysis has been undertaken (or was the delivery framework decided at the same time the problem was identified) (cost effectiveness); and
- What indicators of outcome effectiveness do like entities use and can similar indicators be constructed (outcome effectiveness).

Reasonable assurance means a high, but not absolute, level of assurance. In forming an opinion, it is reasonable to point to whether the use of proxy data, trends and benchmarks raises questions as to whether a particular agency or activity is operating at an expected level of economy, efficiency or effectiveness.

The challenge will be, as it was when performance audit first commenced, how the audit office manages the reaction of agencies and the Parliament to audit assertions and conclusions which have been formed on indirect measures. The key to success in this respect will be how well the audit scope and approach is explained, how entities are brought along the audit journey and, probably most importantly, how the capability and skills to undertake the work is developed.