

Value for Money Auditing In a Statutory Board

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AUDIT GUIDANCE STATEMENT

AGS 7

Value for Money Auditing in a Statutory Board

Foreword

- i The concept of value for money (VFM) auditing has gained wide currency in countries such as the UK, USA and Canada. VFM auditing is also referred to variously as comprehensive auditing, operational auditing, extended scope auditing, performance auditing, and management auditing. Although these terms may not be exactly synonymous, they serve the purpose of distinguishing VFM auditing from the conventional audit of financial statements.
- ii Although VFM auditing is relevant in both the private sector and the public sector, it is the public sector that has taken the lead because of the special need for government organisations to demonstrate their accountability and their regard for economy, efficiency and effectiveness in the use of public funds and other resources.
- iii In Singapore the Public Accounts Committee, in a Report presented to Parliament in June 1984, recommended that private sector auditors undertaking an audit of the financial statements of statutory boards should also audit on, and satisfy themselves with, the arrangements made by management to ensure value for money in the use of resources. Elaborating on this recommendation, the Report states that the Committee considered the alternative of having the external auditors undertake a VFM audit on the statutory board's activities but decided in favour of the external auditors auditing on, and satisfying themselves with, the arrangements made by the statutory board to secure value for money.
- iv The purpose of this Statement is to introduce the concept of VFM auditing and to provide guidance for external auditors of statutory boards in conducting an audit on VFM arrangements as recommended in the Report.

Introduction

- 1. VFM auditing is particularly appropriate for any organisation whose activities cannot be judged solely by their contribution to profit. VFM auditing is therefore particularly relevant to public sector entities.
- 2. This Statement provides guidance for external auditors for statutory boards undertaking a VFM audit as envisaged by the Public Accounts Committee in its Report (June 1984), namely, an audit on the arrangements made by management to ensure value for money in the use of resources, rather than the value for money actually achieved.
- 3. It is important for the auditor to establish with the statutory board's management at the commencement of the engagement that the responsibility for securing value for money rests on the management and not on the auditor.
- 4. In carrying out an audit of the financial statements, the auditor may make recommendations for improving the accounting and internal control systems. The recommendations may take into consideration value for money aspects. The subject of this Statement is not value for money considerations in the financial statement audit but a separate and specific examination of a statutory board's VFM arrangements, resulting in a separate report by the auditor. The findings in the financial statement audit, however, may well affect the auditor's examination of, and report on, the statutory board's arrangements to secure value for money in its use of resources.

VFM Audit

Concept

5. Central to the concept of value for money in public sector organisations is the principle that public funds should be put to the best possible use and that those who conduct public business should be accountable for the economical, efficient and effective management of the resources entrusted to them. Public sector managers have an obligation to demonstrate that resources such as people, goods and money are used as productively as possible, that is, with due regard for value for money, in achieving the intended results. Although there may be no reason to believe that problems exist, an objective review and resulting recommendations can be of benefit to the organisation being reviewed.
6. A VFM audit has a broader scope than a financial statement audit. It calls for a variety of techniques in examining both financial and management controls and could well require a multi-disciplinary audit team. The more obvious areas covered by VFM auditing are the following:
 - financial planning, budgeting and controlling;
 - human resource management (that is, planning, development, appraisal);
 - planning, acquisition and utilisation of physical assets such as property, plant and equipment;
 - the development of management information systems necessary to plan, operate and control an organisation.
7. A VFM audit may be conducted by internal auditors reporting to management or by external auditors providing an independent report to those to whom management is recognised as being accountable - these may be legislators, elected representatives, senior administrators and the general public. This Statement is directed to the external auditor and the term 'VFM audit' in the rest of this Statement as defined in paragraph 8. This is in line with the recommendations of the Public Accounts Committee referred to in the Foreword (paragraph iii).

Definition

8. A VFM audit is an objective, professional and systematic examination of the systems and procedures that management has established for the purpose of ensuring that resources, such as financial, human and physical resources are managed with due regard to economy, efficiency and effectiveness.
9. *Economy* refers to the acquisition of resources in appropriate quality and quantity at minimum cost.

Efficiency refers to the maximum output for any given set of inputs or the minimum inputs for any given quantity and quality of goods or services provided.

Effectiveness refers to the extent to which any activity achieves the intended results.
10. Of the above, ensuring effectiveness presents the most difficulty as effectiveness is usually not easy to measure. When commenting on management's procedures for ensuring effectiveness, the auditor should be careful that the organisation's policy objectives are not questioned as this would ordinarily go beyond the auditor's terms of reference. It is, however, the auditor's responsibility to report on management's procedures to review the effects of policy and the arrangements by which policy decisions are reached.

Scope and Emphasis

11. The auditor's objective in carrying out the VFM audit as envisaged in this Statement is to obtain assurance by the examination of financial and other information that the statutory board has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. However, the scope of each VFM audit can be modified. In any case, the terms of the engagement should be clearly set out in the engagement letter.

12. The achievement of economy, efficiency and effectiveness depends upon the existence of sound arrangements for the planning, appraisal, authorisation and control of the use of resources. It is management's responsibility to establish these arrangements and to ensure that they are implemented and effective. The auditor's responsibility is to verify independently that these arrangements are in place.
13. An audit of financial statements culminates in an audit report being issued in accordance with the Singapore Standards on Auditing. A similar opinion would not be appropriate for the VFM audit. Because 'economy', 'efficiency' and 'effectiveness' are relative terms, it is not possible for the auditor to express an opinion on whether a statutory board's procedures have achieved the maximum practical level in each of these respects. Moreover, it would be difficult to set objective or standard criteria that can be used to assess the degree of achievement. Instead, the VFM audit culminates in a report of the auditor's findings on specific procedures.
14. The VFM audit may be seen as comprising the following three stages:
 - (a) acquiring data on the procedures of the statutory board;
 - (b) ascertaining and reporting on the extent of compliance with these procedures;
 - (c) reporting findings and recommendations for improvement or further action.
15. Developing recommendations is an intrinsic part of the VFM audit and the portion of the report setting out the auditor's recommendations would be of greatest value to the statutory board. Findings often confirm problems that management already believes exist whereas recommended solutions provide new ideas. It is not envisaged that recommendations would take the form of a complete plan of action. As the development of alternative solutions and recommendations for specific courses of action can require considerably more time and effort than identification of the problems, the amount of effort to be expended in this respect should be agreed at the outset and referred to specifically in the engagement letter. Unless otherwise predicted by the scope of the engagement, it should be borne in mind that in making any recommendations the emphasis should be on identifying opportunities to increase value for money rather than on developing solutions as the latter is a function of management.
16. The auditor would expect that in establishing procedures for ensuring economy and efficiency management's considerations would include the following:
 - Are sound procurement practices followed?
 - Are there procedures to ensure that the required type, quality and amount of items are available, properly used and maintained?
 - Is duplication of effort by employees avoided?
 - Is work that serves little or no purpose avoided?
 - Is overstaffing avoided?
 - Are operating procedures efficient?
17. Similarly, to ensure effectiveness management's considerations would include the following:
 - Is management's system for measuring effectiveness adequate?
 - To what extent does an activity achieve the desired level of results?
 - What factors inhibit satisfactory performance?

Where the auditor's review of management's procedures for ensuring effectiveness concern policy matters (see paragraph 10), it would be appropriate for the auditor to consider the following:

- (a) That policy objectives have been determined, and policy decisions taken, with appropriate authority.
- (b) That policy objectives are set, and decisions based on sufficient, relevant and reliable financial and other data, and with the critical underlying assumptions made explicit.

- (c) That there are satisfactory arrangements for considering alternative options, including the identification, selection and evaluation of such options.
 - (d) That established policy aims and objectives are clearly set out; that subsequent decisions or the implementation of policy are consistent with the approved aims and objectives, and are taken with proper authority at the appropriate level; and that the resultant instructions to staff accord with the approved policy aims and decisions and are clearly understood by those concerned.
 - (e) That there is no conflict or potential conflict between different policy aims or objectives, or between the means chosen to implement them.
 - (f) That the costs of alternative levels of service, etc. have been considered and are reviewed as costs change.
18. Finally, when considering the scope of the VFM audit it is useful to note the limits of the VFM audit. VFM auditing is not a panacea for every problem of an organisation. Firstly, it cannot identify every strength and weakness within the organisation, though it should identify the major problems. Secondly, the VFM audit only indicates what improvements may be made; whether improvements result from the VFM audit depends on whether management acts on the findings and recommendations. Thirdly, the VFM audit does not always result in savings to the organisation, though normally the implementation of the improvements identified could lead to savings or increased efficiency of greater value than the cost of the VFM audit.

Characteristics of a VFM Audit

Basic Auditing Principles

19. As with the financial audit, the VFM audit should be carried out in accordance with the basic principles and essential procedures as set out in the Singapore Standards on Auditing and other pronouncements issued by the Institute insofar as they are applicable. This would ensure that the report is independent and reliable, and based on a disciplined examination of appropriate evidence.

Audit Cycle

20. The broad scope of the VFM audit may necessitate a cyclical approach. It would not usually be envisaged that all the major aspects of the organisation's activities, systems, procedures and controls be audited simultaneously. Instead the audit may be conducted on a selected basis over a designated period of time. The actual length of the audit cycle will be determined by such factors as the size and complexity of the statutory board, the degree of change being experienced, the extent to which its key systems can be relied on to ensure continuing regard for value for money. It is envisaged that a review of overall VFM procedures will be carried out in the first year and updated as necessary in each subsequent year. This overview would provide the auditor with a basis for planning in-depth reviews of specific areas for the cycle period.

Co-ordination and Co-Operation with Client Personnel

21. The opportunities for the auditor to rely on work done by client personnel would be greater in the VFM audit than in the financial statement audit. In order to reduce time costs and demands on management time, the auditor should co-ordinate with, and rely on the work of, the internal audit department as well as those departments which are not necessarily of a strictly audit nature, for example, the management planning unit or quality control circles.
22. The benefits of the VFM audit are likely to be achieved only if there is a spirit of co-operation and interest among all parties concerned. It is essential that a continuing dialogue be maintained between the auditor and client personnel. Management should be kept regularly informed of the progress of the audit and the final report should contain no surprises.

Constructive Report

23. The VFM report is not only analytical, that is, in addition to identifying weaknesses it makes constructive recommendations as to what improvements can be made. The report is future

oriented and intended to be helpful. For this reason, although criticism of past performance may sometimes be necessary, the report should avoid language which generates defensiveness and opposition. The emphasis in the report should be on the steps necessary to effect improvement.

Audit Process

24. The VFM audit process may be divided into three main areas - planning, review and reporting. As these areas are applicable also to the financial statement audit, only those aspects which are of particular relevance to the VFM audit are mentioned.

Planning

25. The engagement letter should set out the nature and scope of the work to be performed, the approach to be adopted and the nature of the report to be submitted. Appendix I identifies certain issues that may be addressed in an engagement letter.
26. When planning staff requirements for the VFM audit it needs to be considered whether the audit team should include consultancy or other specialists. The team may be supervised by a management consultancy manager.
27. In the first year of the engagement an overview of the entity's structure and VFM procedures should be carried out. The overview would form a basis for planning the strategy of future VFM audits for, say, a five-year cycle. One or more areas for review would then be selected for the first year.

Review

28. A detailed programme of work defining the scope of the review in a particular area should be drawn up. A programme for the VFM audit should be flexible and framed in broad terms so as to encourage an open-minded approach.
29. Before commencing the review, the scope should be discussed with the chief executive, the finance officer and the internal auditor. It is important to establish with all levels of client staff that the VFM audit is primarily to offer them constructive assistance in carrying out their duties. Useful ideas are often gained from client personnel and their co-operation would be enhanced if all findings are discussed with the officers involved before they are reported to their superiors or included in the final report.
30. The report should be addressed to the person(s) with whom the arrangements for the engagement were made, for example the chief executive officer of the statutory board. The report is usually distributed only to the addressee; any further distribution is made by the engaging party or at its direction. Appendix II illustrates the nature and content of the introduction to a report; it is intended to be informative and should not be regarded as a mandatory requirement.
31. Although reports vary in format, a report generally comprises the following:
 - (a) Engagement objectives, scope and approach. A summary of these provides a framework for considering the findings and recommendations. The following may also be included:
 - a general description of the procedures employed (for example. interviews, flow charts);
 - a discussion of the rationale for selecting procedures and a description of the origin and application of the measurement criteria used;
 - a reminder that the report generally focuses on weaknesses and areas for improvement rather than on the strengths of the entity.
 - (b) Specific findings and recommendations. The structure of the report is not as important as the content. It may be organised by operation or by subject (for example, organisation, data processing controls, productivity). The related findings and recommendations would be presented in each section. The report may include recommendations for further study of areas that were not subjected to a sufficiently detailed review or of areas where

appropriate recommendations were not developed due to the constraints of the engagement. A recommendation for further study is generally supported by an explanation of why it would be beneficial.

Reporting

32. It is important for draft reports to be cleared with each level of management concerned before the final report is submitted. Management's response to the report or management's comments may be included in the report.
33. In the following year, action taken on reports previously submitted should be followed up on a formal basis.

APPENDIX I

Considerations for the Engagement Letter

In addition to establishing an understanding of the overall objective of the engagement (that is, to carry out an examination of financial and other information in order for the auditor to gain assurance that the entity has made proper arrangements for securing economy, efficiency and effectiveness in the use of resources), the engagement letter may also establish an understanding of the following aspects of the engagement:

- 1) background of the engagement
- 2) scope of the review
 - areas or activities included or excluded
 - sources and possible limitations of relevant data
 - other anticipated limitations
- 3) approach or work plan to be followed
- 4) evaluative criteria to be used or course of action to be followed in the absence of criteria
- 5) nature of end products to be expected from the engagement, particularly with respect to whether and to what extent recommendations for corrective actions are to be included
- 6) special understandings, if any (for example, that no opinion will be expressed on the entity's overall achievement of economy, efficiency and effectiveness in the use of resources)
- 7) staffing, including information about other outside specialists involved and the scope of their work
- 8) extent of client involvement
- 9) estimated time and fee (including any billing arrangements)
- 10) progress reports
- 11) report distribution
- 12) follow-up arrangements.

APPENDIX II

Illustration of An Introduction to a VFM Audit Report

To: The Chief Executive Officer
XYZ Board (Board)

In October 20X1 we concluded an audit of the arrangements made by the Board to secure value for money.

Objective, scope and approach

The scope and approach of this engagement, which were more specifically outlined in our letter dated _____, were as follows:

- 1) To document, analyse and report on the Board's current arrangements for securing value for money;
- 2) To identify opportunities for improvement in these arrangements;
- 3) To make recommendations for improvement or corrective action.

Our examination included the financial and operational conditions of the following departments:

Our examination involved interviews with management personnel and selected operations personnel in each of the departments mentioned. We also reviewed selected documents, files, reports, systems, procedures and policies as we considered appropriate. After analysing the data we developed recommendations for improvements. We then discussed our findings and recommendations with appropriate management personnel and with you prior to submitting the attached report.

Findings and recommendations

All significant findings are included in the report for your consideration. The recommendations in the report represent, in our judgement, those most likely to bring about beneficial improvements to the operations of the Board. The recommendations differ in such aspects as difficulty of implementation, urgency, extent of benefits, required investment of additional resources. The varying nature of the recommendations, their implementation costs and their potential impact on operations should be considered in reaching your decisions on courses of action.