

2007 ANNUAL REPORT

TRANSPARENCY, EFFECTIVENESS, EFFICIENCY & ACCOUNTABILITY



WASHINGTON
BRIAN SONNTAG
STATE AUDITOR

FROM THE STATE AUDITOR



Citizens of Washington:

I am pleased to present to you this Annual Report summarizing our audit work for 2007. During this past year, we made significant strides in advancing accountability in state and local governments. We are proud of our achievements and remain deeply committed to helping government work better for all of us.

With voter approval of Initiative 900 in 2005, Washington citizens entrusted us with a monumental responsibility – new authority to conduct performance audits of state and local governments. After spending much of 2006 gearing up and getting initial audits underway, we are proud to show significant results in 2007.

During 2007, we completed and publicly reported the results of eight performance audits focused on transportation, education, health care and general government services. Collectively, the audits contained far-reaching recommendations that, if followed, would save taxpayers more than \$100 million over five years. In addition, our performance audit of traffic congestion in the Puget Sound area identified significant steps to reduce congestion, saving an estimated \$600 million annually in economic impact to citizens, businesses and the environment. That's \$3 billion over five years.

In all, the \$3 billion of identified savings compares with the \$7.4 million costs of conducting them. That is a 8-to-1 return on investment. Beyond the dollars saved, these audits also recommended major ways for state and local government to operate more effectively and provide better service to the public.

We recognize the public's trust in government is fragile. We remain strongly committed to fulfilling citizens' expectations when they approved I-900 by an overwhelming 57 percent margin.

To ensure these audits are correctly focused, we continue to ask where citizens want us to direct our efforts. Through focus groups, town hall meetings and surveys, we actively engaged citizens across Washington, listened to their thoughts and ideas and applied that information to our performance audit planning and efforts to inform the public. The audits we undertook were the direct result of what citizens told us. As we embark on further audits, we will keep eliciting suggestions from the public.

While we conduct performance audits, we are emphasizing our other important audit work. This past year, we performed roughly 1,000 audits of state and

local governments, ensuring that taxpayer dollars were spent properly, that applicable laws were followed and that sufficient safeguards over public assets were in place.

We took further actions to improve government accountability. Following the approval of legislation earlier in 2007, we established a Government Accountability Hotline to give citizens another avenue to report potential improper and illegal government actions and activities. During its first six months, the hotline has proven to be a useful tool for the public.

We strengthened our already effective Fraud Detection and Prevention Program, which, in addition to rooting out fraud, trains state and local government financial managers to identify instances of misappropriations. We also have reshaped the State Employee Whistleblower Program so it continues to serve as a successful vehicle for employees to report possible improper government activity.

The support we have received from citizens, from the Legislature and from public employees means a great deal to us. We will continue to ensure our work is independent, objective, of high quality and that it provides real value 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

GOVERNMENT ACCOUNTABILITY HOTLINE

Citizens now have another opportunity to share ideas and suggestions to make government more accountable and efficient. In July 2007, we launched a Government Accountability Hotline to give the public another avenue to report on government actions.

Our Office has long operated an effective Constituent Referral Program, for which we have actively elicited public concerns, questions and comments about state and local government activities. We have referred issues brought to us by citizens to our audit teams located in Olympia and 13 offices across the state.

“FROM JULY THROUGH NOVEMBER, THE HOTLINE RECEIVED 169 REFERRALS.”

The Hotline was prompted by legislation that the Governor signed into law earlier this year. The intent of the law is for citizens to:

- Recommend ways to improve efficiency.
- Report waste, fraud and abuse.
- Report outstanding achievement and efficiency in government.

We have set up a dedicated toll-free statewide telephone number and made the Hotline an important feature of our Constituent Referral Program. We also have worked to raise public awareness of our efforts to seek issues from citizens.

These efforts are proving effective. From July through November, the Hotline received 169 referrals. Issues that we are able to take action on are referred to

our audit teams throughout the state. Citizens brought issues to us by using the toll-free number, using our Web site and by sending a letter.

Reports and assertions can pertain to all state and local governments, public employees and government contractors. Hotline users' confidentiality is maintained until a report is issued, at which time all records become subject to public records laws. State employees who wish to ensure their confidentiality permanently may contact our Office's State Employee Whistleblower Program.

Three points of contact:

1. *A toll-free phone number:
1-866-902-3900.*
2. *The State Auditor's Web site:
Follow the link above to fill out a Web form that is submitted electronically to the Office.*
3. *Mail:
Washington State Auditor's Office
ATTN: Hotline
P.O. Box 40031
Olympia, WA 98504-0031*



2007 Hotline Statistics

As of November 30, 2007, the Hotline received 169 referrals. Citizens submit referrals three ways:

Toll-free phone number

61
Referrals



Letter

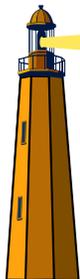
59
Referrals



Web site form

49
Referrals

HOTLINE RESULTS & OUTREACH



Washington State Auditor's Office

Shine the light on government waste, fraud and efficiency

Toll-free hotline

1-866-902-3900



Some examples of issues referred to our Government Accountability Hotline are:

- A citizen asserts that a town is misappropriating funds and using public funds for a private interest. Referral asserts the town issued a warrant to the Washington Department of Licensing to license a vehicle that does not belong to the town.
- A citizen has a concern regarding Washington State Department of Transportation and Washington State Ferries. The citizen requested an audit of the Ferries' planning and procurement process. Audit should consider what, if any, impact the reported sale of the steel electric depreciation rights through 2014 had on those processes.
- A caller bid on a state surplus vehicle offered through eBay. Caller was not the winning bidder. Caller later went back to eBay and saw the same vehicle, only missing a great deal of the parts and at a lower price. Caller believes someone may have bought it, removed the parts, returned it to the state agency and could possibly bid on the truck and receive it at a lower price. Then he/she could put the parts back on it and sell at a profit.
- A citizen is concerned about where Safety Net Funding is

being used by a school district.

- A citizen feels the Washington State Lottery Commission is misrepresenting themselves with the games Hit 5 and Daily Keno. The Commission states that a \$1 prize is considered a win for a \$1 ticket. The individual feels that a \$1 prize is not a win, it should be referred to as "breaking even."

each employee receives four hours of paid leave without submitting a leave slip when it's "their" Friday.

Issues that we are able to take action on are referred to our audit teams throughout the state. As part of our public awareness effort, we created posters and brochures and sent them to every government office in the state of Washington. In all, we sent posters and brochures to some 2,500 offices.

We added a section to our Web site with information about the Hotline and a means for citizens to state their issues on line. We have submitted a Public Service Announcement to radio stations across Washington to inform citizens about the Hotline.

Fraud • Waste • Abuse

1-866-902-3900

Call the Washington State Auditor's toll-free hotline to:

Recommend ways to improve efficiency

Report fraud, waste and abuse

Report outstanding achievement

by state and local government, its employees and contractors.



REACH THE HOTLINE BY...

www.sao.wa.gov	State Auditor's Office AT THE Hotline P.O. Box 40031 Olympia, WA 98504
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Our Mission
 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.


 WASHINGTON
BRIAN SONNTAG
 STATE AUDITOR

Hotline Poster

- A citizen is concerned that a school district and school district board members are not able to speak freely.
- A citizen is trying to get approval for a Vehicle Identification Number from Washington State Patrol for a homemade vehicle. The vehicle gets 100 miles per gallon and the State Patrol is not providing a valid reason why they cannot give him a number.
- A citizen asserts that on each Friday a different employee at a county treasurer's office gets to go home at lunch. Consequently,

Have you seen

Fraud,

Waste,

Abuse,

or Efficiency

in state or local government?



Hotline Brochure Cover

WHISTLEBLOWER PROGRAM

The State Auditor's Office administers the State Employee Whistleblower Program, which gives state employees a vehicle of reporting assertions of improper state government actions and activities. The program was created by law in 1982 to improve government accountability and provide rights and protections to state employees who wish to report suspected improper actions. Our authority does not extend to local governments or private businesses

In 2007, we investigated 77 assertions. We found reasonable cause to believe that an improper governmental activity occurred in 40 percent of the assertions.

The substantiation rate was the same in 2006. That year, we investigated 63 assertions.

The highest number of cases were reported at the Department of Social and Health Services, followed by the Department of Corrections and the Department of Transportation. It is not uncommon for these agencies to top the list because of their size and complexity.

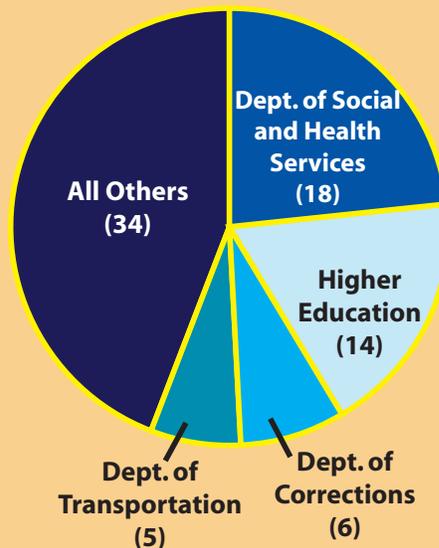
The bulk of assertions that we receive involve improper use of state resources.

Every year, we receive a number of

cases that we are unable to investigate because they fall outside of the scope of the state laws governing Whistleblower cases. In 2007, we received 108 cases that were outside of the scope of the program, compared with 70 in 2006. When possible, we refer those cases to our audit teams to determine whether audit issues were involved. We also refer them to the appropriate government agency.

Assertions by Agency or Area

A breakdown of the assertions we investigated in 2007



Assertions and Percentage Substantiated in 2007

Year	2004	2005	2006	2007
No. of Assertions	69	90	63	77
% Substantiated	25%	32%	40%	40%

Examples of substantiated assertions include:

- *A Green River Community College Instructor authorized payment of College funds to a student for the painting of the instructor's house.*
- *An employee at the Department of Social and Health Services used state resources for non-work-related purposes and in connection with an outside business.*
- *An employee at the University of Washington used state resources for personal use.*
- *An employee at the Department of Labor and Industries failed to secure three competitive bids for merchandise totaling \$11,769.*
- *A Regional Administrator at Washington State Department of Transportation facilitated the lease of state lands without collecting lease payments*

The bulk of assertions that we receive involve improper use of state resources.

PERFORMANCE AUDIT

The past year marked a significant turning point for greater government accountability and the efficient, effective use of taxpayer dollars. In the second year since Washington voters approved Initiative 900, our Office completed and issued eight performance audits involving transportation, health care, education, and general government operations.

The audits made 400 recommendations to entities and their legislative bodies that, if followed, would significantly improve the operations of state and local government entities. In addition, the financial impact of all those recommendations could provide \$3 billion in cost savings and economic benefits over five years.

Three audits focused on the state's transportation system. The audits, directed by Legislature under provisions of Engrossed Substitute Senate Bill 6839, made 43 recommendations and identified significant cost savings and economic

impacts in the Washington State Department of Transportation alone. We will issue a fourth performance audit report, about the Department of Transportation's highway maintenance and construction management in early 2008.



Stuart Elway of Elway Research Inc., Seattle Times Chief Political Reporter David Postman & State Auditor Brian Sonntag talk to citizens during a televised electronic town hall meeting on TVW.

We have identified two follow-up performance audits based on this year's work. One will be a comprehensive performance audit of

the Port of Seattle. The other will be Sound Transit's long-term financial viability. In addition, we are exploring opportunities in health care, construction management and in areas that affect vulnerable citizens.

We expanded on our extensive citizen outreach effort that we started in 2006. We gathered citizens for three town hall events, culminating in a ground-breaking electronic town hall that was broadcast live on TVW, Washington's public access channel. In total, we heard from 819 Washington voters who shared their thoughts about government accountability. We will factor those results into the performance audit selection process and our public information efforts. The results of all of our outreach are available on our Web site.

We are proud of our achievements since voters granted us the authority to conduct performance audits. We remain committed to applying these audits to achieve results that citizens demand, expect and deserve.

Performance Audits Released in 2007

	Audit	Conclusion
	<p>General Administration Motor Pool Released February 28, 2007</p> <p>Recommendations: 4 Cost Savings over 5 years: \$2.3 million Audit Cost: \$255,285</p>	<p>The motor pool had 113 under-used vehicles that it needed to sell and it was charging rental rates that were too low to recover its maintenance and purchasing costs. The Department needed to reassess its method of purchasing vehicles. We conducted this audit with our own resources, while the rest were done with private contracted firms with special expertise.</p>
	<p>Department of Health Office of Professions Quality Assurance Released August 21, 2007</p> <p>Recommendations: 67 Cost Savings over 5 years: Public Safety Audit Cost: \$1,048,542</p>	<p>The audit helped determine the root cause of many problems that were putting the public at risk. While HPQA initiated many corrective actions during the audit, some areas still need improvement to ensure public safety is protected. The Department also needs to strengthen internal processes and procedures in order to better oversee health professionals' licensing, discipline and compliance, which will improve public safety.</p>

PERFORMANCE AUDIT

	<p>Department of Transportation State Ferries Released September 4, 2007</p> <p>Recommendations: 10 Cost Savings over 5 years: \$50.2 million Audit Cost: \$947,682</p>	<p>The audit recommendations focused on improving efficiency at Eagle Harbor maintenance facility, standardizing business processes and communication across the agency and adjusting the ferry runs to reduce operational losses.</p>
	<p>Educational Service Districts Released September 18, 2007</p> <p>Recommendations: 215 Cost Savings over 5 years: \$25.3 million Audit Cost: \$1,758,749</p>	<p>The audit found that the nine ESDs are generally operating well and provide a valuable service to school districts. There are opportunities for significant cost savings if the ESDs take advantage of a federal telecommunications rebate and re-evaluate staffing structures. ESDs can provide continuity of service by creating long-term strategic plans and by working together to reduce duplication in services.</p>
	<p>Sound Transit Light Rail Construction Management Released October 4, 2007</p> <p>Recommendations: 20 Cost Savings over 5 years: \$5.1 million Audit Cost: \$557,759</p>	<p>The audit identified three overarching findings.</p> <ul style="list-style-type: none"> • Sound Transit was unable to complete the Link Light Rail Line at a cost and within timeframes communicated to voters in 1996. • Sound Transit initially lacked procedures for land acquisition, environmental compliance, permitting and construction management, contributing to its inability to meet project costs and timeframes communicated to voters in 1996. • Sound Transit has extensively improved its construction planning and management processes since 2002.
	<p>Department of Transportation Managing and Reducing Congestion in the Puget Sound Released October 10, 2007</p> <p>Recommendations: 22 Estimated Economic Impact: \$3 billion Audit Cost: \$1,610,774</p>	<p>The Washington Department of Transportation needs to make congestion one of its main agency priorities, along with safety, maintenance and the environment. The Department could reduce the number of hours people spend in traffic by 20 percent by making four short-term changes to existing infrastructure that require minimal resources. The audit identified additional long-term investments that will further alleviate congestion.</p>
	<p>Department of Transportation Administration & Overhead Released November 15, 2007</p> <p>Recommendations: 11 Cost Savings over 5 years: \$18.1 million Audit Cost: \$672,833</p>	<p>This audit made recommendations that focus largely on streamlining and centralizing operations within the Department, resulting in \$18 million to \$23 million in cost savings over the next five years. Those resources can be redirected to make improvements at the Department the we recommended in other performance audits, echoing citizens' priorities.</p>
	<p>Port of Seattle Third Runway and Construction Management Released December 2007</p> <p>Recommendations: 51 Cost Savings over 5 years: \$96.9 million Audit Cost: \$551,035</p>	<p>The Port lacks, or in some cases does not follow, internal controls, policies and procedures to ensure costs are controlled. The Port has not demonstrated accountability and transparency. The Port Commission has delegated responsibility for Port operations to Port employees. All of those conditions leave the Port vulnerable to fraud, waste and abuse.</p>

PERFORMANCE AUDIT SUMMARY

2007 Performance Audit Statistics

In 2007, the performance audit program released eight reports that resulted in:

400

Recommendations



\$3

billion

in potential cost savings over a 5-year period



\$7.4

million

in audit costs

Performance Audits in Progress as of December 31, 2007 (expected to be released between January 2008 and December 2008)

Entity Name	Brief Description of Scope
Washington State Department of Transportation	Highway Maintenance and Construction Management
30 Entities: 10 State Agencies; 10 Counties; 10 Cities	Open Public Records Practices
Washington State Parks and Recreation Commission	Comprehensive Agency-Wide Audit
Washington State Department of Fish and Wildlife	Salmon, Pheasant and Crab Programs
10 Largest School Districts: Seattle, Spokane, Evergreen, Puyallup, Tacoma, Kent, Lake Washington, Vancouver, Edmonds and Federal Way	Administrative Overhead and Operations
13 School Districts: Spokane; Central Valley; Yakima; Sunnyside; Toppenish; Evergreen; Vancouver; Port Angeles; Seattle; Tacoma; Clover Park; Pasco and Walla Walla	Travel Practices
Six State Agencies: Ecology, Labor and Industries, Employment Security, Community Trade and Economic Development, Revenue and Transportation	Debt Collection
Five Cities: Vancouver, Olympia, Federal Way, Redmond and Maple Valley	Collection and Use of Impact Fees (cities that collected the highest amount of impact fees in 2004, 2005 and 2006)
Three Public Hospitals: Valley Medical Center (Redmond), Evergreen Medical Center (Kirkland) and Stevens Memorial Hospital (Edmonds)	Administration, Capital Projects and Citizen Accountability

PREVENTING AND FINDING FRAUD

During the past year, we took steps to strengthen our nationally recognized Fraud Prevention and Detection Program.

We restructured the program and aligned it more closely with our State Employee Whistleblower and Government Accountability Hotline programs. This will enable us to draw on the resources of the three investigatory-related programs and better coordinate their activities.

Our fraud program is overseen by a fraud investigations manager, who coordinates the activities of each of the 17 fraud-detection specialists assigned to audit teams throughout the state. The program is intended to pursue suspected instances of fraud and to provide training to state and local government financial managers so they are better able to identify signs of misuse, abuse and misappropriation.

In 2007, we reported 25 fraud cases representing \$1.7 million in losses among state and local governments. That compares with 41 cases and \$421,883 in losses the previous year. Of the 2007 cases, 44 percent were losses less than \$5,000. More than 27 percent (3 out of 11 cases) of those losses were less than \$1,000. In the past decade, fraud has cost the state and local governments \$9.9 million.

The largest loss in 2007 was \$843,118

in diverted funds from the Pierce County Fire Protection District No. 17 in Roy. The District's secretary had been writing checks to herself and others for more than 12 years. The District discovered the theft after they had fired her for poor performance and discovered a checkbook for an account they thought was closed. Further investigation revealed the account was open and active, so the district referred the possible fraud to our Office.

The smallest quantifiable fraud case we reported was \$50 in misappropriated funds at Washington State University. The University identified the fraud in connection with a theft case involving a security guard and referred it to our office.

In our fraud prevention efforts, we provided training to 445 government finance professionals and managers between July 2006 and June 2007. Since July 2001, our Office has provided 475.5 hours of training to 13,540 government employees.

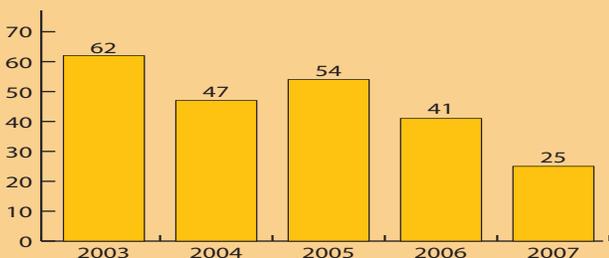
Other examples of fraud cases reported in 2007:

- *A medical treatment adjudicator at the Department of Labor and Industries received calls from some providers asking for their payments. In pursuing the*

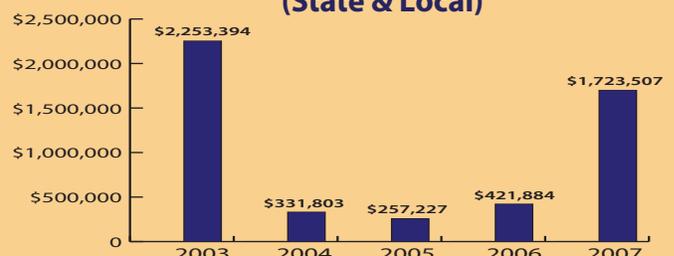
issue, the Department found the checks had been deposited into an employee's account. Our investigation revealed that the ex-employee circumvented controls to misappropriate at least \$431,376 in cash disbursements over seven years. We referred the case to the Thurston County Prosecuting Attorney's Office.

- *The City of Algona converted to a new computerized utility billing system that had stronger controls than the previous, manual system. After utility bills were sent out from the new system, customers complained that they had already paid their bills. We found that the former cashier misappropriated at least \$1,938 from utility payments at the City. We referred the case to the King County Prosecuting Attorney's Office.*
- *An accountant for the contract company in charge of operating Clark County's golf course noticed missing deposits. An employee of the company admitted taking public funds and using it for personal purposes. The County Sheriff's Office investigated and determined the ex-employee misappropriated at least \$23,333 from the golf course. We referred the case to the Clark County Prosecuting Attorney's Office.*

Number of Fraud Cases



Amount of Loss Due to Fraud (State & Local)



STATE GOVERNMENT AUDITS

Agencies without Findings

Several agencies that we audit annually have gone a significantly long time without receiving an audit finding.

This list includes:

State Investment Board
16 years
without a finding



Department of Revenue
15 years
without a finding



Office of the State Treasurer
15 years
without a finding

Higher Education Audits

Washington's public higher education system has 40 institutions that include four-year colleges and universities and community and technical colleges. The expansion of branch campuses and partnership programs between universities and community colleges has resulted in a growth in decentralized financial systems. This has created challenges for colleges and universities in their ability to monitor and account for public assets.

In addition to our audits of individual colleges and universities, we audit the Higher Education Coordinating Board, the State Board for Community and Technical Colleges and the Center for Information Services. These organizations provide oversight and assistance and maintain some centralized systems for colleges and universities.

Our audits in 2007 emphasized seven areas. They included state and federal financial aid grants to assist students in paying their college expenses, such as the State Need Grant, Academic Competitiveness Grant and Science and Mathematics Access to Retain Talent (SMART) Grant. We also looked at the colleges' policies and practices for recommending banks and other lenders when students applied for loans to help pay for college expenses.

The other areas of audit emphasis included the Running Start program, purchase card transactions, athletic department cash receipting and conflict of interest, and open competition among student loan lenders. Several of these audit areas also were examined during the 2006 audits, including the Running Start program, athletic department cash handling and aspects of student financial aid.

We identified audit issues related to unallowable purchase card transactions between colleges and state agencies. For example, a college cannot use its purchase card (i.e. credit card) to pay for goods and services provided by another college or state agency. The state is charged a transaction fee by the credit card company that it would not otherwise have to pay had the college used other methods of payment, such as checks or petty cash.

We also noted unallowable fees charged to Running Start students. State law prohibits a college from charging tuition and fees to high school students who are taking college classes through the Running Start program. Students are obligated to pay for books and supplies. We identified colleges charging Running Start students fees that went beyond this exception, such as math lab, science lab and computer lab fees.

Higher Education Statistics

Year	2004	2005	2006
No. of Audits	23	22	29
No. of Findings	4	11	5

Medicaid

Medicaid is a jointly funded state and federal program that provides health-care coverage for selected people with low incomes. It is administered primarily by the Department of Health and Social Services. Other agencies with significant responsibilities include the Attorney General's Office, which runs the Medicaid Fraud Control Unit, and the Department of Health, which is the agency designated by the federal grantor to perform Medicaid validation and licensure surveys of certain Medicaid service providers.

Washington's Medicaid program spent more than \$6 billion during fiscal year 2007. Due to the size and complexity of the Medicaid program, coupled with frequent changes in federal law, it is not surprising that our audits have identified issues with Medicaid. In our audit of

the program for fiscal year 2006, we identified 19 issues significant enough to report as audit findings. For the fiscal year 2007 audit, we anticipate reporting approximately half that number. However, all future Medicaid reports will be issued in the State of Washington Single Audit Report, published by the Office of Financial Management.

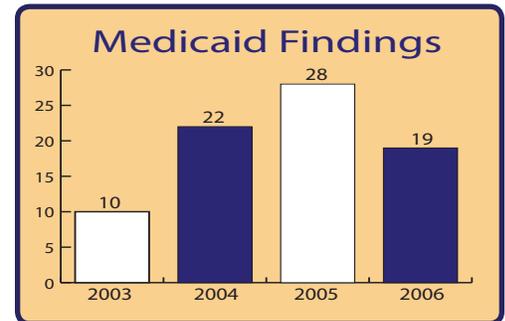
Many factors contribute to the reduction in number of audit findings, the most significant of which is a better understanding by all parties of the roles and responsibilities of all of the involved parties:

- The Auditor's Office.
- The Department of Social and Health Services and other Medicaid agencies.
- The federal grantor, U.S.

Department of Health and Human Services – Centers for Medicare and Medicaid Services (CMS).

By establishing an ongoing dialogue with CMS, we have been able to resolve a number of prior audit findings through clarification with CMS on federal policy and directives.

Credit also goes to the Department of Social and Health Services and the Department of Health for taking corrective action on a number of issues.



Statewide Technology Audit Team

The State Auditor's Statewide Technology Audit Team helps auditors access data from agencies and prepares data for analysis. There are four main components to the team's work.

Information Systems

The team looks for computer controls that ensure:

- Integrity of the data.
- Availability of the data.
- Management's control over the data, which includes access to the data and programs and maintaining confidentiality.
- Auditability of the information.

General and application control reviews assess whether there are controls in place to address the areas discussed above.

Application Controls

Specific applications are reviewed to address the four high-level controls by looking for controls that ensure accuracy and completeness of the input, processing and output of data.

General Controls

Our review of general controls addresses:

- Organization of agency
- Physical security
- Electronic access
- Backup/recovery
- Application design
- Operating system
- Change management

The Auditor's Office takes a risk-based approach and looks at areas where there is a higher risk to the State if its assets are not safeguarded. The Statewide Technology Audit Team takes a cyclical approach to

risk-based audits, where areas not reviewed in one audit cycle may be reviewed in another.

STAT identifies risks that may exist in the system and recommends controls that could be put in place to address those risks.

Computer-Assisted Audit Techniques (CAATs)

- Summarizing data to look for patterns that stand out
 - Refunds by the person issuing refund
 - Vendor payment summaries
 - Payroll exception reports
 - Security reports for access control
- Eligibility requirements (matching with other systems)
 - Age requirements
 - Income requirements

LOCAL GOVERNMENT AUDITS

Giving Local Governments A Choice of GAAP or Cash Reporting

In July 2007, our Office gave local governments the option of reporting financial information using either Generally Accepted Accounting Principles (GAAP) or cash basis as outlined in the Budgeting, Accounting, and Reporting System (BARS) manuals.

Significant new accounting and auditing standards, beginning with the Government Accounting Standards Board or GASB Statement 34 implementation a few years ago, have added to the workload and complexity of financial reporting for local governments, and this has resulted in reporting delays and an increase in financial statement errors. In many cases the additional GAAP requirements have increased each government's accounting and audit costs.

Given these circumstances, we eliminated the population and

revenue thresholds prescribed in the BARS manuals allowing local governments to choose either GAAP or cash basis reporting. This will alleviate some of the costs related

to financial reporting such as audit costs, personnel training and time for some local government entities, resulting in more timely financial reporting.

Local Government Audits and Findings

2005	City	County*	Other Locals**
Audits	421	71	1,305
Findings	78	32	79
2006			
Audits	369	86	1,234
Findings	50	44	81
2007***			
Audits	338	71	1,298
Findings	53	35	199

*County audit numbers include financial, accountability and federal audits.

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

***2007 encompasses reports issued from January through November 2007. All other years' figures are January through December.

New Audit Standards for Local Governments

A number of changes have been made in recent years to auditing standards set by the American Institute of Certified Public Accountants (AICPA), one of the standards-setting bodies for auditing. One of these changes, Standards of Audit Statements 112 (Communicating Internal Control Related Matters Identified in an Audit), is having a significant effect on our local government audits and has resulted in a number of audit findings and management letters.

This audit standard provides guidance on identifying and communicating control deficiencies related to financial

statement reporting. It requires auditors to report serious deficiencies in internal controls over financial reporting, which we have done in the past. However, the new standard sets a lower threshold for the types of deficiencies that are reported.

SAS 112 is a result of Sarbanes-Oxley concepts being adopted by standard-setting bodies and is an attempt to reinforce management's responsibility for ensuring sufficient internal controls over financial reporting and the auditor's responsibility to report deficiencies in those controls that come to our attention.

The Sarbanes-Oxley Act

The Sarbanes-Oxley Act became law in July 2002 in response to a number of corporate and accounting scandals involving companies such as Enron and WorldCom. The Act established new and strengthened existing standards for publicly held companies and accounting firms. It also applies to federal, state and local governments.

The act requires internal controls to assure the accuracy of financial reports and disclosures, and mandates both audits and reports on those controls. Auditors are held to a stronger standard when reporting their findings and regarding independence.

Public Schools

Audits of School Districts and Educational Service Districts covering the 2005-2006 fiscal year found three major issues affecting school operations. Some of these issues are recurring funding-related problems identified in previous years.

In light of the financial struggles we observed in the past three years, we continue to focus our audits on the financial health of public schools. We examined school districts' processes and controls for monitoring their financial operations.

We found five districts with significant decline in financial health. Of the five districts, all but one were very small. Three districts had negative fund balances at the end of the 2006 fiscal year. The largest gap where spending exceed income was \$4 million. One school district in the Lewis County community of Vader closed August 31, 2007, due to financial problems.

In our audits, we particularly looked at school districts' accuracy of reporting student enrollment, a major factor that determines funding

from state government. It has proven to be a challenging issue.

The Office of Superintendent of Public Instruction (OSPI) establishes the rules and provides instructions on how school districts should report enrollment for state funding. Students are funded based on the number of hours per week they are enrolled in school and must meet certain attendance requirements to be counted. For example, a high school student enrolled in at least 25 hours each week is considered full-time and counted as one full-time equivalent (FTE) for funding purposes. These calculations are complex and confusing.

Of 92 school districts audited in 2006, we found enrollment-related issues in 51. All but three instances were minor and did not call for an audit finding.

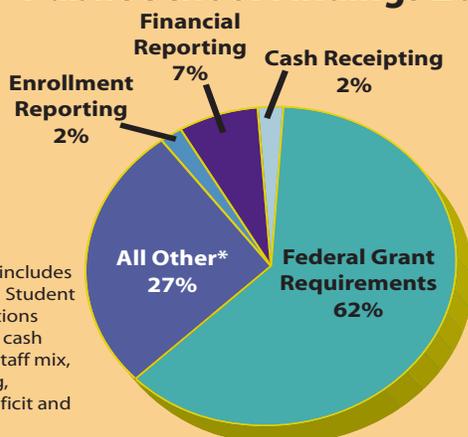
We also focused on Associated Student Body (ASB) activities at high schools. Eleven findings and 23 management letters in our audit reports were related to ASB activities. One particularly problematic area involved inadequate record keeping and procedures for handling money related to ASB activities.

General cash receipting at school districts was another issue. Food services and general offices had varying issues related to cash handling practices. Thirteen management letters were issued relating to poor cash receipting practices.

We will continue to watch enrollment reporting closely. OSPI will look at the enrollment formulas to see if they need to re-interpret the current enrollment rules in accordance with state law.

“...WE CONTINUE TO FOCUS OUR AUDITS ON THE FINANCIAL HEALTH OF PUBLIC SCHOOLS.”

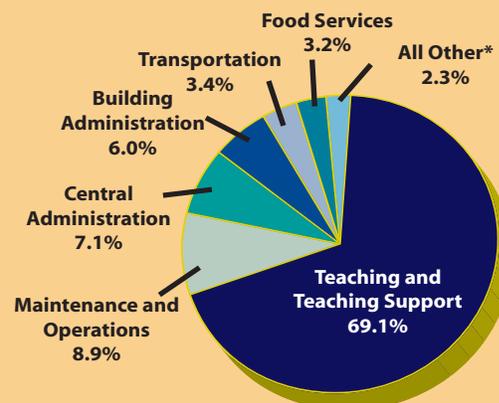
Public School Findings 2007



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

Public School Expenditure Percentages

(from the General Fund for the 2005-2006 School Year)



* All other includes information services, insurance, public activities, warehousing & distribution, printing, debt service and motor pool.

State of Washington Single Audit

The State Auditor's Office annually audits federal grant expenditures for the state of Washington as required by the U.S. Single Audit Act. For fiscal year 2007, the State reported almost \$10 billion in federal assistance, including grants, loans, equipment, and other forms of federal aid.

Using the criteria specified by the federal Office of Management and Budget, we select 30 different federal programs to audit during the year. These programs represent almost \$6 billion of the state's total federal assistance. The Single Audit report is issued by the state Office of Financial Management by March 31 of each year.

New Electronic Subscription Service

The Washington State Auditor's Office is pleased to announce a free subscription service that notifies subscribers when audit reports are released or when additional audit related news is posted to our Web site.

Our new service allows subscribers to choose which reports you wish to subscribe to by entity type (state government or local government); government type (city, fire district, etc.), county, individual entity, report type (financial, performance, etc.) or a combination. You also will have the option of receiving only reports with findings, which can be used in conjunction with all of the other selections mentioned above.

You will receive an e-mail notification and links to specific reports when we release an audit report you have requested.

Other available information includes: annual updates to your BARS manual(s), release of updated BARS reporting packages, mid-year requirement changes/additions, annual report information, training class schedules, and audit reports.

All existing requests for electronic notification made prior to the release of this new subscription service will be discontinued on January 1, 2008. Please sign up for this convenient new service today by logging in at: www.sao.wa.gov/applications/subscriptionservices

Who audits the auditor?

This year, the Office underwent a healthy examination of our quality assurance controls and audit practices. This was a peer review conducted under the auspices of the National State Auditors Association (NSAA) in conjunction with the National Association of State Auditors, Comptrollers and Treasurers (NASACT).

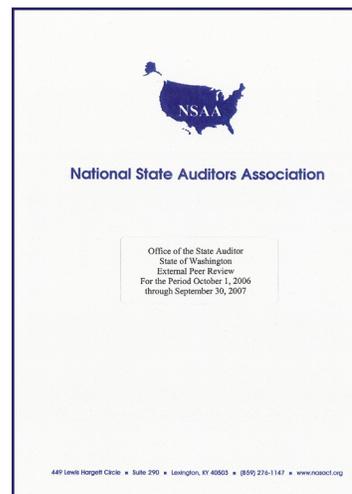
A review team of seven auditors and audit managers from throughout the country conducted the audit over eight days in November. The team members came from state auditors' offices in Michigan, Minnesota, Missouri, Idaho, Georgia and Montana, and from the U.S. Office of Inspector General.

The team's report gave our Office an "unqualified opinion," which is the highest level of assurance that an external review team can give on a system of audit quality control.

The audit reports we issued from

January 1, 2005, through December 30, 2006, were in compliance with the quality control policies and procedures outlined in Government Auditing Standards issued by the U.S. Government Accountability Office.

Our next peer review is scheduled for 2009. It will focus on our performance audit program.



STATE AUDITOR'S OFFICE

Our Mission

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

Ever since he was first elected State Auditor in 1992, Brian Sonntag has been a passionate, leading advocate for citizens of the State of Washington.

Now in his fourth term as Auditor, Brian remains committed to ensuring state and local governments are accountable, accessible and responsive to citizens.

He has a distinguished career in public service. He was elected Pierce County Clerk when he was 26 years old and served eight years in that office. Brian was also elected twice to the office of Pierce County Auditor (an office his father held for 22 years) before being elected State Auditor.

Brian serves as a board member of the Washington Coalition for Open Government. His advocacy for open government earned him the Washington Newspaper Publishers Association's Freedom's Light Award in 1999. And for his efforts to improve

local government operations, Brian received the Warren G. Magnuson Award from the Seattle Municipal League in 1999.

Brian also is a member of the state Productivity Board and co-chairs Public Service Recognition Week, an annual event showcasing the achievements of state employees.

In 2007, Tacoma Community College selected Brian as its distinguished alumni of the year for his public service and community involvement, which includes serving on the boards of United Way and the Boys and Girls Club, as well as many years as a youth baseball and basketball coach. He is a member of the Tacoma Athletic Commission.

Professionally, he holds the designation as a Certified Government Financial Manager from the National Association of Government Accountants. He also serves as a trustee on the Association of Government Accountants Academy of Government Accountability.

He and his wife, Jann, live in Tacoma, have raised five boys, and have three grandchildren.

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State Auditor 2007



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