

2006 ANNUAL REPORT

PERFORMANCE AUDIT: THE FIRST YEAR



WASHINGTON
BRIAN SONNTAG
STATE AUDITOR



January 2007

Citizens of Washington:

I am privileged to present our Annual Report that reviews important aspects of our work and responsibilities during 2006. The year has been truly groundbreaking. Voter approval of Initiative 900 in late 2005 gave the Office of State Auditor independent, comprehensive authority to conduct performance audits of state and local government. It is one of the most significant expansions of our constitutional responsibilities since the Office was created.

During the past year, we have dedicated ourselves to ensuring the trust that citizens showed in our audit work was well-directed. We spent 2006 establishing a core performance audit team, eliciting ideas and opinions from citizens on where to focus the audits, and getting our initial work well under way.

We are very proud that our work to put Initiative 900 in place has received considerable national attention. The national Association of Government Accountants conducted a research study, the results of which are being used as a model for other states creating performance audit programs. Our effort to engage citizens in performance audits was noted prominently by *Governing* magazine.



Because of the significance of this performance audit authority and the heightened level of our activity related to it, we devote a considerable portion of this Annual Report to describing how we are undertaking our new responsibility. We are committed to conducting independent, fair and objective performance audits that achieve meaningful results and lead to government working better for all of us.

But as we carry out this new authority, we are not diminishing our other important responsibilities. We conduct about 1,000 financial and accountability audits annually. We value the constructive working relationship we have with the 2,700 units of state and local government we audit. We constantly reassess how we audit to ensure our work provides real value to the entities we audit and, above all, to citizens.

Our State Employee Whistleblower Program continues to serve as an effective avenue for employees to report suspected instances of improper government actions. We have an active fraud program that emphasizes training state and local government financial managers to identify and report fraudulent activities.

Finally, I am privileged to work with a dedicated, highly skilled team of auditors and administrative and support staff who make up our Office. We all hope this report is useful to you.

Sincerely,

A handwritten signature in blue ink that reads "Brian Sonntag". The signature is stylized and cursive.

Brian Sonntag, CGFM
Washington State Auditor

A little more than a year ago, citizens overwhelmingly decided to give the State Auditor's Office an opportunity to help make government more accountable, accessible, responsive and transparent to the public.

Their approval of Initiative 900 in the 2005 general election – by more than 57 percent – put in place the most independent, extensive performance audit authority in the country.

Since then, we have been engaged in a far-reaching, nationally recognized effort to create a performance audit program and to ensure that citizens' trust and confidence in our work has been well placed. We have:

- Formed a core team of performance auditors.
- Conducted a one-of-a-kind effort to elicit opinions and recommendations from citizens and public employees.
- Begun our first wave of audits.
- Developed an ambitious work plan that identifies 30 specific performance audits that we intend to conduct between now and the end of 2007.

By the end of June, we expect to have completed 19 specific performance audits. These audits range from a large-scale review of highway efficiency efforts by the state Department of Transportation to a narrowly focused audit of the state's debt collection process. The audits also include local governments such as the Port of Seattle, Sound Transit and a broad look at public development authorities.

Our efforts have received national recognition. The national Association of Government Accountants conducted a research project to study how we launched our performance audit program. The association is using the published results as a model for other public auditors and financial managers on how to establish effective performance audit programs in their states.

In addition, *Governing* magazine recently recognized our public outreach initiative to involve citizens. The magazine described it as a "one-of-a-kind experiment that seeks to bring back citizens into the decision-making fold."

Those inside government are embracing performance audits. Gov. Christine Gregoire valued our work and asked us to conduct a performance audit of the state Department of Health's licensing of health care professionals. That audit is under way.

The Legislature also directed us to do a comprehensive performance audit of the state's transportation system. We are now using private firms to perform four separate but complementary audits of the Department of Transportation. While some disagreement over our audit scope has emerged, lawmakers generally view us as able to use our position of independence to pursue an important area of government.

We believe this demonstrates the credibility and quality of our work, which has been built on years of financial and legal compliance auditing of all state agencies and local governments in Washington.

"We are committed to performance audits that produce objective and meaningful results..."

The next step will be to blend performance audits in with that traditional financial and legal compliance work. This enables us to use our current staff and to take advantage of their audit experience and perspective of state and local government. This is what the U.S. Government Accountability Office intended in 1972 when it developed standards for performance audits, financial audits and statutory compliance audits. GAO believed those three methods of auditing should complement each other in an integrated, comprehensive audit program.

We have begun training and equipping audit staff with skills unique to performance audit. We will carefully assess the need to hire new auditors to ensure we do not create another government bureaucracy.

With our performance audit authority, we will work cooperatively and constructively with governments while fiercely maintaining our independent role as the public's auditor. And we are committed to performance audits that produce objective and meaningful results, leading to improvements in government operations.

Nine Elements of Initiative 900

Initiative 900 requires that each performance audit include, but not be limited to:

- Identification of cost savings.
- Identification of services that can be reduced or eliminated.
- Identification of programs or services that can be transferred to the private sector.
- Analysis of gaps or overlaps in programs or services and recommendations to correct them.
- Feasibility of pooling the entity's information technology systems.
- Analysis of the roles and functions of the entity and recommendations to change or eliminate roles or functions.
- Recommendations for statutory or regulatory changes that may be necessary for the entity to properly carry out its functions.
- Analysis of the entity's performance data, performance measures and self-assessment systems.
- Identification of best practices.



Our Ambitious Work Plan

In identifying our initial performance audits, we sought to balance citizens' near-term expectations, required mandates and the need for deliberative planning for long-term results.

These considerations are reflected in our work plan, which identifies 30 performance audits that we are undertaking between now and the end of 2007. They include state government agencies and functions and local government programs. Some are high-profile, others are not. We will complete some relatively quickly while others will take more time. We will revise the plan quarterly to add new audits as we conclude others.

Initiative 900 calls for us to start with the largest, costliest state agencies. We have met that mandate with four performance audits of the state transportation system. We also are looking at K-12 education by first focusing on the nine educational service districts that touch virtually all of the 296 school districts in the state.

Audits of large local government entities are included among our first examinations. Those include Sound Transit and the Port of Seattle.

Two of our state government performance audits involve large expenses among several state agencies. The collection of state debt audit encompasses the six state agencies that represent about two-thirds of the \$5 billion owed to the state as of June 30, 2005.

Another audit will review all state agencies' purchasing practices to determine:

1. Whether state employees are spending public money on items that are not needed to accomplish the state's business, such as first-class airfare or pricey meals.
2. Whether state agencies are purchasing items that are of a high enough quality to be serviceable to the agency for the best price.

3. Whether mandatory state purchasing contracts cost the state more money than if agencies were able to buy comparable products from other places.

Several of our performance audits were undertaken at the request of others. The four Department of Transportation audits were mandated by the Legislature. Gov. Christine Gregoire requested that we take a look at the Department of Health's licensing of health professionals with the hope that providing improved oversight will result in better protecting our citizens and better oversight of health care providers.

Our first audits involving local governments are starting. They will review overtime and take-home vehicle practices. We are also embarking on our first performance audit to encompass both state and local government. In the audit, we are evaluating how effectively state agencies and large cities and counties respond to citizen requests for public records.

The goal for each and every one of our performance audits, regardless of topic or auditee, is to improve public accountability, transparency and effectiveness.

Audit Themes

We consider six themes in determining where we direct our audits. Those themes are:

1. Public interest
2. Inherent or recurring difficulties within an entity
3. Matters that affect all entities
4. Flow of money between state and local entities
5. Capital projects
6. Administrative costs

What is a Performance Audit?

Performance audits determine whether government programs and services achieve results. Performance audits ensure that public dollars are spent for the right things and what was achieved with the money.

In addition to effectiveness, performance audits also look at the efficiency of programs and services. In other words, can a government achieve the same – or a better – result in a more economical way?

Performance audits are also intended to look for ways to

eliminate duplication and to improve outdated or inefficient practices and processes.

In addition, our performance audits examine what state and local governments in Washington are doing compared to similar programs and functions in other states, to private business and to industry standards and practices. That will enable us to identify and share best practices and to find better ways to do things.

Performance audits are not a quick fix. But used constructively, they can serve as an effective management tool to streamline operations, cut costs and improve services to citizens.

PERFORMANCE AUDIT WORK PLAN

Performance Audit Topic	Completed by	Themes
STATE GOVERNMENT		
General Administration motor pool	1/31/07	1, 6
Collection of state debt	1/31/07	1, 6
Department of Transportation inventory/project management	6/30/07	1, 5
Washington State Ferries	6/30/07	1, 5
Department of Transportation administration/overhead	6/30/07	1, 6
Department of Transportation highway efficiency	6/30/07	1
Department of Health - Health Professions Quality Assurance	6/30/07	1
Purchasing by state agencies	6/30/07	6, 3
Department of Labor and Industries pharmaceutical payments	6/30/07	1, 2
Labor and Industries' Vocational Rehabilitation	6/30/07	1, 6
General Administration Smart Buy Program	6/30/07	3, 6
Community and technical colleges' accounts receivable	6/30/07	1, 6
Community and technical colleges' staff-to-student ratio	6/30/07	1, 6
Community and technical colleges' cost recovery of trade programs	12/31/07	1, 6
Four-year colleges' salary and extra pay for instructors	12/31/07	1
Four-year colleges' accounts receivable	12/31/07	1, 6
Department of Printing	12/31/07	6
General Administration office space leasing	12/31/07	6
LOCAL GOVERNMENT		
Overtime practices	6/30/07	1, 3
Take-home vehicle practices	6/30/07	1
Sound Transit light rail project construction management	6/30/07	1, 5
Public Development Authorities' transparency	6/30/07	1
Public Development Authorities' oversight by local counties and cities	6/30/07	1, 2
Educational Service Districts	6/30/07	1, 6
K-12 travel practices	6/30/07	1
K-12 administration	12/31/07	1, 6
Sound Transit financial viability	12/31/07	1
Port of Seattle third runway project	12/31/07	1, 5
Impact fees	12/31/07	1
AUDITS TO CROSS STATE/LOCAL LINES		
Open public records - state, large counties and cities	6/30/07	1, 3
Department of Social and Health Services	3 - 5 years	1, 4
Department of Transportation	3 - 5 years	1, 4
Department of Health	3 - 5 years	1, 4
Department of Ecology	3 - 5 years	1, 4
Community, Trade and Economic Development	3 - 5 years	1, 4
Military Department	3 - 5 years	1, 4

How We Conduct Audits

Performance audits are conducted in one of three ways:

1 Contracting out entire performance audits to private firms, with close oversight by our performance audit managers. We set the scope and objectives of each audit. We provide contractors with any necessary training, such as technology or an agency protocol. For example, we provided training for our contractors to familiarize them with confidentiality requirements for the audit at the Department of Health.

2 Conducting specific or technical performance audits using our own staff and bringing in outside expertise when needed for specific aspects of a performance audit.

3 Conducting performance audits using our own staff when appropriate and when it is the most effective route. We are integrating performance audits with our regular financial and legal compliance audits, which are conducted by our existing state and local government audit teams throughout the state.



Our Comprehensive Look at Transportation

Our look at the elements of the state's transportation system are the most significant performance audits we have under way.

In 2005, prior to passage of Initiative 900, the Legislature directed us to conduct audits of the state Department of Transportation and appropriated \$4 million for the effort. Lawmakers reaffirmed their desire for these transportation audits by approving another piece of legislation in the 2006 session.

Legislators called on us to take an independent, comprehensive look at the Department and to contract with private firms for the audits.

Because of the Department's size and complexity, we approached the legislative assignment by dividing it into four separate audits of specific areas of the transportation system. Collectively, we believe these audits meet the Legislature's mandate for a comprehensive evaluation.

The audits, which are being performed by private contracted firms, are examining:

- Administration, overhead and the Department's organizational structure. We will compare administrative costs with related public and private-sector entities in other states with an eye toward recommending possible efficiencies.
- Management of the Department's consumable supplies inventory, including the purchase of large quantities of hot-mix asphalt for highway surface

maintenance and repair. As part of the audit, we will look at management of construction and maintenance projects and compare them with identified best practices of similar operations in other states.

- The Washington State Ferry System. We will do a comprehensive examination of the \$300 million operation, including management of its capital acquisitions, maintenance and refurbishments of ferries and terminal facilities, staffing and other aspects of its overall operations.
- How effectively the Department's planning and management of highway construction projects reduces traffic congestion and delay times faced by motorists. Our audits will focus on heavily traveled segments of interstate and state highways in the Puget Sound region.

The scope of these audits was determined by 14 criteria set by the Legislature and by concerns expressed by citizens in focus group sessions, public forums and surveys we conducted throughout the state. For example, citizens overwhelmingly cited traffic congestion as the No. 1 transportation problem in the state.

Our audit objectives are designed to produce recommendations that could bring about transportation system improvements and identify programs and practices that are working well.

We appreciate the Legislature's confidence in our work, and we are committed to fair, independent and constructive audits of the transportation system.

Governing magazine lauds outreach effort

Our extensive, innovative effort to involve citizens in our performance audit process has been recognized nationally.

In the October 2006 issue, *Governing* magazine highlighted our citizen outreach in its feature article. Magazine correspondent Jonathan Walters described our efforts as a "one-of-a-kind experiment that seeks to bring back citizens into the decision-making fold."

The monthly magazine, which has 275,000 readers composed largely of state and local government public officials, described our Office's citizen-supported

performance audit programs and how we are asking the public to help us identify priorities in determining where we direct audits.

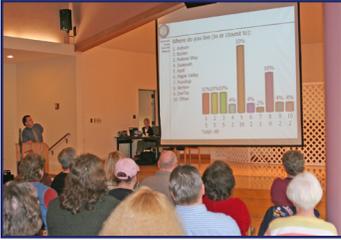
Governing also asked us to make a presentation at its annual Performance Management Conference in Austin, Texas, last October. At the conference, we described our performance audit responsibilities and, in particular, how we are engaging the public. The conference also featured a keynote address by Gov. Christine Gregoire, who explained her performance-based management initiatives.

We are proud of the recognition and consider it an affirmation that we are doing the right things.

ANATOMY OF PERFORMANCE AUDIT

The process for each performance audit we conduct is:

Audit pre-planning and outreach work



Audit planning and survey



Audit work finished/ draft report issued



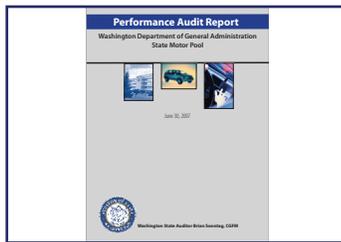
Audit Begins (Fieldwork)



Comments from responsible officials



Final Report Issued



Public hearing held within 30 days of issuance of final report



Working with the Joint Legislative Audit and Review Committee

Initiative 900 builds in extra measures of accountability to ensure that findings and recommendations in our performance audits will be seriously considered and put into practice. The Initiative requires the audited entity to provide a plan for instituting the recommendations. It requires justification for any recommendations not instituted.

The Initiative also requires an entity's legislative body to hold public hearings within 30 days after we issue a performance audit report and to track the status of our legislative recommendations.

The Legislature has given its own audit panel – the Joint Legislative Audit and Review Committee – the responsibility for holding public hearings and follow-up on all performance audits involving state government. Follow-up will include tracking the Legislature's action on recommendations in our performance audit reports. The committee will issue a report by July 1 each year detailing the status of performance audit recommendations.

We will provide the Committee copies our performance audit reports of both state and local governments. The Committee will then distribute the reports to the appropriate legislative committees. In addition, we will notify the Committee of the expected release dates of our performance audit reports so the public hearings can be scheduled.

Meanwhile, we will review the Committee's legislatively directed audit work to avoid duplicating efforts and to enhance our own examinations.



2006 Citizen Outreach Engagements

Focus Groups 1 & 2
When: March 9, 2006
Where: Burien
Audience: Two focus groups. The first supported Initiative 900 and the second voted against or had no opinion of the initiative.

Focus Group 3
When: March 13, 2006
Where: Spokane
Audience: One focus group, consisting of 50 percent for and 50 percent against Initiative 900.

Town Hall Meeting 1
When: April 17, 2006
Where: Kent

Town Hall Meeting 2
When: April 20, 2006
Where: Lynnwood

Town Hall Meeting 3
When: April 24, 2006
Where: Vancouver

Town Hall Meeting 4
When: April 25, 2006
Where: Tri-Cities

"We missed one terribly important thing. Nobody said, 'find out what's working.' Nobody said that!"
-Citizen in Pasco

A State-of-the-Art Approach

In the spring of 2006, we embarked on an effort to reach out to the citizens of Washington to hear what they had to say about government and performance audits. We conducted a series of town hall meetings and public forums, all moderated by Stuart Elway of Elway Research, a longtime Washington public opinion polling firm. In all, we heard from 188 registered voters.

"I would like to see a state audit to come up with some kind of information about the kids who fall through the cracks that need to have an alternative kind of a system because they don't fit the standard school system."

-Citizen in Pasco

Our outreach effort was innovative because it combined several research methods: focus group, surveys and forums. In those public forums, we recruited citizens at random to ensure attendance and to reflect the state's demographics as closely as possible. We also wanted to hear a broad range of opinions.

"Traffic is not being addressed, and it affects everything... from getting here to having a heart attack...getting care for having a baby, and automobile accidents. I mean, it's just monumental and nobody's been addressing it. It's not fair to the citizens."

-Citizen in Lynnwood

Another important part of our outreach effort has been eliciting suggestions and opinions from public employees.

They usually are in the best position to identify inefficient and outdated systems and practices. Yet, they are often overlooked. We have spoken to many groups, boards, representatives and front-line employees of state and local governments and public schools.

"We can do more to open up congestion. We tried to do a little bit with our express lanes and stuff, but there's more things they can do. Opening up lanes (changing HOV restrictions in off hours), moving trucks on the road will make us be able to get to work and get home in less time."

-Citizen in Kent

As State Auditor Brian Sonntag recently told a citizens group, "I've been in public service 34 years and I have never seen an effort to engage and involve citizens as extensive as we are doing."

We are also pleased that the Governor recognized the benefit of our citizen outreach work and conducted similar efforts.



The Association of Government Accountants studied our efforts to start a performance audit program from the ground up. It issued the study in June 2006 and other governments are now using it as a primer on how to start their own performance audit programs.

Relmond Van Daniker, the Association's executive director, wrote the following guest opinion page column and submitted it to several newspapers for publication:

"The interest and excitement in the voters' approval of Initiative 900 extends far beyond Washington state. The eyes of the national financial management community are firmly fixed on your state's commitment to bring greater accountability to government services.

The initiative gives State Auditor Brian Sonntag the most extensive, constructive performance audit authority in the nation. It creates a real opportunity for the state of Washington to become a national showcase for making government work more efficiently and effectively for its citizens.

Based on my knowledge and observations, Brian Sonntag's Office is well equipped and is already beginning to meet the challenges, responsibilities and opportunities to transform government, streamline operations, save money and provide better service to taxpayers.

Because this undertaking is so significant, the national Association of Government Accountants undertook a research project to study how the State Auditor embarked on this new effort. We are using the valuable research gained as a model for other public auditors and financial managers on how to establish an effective performance audit program.

A number of states have expressed a desire to learn about Washington's experience and apply it to their governance.

Leading this research project are two performance audit experts: former elected three-term State Auditor Ralph Campbell of North Carolina and Ronell Rauum, a long-time performance auditor for the U.S. General Accountability Office who now develops curriculum for the U.S. Department of Agriculture-based Government Audit Training Institute. The research is being sponsored by Accenture, a global management services company.

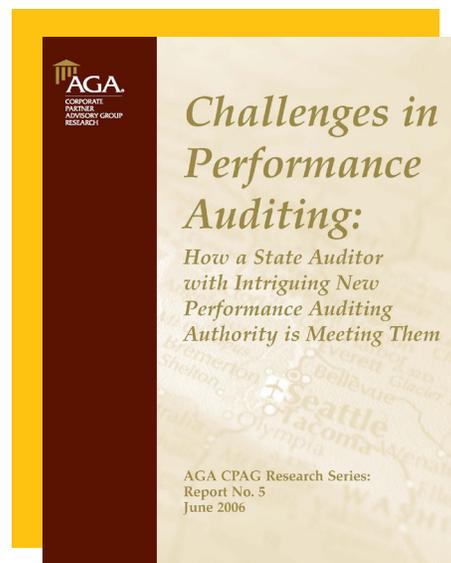
We are excited about this project. Nationally, and even internationally, there is substantial interest in enhanced performance-based government. Of particular interest in Washington state is how your State Auditor obtained his authority – through an initiative that won with overwhelming citizen support and with endorsements from newspapers and diverse organizations.

AGA is well positioned to conduct this study. With a membership of more than 15,000 accountants, auditors and financial managers at all levels of government, our central mission is to advance government accountability. One way we achieve that is through independent research that advances the profession.

In my opinion, the State of Washington is uniquely suited as a case study. First, the State Auditor's Office is beginning a performance audit program from scratch. Also, the Office is independent. Brian Sonntag is an elected public official, not a legislative auditor or an appointed administrator serving a governor.

Finally, we are well aware of his long advocacy for performance audits to achieve greater accountability and to boost the public's trust and confidence in government. We already have met with the State Auditor's Office and have come away impressed with the quality of staff hired and the speed at which the Auditor is moving to put the performance audit program in place.

We published our research on the Washington State Auditor's Office and share it broadly with state and local governments. We believe Washington's experience can provide valuable information for others to use."



Protecting Taxpayer Dollars from Misuse

The State Auditor's fraud program is a nationally recognized effort to detect and prevent misappropriation and abuse of public resources among government entities. A fraud investigations manager oversees the program, and we have fraud-detection specialists on each of our 17 audit teams throughout the state.

During 2006, we reported 41 fraud cases representing \$421,883 in losses among state and local government. Of those cases, 78 percent were losses of less than \$5,000. More than two-thirds of those losses were less than \$1,000. We attribute to relatively low dollar amounts in the majority of fraud cases to managers who are trained to detect fraud before the losses are allowed to escalate. In the past decade, fraud has cost state and local governments \$8.2 million.

The largest loss was \$146,197 in diverted funds from the Everett Events Center, which is overseen by the Everett Public Facilities District. The smallest quantifiable fraud case we reported was \$18 in misappropriated parking validation stickers at the University of Washington.

Our program emphasizes training state and local government managers and employees how to detect and prevent fraud. From July 2005 through June 2006, our Office provided 127 hours of training to 2,655 government finance professionals and managers. Since July 2001, our Office has provided 459 hours of training to 13,095 government employees.

Examples of fraud cases reported in 2006:

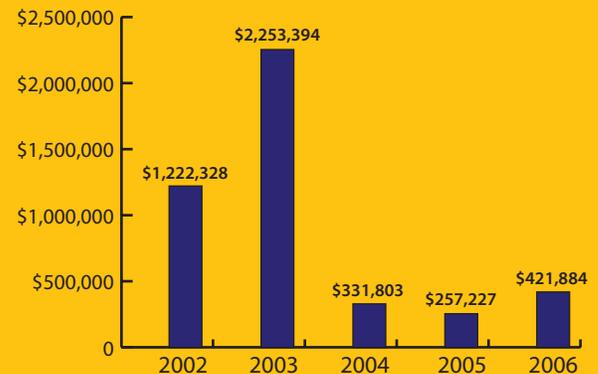
- A cashier supervisor at Western Washington University misappropriated more than \$88,000 through a check-for-cash substitution scheme involving private scholarship checks. Two citizens alerted the university that scholarship funds had not been applied to the corresponding student accounts. The University audited its bank deposits and found falsified deposit slips that concealed the fraud for more than three years. The University terminated the employee. We referred the case to the Whatcom County Prosecuting Attorney's Office.
- A contractor's bookkeeper responsible for the Asparagus Commission's accounts misappropriated funds from the Commission. The bookkeeper forged signatures on checks to make payments to herself and made unauthorized credit card purchases for personal benefit. During her interview, the bookkeeper stated she misappropriated more than \$36,000 in public funds from the Commission and from her employer. We referred the case to the Franklin County Prosecuting Attorney's Office.

Fraud Training

We train government managers at public entities to detect and prevent fraud.

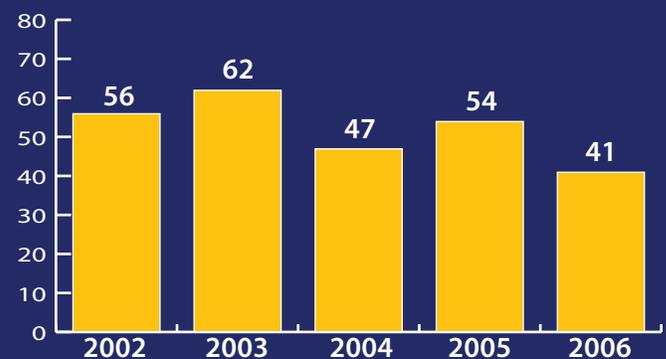
Fiscal Year	July '02- June '03	July '03- June '04	July '04- June '05	July '05- June '06
No. of hours	67	78	106	127
No. of people	2,315	2,285	2,900	2,655

Amount of Loss Due to Fraud (State & Local)



Fiscal years 2002 and 2003 each had an exceptionally large fraud. We also investigated more cases in those years.

Number of Fraud Cases



Our Valued Program for State Employees

The State Auditor's Office administers the Whistleblower Program, in which we investigate and report assertions of improper actions by state employees using state resources. The program was created by law in 1982 to improve government accountability and provide confidentiality to state employees who wish to report suspected improper actions.

In 2006, four whistleblower investigators reviewed 63 assertions. In 40 percent of those cases, we found reasonable cause to believe that an improper governmental action occurred.

In 2005, we investigated more than 90 assertions, 32 percent of which were substantiated.

The agency with the highest number of cases was the Department of Social and Health Services, followed by colleges and universities and the Department of Transportation. It is not uncommon for agencies of their size and complexity to have higher numbers of whistleblower assertions.

The bulk of the assertions that we receive involve improper use of state computers and technology. Examples of substantiated assertions include:

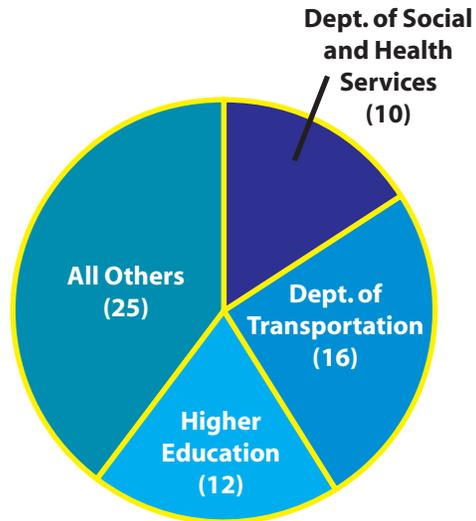
- A Department of Transportation employee violated the state's and the Department's Internet and e-mail policies by excessively using the Internet for non-work-related purposes. The employee sent or received more than 600 personal e-mails in an eight-month period.
- A Department of Labor and Industries employee was using the Internet on a state-owned computer during working hours to access personal Web sites, including online banking, an online dating service, a beauty consultant's Web site and streaming music. The employee also used state e-mail for personal reasons.

- A Department of Transportation employee used state e-mail, Internet, computer equipment and hard drive space during working hours for a freelance writing and photography business.
- A Department of Social and Health Services employee made long-distance phone calls to family members at the state's expense. The employee also used agency-provided Internet to access gaming, shopping, music and video Web sites and sent personal e-mails through the state's e-mail system.

In 2007, the Whistleblower program's annual report summarizing its 2006 activities will be posted to our Web site at www.sao.wa.gov/Whistleblower/WBReports/WhistleblowerReportsPage.htm.

Assertions by Agency or Area

A breakdown of the assertions we investigated in 2006



Whistleblower Cases

Year	2003	2004	2005	2006
No. of Assertions	56	69	90	63
% substantiated	45%	25%	32%	40%

In 2006, 70 assertions were not within the scope of the programs authority. Our authority does not extend to local governments or private businesses.

New State Programs in 2006

Our audits of state agencies during the 2006 fiscal year revealed no significant trends, although many agencies continue to struggle with complying with federal grant requirements, particularly documenting payroll. Federal grant requirements are very specific and we are required to document when state agencies fail to meet those requirements. Overall, our audit findings indicate that state agencies receiving federal funds find it difficult to keep track of myriad federal requirements.

Noteworthy conditions we found in 2006 include:

- The Department of Early Learning was established in July 2006. It was created by the Legislature at the request of the Governor. The new agency combines two early learning programs that formerly operated under Department of Social and Health Services and Department of Community, Trade and Economic Development. Our first accountability audit of the new agency will review fiscal year 2007 information and will be conducted in the fall of 2007.
- We continue to build a positive relationship with the Department of Social and Health Services. While we continue to find issues that need attention, it is not unusual for an agency of that size and complexity to have issues.
- Payments to ineligible or deceased claimants by the Employment Security Department. We have identified this condition in each of the past three years. Because the Department has made significant improvement in this area, we will not be reporting a related audit finding for 2006.
- The Department of Personnel began using a new payroll system in 2006. A number of state agencies have expressed concerns about the system, so we will take a look at it during fiscal year 2007 audits.
- We will also take a look at grant monitoring during the fiscal year 2007 audits because of issues that have been problematic in the past.

Several agencies that we audit annually continued a track record of audits without findings. They are:

1. State Investment Board: 15 years without a finding
2. Department of Revenue: 14 years without a finding
3. Office of the State Treasurer: 13 years without a finding

We have built a positive and constructive relationship with Gov. Christine Gregoire's administration. Her focus on government accountability and performance has had positive effects on agencies' cooperation with our Office. The Office of Financial Management is working with state agencies to help them take corrective action related to any issues our audits identify.

Medicaid Issues Continue

Medicaid is a jointly funded state and federal program that provides health-care coverage for selected people with low incomes. Washington's Medicaid program spent more than \$6.2 billion during fiscal year 2005. It is administered by the Department of Social and Health Services.

Because the program is complex and has a large budget, we have been conducting the annual Medicaid audit separately from our audit of DSHS.

Our 2005 audit of Medicaid reported 35 issues within the program. This year's audit repeated 32 of the same issues from 2005. There are several pervasive issues within Medicaid that have required us to audit the same areas repeatedly. For example, we have audited the Basic Health Plus program for seven consecutive years.

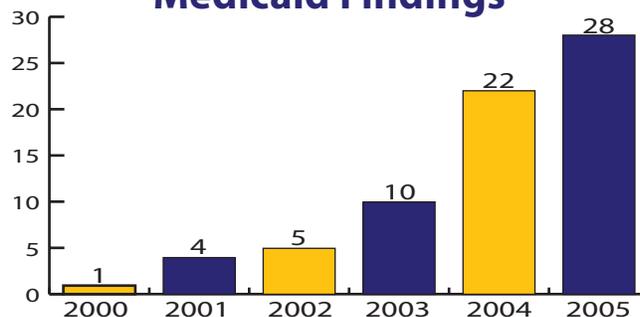
This year's audit data indicates that some improvements have started to occur in the program:

- The Department has started monitoring recipients' Social Security numbers.
- The Department is improving its oversight of pharmaceutical payments.
- The Department is keeping track of its refunds to the federal government.
- The Department is taking steps to stop payments on behalf of deceased or ineligible people.

Two areas where we have not yet but would like to see resolution are:

- Better controls over not paying emergency care claims for undocumented nonresidents.
- A resolution between the U.S. Office of the Inspector General and the federal Centers for Medicaid Services. For several years, we have been auditing to the legal standards according to the Inspector General, while the Medicaid Service Center has given the state advice that appears to contradict the standards.

Medicaid Findings





Colleges and universities

The state has 40 public colleges and universities. Some of our audits combine individual colleges into one audit, such as the Community Colleges of Spokane and Seattle Community Colleges. We also audit the Higher Education Coordinating Board, the State Board for Community and Technical Colleges and the Center for Information Services, which maintains computer systems for community and technical colleges.

In 2006, we identified four areas of audit emphasis: student financial aid, the Running Start program, athletic department cash handling and receivables and procurement related to construction projects. We identified those areas of emphasis based on results of our previous audits and changes in regulations.

We are planning performance audits in the higher education arena. We anticipate conducting field work at several colleges during fiscal year 2007 for the performance audits of faculty workload and salary, administrative staff-to-student ratios and collection of outstanding debt.

Year	2004	2005
No. of Audits	23	22
No. of Findings	4	11

In 2004, two findings were related to athletic department, one was related to federal regulations and one was related to cash receipts/inventory.

In 2005, four findings were related to fraud, four were related to cash receipts, two were related to federal regulations and one was related to state prevailing wages.

Other State Audit Statistics

Commodity Commissions

Year	2004	2005
No. of Audits	9	8
No. of Findings	6	2

Commodity commissions are boards and commissions that represent Washington producers, such as the Asparagus Commission and the Wine Commission.

All Other State Audits

Year	2004	2005
No. of Audits	42	56
No. of Findings	44	46

Other state audits include all state agencies. They do not include Medicaid, commodity commissions or public colleges and universities.

Local Governments Audit Overview

In the past audit cycle, we focused on two areas of local government:

- Use of restricted money. Restricted money is earmarked for a specific purpose, such as impact fees and hotel-motel tax. For the past few years, unrestricted revenue sources have in the best cases stayed level and in many cases decreased. However, the demand for services and the strain on governments' resources has increased. We have carefully monitored local governments' use of restricted funds to make sure they comply with the laws that apply to each type of fund.

An example of misuse of restricted funds was found in a December 2005 audit of the City of Wapato. We found the City was not appropriately spending an \$80,000 criminal justice sales and use tax that was approved

by voters. The City was required to use the earmarked money for "criminal justice purposes," for improvements to public safety or criminal justice services, and hiring law enforcement officers. Our audit found the City used approximately \$68,000 for a community center and a code enforcement officer, which did not fall under a criminal justice definition.

- Timely financial reporting. Local government entities sometimes fail to meet state law requiring them to report financial information to us within 150 days of the end of the entity's financial year. Failure to meet that deadline sometimes results in a failure to meet federal timelines. It also creates a situation in which accurate financial information is not available to local elected officials and citizens. In our view, local governments' failure to meet the legal deadline indicates a lack of internal controls over the financial reporting process and impairs accountability.



Public Schools' Enrollment Decline

Our audits of school districts and educational service districts from September 2005 through May 2006 identified two significant issues that are negatively affecting schools' financial health.

The first is declining enrollments and increasing operating costs. Student enrollment is the primary source of revenue for school districts. Reduced enrollment means schools receive less funding. Reduced funding, coupled with increased operating costs, is depleting districts' financial reserves. Those factors are leading to the closure of school buildings and other reductions in operating expenses. Seattle is the prime example: its School Board in 2006 decided to close up to seven schools.

The second issue is the fact that 15 of the 126 districts we audited miscalculated student enrollment, resulting in overpayments. Those districts must return the money to the state.

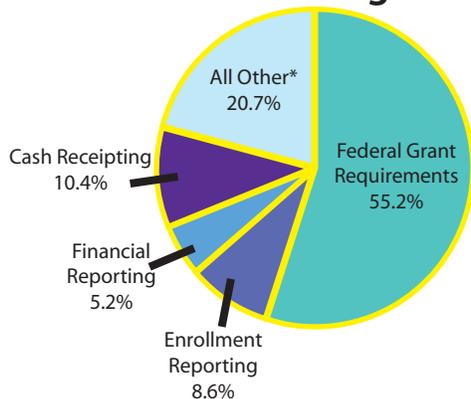
Enrollment reporting has been a recurring issue. In 2005, we reported seven findings related to enrollment reporting, compared to two in 2004. Therefore, one of our audit focuses for 2006 was schools' accuracy of reporting enrollment.

Additionally, we will conduct a performance audit of school districts' administrative and overhead costs in 2007 to identify opportunities for cost savings for the districts.

Other trends during the last audit cycle:

- Federal grants carry complex accounting and reporting requirements. Therefore, many of our findings are related to that issue.
- Accountability and legal compliance findings were mostly related to Associated Student Body activities. The issues involved inadequate policies and procedures to ensure appropriate cash handling, protection of inventory and purchasing practices.
- Financial findings in 2005 were related to the decline of districts' financial condition due to lower enrollment and insufficient monitoring of financial activities.

Public School Findings 2006



*All other includes Associated Student Body functions aside from cash handling, staff mix, purchasing, budget/deficit and bid laws.

Added Responsibilities for Citizen-Supported Initiative 937

Citizen approval of Initiative 937 in November's general election gave our Office the authority to ensure that public utilities comply with the measure's requirements.

The Initiative requires the state's largest public and private utilities to provide a portion of their electricity from renewable resources, such as wind and solar generation. Its goal is for utilities to provide 15 percent of their power from renewable resources by 2020.

I-937, which applies to utilities with 25,000 or more customers, also requires them to establish and report target levels of "achievable cost-effective conservation" beginning in 2010.

Those targets must be updated every two years as a way to show progress toward the 15 percent goal for 2020.

Our role will be to audit the municipal utilities, such as Seattle City Light and Tacoma City Light, and public utility districts that meet the customer threshold to ensure compliance with the initiative's provisions. We will not audit private utilities.

The Initiative also applies to rural electric cooperatives. Our audit authority extends to the largest of those cooperatives, such as Peninsula Power and Light.

Local Government Audits & Findings

Year	City	County	Other local governments*
2004			
Audits	377	71	957
Findings	83	31	67
2005			
Audits	421	71	1305
Findings	78	32	79
2006**			
Audits	330	73	1140
Findings	38	36	70

*Other local governments include fire districts, hospital districts, water-sewer districts, public development authorities and housing authorities.

** 2006 encompasses reports issued from January through November 2006. The other years' figures are January through December.

Mission Statement

The State Auditor's Office independently serves the citizens of Washington by promoting accountability, fiscal integrity and openness in state and local government. Working with these governments and with citizens, we strive to ensure the efficient and effective use of public resources.

About the Office

The founders of Washington created the Office of State Auditor in the Constitution as an independent check and balance on government finances and operations. Accountability is fundamental to that constitutional responsibility. As the "auditor of all public accounts," we examine the finances of all 2,700 units of state and local governments. We also audit to determine whether state agencies, cities, counties, schools and various taxing districts follow applicable laws and regulations related to their financial management practices. We take seriously our role to ensure that governments are good stewards of public resources.

Since citizen approval of Initiative 900 in 2005, we have the authority to audit the performance of all state and local governments. This enables us to recommend ways for government to operate more efficiently and effectively and to provide better service to the public.

Independence is paramount to our audits. As a statewide elected official, the State Auditor reports directly to the citizens of Washington. The Legislature and Governor have no direct oversight of our work beyond approval of our budget and enactment of laws and policies that affect our operations. And while the office is partisan, the work is not. It must remain fair, objective and free from bias or partiality.

We base our financial and legal compliance audits on risk. That means we concentrate our examinations on areas in which taxpayer dollars are most vulnerable to misuse and abuse. We have a nationally recognized fraud program that investigates fraud and provides extensive fraud prevention training. We also administer the State Employee Whistleblower Program, in which state workers can confidentially bring to us assertions of improper government actions. We investigate those assertions and publicly report the results.

Our Office is composed of about 370 highly trained and professional auditors and executive and support staff located in Olympia and 14 locations throughout the state.

About State Auditor Brian Sonntag

When Washington voters first hired Brian as their State Auditor in 1992, he became the eighth elected Auditor in state history. Now in his fourth term, Brian is a senior statewide elected official. Throughout his 15 years as State Auditor, he has advocated for an open, accessible government and one that bases its performance on results and outcomes instead of outputs and processes.

Brian has a long career of public service. He was elected Pierce County Clerk in 1978 when he was 26 years old and served eight years in that office. Brian was also elected twice as Pierce County Auditor, an office his father held for 22 years.

He attended Tacoma Community College and the University of Puget Sound and studied public affairs at the University of Washington.

He is a Certified Government Financial Manager, a member of the National State Auditors Association's Performance Audit Task Force and a board member of the Washington Coalition for Open Government. Brian is a trustee for the National Association of Government Accountants' Academy for Government Accountability.

Brian received the Seattle Municipal League's Warren G. Magnuson Memorial Award for his contributions to help improve state and local government operations. He also is the recipient of the Washington Newspaper Publishers Association's Freedom's Light Award for his advocacy of open government.

Brian and his wife, Jann, are lifelong residents of Tacoma. He has three sons, a grandson and two stepsons.

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