

Creating a Niche for Performance Auditing in the Public Sector:

Utilizing Integrated Compliance, Efficiency and Effectiveness Reporting

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Abstract

Supreme Audit Institutions (SAIs), being public sector audit organizations, usually derive their mandate from the highest law of the land. They perform three broad types of audits- financial, compliance and performance audits. Each audit type has a specific purpose and its conduct is guided by the applicable legal framework, auditing principles and standards. In the context of Pakistan, while the SAI conducts all three types of audits, in terms of overall audit coverage, the share of performance audit is generally on the lower side compared with financial and compliance audits. One reason for this could be the practice of conducting performance audits as stand-alone audit assignments, separately, and distinct from financial and compliance audits. Performance audit cycle is entirely different from other types of audits and is generally more resource-intensive. While a significant number of entities get audited from financial and compliance perspective every year, not all get a chance to benefit from performance audits. Since the latter is generally considered to be more holistic and wide-ranging, compared with other audit types, there is a dire need to increase its coverage in the overall audit mix. Many strategies can be adopted to accomplish this task. This paper proposes that audit cycle for performance audits may be combined with that of

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compliance audits. Since the latter are the mainstay of public audits, their integration with performance audits, will give a boost to the coverage of the latter. The combined reports, covering compliance, efficiency and effectiveness aspects, will provide a more fulfilling and rich experience to the stakeholders, contributing to enhanced transparency and accountability for the entrusted resources.

Keywords: *Compliance Audit, Integrated Audit, INTOSAI, Performance Audi, Supreme Audit Institutions (SAIs).*

1. Introduction

Public audit is an inalienable component of the accountability cycle. It addresses the need for economic, efficient, and effective utilization of resources, in accordance with the legal and regulatory framework. These resources are typically provided by the legislative authorities, and to get assurance for their intended utilization, the SAIs are brought in to provide audit services and act as a bridge between the executive and the legislature with their periodic audit reports, covering financial, compliance and performance aspects of governmental operations. Whatever the type of audit employed by the SAIs, the broader objective remains the timely provision of critical information to the stakeholders on the entities' adherence to the financial, compliance and performance benchmarks. Each audit type, nevertheless, has its own specific objectives and its conduct is guided by the applicable constitutional and legal provisions, SAI's strategic priorities and the relevant auditing principles, standards and practices.

1.1. Statement of the Problem

Performance audit is an independent, objective and reliable examination of government undertakings, systems, operations, programs, activities or organizations, with reference to the principles of economy, efficiency and effectiveness. Compared with other audit types, performance audit tends to be holistic in nature, as it offers, or is expected to offer, new information, analysis or insights (INTOSAI-Performance Audit Principles, 2019). Public sector entities face arduous challenges in discharging their mandated functions with enhanced efficiency, economy, effectiveness and with due regard to environmental sustainability, equity and ethical principles. This could be attributable to the overall world environment that is characterized by VUCA-volatility, uncertainty, complexity, and ambiguity (Nur Baity Al Wafiroh, 2022). SAIs, too, having realized the limitations inherent in traditional auditing, have been looking for more robust methodologies to provide much-needed independent assurance to the interested parties, on public sector's efficiency and effectiveness. Performance auditing, with its inherent tendency to focus

on outputs, outcomes and impact (ISSAI Implementation Handbook-Performance Audit, 2021), is the most appropriate audit type that can help SAIs address complex dimensions of public expectations in a systematic and effective manner. Most public audit practitioners, would not only agree to this but would tend to pitch performance audit in the stratosphere compared with financial and compliance audits. There is nevertheless a tacit acceptance, backed by data, that somehow performance auditing has not been able to create a niche for itself in the policy circles. Contrary to what the auditors tend to believe and notwithstanding the refined and sophisticated nature of performance audit, it remains surprisingly underutilized. In many audit jurisdictions, it has not been able to find a receptive audience and is seen struggling to claim its rightful place in the galaxy of audits. In case of SAI Pakistan, for instance, available data from the year 2015-16 to 2022-23 indicate that, on an average, the share of performance audit reports to the overall audit reports, has been less than 10% (OAGP Annual Reports, 2015-16 to 2022-23). True that performance auditing is comparatively a new discipline but to say that it is in its infancy would be factually incorrect since it has been around, for quite some time now, more than three decades at least, in our context (Performance Audit Wing, 2024).

1.2. Research Questions

- a) To what extent is performance audit different from other types of audits?
- b) What could be the possible reasons for the apparently low coverage of performance audits in the overall audit mix?
- c) How can performance audit attract and retain a niche clientele in the public sector?

2. Literature Review

There is abundant literature produced by the global public sector audit community on the need, utility and methodology of performance auditing. The International Organization of Supreme Audit Institutions (INTOSAI), issued the Lima Declaration in 1977, wherein performance audit was mentioned as “another equally important type of audit” that covered efficiency, economy and effectiveness aspects while focusing on specific financial operations as well as organizational and administrative systems (INTOSAI-The Lima Declaration, 1977). Another significant work was produced by INTOSAI in 2001 in the form of a set of ‘Basic Principles in Government Auditing’. It described in detail the three main types of audits i.e. financial, compliance and performance. This was followed up with the ‘Fundamental Principles of Performance Auditing’ (2013)

which, later on came to be known as 'Performance Audit Principles'. The document outlined the utility of performance audit in terms of its capacity to offer independent and authoritative view or conclusion based on audit evidence. It expected of the performance audit to furnish new information, knowledge or value by offering new analytical insights or deeper analysis (INTOSAI-Performance Audit Principles, 2019). The 'Standard for Performance Auditing' (2016) is another significant work providing comprehensive set of instructions for planning and executing performance audit tasks. Importantly, it permits elements of performance auditing to be made part of a more extensive audit that also covers compliance and financial auditing aspects (Performance Audit Standard, 2019). Suitability of performance auditing to audit specialized sectors has also been studied. In fact, over a period of time, performance auditing has established itself as the most appropriate audit type when confronted with challenges of auditing the sophisticated and refined aspects of public sector management. Sustainable Development Goals, for example, are best audited using performance audit methodology. One set of guidelines while focusing on audit of sustainable development, highlighted that for most sustainable development related programs, the scope and study design of audit would be similar to that of any other performance audit (GUID 5202-Sustainable Development: the role of Supreme Audit Institutions', 2019). The Global Stocktaking Report issued by the INTOSAI Development Initiative, every three years, is, *inter alia*, a good measure of progress of the SAIs in several dimensions. The 2023 report indicated that only 52% SAIs have adopted the Performance Audit Standard (Global SAI Stocktaking Report, 2023). Another study focusing on the impact of performance audit concluded that performance audit can have a positive impact on government organizations, and in fact, the impact could be much broader than the typical implementation of audit recommendations (Keulen, 2023). The competency of auditors undertaking performance audits has also been studied in the context of SAI's knowledge, skills and abilities (ISSAI Implementation Handbook-Performance Audit, 2021).

3. Research Methodology

The study has approached the subject from three dimensions. Firstly, an effort was made to develop and document understanding of the situation on ground viz. the implementation issues in the conduct of performance audits. Secondly, the practitioner's perspective was added and synthesized to augment the situational analysis. It was made substantive by utilizing an innovative methodology of constructing a hypothetical case through a dialogue between the auditee and the auditor to bring to the fore the diverging perspectives that practitioners, on both sides, need to understand and appreciate. The study then



proposes a simple and workable strategy of combining compliance and performance audit to address the challenges faced by the stakeholders in the mainstreaming of performance audit. Thirdly, the pros and cons of the suggested approach have been discussed to methodically address the potential change management issues.

3.1. Significance of the Study

The study is relevant for policy makers, government officials, public auditors, international development partners, global audit community and the citizens, across jurisdictions. It is expected to bridge the expectation gap that exists between public auditors and auditee management. The stakeholders are expected to better appreciate the utility of performance auditing for efficient, economic and effective public service delivery. This, in turn, will positively impact the transparency and accountability aspects of governance. It is also expected that implementation of combined audits will help auditors produce more useful audit products for the stakeholders.

3.2. Situational Analysis

The Constitution of the Islamic Republic of Pakistan, 1973 read with the Auditor General's (Functions, Powers and Terms and Conditions of Service) Ordinance, 2001 bestow audit mandate to the Office of the Auditor General of Pakistan (OAGP). In line with the mandate and in accordance with the INTOSAI Framework of Professional Pronouncements (IFPP), the OAGP conducts three types of audits- financial, compliance and performance. Article 170 (2) of the Constitution of the Islamic Republic of Pakistan, 1973, does not leave any doubt when it says that "audit of the accounts of the Federal and of the Provincial Governments and the accounts of any authority or body established by, or under the control of, the Federal or a Provincial Government shall be conducted by the Auditor-General, who shall determine the extent and nature of such audit (Constitution of the Islamic Republic of Pakistan, 1973). This is in conformity with international best practices that expect the endowment of similar mandate to the Supreme Audit Institutions as a pre-requisite for their independent and effective functioning (INTOSAI-The Lima Declaration, 1977). The determination of 'nature and extent' of audit is more of a duty and less of a discretion as is evident from the unequivocal use of 'shall' before 'determine'. A plain reading of the applicable constitutional and legal provisions would lead us to the safe conclusion that audit mandate vested in the OAGP is exclusive, comprehensive, and is aligned with international auditing principles and standards. The detractors of performance audit may argue that Auditor-General's duty is to audit the 'accounts' and not 'performance'. This argument, apparently, is the result of an inconclusive

understanding of public audit. The accounts reflect performance and, for all intents and purposes, the two are inextricably connected. International Standards of Supreme Audit Institutions (ISSAIs) add credence to this by providing for three main types of public sector audit (Fundamental Principles of Public Sector Auditing, 2019). Additionally, the Lima Declaration, considered to be the Magna Carta of government auditing, while acknowledging that the traditional task of Supreme Audit Institutions was to audit the legality and regularity of financial management, categorized performance audit as a type of audit that was oriented towards efficiency, economy and effectiveness of public administration (INTOSAI-The Lima Declaration, 1977). Hence, audit by the OAGP, or by any other SAI, could be financial, compliance or performance or all combined into a single comprehensive audit package (Fundamental Principles of Public Sector Auditing, 2019), depending ultimately on audit objectives required to be achieved from a particular audit type. Consider a financial statement showing a chunk of public money spent on procurement of goods. The regularity auditors (financial and compliance) would follow specific audit objectives applicable to the audit of procurement and will cover, inter alia, aspects like validity, existence, occurrence, completeness, measurement, presentation and disclosures, besides the overall observance of the procurement code (Financial Audit Manual, 2012). Performance auditors, building up on that, may, at a minimum, add new facets by looking at efficiency of procurement operations and to what extent was procurement linked to the attainment of organizational or program objectives- the effectiveness (Performance Audit Manual, 2012). They may also explore environmental and sustainability aspects. There is a high likelihood that most stakeholders would welcome being apprised of these dimensions, in addition to the basic assurance that procurement did occur, was appropriately recorded and presented in the books of accounts under the relevant coding of the chart of accounts, and was broadly in consonance with the set of rules and regulations. For sophisticated audit subjects, like the Sustainable Development Goals (SDGs), performance auditing is always the first choice. The data shows that some 49% SAIs undertook performance audits of the preparedness of national governments to implement SDGs, while 43% SAIs undertook performance audits on national implementation of SDGs (Global SAI Stocktaking Report, 2023). The OAGP, too, in the last couple of years, has experimented with an indigenous variant of performance audit- the impact audit, which can be considered as upscale performance auditing (OAGP, 2024). Lest readers misconstrue, the intent here is not to portray performance auditing as an ethereal audit genre by playing down the regularity (financial and compliance) audits. The objective is to bring to the fore the merits of holistic and multi-dimensional reporting for the stakeholders



which can be accomplished more effectively through performance auditing.

3.3. Gap Analysis

For public auditors, performance audit is just another type of audit. The distinction between the types of audits, in their assessment, is simple. Financial audit certifies the financial statements and evaluates their conformity with the applicable accounting framework. In compliance auditing, the adherence to the laws and regulations gets examined. Performance audits place under their microscope the 3Es (Economy, Efficiency and Effectiveness). That performance auditing is part of their overall mandate, may be taken for granted by most auditors; however, this understanding may not be reciprocated by, at least some clients who may get distracted at the mention of 'value for money', 'performance', 'sustainable', 'key performance indicators', 'effectiveness', 'efficiency', 'outputs', 'outcomes', and 'impact'. Audit mandate gets questioned straightaway. Those who have clarity on the mandate may become skeptical about the quality of audit work. Let us explain this gap with a hypothetical scenario. Imagine that audit of a public sector educational institute has just been concluded. Audit team has come up with some observations. These relate to 'non-existence of key financial controls', 'improper maintenance of accounts', 'splitting up of expenditure', 'unauthorized re-appropriation of funds', 'deviation from delegated powers', 'non-adherence to procurement procedures'. The entity management is not happy, of course, but does understand that these issues have to be addressed. Last year, too, audit made similar nature of audit observations! A layer of complexity is added, however, as this time around, audit team had an additional audit program which went somewhat beyond the accounting and compliance considerations and led it to understand and explore the core functions and performance of the entity. The conversation, that most likely will take place, is presented below, indicating the gap between audit and the responsible party (management).

Audit: As per the applicable legislation, the Institute was supposed to impart quality education to the students at affordable fees.

Management. Yes, that's correct, and as you can see, we charge only a fraction of what the private institutions charge. In fact, mostly, it is free!

Audit: That's true but when it comes to results, the data shows gaps in the expectations of the government and performance of the institute. In the recently announced results, there are some 60% who could not qualify the examination and majority of the remaining 40% could pass with a D-Grade. Oh yes, there are a couple in C-Grade as well, and that's it. Ah, the previous results were no better. By the way, comparison with similar institutes in the district also depicts under-performance by this institute.

Management. Yes, that is quite unfortunate.

Audit: Any review of this state of affairs and any new controls established or the existing ones strengthened to improve the results in the next scheduled examination?

Management: We are quite aware of the situation and are taking necessary steps as deemed appropriate.

Audit: Right! Here is an audit observation to that end. We will follow it up at the time of next scheduled audit or at the time of next meeting of the Departmental Accounts Committee, whichever is earlier.

Management. What? Is it your mandate?

Audit: Yes, the mandate is quite clear (cites the relevant provisions).

Management: But how can you? I mean you are no expert! This is our domain.

Audit: Well, you are right. This is your domain and it is not our job to guide you about ways and means to discharge your functions. What we have done is that we have added another dimension to the accountability for utilization of public resources. In this case, we have seen that while the Institute's budgetary grants from the government have witnessed a steady increase in the last three years, the performance has not been encouraging. If you look closely, we have used, as criteria, the 'Deliverables' and the 'Key Performance Indicators' (KPIs) set by the Education Department (Government) -applicable on you- and have matched these with the actual performance of the Institute. Additionally, we have performed root cause analysis of this sub-optimal performance against the approved KPIs. We have highlighted issues like less number of days for which classes were held, the vacancy of key teaching positions, the infrequency of internal assessments, students' minimum attendance levels and under-performance in the internal assessments, inadequate and, at times, non-existent internal academic controls; and many other things, in fact. In the Annex to this audit observation, you will find comparison with similar institutions of the district, and at the provincial level. We have mentioned a few actionable recommendations as well. So hopefully this would help the Institute in better management of available resources and improve the service delivery aspect for which the institute was created in the first place.

Management: We don't think you have the mandate!

3.4. Making Sense of the Gap

The subject, setting, wording and expressions, could vary but this dialogue may well keep coming back. The fundamental issue is that both parties- audit and management- do not (may not) see eye to eye on mandate and expertise vis-à-vis performance audit. Sometimes, mandate is questioned, at times, the expertise is put in the dock and many a time, both may be looked down upon. This problem is unique to performance audit as the traditional audits have

become deeply entrenched in the system, and it would not be an exaggeration to say that, by and large, these are perceived to be routine occurrences. Performance audit, on the other hand, in most of the cases is more like a limited-edition, mostly unfamiliar. This is in part owing to a general tendency among the public audit professionals to plan, execute, and report performance audit as a separate assignment. This practice might have originated at a time when information gathering and data collection took considerable time and required a good number of person-hours to be spent on planning, executing and reporting the results of work. Since the last decade at least, the flow of information and accessibility of data has been revolutionized. The technology has made it possible to monitor the transactions in real time, and therefore the auditors need not wait for the end of a year to ask questions (The audit in 10 years, 2022). In all earnest, therefore, the existing audit cycle for performance audit has become outdated, and it is high time that performance auditors become efficient, imaginative, experimental and innovative before they venture out to comment on the efficiency and effectiveness of clients. Another aspect of the problem, that compounds and complicates the issue, is the confusion, if not an outright misunderstanding, that has taken strong roots on both sides of the table, regarding what can and cannot be performance audited. It is generally believed that performance auditing is applicable to projects and programs only, having milestones and key performance indicators. It is worthwhile to dispel this impression as auditing principles clearly stipulate that the subject matter of a performance audit need not be restricted to specific programs, entities or funds. In fact, all activities with their outputs, outcomes and impacts can be performance-audited (INTOSAI-Performance Audit Principles, 2019). The subject of a performance audit, therefore, can be a closed or on-going program or project, a government department, a functional area or a set of activities. At the level of SAI, performance audit can be somewhat inhibitive in view of its resource-intensive nature. A typical performance audit assignment consumes considerable resources, throughout the audit cycle, in particular when preparing elaborate reports and plans like the Preliminary Survey Report and Audit Assignment Plan (Performance Audit Manual, 2012). Auditors, therefore, have historically been very selective when it came to performance audit. Despite this heavy investment in performance audit planning, there is a likelihood that planning will remain disconnected from the execution of performance audit programs, which in turn will produce insufficient and unsubstantiated evidence and, ultimately the report will fall short of expectations of stakeholders, internal and external.

3.5. The Combined Audit

Performance auditing is a remarkable audit resource. It is imperative to harness its potential by increasing its share in the overall audit mix. One workable solution, depending upon the leverage available in SAI's strategic plan, is to explore the possibility of integrating, combining and mixing performance audits with the routine and comparatively run-of-the-mill compliance audits. The combined approach requires judgement of an individual Supreme Audit Institution (Compliance Audit Principles:ISSAI-400, 2019). In performance auditing, compliance component is included (Performance Audit Manual, 2012) and, on the same analogy, elements of performance auditing can also be included in the compliance auditing. As a starting point, entities deemed 'high-risk, high-materiality' may be compliance-performance (C-P) audited. The selection of entities can be done by the SAI, as part of its annual planning process, at the field audit office level, with structured application of professional judgement. The C-P audits, initially, should be in addition, and not in substitution of the existing practice of performing stand-alone performance audits. This is necessary as intention here is not to obliterate the individuality of performance audit but to make it familiar and increase its frequency. This will allow it to attain the critical mass, in short to medium run, and reach the desired tipping point, to get institutionalized and thus have greater impact on governance and service delivery. In C-P audits, there would not be any need for devoting precious audit resources on preparation of the PSRs and AAPs. Even in case of exclusive performance audit tasks, it would not be a bad idea to do away with the PSR (Performance Audit Manual, 2012). Performance audit objectives will be addressed through smart insertions of performance criteria in the compliance audit program. As is common in all audits, in case of C-P audit also, communication with external stakeholders like the entity management as well as those charged with overall governance of the audited entity must be undertaken throughout the audit cycle (Performance Audit Standard, 2019). It is worth mentioning that, *per se*, there is nothing new in the C-P approach. In fact, many auditors have been using this methodology, without a brand name, at their own volition, albeit at a modest level. There is need to do it at a reasonably large scale, in a consistent and structured manner, so that its impact is felt by the stakeholders and audit effort does not remain inconsequential. The approved compliance-performance audit programs should be fully executed during the field work and evidence collected for meaningful discussion with the management. Similarly, the initial and final reports should unmistakably identify and categorize these audit observations under performance audit, and these should be followed up as such.



3.6. The Benefits

There could be many benefits to using this combined or integrated approach. First of all, apart from the responsible party's adherence to rules and regulations, the stakeholders would get to know their performance vis-à-vis sustainability, efficiency, economy and effectiveness. This would give them a 360-degree view and will remove many blind spots that might otherwise, continue to exist in the traditional compliance reports. Two, the number of performance audits would increase manifold under a rotation plan and hence the stakeholders would be able to reap the benefits of value-added reporting. The rotation plan should be kept flexible and subject to periodic review so that, apart from 'high-materiality, high-risk', subjects assessed by the SAI, the stakeholders' specific requests, government's strategic priorities and expressed areas of concerns, citizens' expectations under the Citizen Participatory Audits, and the like, get included in the C-P audits. Three, performance auditing will inch up the ladder, at a fast pace, to occupy the place it deserves. Performance issues will crop up in all major reports of audit and will remove the one-off tag from performance audit which apparently has slowed down its mainstreaming. Four, the resources, especially the person-hours that were ordinarily spent on a single performance audit, would get distributed among scores of assignments with better results, improving audit efficiency. Five, it would compel audit teams and their supervisors to come out of their comfort zones and focus on more challenging areas. Six, it will add muscles to the compliance reports. Last but not the least, the reports, when being discussed at the levels of Departmental Accounts Committee and Public Accounts Committee, will create a sense of urgency that will help speed up resolution of both performance and compliance issues. SAIs public image as a champion of performance and service delivery issues will bring it closer to the stakeholders.

3.7. Change-Management

The shift to this methodology would require some adjustments and, most importantly, a change in the compliance-mindset. It may not be a smooth sailing. Challenges are nevertheless worth- embracing in view of the potential benefits explained in the preceding lines. Things may well be slow in the beginning, however, consistent implementation will remove the bottlenecks within short-to-medium run. One challenge that would need to be addressed is on the supply side as on ground, even the most experienced and accomplished compliance auditors, despite their enthusiasm and willingness to dive into the deep waters of performance auditing, may have serious capacity constraints. It is expected that the audit team, collectively, possess the desired professional competence to undertake performance audit (Performance

Audit Standard, 2019). However, despite the SAI having adequate number of performance audit trained personnel, the disconnect between the theory and the practical work may be more pronounced. The shift to the C-P approach would, therefore, need to be incremental. Practical considerations require that, at least for the initial audit cycles, audit management may have to place a tab on its ambitions and be contented with having just one on-job trained performance auditor attached with the compliance team. Secondly, auditors need to be guided about determining performance audit criteria. This may not be readily available in all cases (Performance Audit Standard, 2019). In many cases, this should not be allowed to become an issue as a lot of work has been done by government ministries and departments in developing yardsticks of performance and service delivery. In the context of Pakistan, the Medium Term Performance-based Budget (the Green Book) and Performance Monitoring Reports may come quite handy (Ministry of Finance, 2024). The real challenge would be to include criteria in a digestible form in the audit programs for collection of audit evidence. In most cases, there will be no need to develop separate criteria for similar entities. For health related entities of similar nature (e.g. public health facilities dealing with basic health services), uniform criteria should be sufficient in most of the cases. In cases where acceptable criteria are unavailable or are considered inadequate, or expertise is not available with the SAI, it would be better to forego the C-P approach. Developing or modifying the criteria and getting expertise may take considerable time and resources. Such subjects may be performance- audited separately, if the need for performance audit is assessed to be high. Thirdly, the initial report, before issuance to the management would have to be carefully evaluated with reference to the achievement of audit program. Any leeway in this regard (a poorly developed performance audit observation lacking appropriate criteria and evidence) may create reputation risks for audit in general, and performance audit in particular, among the stakeholders. This would be anathema to what the audit intended to accomplish. Hence, performance audit reports require strong editorial input of senior field audit management to preserve and communicate the intended message. While filtering, this has to be kept in view that performance audit is expected to offer new information, analysis or insights (INTOSAI, 2019). If audit has nothing worthwhile to offer, it should rather be silent.

4. Conclusion

Performance audit, at its basics, is just another way of looking at data and records in an attempt to augment the traditional compliance audit by topping it up with consideration of economy, efficiency and effectiveness. It can be done as a stand-alone audit, as is currently being done on a limited scale, or can be



combined with compliance audits, thereby increasing its coverage, outreach and impact. The ultimate choice is that of an individual SAI. The C-P approach is a low-hanging fruit and does not require full scale business process reengineering. Small changes need to be incorporated in the planning and implementation framework. The benefits on offer are immense starting with more challenging audit assignments leading to more useful audit reports for the stakeholders. In a couple of audit cycles, the up-graded and rejuvenated audits will start bearing tangible results in terms of better service delivery and greater respect for the available resources.

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