



THE PERCEPTION OF PUBLIC SECTOR AUDITORS  
ON PERFORMANCE AUDIT IN THE MALAYSIAN  
CONTEXT

BY

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A dissertation submitted in fulfilment of the requirement for  
the degree of Master of Science in Accounting

Kulliyyah of Economics and Management Sciences  
International Islamic University Malaysia

AUGUST 2013

## **ABSTRACT**

The aim of this study is to explore the perception of Malaysian public sector auditors concerning performance audit. These auditors' opinion are on whether performance audit is achievable, involvement of auditors in policy making, auditors' professional judgment in expressing audit opinion, involvement of other experts in performance audit, constraints faced and the possibility of performance audit improving public administration. This study used the survey method to collect the data. The respondents were from the federal and state levels of the National Audit Department in Malaysia. Descriptive analysis was used to derive the percentages and mean values of the data collected. The results revealed that performance audit is achievable. The auditors should be given the opportunity to influence policy decisions. Public auditors are not the only profession to make audit judgment, but to team up with other groups of profession in undertaking a performance audit. Lack of cooperation and commitment from auditees in conducting a performance appeared to be the most severe constraint. Finally, respondents believe that the performance audit could achieve better public accountability, as well as be economical, efficient as well as effective in utilising public resources. In conclusion, the research findings provide some informative information to the researchers and practitioners particularly the government of Malaysia.

## ملخص البحث

تهدف هذه الدراسة الى استكشاف تصور مراجعوا القطاع العام الماليزي بشأن مراجعة الأداء. آراء المراجعين هذه تكمن في ما إذا كان مراجعة الأداء يمكن تحقيقه, إشراك مراجعي الحسابات في صنع السياسات, التحكيم المهني للمراجعين في التعبير عن قرار التدقيق. إشراك غيرهم من الخبراء في مراجعة الأداء, المعوقات المواجهه وإمكانية مراجعة الأداء في تحسين الإدارة العامة. هذه الدراسة استخدمت طريقة الإستبيان في في تجميع البيانات. وقد أخذت العينات من المستويات الفيدرالية والاتحادية من دائرة الرقابة الوطنية في ماليزيا. كما تم استخدام التحليل الوصفي لاشتقاق النسب المئوية وقيم المتوسطات من البيانات التي تم جمعها. وكشفت النتائج أن مراجعة الأداء يمكن تحقيقه, كما ينبغي إيلاء المراجعين الفرصة للتأثير على القرارات المتعلقة بالسياسات. مدققوا القطاع العام لا تتعلق مهنتهم فقط في إجراء أحكام التدقيق ولكن يجب إشراكهم في المجموعات الاخرى لمراجعة الأداء. عدم التعاون والالتزام من الجهات الخاضعة للمراجعة في إجراء الأداء يعتبر العائق الاكبر فيما يبدو. كما أن أفراد العينة يعتقدون أن مراجعة الأداء يمكن أن تؤدي إلى مسؤولية عامة أفضل فضلا عن أنها تكون اقتصادية وفعالة بالإضافة إلى كونها ذات فعالية في استخدام الموارد العامة. في الختام، نتائج البحث وفرت بعض المعلومات المفيدة للباحثين والممارسين وخاصة حكومة ماليزيا.

## APPROVAL PAGE

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## DECLARATION

I hereby declare that this dissertation is the result of my own investigation, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any degrees at IIUM or other institutions.

Loke Chew Har

Signature .....

Date .....

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**THE PERCEPTION OF PUBLIC SECTOR AUDITORS  
ON PERFORMANCE AUDIT IN MALAYSIA**

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## ACKNOWLEDGEMENTS

I appreciate very much on completion of the programme coursework and dissertation in my study, that is the Master of Science in Accounting at International Islamic University Malaysia (IIUM), Gombak, Kuala Lumpur.

The major credit and appreciation definitely belongs to my supervisor, Associate Professor Dr. Suhaiza Bt. Ismail and the co-supervisor, Assistant Professor Dr. Fatima Bt. Abdul Hamid. The completion of this dissertation was only possible with their valuable comments, precious time spent, positive synergy, and patience to supervise me. Their dedication in supervising this dissertation is admired and unforgettable. Again, really thank you to both of you, DrSuhaiza and Dr Fatima.

Furthermore, I would like to convey my appreciation to all the professors, lecturers and administrative staff in IIUM, particularly those who had conducted the lectures, namely, Professor Dr. Abdul Rahim Bin Abdul Rahman, Associate Professor Dr. Hafiz-Majdi Bin Ab. Rashid, Associate Professor Dr. Suhaiza Bt. Ismail, Dr. Fatima Bt. Abdul Hamid, Dr. Khadijah Bt. Mohd. Isa, Dr. HairulAzlan Bin Annuar and Dr. Sherliza Bt. Puat Nelson. Thank you so much for all contributions to my master programme in IIUM. The same appreciation is dedicated to Professor Dr. Abdul Rahim Bin Abdul Rahman, Associate Professor Dr. Muslim HarSani Bin Mohamad, Dr. Ahmad Zambri Bin Osman @ Hussin, Dr. GholamrezaZandi Pour Joopari, DrSuanizaBtMamat, who provided me with useful comments on the questionnaire pilot test.

In additiona to the above, my thanks go to the Audit General of Malaysia, H.E. Tan Sri Dato' Setia Haji Ambrin Bin Buang, who granted my request to conduct the questionnaire survey at both the federal and state level of the National Audit Department, Malaysia. The same goes to Dr. MasiahBinti Ahmad, Special Audit and Research Sector Director, who provided support on the distribution of the questionnaire. Of course, I need to record my sincere appreciation to all the respondents of this research; without their cooperation, the initial research would not be achieved. Thank you so much for the effort contributed in this research.

Next, sincere appreciation must also be dedicated to all the seniors, classmates, and friends in IIUM. It is great to have your assistance, sharing and company along my study.

I am indebted to my beloved family members, who supported me all the way. Finally, thank you for the team who decided to accept my application of study in IIUM, Gombak Kuala Lumpur. My study in IIUM is one of the priceless present in my life.

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## LIST OF ABBREVIATIONS

3Es	Economy, Efficiency, and Effectiveness
AG	Auditor General
NAD	National Audit Department
OBB	Outcome Based Budgeting
RO	Research Objective
RQ	Research Question
SAIs	Supreme Auditing Institutions
SPSS	Statistical Package for Social Science
U.K.	United Kingdom
U.S.	United State
VFM	Value for Money
CD-ROM	Compact Disc Read-Only Memory

# **CHAPTER 1**

## **INTRODUCTION**

### **1.0 INTRODUCTION**

This chapter provides an overview of the present study on public sector performance audit and is divided into six sections. Section 1.1 offers a background of the study, followed by problem statements in Section 1.2. Sections 1.3, 1.4, and 1.5 address the motivation, research objective, and significance of the study, respectively. Finally, Section 1.6 provides the organisation of this dissertation.

### **1.1 BACKGROUND OF THE STUDY**

The public sector refers to the government, which, in Malaysia, consists of three main levels – Federal Government, State Government, and Local Government (Ismail, Ali, Fadzil, and Hussin, 2011). The public sector has considerable responsibility to the public, in respect of health, human resources, transportation, communication, education, and defence. Each financial year, there are budget allocations for each of these areas to provide the necessary services to the nation and society at large. In relation to the budget allocations, audit of the government entities is crucial to ensure efficient utilisation of these allocations. Hence, this study focuses on the aspect of auditing in the public sector entities.

Basically, there are three types of audit in the public sector – financial audit, compliance audit and performance audit. The financial audit examines the true and fair view of the public sector financial statements, whereas compliance audit inspects and evaluates the activities or programmes of the different government departments

and whether they are complying with all the stipulated statutory rules, regulations, and laws. Conversely, performance audit assesses the performance of the public sector entities in achieving the stated objectives or goals, which are beyond the scope of the financial and compliance audit (Glendinning, 2007; Guthrie, 1987).

The term ‘performance audit’ is used in this study as it is a common technical terminology used in the public sector auditing literature (Hossain, 2010; Pollitt, 2003; Ismail et al., 2011). As mentioned above, this term refers to an audit of whether the public sector entities meet their goals in their activities, i.e. performance. Thus, performance audit is an independent evaluation of three related elements in government performance – economy, efficiency, and effectiveness (3Es), (Hossain, 2010; Keen, 1999; Pendlebury and Shreim, 1990). The element of economy refers to how well the government input cost could be minimised, whereas efficiency refers to the relationship between maximising outputs with the minimum input, and effectiveness concerns the achievement of goals and desired results in public sector organisations (Gronlund, Svardsten and Ohman, 2011). Although there are issues and challenges concerning each of the three elements, auditing the effectiveness is claimed to be the most challenging in a performance audit (Hossain, 2010; Pendlebury and Shreim, 1990). Basically, these definitions are referred to in the context of this present study.

The uniqueness of performance audit is that it provides an assessment concerning the achievement of the objectives or goals of government policies. Upon completion of an audit, greater public accountability and transparency of public financial reporting are provided to the public. In other words, it can boost better governance and attain greater public confidence in the performance of the government.

After providing a brief background on the public sector and auditing in the public sector, particularly that of the performance audit, the next section identifies the problems in relation to the research objectives of this study.

## **1.2 PROBLEM STATEMENTS**

In recent times, the society or public at large has become more concerned about the financial management of the government (Buang, 2006; Ismail et al., 2011). In particular, the concern is about whether the respective government departments have utilised the yearly budget allocations economically, efficiently, and effectively. Performance audit is one of the mechanisms in ensuring proper management of the financial resources, which, ultimately, leads to better accountability of the government to the public. As stated in the previous sections, a performance audit comprises three components – economy, efficiency, and effectiveness. Of the three elements, the effectiveness element of a performance audit poses the most challenging problem in the eyes of the public auditors, although it does not mean that the economy and efficient elements are free from problems. This is supported by Athmay (2008) who claimed that the subjectivity in the objectives or goals of the government activities and programmes creates a fundamental problem in undertaking an audit of effectiveness.

These problems and challenges could deter public sector auditors from successfully carrying out a performance audit. They may also consider that the effectiveness component of performance audit should not be audited as it is not practical due to its challenges. Therefore, the current study explores the perception of public sector auditors on performance audit as they are the individuals who have to carry out an audit of the public entities' performance. Thus, they are the ones who

would have an opinion on the feasibility and challenges of performance audit as well as the component of effectiveness.

In light of the above, the present study focuses on certain aspects of a performance audit such as, the concept of performance audits, suitability of public sector auditors in undertaking a performance audit, other relevant professionals involved in the performance audit, various constraints in undertaking a performance audit and the impact of a performance audit on accountability. These issues were addressed in the survey questionnaire that public sector auditors responded to in order to give their views. Hence, after briefly discussing the problems regarding performance audit, which warranted this study, the next section elaborates on the motivation of the study.

### **1.3 MOTIVATION OF THE STUDY**

There are a few motivations for this study. Firstly, the study is motivated by the emphasis of the Malaysian Government on the importance of performance audit. Specifically, in his speech, the Prime Minister, YAB Dato' Sri MohdNajibTun Abdul Razak, mentioned that public sector audits in Malaysia should focus on performance audit (Abdullah, 2011). More importantly, the new budgeting system adopted by the Malaysian Government, called the outcome based budgeting (OBB), and which replaces the modified budgeting system, focuses on the outcome of projects or programmes instead of the output in ensuring the effective utilisation of public resources (Abdullah, 2011; Buang, 2006). This is in line with the performance audit, which focuses on outcome rather than merely output.

Secondly, performance audit is not a recent issue and have existed since the nineteenth-century (Flesher and Zarzeski, 2002). However, research and literature on



performance audit is still lacking internationally, particularly in Malaysia. Hence, the present research aims to contribute to the literature on performance audit particularly concerning the concept of performance audit, professional groups that participate in carrying out a performance audit, constraints in undertaking a performance audit and the impact of a performance audit on accountability.

Thirdly, the Auditor General (AG) of Malaysia, H.E. Tan Sri Dato' Setia Haji Ambrin Bin Buang, expressed his concern about the importance of public accountability and the role of the public sector audit in discharging accountability. He mentioned in his speech in Shanghai, China, that various parties of the society including the media, non-governmental organisations, parliamentarians, central agencies and the public at large are now more vocal in raising issues concerning the government's financial management and performance (Buang, 2006). Hence, to some extent, the audited annual report of the government could be a means for the public to obtain relevant information, such as government's spending and collection of a financial year.

Based on the above, the encouragement from the Malaysian Government as well as inadequate research in this area has motivated this study. The next section clearly states the research objective of this study followed by the research questions.

#### **1.4 OBJECTIVE AND RESEARCH QUESTIONS OF THE STUDY**

The aim of this study is to investigate the perception of public sector auditors on performance audits in the Malaysian context. In order to achieve the aim of the research, the research objective (RO) has been formulated as follows:

RO 1: To examine the perception of the Malaysian public sector auditors concerning performance audit.

The following are the research questions (RQ) to meet the above mentioned RO.

RQ 1: Should effectiveness be an element of a performance audit?

RQ 2: Do auditors need to get involved in policy making in order to perform well in a performance audit?

RQ 3: Are auditors the appropriate profession to carry out a performance audit?

RQ 4: What other professions should be involved in a performance audit?

RQ 5: What are the obstacles to carrying out a performance audit?

RQ 6: Does a performance audit improve public administration?

Based on the above, the present research can be best described as an exploratory study as the aim is to discover the perception of the public sector auditors concerning performance audit.

## **1.5 SIGNIFICANCE OF THE STUDY**

This exploratory study is expected to contribute considerably to various parties. To the best knowledge of the researcher, so far, there is no similar study on the perception of the public sector auditors concerning the performance audit in Malaysia. Therefore, it is hoped that this study would fill the gap in the literature and trigger more research concerning the public sector, particularly in relation to public sector audits.

The findings of the present study are also important to the government, National Audit Department (NAD), other practitioners, academicians, students, and the public at large, as it provides them a better understanding concerning the performance audit on the Malaysian Government, particularly concerning the concept of the performance audit and several important issues of performance audit in Malaysia.

Moreover, it is believed that the empirical evidence offered in this study provides insightful information to the Malaysian Government and NAD, which will enhance the quality of performance audits, and thereby improve the efficiency of the government, particularly by overcoming the constraints and challenges in carrying out the performance audit, as well as obtaining involvement from other relevant professions.

## **1.6 ORGANISATION OF THE STUDY**

This study has been organised into five chapters:

Chapter 1 Introduction: the first chapter provides an overview for this research. It consists of the background of this study, problem statements, research objective, and motivation, as well as the significance of this study.

Chapter 2 Literature Review: this chapter reviews the prior literature on performance audit. Firstly, it provides a general explanation concerning the types of audit in the public sector, followed by a review of the concept of performance audit. Next, it examines the conceptual and empirical studies being carried out on performance audit. This chapter concludes by identifying the gap in the literature.

Chapter 3 Conceptual Framework and Research Method: this chapter provides a conceptual framework underlying the concept of the performance audit. The accountability framework has been applied in this study and justification of the link to performance audit is provided. This chapter continues with a discussion on the research method applied in this study. The discussion includes an explanation of the sample selection, data collection method, research design, pilot test, and statistical analyses.

Chapter 4 Findings and Discussion: this chapter focuses on the analyses of the research findings through the use of Statistical Package for Social Sciences (SPSS), presenting all relevant diagrams and tables, and providing a thorough discussion of the demographics and findings.

Chapter 5 Conclusion: This is the final chapter of the study. This chapter consists of the conclusion for the study, implications of the findings, limitations, and contributions of the present research. Finally, it concludes with potential recommendations for future studies.

## **CHAPTER 2**

### **LITERATURE REVIEW**

#### **2.0 INTRODUCTION**

This chapter reviews the literature related to this present study. It consists of four sections. Section 2.1 provides a general explanation on auditing in the public sector. This is followed by a discussion on performance audit and a review of prior studies on performance audit in Sections 2.2 and 2.3, respectively. Section 2.4 identifies the gap in the literature and presents the summary of the chapter. Different terminologies will be used interchangeably in this chapter as different countries, and, consequently, different studies, have applied dissimilar terms for performance audit, such as ‘management audit’, ‘operational audit’, ‘value for money (VFM) audit’ and ‘comprehensive audit’.

#### **2.1 AUDITING IN THE PUBLIC SECTOR**

Auditing is an investigatory service by the auditors to examine the truth and fairness of the financial statements, as well as the completion of all the required documents and accounting records that are prepared in accordance with the Acts and Standards (Jones and Bates, 1990). Auditing is one of the crucial mechanisms that could enhance public sector accountability in utilising public money (Jones and Bates, 1990; Muniain, 2005). In other words, relevant government authorities, such as public sector auditors, carry out necessary investigations to ensure the proper utilisation of public money and to detect its misuse. This is crucial to enable better management of funds to run a country.

In Malaysia, the Malaysian Audit Act (1957) Section 6 governs the audit of public sector organisations (NAD). Under this Act, public auditors are required to ensure that public money has been properly safeguarded, utilised and recorded. Furthermore, authorised activities are to be carried out economically, efficiently and effectively.

In general, there are two types of audit – internal audit and external audit. Internal audit refers to ensuring the proper management of operations with sound internal control systems in order to detect any material fraud or error in an organisation. This function is normally carried out by independent internal auditors in the internal audit department of an organisation (Jones and Bates, 1990).

On the other hand, external audit refers to the role of performing verification on records and ensuring proper compliance with the programmes or activities of an organisation. This role is undertaken by external qualified bodies, such as private auditors from accountancy firms or the auditor general from the public sector (Jones and Bates, 1990). Under the external audit, there are three common types of audit – financial audit, compliance audit and performance audit (Rauf et al., 2008).

A financial audit in the public sector is carried out in accordance with the provision of the Malaysian Federal Constitution and Malaysian Audit Act 1957 (NAD). This is to ensure a sound accounting and financial system, so that all accounting transactions are under proper control and authorisation (Jones and Pendlebury, 2000). The financial audit has the priority among other types of audit, because its objective is to report on the true and fair view of the financial statements and their compliance with all the required legal and regulatory requirements.

Next, is the compliance audit, which is a mandatory audit under the Malaysian Audit Act, 1957 (NAD). It is used to verify that all incurred expenditure has been

approved and is in accordance with the policies, laws and regulations (Jones and Pendlebury, 2000). The auditors will report on the degree of compliance of the government financial or operating activities in accordance with stipulated rules and policies.

Finally, the performance audit is the audit to ensure that the government is not paying extra public money for any spending on goods or services but solely to achieve the established goals or objectives of a public organisation (Rauf et al., 2008). The following sub-section further explains the definition, components, and the needs of a performance audit.

## **2.2 PERFORMANCE AUDIT**

A performance audit comprises three elements, i.e. the 3Es – economy, efficiency and effectiveness (Jones and Pendlebury, 2000). According to Jones and Pendlebury(2000), a performance audit is an examination of the economy, efficiency and effectiveness of an undertaken programme or activity of a public entity to achieve the established goals and objectives. Moreover, Flesher and Zarzeski (2002) defined a VFM audit or operational audit as a non-financial audit, as it is an operational assessment of an entity to enhance the efficiency and effectiveness of the public administration.

A standardised definition of a performance audit could lead auditors to the right path with less confusion when undertaking an audit. This is because, various countries have their own definition and practice of what comprises a performance audit. It may not necessarily be all the 3Es. As agreed by Grimwood and Tomkins (1986), a standard definition is needed before the audit assessment is undertaken. Conversely, if auditors have dissimilar understanding on the definition then it could

create various subjective judgments, which would reduce the credibility of the audited report. Even though such a definition is important, a standardised definition of a performance audit is little emphasised in practice. Nevertheless, the following discussion explains the components of a performance audit.

Economy means the *'provision of what, in the light of any given policy, at any given time, is required at minimum cost'* (Glendinning, 2007). Thus, economy is assessed based on the quantity and quality elements with the aim of avoiding the unnecessary spending of public money. Whereas, efficiency refers to the maximum output of achievement from the resources provided in a programme or activity (Glendinning, 2007). In addition, effectiveness means attaining the intended results through the utilisation of resources economically and efficiently (Glendinning, 2007).

Each element plays its respective crucial role in undertaking a performance audit. Audit of the economy element is the least challenging issue, as it can be audited using various economic methods. However, in terms of efficiency, it is more challenging compared to the economy element. This is because it needs to ensure the indicated objective is met. In this respect, not all programmes or activities have clearly specified objectives, as it is not easy to specify goals or objectives. Since effectiveness combines the elements of economy and efficiency, the challenge of defining objectives under efficiency would also have implications for measuring effectiveness. As a result, the effectiveness element presents the main problem, both theoretically and practically.

In theory, the definition of effectiveness is actually relatively general, for instance, *'attaining of good result'*. The issue is, how should the auditor evaluate whether a good result has been achieved? In practice, many auditors are concerned