

# Linking Performance Management, Measurement, and Auditing to Fraud

Presented to APIPA 2010  
Stephen L. Morgan  
July 23, 2010  
Pohnpei, FSM

1



## Linking Performance Measurement, Management, Auditing, and Fraud

- **Session One: What are the Models?**
- **Session Two: How does Performance Management, Measurement, and Auditing Discourage or Encourage the Occurrence of Unethical Behavior or Fraud?**

2



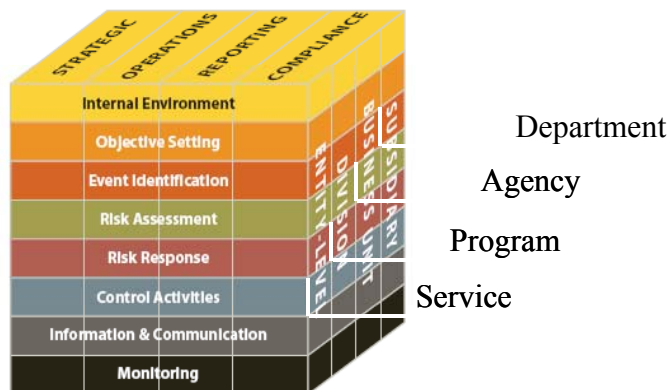
## Session One Outline: What are the models?

- I. COSO/ERM
- II. Performance Management
- III. Performance Measurement
- IV. Performance Auditing
- V. Fraud Triangle or Diamond

3



## I. COSO/ERM Model in the Private and Public Sectors



4



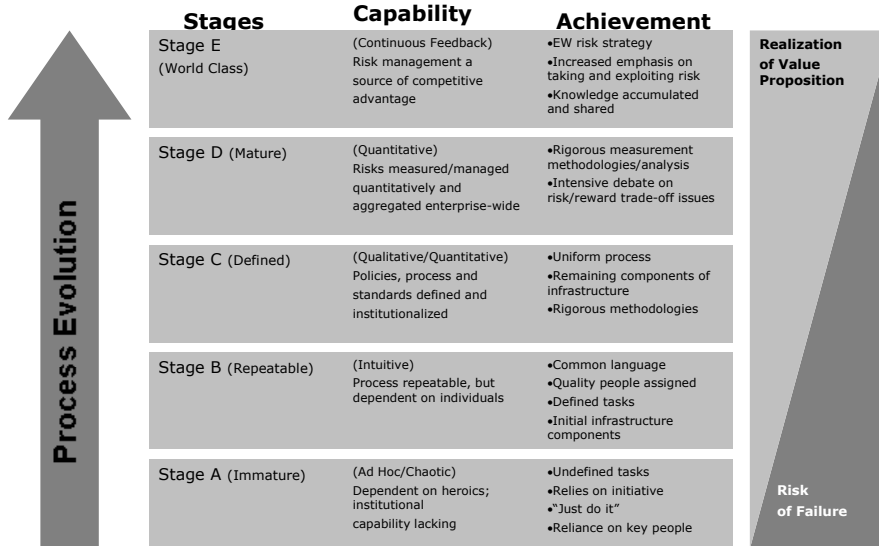
## Enterprise Risk Management Defined

- **Enterprise risk management is a process, effected by an entity's board of directors, management and other personnel, applied in strategy setting and across the enterprise (department/agency), designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives.**

5

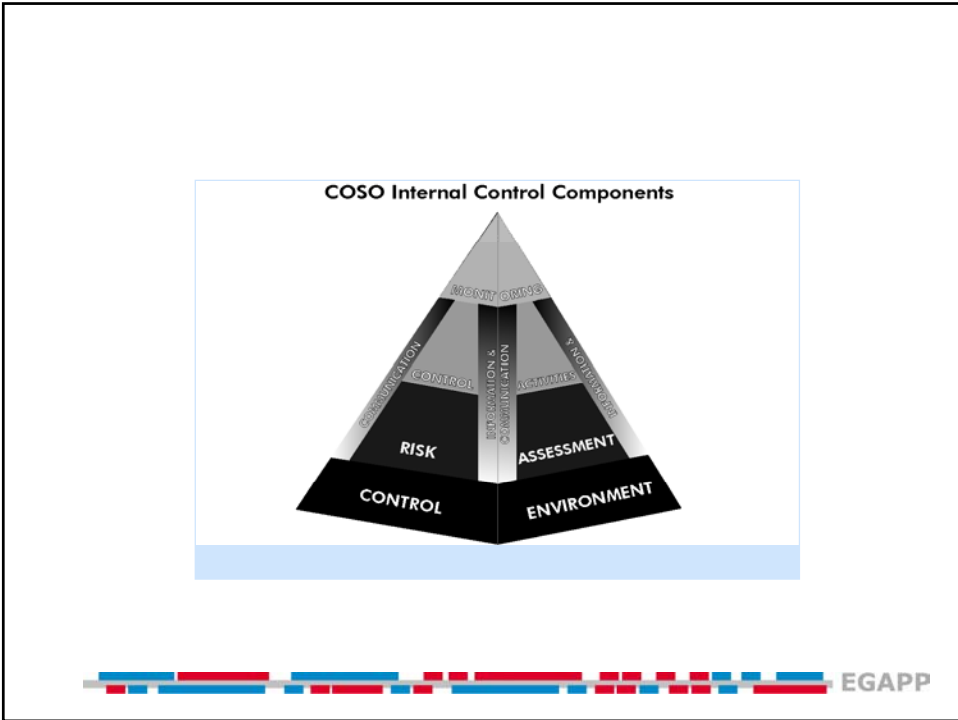


## Capability Stages of Maturity

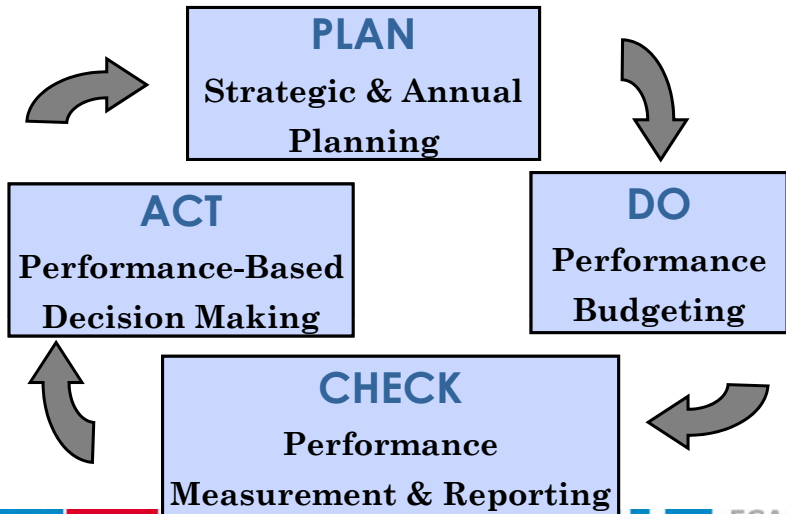


6

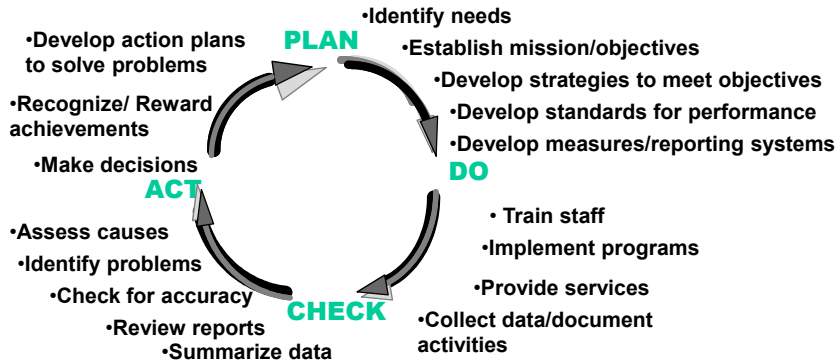




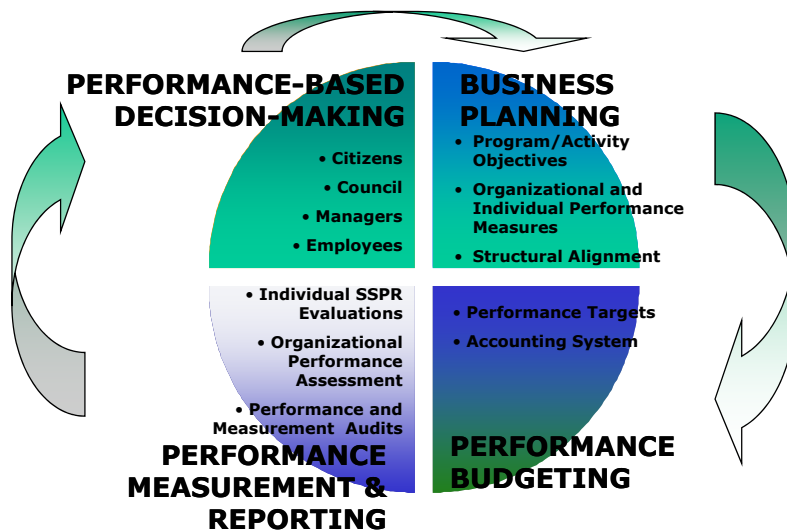
## II. Performance Management: Performance Accountability System



# Management Control System



# Performance Management: Austin's Performance Accountability System



# Performance Expectations or Goals

<b>COMPONENTS OF PERFORMANCE ACCOUNTABILITY</b>			
<b>MISSION PERFORMANCE GOALS</b>			
<b>INPUT ECONOMY</b> ♦ Financial - amount - timing ♦ Physical - quantity - quality - timing - price	<b>PROCESS EFFICIENCY</b> ♦ Productivity ♦ Unit Cost	<b>OUTPUT EFFECTIVENESS</b> ♦ Quantity ♦ Quality - products - delivery ♦ Timeliness ♦ Price/Cost	<b>OUTCOME EFFECTIVENESS</b> ♦ Mission & Outcome Goal Achievement ♦ Financial Viability ♦ Cost-Benefit ♦ Cost-Effectiveness
<b>CROSSCUTTING PERFORMANCE GOALS</b>			
←----- Compliance with Laws and Regulations ----->			
←----- resources - Safeguarding - infrastructure ----->			
←----- Continuous Improvement ----->			
←----- Reliability, Validity, & Availability of Information----->			
----- Underlying Values (ethics, equity) -----			
←----- Customer and Stakeholder Satisfaction ----->			

11

EGAPP

## Sources of Criteria for Establishing and Quantifying Performance Expectations/Goals

- **Historical trends and baselines**
- **Program requirements or intent**
- **Customer expectations or demands**
- **Industry or sector standards**
- **Benchmarking within the organization**
- **Benchmarking outside the organization**

12

EGAPP

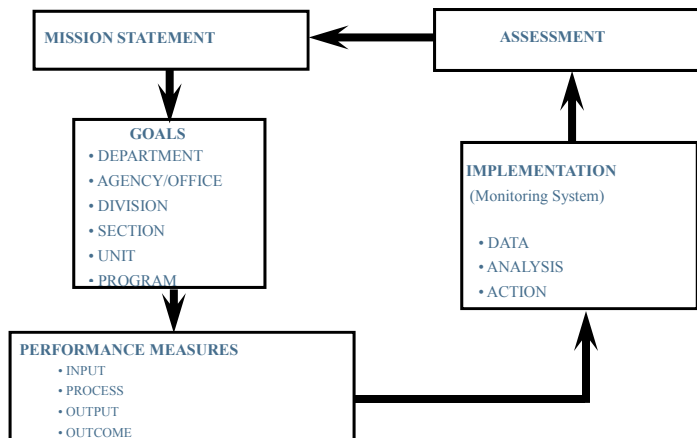
## Exercise #1

- What is the best source of criteria for establishing performance expectations?
- How do we determine if performance expectations are reasonable?
- Does your organization establish reasonable performance expectations?

13

EGAPP

## III. Organizational Performance Measurement System



14

EGAPP

## Analyze/Audit Organizational Performance

Model Component	Expectation/Goal (Criteria)	Measure (Condition)
Input Economy	In FY 2010, decrease the purchasing office's personnel allocation by five positions.	Number of purchasing office positions deleted in FY 2010.
Process Efficiency	In FY 2010, provide vehicle preventive maintenance services at the unit cost \$500 or less per vehicle serviced.	Average vehicle preventive maintenance unit costs in FY 2010.
Output Quality (accuracy)	In FY 2010, reduce the restaurant critical inspection error rate by 10 percent.	Percentage reduction in the restaurant critical inspection error rate in FY 2010.
Output Quantity	In FY 2010, expand "green energy" electrical services to 1000 additional homes and businesses.	Number of additional homes and businesses in FY 2010 receiving "green energy."
Output Timeliness	In FY 2010, all Level 1 emergency calls will be responded to with a unit on site within six minutes.	Response times (range) to Level 1 emergency calls in FY 2010.
Outcome Effectiveness customer satisfaction	In FY 2010, increase convention center customer satisfaction rate from 4.5 to 4.7 on a 5.0 scale.	Change in convention center customer satisfaction rate during FY 2010..

## Why Performance Goals Are Not Accomplished

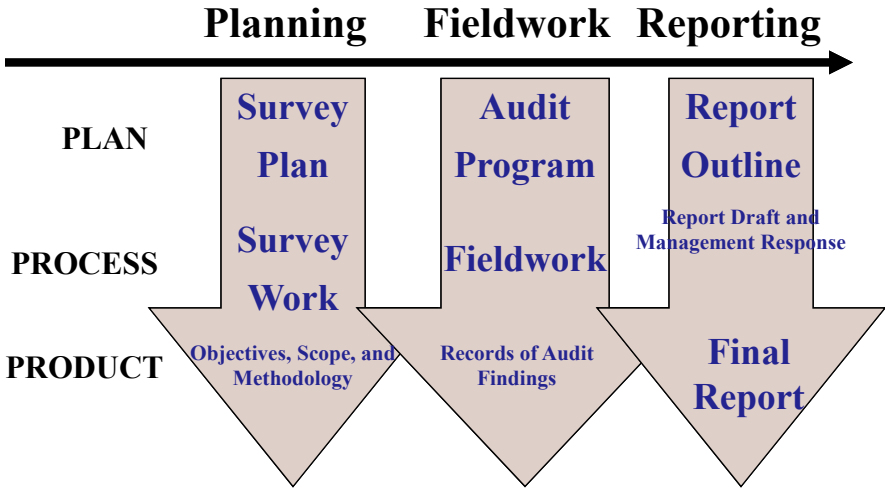
- Theoretical framework is flawed, i.e., no direct cause and effect relationship exists between program and desired outcomes
- Intervening or external variables which negate, deflect, or mask the program's effect, i.e., GASB's emphasis on explanatory information
- Management systems/processes are deficient
- Program goals/expectations are unrealistic/unattainable
- Inputs/resources are inadequate
- Fraud or unethical behavior get in the way



### Exercise #2

- How should organizational performance analyses and reports be used?
- Should performance reports be provided to external stakeholders? (stockholders, investors, citizens, media, etc.)

## IV. Performance Audit Process



## **Professional Organizations Provide Audit Guidance and Technical Assistance**

- **GAO issues professional standards updates and technical guidance through the “Yellow Book” website including regulatory updates**
- **IIA publishes the International Professional Practices Framework— the “Red Book” and related papers, advisories, practice guides**
- **AICPA issues SASs and technical guidance**
- **International Auditing and Assurance Standards Board issues International Standards on Auditing (Financial Only)**

19

EGAPP

### **The Performance Audit Planning Process**

## **Auditors Develop New Information and Verify Existing Information**

“Performance audits are defined as engagements that provide assurance or conclusions based on an evaluation of sufficient, appropriate evidence against stated criteria, such as specific requirements, measures, or defined business practices. Performance audits provide objective analysis so that management and those charged with governance and oversight can use the information to improve program performance and operations, reduce costs, facilitate decision making by parties with responsibility to oversee or initiate corrective action, and contribute to public accountability. (1.25) Performance audit objectives may vary widely and include assessments of program effectiveness; economy and efficiency; internal control; compliance; and prospective analyses. These overall objectives are not mutually exclusive. (1.28)

Source: Government Auditing Standards, 2007 Revision

20

EGAPP

## **How to Conduct a Measurement Based Audit**

- **Identify the program's inputs, processes, outputs, and outcomes**
- **Identify program's performance expectations and actual conditions**
- **Develop and prioritize performance audit objectives based on risk and vulnerability assessment**
- **Assess existing performance measurement system including relevance and reliability of measures**

## **How to Conduct a Measurement Based Audit—Cont.**

- **Develop and implement "ad hoc" performance measurement system**
- **Using selected performance expectations as "criteria" and performance aspects or measures as "condition," analyze program performance**
- **Identify causes of variances and develop audit recommendations**

**New Book on Performance Auditing from  
theIIA.org**

**Performance Auditing: A Measurement  
Approach (Second Edition)**

**Raum and Morgan**

23



**Auditor Roles and Processes: Auditors  
Determine if Controls are Mitigating  
Organizational Risk**

- **Assurance/Accountability (Audit)**
- **Consulting/Advisory Assistance**
- **Integrity – Investigative Audits**
  - Deterrence
  - Detection
  - Investigation
  - Follow Through

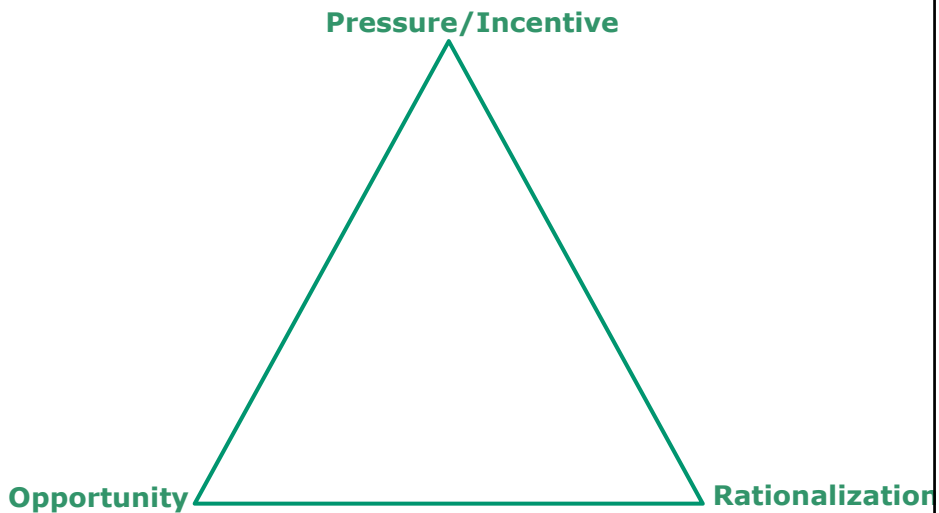
24



**Exercise #3: Types of Risk—Can you define these? Which risks can result in fraud?**

- **Inherent risk**
- **Control risk**
- **Audit risk**
- **Reputational risk**

**V. FRAUD TRIANGLE**



## Exercise #4: Fraud Models

What additional aspect could be added to the fraud triangle to convert it into a fraud diamond?

## Session Two Outline: What are the linkages?

- I. Facilitated Exercise: "The Good News"**
- II. Facilitated Exercise: "The Bad News"**
- III. Aspects of the systems that discourage (prevent, deter, or detect) unethical behavior or fraud**
- IV. Aspects of the systems that may encourage unethical behavior or fraud**

**I. Exercise #5: What aspects of the models discourage unethical behavior or fraud?**

**COSO/ERM?**

- **Tone at the top (New Austin CM)**
- ?
- ?
- ?
- **Describe a "real life" example.**

**Exercise #6: What aspects of the models discourage unethical behavior or fraud?**

**Performance Management**

- **Accountability for quality (Airport, Fire)**
- ?
- ?
- ?
- **Describe a "real life" example.**

**Exercise #7: What aspects of the models discourage unethical behavior or fraud?**

**Performance Measurement**

- **Measure customer satisfaction (COA Airport)**
- ?
- ?
- ?
- **Describe a “real life” example.**

31



**Exercise #8: What aspects of the models discourage unethical behavior or fraud?**

**Performance/Internal Auditing**

- **Risk/Vulnerability Assessment (Fleet Audits)**
- ?
- ?
- ?
- **Describe a “real life” example.**

32





**II. Exercise #9: What aspects of the models might encourage unethical behavior or fraud?**

**COSO/ERM?**

- **Overreliance on “technical” risk assessment (New York Banks).**
- ?
- ?
- ?
- **Describe a “real life” example.**

33



**Exercise #10: What aspects of the models might encourage unethical behavior or fraud?**

**Performance Management**

- **Unrealistic/Unattainable Goals (Budgets)**
- ?
- ?
- ?
- **Describe a “real life” example.**

34



**Exercise #11: What aspects of the models might encourage unethical behavior or fraud?**

**Performance Measurement**

- Measuring individual employee performance
- ?
- ?
- ?
- Describe a "real life" example.

35



**Exercise #12: What aspects of the models might encourage unethical behavior or fraud?**

**Performance/Internal Auditing**

- Exception Based Audit Approach (need balanced perspective)
- ?
- ?
- ?
- Describe a "real life" example.

36



### **III. Aspects of Models That Prevent/Deter or Detect Unethical Behavior or Fraud**

- **“Soft controls” including “tone at the top,” establishing an ethical culture, and supporting values such as honesty, transparency, and accountability**
- **“Hard controls” such as accounting systems, policies and procedures, and routine internal monitoring of inputs, processes, outputs, and outcomes**
- **Sustained support for audits, self assessments, and reporting mechanisms**

37



### **EXAMPLES FROM THE CITY OF AUSTIN**

- Performance Management System’s Continuous Improvement**
- Implementation of Detailed Guidelines for Performance Management including “Measure Change Controls”**
- Self Assessments and Audits to Ensure Measures are Relevant and Reliable**
- Close coordination between performance auditors and fraud investigators**

38



#### **IV. Aspects of Models that Might Encourage Unethical Behavior or Even Fraud**

- **Establishing unreasonable expectations for employees and managers**
- **Tolerating the “gaming” of systems” (process for establishing expectations and rewarding expectations)**
- **Ignoring unethical or illegal behavior**
- **Failing to address perceptions of inequities**
- **Creating overly complex systems/processes**

39

EGAPP

#### **EXAMPLES FROM THE CITY OF AUSTIN**

- **“Everything is a shade of grey” (efficiency and timeliness)**
- **“Providing oversight for federal funds doesn’t matter” (funding and outcomes)**
- **What would you have done in my place? (externally imposed performance goals)**
- **“He won the Silver Star” (entity wide controls)**

40

EGAPP

## **Conclusion: Management, Audit and Investigative Environment Becoming Increasingly Complex**

- Human Capital
- Knowledge/Information Management
- Economic and Financial Sustainability
- Globalization
- Accounting and Reporting

41



## **Conclusion: Management and Auditors Should Cooperate to Optimize Performance and Discourage Fraud**

- Fight ethics and corruption
- Establish and sustain governance structures
- Solve problems with intergovernmental and global partnerships
- Encourage “worldwide best practices”
- Nurture a positive organizational culture and values

42

