

# *Challenges in Performance Auditing:*

*How a State Auditor  
with Intriguing New  
Performance Auditing  
Authority is Meeting Them*

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# ACKNOWLEDGEMENTS

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The views expressed in this report are those of the authors and not necessarily those of AGA.

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# CHALLENGES IN PERFORMANCE AUDITING

## Background

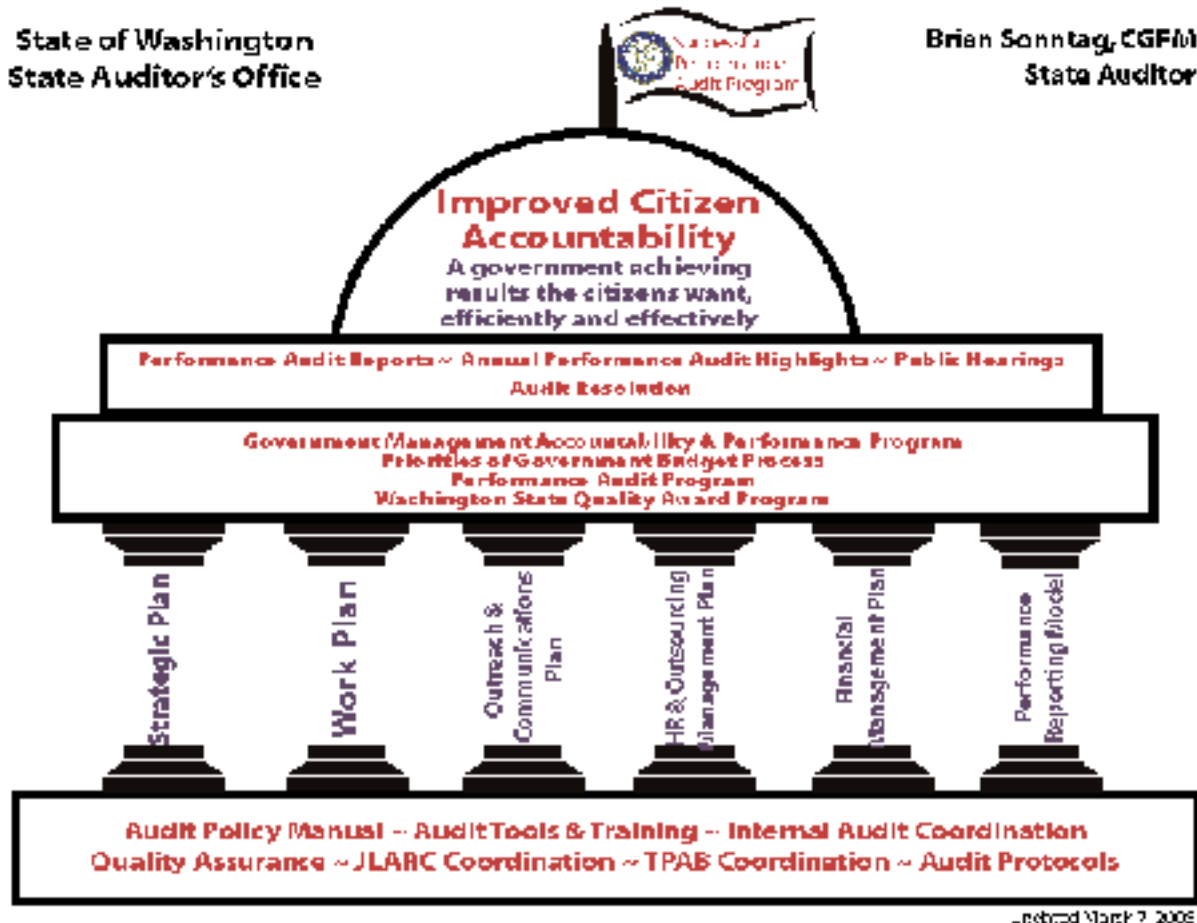
In November of 2005 the citizens of Washington state voted to give their state auditor the most extensive authority in the country to conduct comprehensive, independent performance audits of state and local governments. To carry out this authority, the citizen-sponsored initiative dedicated a portion of the state sales and use tax revenue solely for the conduct of performance audits. Among its provisions, the initiative requires the state auditor to follow Government Auditing Standards, and states that no legislative body, office holder or employee may impede or restrict the authority of the state auditor to conduct performance audits. On the conduct of audits, it urges the state auditor to focus on the largest, costliest government entities first, and to offer a step-by-step remedy to whatever ineffectiveness and inefficiency is discovered in audited entities.

The initiative, with its monthly revenue stream of \$800,000 to \$900,000, brings with it extraordinary expectations. As

stated by State Auditor Brian Sonntag, "To meet public expectations, we must get audits under way almost immediately, and produce results. We also must balance that with exercising care in deciding what we audit, how we hire and train, and how we involve citizens, public employees and others in our decisions. And our audit work must be fair and objective, it must be sound and of high quality, and it must be credible and constructive." In this context, it is important to recognize that when the initiative was passed, the state auditor had no performance audit staff, no policies and procedures, no space and an inadequate salary structure.

## Research Objective

The objective of this research study is to document the initial actions taken by Sonntag to implement the provisions of the initiative and prepare to conduct performance audits. The graphic below depicts what he wants to achieve.



revised March 7, 2006

# CHALLENGES IN PERFORMANCE AUDITING

## Washington State Voters Call for Independent Performance Audits

On November 8, 2005, Washington state voters restored the state auditor's authority to conduct performance audits of state and local government. State voters restored the authority by approving a citizen-sponsored initiative, Initiative 900, which dedicates 0.16 percent of the state's sales and use tax revenue for the state auditor to independently select and conduct comprehensive performance audits.

Fifty-seven percent of voters approved Initiative 900 (I-900). Initiative proponents described performance auditing as a valuable management tool carefully structured around tough, nationally recognized auditing principles that evaluate whether tax dollars are being spent in an effective, efficient and economic manner. The audits measure a program's actual performance against its goals and objectives and seek to uncover any waste, inefficiency or unnecessary duplication of services and identify steps to resolve such problems.

In the late 1960s the Washington state auditor conducted a

*Performance audit is a valuable management tool carefully structured around tough, nationally recognized auditing principles that evaluate whether tax dollars are being spent in an effective, efficient and economic manner.*

—Heartland Institute (reporting on I-900)

number of performance audits critical of executive branch management and, most important, one audit critical of a trip to Puerto Rico taken by several influential legislators. Embarrassed by the audit results, the Washington State Legislature (the legislature) proceeded in 1969

to preclude the state auditor from conducting further performance audits of state government. It achieved this by adding a provision to the state auditor's budget precluding the use of any funds for performance audits. Subsequently, in 1971, the legislature passed a law transferring the authority to conduct performance auditing from the state auditor to the legislature; to what is now known as the Joint Legislative Audit and Review Committee (JLARC).

The ban on performance audits did not limit the state auditor's authority to conduct financial audits. The state auditor retained this authority and currently has an annual budget of \$22.5 million and a staff of 320 (including support staff) conducting such audits, which include financial statement audits, and accountability and compliance audits. The audits encompass both state and local government agencies and other special-purpose state and local entities. The audited units of government are required to pay for these audits at a rate set by the state auditor.

## The Initiative Capped a Continued Quest for the State Auditor to Conduct Performance Audits

Washington State Auditor Brian Sonntag has advocated for performance audits since he was first elected in 1992, 13 years prior to passage of the initiative. The need for performance auditing was a plank in his initial election campaign. On the limited success of his advocacy efforts, in his

*Thirty state auditors have authority to select and conduct performance audits on their own initiative—without approval of the legislature or some other designated entity. Fifteen of the thirty are citizen elected state auditors.*

—NASACT

own words, "There had been several legislative efforts over the years, most notably since 2002, but they never resulted in anything, until the initiative."

With Sonntag as a vocal advocate, the political and public debate over the state auditor conducting performance audits

continued. In 1993 (Sonntag's first year in office), a group of legislators inserted wording in the state auditor's budget eliminating the outright ban, but said the state auditor could conduct performance audits only when directed and funded by the legislature. However, in the intervening 12 years only one performance audit was funded, approved, and conducted: a review of the Washington State Investment Board in 2001. Since 1990 the JLARC produced 140 audit reports (just over nine a year). The quality of JLARC research is recognized as excellent, however it only audits specific programs as directed by the legislature. Hence, it is not viewed as fully independent.

In most legislative sessions over the last 13 years, legislation has been introduced to provide the state auditor with authority to conduct some performance auditing. However, the legislation either was not passed by the legislature or was vetoed by the governor. In 2005 the legislature passed, and the governor signed, a bill giving the state auditor authority to conduct performance auditing but under the oversight of a politically appointed citizen advisory board. The board would approve the audits and the state auditor would have the audits done on contract. In a separate bill, the Senate authorized \$4 million for independent performance audits of the Department of Transportation and other transportation-related agencies (which was explicitly precluded by the enacted House bill). These audits, which remain authorized and funded, are to be conducted on contract.

Against that backdrop, Washington citizen Tim Eyman introduced Initiative 900 to offer voters, what he called, a "900-pound gorilla" alternative to the legislature's weak and limited versions of performance audits. (Eyman had been involved in a number of tax cut initiatives through the years.) As reported by the press, "Mr. Eyman knows the value of imagery. He wore a gorilla suit when holding I-900 press conferences." In a press conference on passage of his

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*Nothing is more powerful than an idea whose time has come.*

—Victor Hugo

Foundation (a proponent of performance auditing) and talk radio, making Initiative 900 a real cakewalk. Voters instinctively want accountability and transparency, but elected officials don't."

While past Eyman tax cut initiatives drew media opposition, I-900 enjoyed broad media support, particularly from talk radio and most of the state's newspapers. According to a respected state politician who held positions in the state legislature and the federal executive, "The appeal of the initiative was not hurt by the fact that the state auditor is the most popular elected official in the state."

On passage of the initiative, Sonntag is quoted as saying, "We now have a unique opportunity where we have support by the governor's office and the citizens for independent performance audits.

A 57 percent vote is a loud voice. Clearly the people are saying they want accountability and transparency."

*While I-900's adoption in Washington has immediate implications for that state, supporters of limited and accountable government see the initiative's 57 percent approval vote as having an impact on budget debates nationwide.*

—Heartland Institute (in reporting on I-900)

## Unique Features of the State Auditor's New Authority

There are five unique features of the

Washington state auditor's authority and expectations for conducting performance audits. To the knowledge of the research team, very few, if any, audit offices in states where auditors conduct performance auditing have these features. The first feature is one that warrants attention of the entire performance audit community. A full list of the authority conferred by I-900 is in Exhibit A.

1. I-900 provides the auditor with a dedicated source of funding. The voter-approved initiative dedicates 0.16 percent of the state's sales and use tax revenue for the conduct of performance audits. This revenue is to be deposited to an "audits account" from which only the state auditor or the state auditor's designee may authorize expenditures. The funding source and amount is not subject to approval by the legislature. The money is not only dedicated, but the amount is significant; an estimated \$6.6 million in fiscal year 2006 (per the state Office of Financial Management) and a total of \$18.4 million by June 30, 2007.

On the question of how long this situation will prevail, state law prohibits the legislature from changing initiative-induced provisions for two years after enactment. It would be a politically sensitive vote to change what the citizens put in place. The research team was told by a reliable source that given the popularity of the initiative and the state auditor,

the state auditor may have up to five years to demonstrate the value of performance auditing before the legislature will venture to critically review the initiative and the dedicated source of funding.

2. While Initiative 900 states that performance audits may be done on contract, there appears to be an expectation by the legislature and the governor that performance audits will be done on contract. This expectation reflects a desire of a large number of legislators to limit the growth of state employees. As evidence of this expectation, all legislative bills since 2002 on performance auditing have contained a requirement for the audits to be done on contract. Sonntag and Long plan to conduct much of the initial performance audit work under contract with private firms to meet public expectations for near-term results. Their short-term goal is to conduct about 50 percent of performance audits on contract. Their current long-term goal is to conduct about 25 percent of performance audits on contract and about 75 percent with in-house auditors. To the research team's knowledge, no U.S. audit office conducts performance audits on contract as a matter of routine, ongoing practice.

3. Since I-900 was a citizen-driven initiative, Sonntag has embarked on a process to engage citizens and elicit their ideas on where performance audits should be focused. In its *First 100 Day Report*, the Office of the State Auditor indicated that it has contracted with a research firm and is working to develop focus groups, public forums, opinion polling, Web surveys and other means to gather citizens' thoughts and ideas. Those efforts are intended to meet proper qualitative and quantitative research methods. In public forums already held, the audit priorities of citizens were transportation, education, social services and health care. Those issues will be among the initial list of audits conducted.

4. I-900 states that the scope for each performance audit shall not be limited, and that each audit is to include nine elements. In brief, these are to identify:

- cost savings;
- best practices;
- services that can be reduced or eliminated;
- services that can be transferred to the private sector;
- gaps or overlaps in programs and services;
- the feasibility of pooling information technology systems;
- opportunities to change or eliminate departmental roles or functions;
- statutory or regulatory changes that may be necessary for the department to properly carry out its functions; and
- to analyze departmental performance data, performance measures and self-assessment systems.

The last bullet relates to the state's efforts to establish a "performance budgeting and measurement system" (further discussed below).

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These elements pose a challenge to the state auditor in two ways. First, they have implications for audit selection in that the elements can be viewed as expectations for performance audits to achieve. To this end, five of the elements have a cost savings focus. Second, not all of the elements can, as a practical matter, be included in each audit.

5. As noted above, the JLARC conducts performance audits. Only one other state, Pennsylvania, has both a legislative auditor and a state auditor that conducts performance audits (according to NASACT data). Six states (based on NASACT data) have both a state auditor and a legislative auditor, but only in Washington and Pennsylvania do both the state auditor and the legislative auditor conduct performance audits.

*It is important to recognize the positive impact of regular oversight (provide by performance audit). Not only would poor performance be identified and ended, but previously unpublished success stories would become a part of the public record, allowing state managers and workers to establish credibility with voters, something that today is severely lacking.*

—Washington Policy Center

## A Unique Expectation of I-900 Proponents

With one exception, the expectations expressed publicly by proponents of performance auditing were not unusual. They reflect the sentiment one finds in reviewing literature on performance auditing. The exception is an expectation for performance

audits to recognize and report *good performance* along with poor performance. This departs from the tradition in performance auditing, which is to focus on and report on poor performance. Thus, should Sonntag embrace this expectation, he will take an approach to performance auditing not commonly practiced by colleagues in the profession.

The research team compiled a list of expectations and objections expressed by proponents and opponents of performance auditing compiled from a limited review of literature, primarily press reports citing the views of individuals and organizations—in support or opposition to legislative bills on performance auditing (in 2005) and Initiative 900. This list is included as Appendix B.

## He Has the Authority: Now What to Do

“Wow! Now what do we do?” was Sonntag’s response when asked about his first thoughts after Initiative 900 passed. He said that he knew the office had a difficult task ahead since it had no performance audit staff, no operations policies and procedures, no organization structure, no facilities and no plan. “Oh, we had ideas, but no detailed plan of action laying out what we needed to do and how soon to do it. We clearly had our work cut out for us. Compounding our challenges, the initiative raises high expectations for quick results. We get a few months, not a year, to get organized, put a plan together, and start conducting an audit. And while we must focus on doing something fast, we need to do

it right. It has to be good—both in audit quality and results. One misstep could compromise our credibility.”

To illustrate the sense of expectation, with regard to results, I-900 proclaims that performance audit will **save** taxpayers **billions** of dollars. Similarly, the League of Women Voters, in arguments for I-900, stated that the “\$17 million (from the dedicated sales and use tax in 2005-2007 for performance audits) will ensure that **\$40 billion** in taxpayer dollars are spent wisely. The league also reported that the state auditor would complete a draft work plan in November of 2005. The initiative vote was set for November 8, 2005 and became effective on December 8, 2005.

Sonntag explained that the expectation for quick results created a dilemma: If the office didn’t produce results quickly, opponents would say they knew we couldn’t do it, and proponents would be disappointed as well.

Sonntag’s first action after the initiative passed was to thank the voters. “I got on radio shows and met with the media. Since then I have taken every opportunity, as has my director of performance audit, to explain the challenges my office faces in gearing up to conduct performance auditing. In citing the challenges, I have given assurances that we will do the job right.” He explained that he and Long are trying to manage expectations by laying out a chronology of the actions they have taken, those they have planned, and their timeline.

Since then (to March 31, 2006), the state auditor has spoken about the performance audit program to 25 to 30 groups across the state (per his chief policy advisor who tracks such activities). The groups include the Washington Roundtable, Washington Research Council, community organizations, civic clubs, civic activist groups and local government associations. Long and members of the performance management team also have given presentations on the program.

## Important Considerations I-900 Does Not Address

There are several important considerations that are not addressed by the initiative or in Washington state law. While these omissions are not fatal, they do raise issues for implementation.

- The initiative does not include any limitation on access to audit working papers. It is common for audit offices to have a provision that audit working papers are not available for public inspection during the course of an ongoing audit; some audit offices never allow work papers to become public. Some audit offices have a provision that working papers are never available for public inspection.
- Performance audits, by their very nature, require extensive research, thorough analysis and special skill sets. They do not lend themselves to fast turn-around times, especially when a staff is being developed from scratch. Yet voters are likely to expect sweeping and rapid reports.
- Performance audits, in considering effectiveness, regularly point to a shortage of resources for the tasks assigned to agencies. Findings that recommend additional staff or other resources to effectively carry out a mandated task,

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while perfectly valid, could be seen as undermining the cost-cutting results implied by the initiative.

- The initiative does not address using existing financial audit teams to conduct performance audits, although those financial auditors could be a resource in gathering data from locations across the state for evaluation by performance audit teams. This is left to the discretion of the state auditor.
- Pressure to move quickly on performance auditing led to salary waivers for performance audit managers, creating pay inequities with financial audit staff within the same office. The state's pay scale for financial professionals already was inadequate. The combination of a dedicated funding stream directed expressly to performance audits and the need to hire performance audit professionals quickly has the potential to magnify the salary inequities and impact the overall operation of the state auditor's Office.

## Common Challenges in Performance Auditing

Audit offices face a common set of challenges in conducting performance audits. These challenges include: funding, staff salaries, staff quantity and quality, organizational structure, training, audit selection, reporting model, when to conduct audits in-house and on contract, policies and procedures (for conducting and managing audits with in-house staff and with contractors), audit protocol and quality assurance. These concerns pertain to the profession as a whole, as well as to audit offices just getting started. However, because Sonntag plans to conduct audits on contract, at least initially, he has unique challenges to deal with.

In a rush to get started and produce results, Sonntag and Long attempted to address all of these concerns more or less simultaneously. The actions discussed below were those they had completed or had in process at March 31, 2006. The list is limited to the actions related to the common challenges of the performance audit community and those unique to the Washington state audit office.

In presenting the actions of the Washington state auditor and his performance audit staff we have contrasted them with the common practices in performance auditing. In this it is important to recognize that practices in the performance auditing profession are far from standard.

### Funding

#### Common Practice—

Maintaining a secure source of adequate funding is the No. 1 challenge for the government performance audit community. Government audit offices throughout the United States are dependent on the legislature to provide money to fund performance audit operations. This is true even for elected state auditors. The state audit office

in Washington experienced the delicacy of this arrangement firsthand when, in 1969, the legislature barred any money from being spent for performance audits. Performance auditing is a tough, precarious job, and auditors need protection against retribution for doing it well.

#### Washington State Auditor's Unique Funding Arrangement

**Secure Source**—The Washington state auditor has a secure source of funding. Initiative 900, which restored the state auditor's authority to conduct performance audits, dedicates 0.16 percent of the state's sales and use tax revenue for the conduct of performance audits. This revenue is deposited to an account from which only the state auditor or the state auditor's designee may authorize expenditures. The funding source and amount is not subject to approval by the legislature. The research team knows of only one other audit office in the United States that enjoys the added independence afforded by having a dedicated funding source.

**Adequacy**—The amount of dedicated money that accrues is estimated at \$8.5 to \$12 million a year by the Washington State Office of Financial Management. This amount is sufficient to finance a staff of about 60 auditors (to include salaries, facilities, equipment, supplies, etc.) and about \$7 million in contracts. This is a relatively large performance audit staff in the state audit community (per NASACT data). In comparison, the state auditor has an annual budget of \$22.5 million and 300-plus staff to conduct financial audits. Given that the number of government organizations and entities is the same (about 2,700 units), does this suggest that financial and compliance audits are roughly two times more valuable than performance audits? Is this ratio of spending on financial versus performance auditing common in the state auditor community? More research may be needed to answer questions such as these.

#### Staff Salaries

##### Common Practice—

Maintaining an adequate salary structure—from entry through senior auditors—is the No. 2 challenge for the government performance audit community. Without adequate

Entry Level Auditor	Starting pay range	\$19,100 to \$45,700	Mean: \$30,000 - \$35,000
	Top of pay range	\$31,600 to \$77,400	Mean: \$35,000 - \$50,000
Middle Level Auditor	Starting pay range	\$25,300 to \$57,800	Mean: \$30,000 - \$45,000
	Top of pay range	\$35,100 to \$83,300	Mean: \$40,000 - \$55,000
Upper Level Auditor	Starting pay range	\$29,200 to \$66,600	Mean: \$35,000 - \$50,000
	Top of pay range	\$41,100 to \$123,200	Mean: \$45,000 - \$75,000
Audit Supervisor	Starting pay range	\$33,600 to \$76,100	Mean: \$40,000 - \$70,000
	Top of pay range	\$51,600 to \$135,300	Mean: \$60,000 - \$85,000
Audit Manager	Starting pay range	\$37,900 to \$87,600	Mean: \$45,000 - \$75,000
	Top of pay range	\$57,500 to \$155,800	Mean: \$65,000 - \$110,000

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salaries, it is difficult to recruit and retain highly competent, energetic, experienced staff. High turnover is one result as private sector firms and other government organizations with a higher salary scale seek to recruit experienced government auditors.

In government, salary rates and scales are generally determined centrally. Salaries are often based on degreed professions (accounting, computer science, etc.) or some recognized technical skill. Performance auditing is not a “degreed” profession. Hence, a given government entity may not have a position description and salary structure established for performance auditing. As an expedient, some apply the salary structure for accounting and/or auditing, meaning financial statement auditing, a widely recognized profession.

The range in salary rates for performance auditors across governments is significant. The range for all types of auditors within the state audit community—for fiscal year 2005 per NASACT—is illustrated at the bottom of the previous page (the numbers are rounded).

As a general rule, the salaries for government auditors—financial and performance—are below that in the private sector. This is particularly true for accountants and persons with advanced degrees. To compensate, government performance audit offices commonly have special authority to grant pay increases at six-month intervals or to promise rapid advancement for the first two years or so. Federal audit offices commonly promise “new college graduates” with limited experience a promotion from GS-7 to GS-9 to GS-11 within two years. They also emphasize the good health benefits and a true pension program. When hiring professionals with experience, individual audit offices may not have flexibility to offer a salary competitive to the private sector, or with those for other positions in government.

## Washington State Auditor’s Actions—

The state did not, at passage of I-900, have a position description and pay scale for performance auditing professionals. The performance audit team has since developed a job description with the State Personnel Office. The salary structure for auditors was also inadequate. The salary scale for financial staff was at the low end of the median for state audit offices. Perhaps as a consequence, Sonntag has been experiencing a 25 percent turnover rate in his financial audit staff. Sonntag granted a salary “exception” for higher pay to enable him to recruit the performance audit managers.

## Staffing

### Common Practices

**Disciplines**—The general practice in performance auditing is to recruit professionals with a college degree, but not from a single discipline. The U.S. Government Accountability Office hires from a mix of disciplines with an emphasis on advanced degrees for its performance audit staff. The general practice of federal inspectors general is to hire accountants, but some recruit from other disciplines. State auditors conducting performance audits generally hire from a mix of disciplines, as do local government audit offices.

**Number**—No formula has been devised to establish how many performance auditors an organization of a given size should have. In practice, the number varies significantly, from the GAO with more than 3,000 staff to a few cities with only one performance auditor. Staffing at state audit offices conducting performance auditing is relatively low, from five to around 45, with an exceptional high of 380 in one state.

**Organization**—Large performance audit offices tend to organize around subject areas or functions with a manager responsible for each area or function. Some specialization by subject matter or special expertise is common in small as well as large audit offices. Large offices, including the GAO, federal inspectors general and many state auditors, have field locations.

## Washington State Actions—

Sonntag’s initial plan was to have a team of eight performance audit managers with responsibility for specific subject areas, and for each manager to have a staff of two. This staffing structure was decided in consultation with selected audit offices (including GAO), selected Washington state officials, an analysis of state agency spending (90 percent of the state budget is expended by 16 agencies), and total state spending. The structure and area of responsibility remain open to review and adjustment. The performance audit staff will be centralized in Olympia.

Five performance audit managers were hired in early January; a sixth came on board in late February. Hiring of the seventh and eighth managers was in process as of March 31. Of the initial six on-board managers, two have experience conducting performance audits plus a wide range of other experience; two have a variety of work experience, including expertise in working with contractors; and two came from within the auditor’s financial, accountability and compliance audit staff. This number was kept low because in asking other state auditors about their experience in having financial auditors conduct performance audits, Sonntag was told that the conversion is generally difficult. At the cut-off for this research project, Sonntag and Long were still considering what role the financial and compliance audit staff will play in the conduct of performance audits. Three possibilities are the potential for the financial audit staff to: gathering data from locations across the state for evaluation by performance audit teams, verify the reliability and relevance of performance measures, and prepare a trend analysis of changes in performance over time. The staff has the basic prerequisite technical verification and analytical skills.

The credentials of the performance managers are impressive—in education, knowledge and breadth of diversified experience. In interviews with the research team, the managers exuded an excited and positive “we can get it done” attitude. These attributes, and the synergy of the managers in working together, are considered strengths. As stated by one manager, “The team has horsepower (to get things done). We can’t fail.”

Hiring staff to support the managers proceeded slowly due in part to two key problems. First, the state pay structure was not adequate to attract experienced staff. Pay

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exceptions were required (and obtained) to recruit the performance audit managers. Second, the state initially had no civil service position description addressing the knowledge, skills and abilities required of performance auditors. Hiring of additional staff for performance audit began in March.

## Training

### Common Practice—

Training is critical to an audit office's success. No college or university program in the United States specifically trains students to be performance auditors. As a consequence, audit organizations either hire auditors from other audit offices or develop their own. The "development" of professionals into performance auditors is achieved through a combination of formal and on-the-job training, coupled with experience doing performance audits. The success of this development process is heavily dependent on good training.

The importance of training is recognized by the profession. Government performance auditors are required by auditing standards to obtain continuing professional education. Government Auditing Standards require each auditor to obtain 80 hours of continuing professional education every two years with at least 20 hours obtained in one of the years. Auditors obtain the necessary training in a wide variety of ways, to include training from professional audit training organizations.

### Washington State Auditor's Actions—

Sonntag plans to pursue a cross training program to expand the capacity of his professional staff that performs financial and legal compliance audits. The intent is to provide them with new skills that will give the audit office greater flexibility in staffing for all types of audits, and expand career opportunities with the audit office. The state auditor's office is also working with two state universities to provide internship opportunities for students doing graduate work.

**Contractors**—Materials were in place for state audit office staff to provide contractors with pre-audit training on Team-Mate, working papers, public records, referencing and active listening.

## Protocol for Audit Selection

### Common Practice—

To have a full degree of independence, performance audit offices need authority to select subjects for audit without approval of the legislature, governor or some other oversight body. Most, if not all, federal and local government auditors have such authority. Of the 42 state auditors who conduct performance audits, 30 have authority to independently select audits, according to NASACT.

The methods used to select subjects for audit vary among performance audit offices. Many conduct risk assessments, some using the COSO approach that involves constructing an audit universe, prioritizing areas in accordance with risk level, getting validation from a group of advisors, and auditing the highest risk areas first, each year. Others receive leg-

islative or executive branch requests; some act on issues uncovered by investigative and financial audit teams. In preparing annual audit plans, many audit offices seek input from the legislature or from officials of the entity they report to. The research team does not know how many audit offices seek input from citizens. This is not a widely publicized practice.

### Washington State Auditor's Actions—

I-900 encourages the state auditor to look at large-sized, big-dollar organizations first. In that spirit, Sonntag's "First 100 Days Progress Report" states that the initial audit selections were based on size, public concerns, and audit staff knowledge and opinion that the subjects will yield significant opportunities for cost savings and improved services. Input from citizens—a telephone interview survey and an ongoing website survey—weighed heavily in the subjects initially selected for audit. In addition, the state auditor has a legislative mandate, funded at \$4 million, to conduct performance audits of the State Department of Transportation and some transportation-related agencies. These audits must be completed by June 30, 2007.

**Selection Criteria**—The following criteria were chosen to guide selection of specific topics for audit:

- expectations from citizens;
- ideas and suggestions from frontline public employees;
- opinions and recommendations of policymakers, interested organizations and the government entities themselves;
- ideas generated by the governor's performance-based initiatives;
- auditor's own research including analysis of best practices;
- auditor's own judgment from knowledge and long experience in conducting financial and legal compliance audits of state and local governments;
- expectation of identifying significant efficiencies and cost savings; and
- the nine elements contained in I-900. The performance audit team reordered the I-900 cited nine elements to reflect the team's order of priority. As a signal of the team's priorities, it put identifying "best practices" ahead of the five elements that focus on "cost savings."

**Outreach to Citizens**—Sonntag insists that his office engage the public, including public employees. In particular, they must gather information from various public groups on topics of interest for audit. The performance audit team established a website survey which 600 people had completed by March 30, 2006. The performance audit team also contracted with a professional firm with experience in obtaining ideas from diverse public groups—through opinion polls, focus groups and other means—to assist them in obtaining input from the public, to include citizens, business, interest groups and government employees. The state auditor intends for the results of these surveys to play a large role in his audit selection. The first survey was conducted in mid-March. A telephone survey covered 405 voters from a mix of

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ages, genders, regions, political party, employment status, education and income. The citizens were asked about subjects they favored for a first performance audit. The key findings were: 28 percent favored public schools 19 percent favored health care, 17 percent favored transportation, and 16 percent favored social and human services. Of all respondents, 49 percent wanted public schools to be audited either first or second.

**Initial Audit Topics**—The subjects cited in the state auditor’s initial audit plan were based in part on research done by the performance audit managers. Each manager researched and compiled a list of suggested audit areas. The first audit will be on transportation issues to meet the legislated 2007 deadline. An audit of the state’s nine educational service districts is on the list of initial projects. That audit is to look at their governance, organizational structure and services they provide to school districts. Beyond the near term, a comprehensive review of the K-12 education system is scheduled. Public education encompasses nearly half of the state budget. The subject areas selected for audit in the near term are listed below. Per the initial audit plan, the listed audits of health care are dependent on hiring a performance audit manager with expertise in the area.

<b>Transportation</b>	<ul style="list-style-type: none"> <li>• Highway Project Management</li> <li>• Materials Inventory Management</li> <li>• Transportation Administration</li> <li>• Performance Measures and Traffic Congestion</li> <li>• Road Maintenance</li> <li>• Asphalt Buying</li> <li>• Washington State Ferries</li> </ul>
<b>State Government</b>	<ul style="list-style-type: none"> <li>• Health Care Services</li> <li>• Administration of Children’s Programs</li> <li>• Workers’ Compensation</li> <li>• Health and Recovery Services</li> <li>• Agency Customer Service Call Centers</li> <li>• Unemployment Compensation</li> </ul>
<b>Local Government</b>	<ul style="list-style-type: none"> <li>• Sound Public Transit Agency</li> <li>• Port of Seattle-Construction and Management</li> <li>• Public Development Authorities (there are about 50 such entities)</li> </ul>

## Reporting

### Common Practice—

The tradition in performance auditing is to issue written audit reports. Performance audit report formats are as varied as the topics themselves. Some audit offices prefer a short, terse style that resembles the narrative sections of financial audit reports. Others take a broader approach, incorporating graphics, photographs and special fonts intended to make the reports more readable. Each report is unique. It is common practice for public sector audit offices to make their reports available to the public and to post the reports on their websites.

### Washington State Auditor’s Actions—

The state auditor will sign the reports for all performance audits done on contract. The reports will be prepared by the contractors following a prescribed format developed by the performance audit team and the state audit office report specialist. Sonntag has two professional writers on staff; both former newspaper reporters and editors. As a matter of protocol, the policy is to provide regular progress reports during audits and to give completed reports wide distribution. Reports will be posted on the state auditor’s website.

## Contracting for Audit Services

### Common Practice—

Federal and state auditors commonly hire contractors to conduct financial statement audits. They and their colleagues in local government seldom do so for performance audits. Contracting out is generally, but not exclusively, limited to obtaining special technical knowledge and skills needed in a particular audit.

### Washington State Auditor’s Actions—

The legislation passed by the Senate requires transportation or transportation related audits to be conducted by private firms. The legislature and the governor expect that performance audits will be done on contract. This expectation reflects a desire of a large number of legislators to limit the growth of state employees. The short-term goal is to conduct about 50 percent of performance audits on contract. The current long-term goal is to conduct about 25 percent of performance audits on contract and about 75 percent with in-house auditors.

**Template to Contract for Audit Services**—The existing statewide templates for procuring professional services were not sophisticated enough to accommodate the size and scope of performance audits. Hence, the performance audit team prepared a model RFP and contract template. It did so for two types of contracts—to conduct a complete performance audit, and to obtain special expertise. Development of procurement templates was possible because two performance audit managers had extensive experience in contracting for professional services. The performance audit team intends to follow the established state process for advertising Request For Proposal (RFP), to include notifying interested private firms with competence to conduct performance audits.

**Policies for Managing Audits Done on Contract**—The performance audit management team intends to take a hands-on approach in managing audits conducted on contract. This includes participation in planning, observing and monitoring fieldwork and reviewing contractor reports. The extent of their participation in report writing is under consideration. The team is developing policies setting forth the practices they will follow in all four audit phases—survey, planning, fieldwork and reporting. It is also developing procedures for contractor use of TeamMate.

### Strategic Plan

#### Common Practice—

The value of following a strategic plan is widely acknowl-

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edged in both the private and public sectors, and is required by many, if not most, government entities. Beyond a few generally recognized items, such as a vision statement, mission statement, an explanation of how the mission is to be achieved, and measures of performance, organizations are free to decide the form and content for their strategic plans. For performance audit offices, one unique, and important strategic planning item is audit selection—the method and rationale for selecting subjects for audit.

## **Washington State Auditor's Actions—**

Sonntag and Long's stated intention is to totally transform the plan in light of their performance audit authority. At the cut-off date for this research project (March 31, 2006), the plan was still in development.

One item common to strategic plans is a vision statement. Sonntag's vision for performance audit is that the audits:

- be fair,
- be valued and implemented as a management tool,
- promote continuous improvement of quality, efficiency and effectiveness,
- focus on results,
- enhance accountability and trust, and
- complement the state's performance management and budgeting priorities.

His expectation for the performance audit program is that it will achieve profound results, first and every year, measured by success in having recommendations implemented and the impact achieved.

## **Performance Management and Measurement**

### **Current Practice—**

In recent years the federal government, and many state and local governments, have enacted laws requiring establishment of measures of performance and for use of those measures in managing. These laws generally require that executive branch agencies engage in strategic planning to include the development of an agency mission statement, measurable goals for applicable aspects of output and outcome performance, and performance measures indicating the relative success in achieving program goals. Some have a requirement for use of performance measures in budgeting, generically referred to as performance-based budgeting.

To date, the efforts of audit offices in verifying the reliability of agency-prepared performance measures has been limited, based on the knowledge of the research team.

## **Washington's Government Management Accountability and Performance Program (GMAP)**

In 1993 the legislature amended Washington's Budgeting and Accounting Act to require state agencies to engage in strategic planning, including the development of an agency mission statement and measurable goals, program objectives, and budget proposals that incorporate performance measures indicating the relative success in achieving program objectives and goals. This legislation was followed in 1997 by an executive order requiring state agencies to "use

the tools of strategic business planning and performance measures to establish their priorities and measure their progress toward their stated goals." This order established a series of "quality management" activities for state agencies, including the establishment of a quality-improvement representative for individual agencies, and quality steering committees, which were to report to the governor each quarter.

For every major program administered by an agency, program objectives are to be reported with measurable outputs and outcomes, to the extent possible. This performance information is publicly reported, at the agency level, in the biennial executive budget document. The JLARC is responsible for assessing the relevance and reliability of agency performance measures.

The quality of the performance measures developed by agencies can directly affect the results of performance audits. If those measures are broad, vague and difficult to quantify, then the performance auditors will have a difficult time clearly delineating, which measures have been met and which have not. In conducting performance audits, the auditors will be faced with preparing their own measures, which they may recommend that the agency prepare on a regular, recurring basis.

## **Priorities of Government (POG) Budget Process**

The Washington state POG initiative was designed to rank and prioritize state government services and develop a budget strategy from the results of these exercises. POG categorizes all state programs in services into one of 11 results areas. The results areas are statewide desired conditions (for example, improve student achievement in elementary, middle and high schools; improve quality of Washington's natural resources); they are not program-specific.

A guidance team and 11 results teams that corresponded with each of the results areas were developed to implement the POG process. Ultimately, the POG approach informed the governor's proposed budget for the 2003-05 biennium. Budget activities were ranked by contribution to the results, and a line was drawn at the dollar amount allocated to the results. Activities below the line were listed in order to identify how changes in funding might affect service provisions.

## **Washington State Auditor's Actions—**

Initiative 900 cites as one of the 11 items to be included in each performance audit, "an analysis of departmental performance data, performance measures and self-assessment systems." In keeping with this requirement, one of the state auditor's visions for performance audit is that his audits "will complement the state's Priorities of Government Budget Process and the Government Management Accountability and Performance program."

Consistent with these performance-based management initiatives, Sonntag envisions his audits to "be valued and implemented as a management tool." This could prove to be a considerable challenge. The state auditor is independently elected and not considered a member of either the legislative or the executive management team. Moreover, both the legislature and the executive have historically perceived the state

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auditor not only as an outsider, but as an adversary, at least in the context of the legislature precluding his office from conducting performance audits. It must be noted that the audit office is well respected throughout the state and this is attributable to the work done by the financial and compliance audit staff. As an indication of this respect (and recognition of the state auditor's new performance audit authority), the governor, in response to a series of media stories about patient mistreatment and abuse at state licensed health care facilities, asked the state auditor to conduct a performance audit of the state's health care licensing and discipline practices. The request was made, and accepted by the state auditor, as our research report was in final preparation.

This raises a fundamental question for all auditors. What is the appropriate role of audit in government performance management initiatives—initiatives that include measurement-based management, budgeting and reporting? The respective managerial roles of the legislature and executive are established in law, principle and practice. The role of the auditor as an accepted and respected third member of the performance management team has not been articulated. Moreover, it is unclear whether auditors would feel comfortable in this role. Some might perceive such a role as compromising their independence, citing the Government Auditing Standards as their support. The Washington state auditor has said he intends to work cooperatively with the GMAP and POG efforts, primarily to avoid any potential duplication and seek ideas for audits. But he said those programs are clearly separate from the role of auditors, who must remain independent.

The research team believes that further research is needed to explore the appropriate role for public sector auditors in government performance management initiatives.

## Conclusions and Recommendations

The voters of Washington state have given their state auditor a level of independence that is virtually unprecedented in the auditing community. Not only has this citizen-driven initiative given the state auditor a mandate to check the performance of state and local agencies, but it also has given the Office of State Auditor a dedicated revenue stream that is resistant to tampering by those who might resent a critical audit.

The Washington initiative is a sign that at the federal, state and local levels, citizens are demanding more accountability from the government programs they finance with their tax dollars. They do not want to know just how many dollars were spent and how many people were served. Instead, they want the answer to more basic questions: Is the program fulfilling the purpose for which it was created? And is it fulfilling that purpose in the most economical and efficient way? Are there opportunities to improve the performance of those programs, or in some cases, should those programs or activities be reduced or eliminated?

But answering those basic questions requires a three-legged stool approach. The citizens of Washington have supplied one of the legs—performance auditing authority for

their state auditor and the funds to carry out that authority. The two other legs of the stool must come from the executive and legislative branches of government—establishment of meaningful performance measures for every audited agency and ongoing performance management that focuses not only on the quantitative factors of dollars and clients, but also the qualitative factors embodied in the basic performance questions.

Washington state provides a unique laboratory for further study of performance auditing and performance management issues, the development of meaningful performance measures and the adjustments needed to manage enterprises for more than just “number” outcomes.

The Washington state auditor, with the clear support of his citizenry, is in a unique position to encourage the development of performance reporting models and performance measures that could well benefit other jurisdictions.

Because the initiative calls for performance reports that highlight positive outcomes, the state auditor also is in a unique position to identify and promote “best practices” that can be used by other government programs.

With that in mind, the following recommendations are suggested:

- Because the performance auditing authority is citizen-driven, Sonntag has already started to ensure that his work is transparent to the citizens of the state. Those efforts should continue. Also, the State Auditor's Office is undertaking an extensive, perhaps one-of-a-kind, effort to obtain ideas from citizens on subjects for future audit. Other audit offices may consider seeking input on audit topics from citizens to the extent they are not already doing so. Because his office's outreach to citizens may provide some valuable lessons, the Washington state auditor should carefully document the proceedings and the results.
- The state auditor should partner with the state Personnel Office to address the salary disparity between financial audit teams and performance audit teams. Revisions to the state personnel salary scale should be aggressively pursued.
- Financial audit teams, with their broad coverage and access to state and local agencies, should be integrated into the performance audit process. Financial audit teams can be helpful, not only in auditing performance measures for the agencies with which they are engaged, but in analyzing whether measured performance is increasing, decreasing or remaining relatively stable. This issue of integration and performance measurement could well be worth a follow-up study.
- The state auditor can partner with others to develop model legislation for meaningful performance measures that could apply both to local governments and to other jurisdictions.
- Washington state voters, with the encouragement of the state auditor, have shown great innovation in tying a dedicated revenue stream to performance audit authority. Other jurisdictions may want to consider seeking similar

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dedicated funding to ensure the independent voice that citizens want and expect from their government auditing agencies. How those resources are used and managed in Washington state creates another subject for future study and review.

- AGA should consider conducting further research to explore the appropriate role for public sector auditors in government performance management initiatives.

## Appendix A: I-900 Audit Authority and Requirements

**State Auditor's Authority**—The following provisions of Initiative 900 lay out the state auditor's authority for conducting performance audits.

- The state auditor shall conduct independent, comprehensive performance audits of state government and each of its agencies, accounts and programs; local government and each of its agencies, accounts and programs; state and local education governmental entities and each of its agencies, accounts and programs; state and local transportation governmental entities and each of its agencies, accounts and programs; and other governmental entities, agencies, accounts and programs. Government includes all elective and nonelective offices in the executive branch and includes the judicial and legislative branches.
- The state auditor shall review and analyze the economy, efficiency and effectiveness of the policies, management, fiscal affairs, and operations of state and local governments, agencies programs and accounts.
- The state auditor may, at any time, conduct a performance audit . . . Follow-up performance audits . . . may be conducted when determined necessary by the state auditor.
- No legislative body, officeholder or employee may impede or restrict the authority or the actions of the state auditor to conduct independent, comprehensive performance audits.
- The state auditor is authorized to issue subpoenas to governmental entities for required documents, memos and budgets to conduct the performance audits.
- These performance audits shall be conducted in accordance with the U.S. Government Accountability Office government auditing standards.
- The state auditor may contract out any performance audits.
- For counties and cities, the audit may be conducted as part of audits otherwise required by state law.
- Each audit report shall be submitted to the corresponding legislative body or legislative bodies and made available to the public on or before 30 days after the completion of each audit or each follow-up audit.
- Beginning on December 8, 2005, 0.16 percent of the sales and use taxes collected shall be dedicated to funding comprehensive performance audits. This revenue shall be deposited in the Performance Audits of Government Account. Only the state auditor or the state auditor's designee may authorize expenditures from the account.

**Expectations**—The following provisions lay out key expectations of I-900 performance audits.

- The people encourage the state auditor to aggressively pursue the largest, costliest governmental entities first but to pursue all governmental entities in due course.
- The scope for each performance audit shall not be limited and shall include nine specific elements: (1) identification of cost savings; (2) identification of services that can be reduced or eliminated; (3) identification of programs or services that can be transferred to the private sector; (4) analysis of gaps or overlaps in programs and services and recommendations to correct gaps or overlaps; (5) feasibility of pooling information technology systems within the department; (6) analysis of the roles and functions of the department, and recommendations to change or eliminate departmental roles or functions; (7) recommendations for statutory or regulatory changes that may be necessary for the department to properly carry out its functions; (8) analysis of departmental performance data, performance measures, and self-assessment systems; and (9) identification of best practices.
- To the greatest extent possible, the state auditor shall instruct and advise the appropriate governmental body on a step-by-step remedy to whatever ineffectiveness and inefficiency is discovered in the audited entity.

**Requirements of Report Recipients**—The following I-900 provisions lay out the requirements of audit report recipients.

- On or before 30 days after the performance audit is made public, the corresponding legislative body or legislative bodies shall hold at least one public hearing to consider the findings of the audit and shall receive comments from the public.
- For performance audits of state government and its agencies, programs and accounts, the legislature must consider the state auditor reports in connection with the legislative appropriation process.
- An annual report will be submitted by the joint legislative audit and review committee by July 1 of each year detailing the status of the legislative implementation of the state auditor's recommendations. Justification must be provided for recommendations not implemented. Details of other corrective action must be provided as well.
- For performance audits of local governments and their agencies, programs and accounts, the corresponding legislative body must consider the state auditor reports in connection with its spending practices.
- An annual report will be submitted by the legislative body by July 1 of each year detailing the status of the legislative implementation of the state auditor's recommendations. Justification must be provided for recommendations not implemented. Details of other corrective action must be provided as well.

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## Appendix B: Expectations and Objections of Proponents and Opponents

This list of expectations and objections expressed by proponents and opponents of performance auditing were compiled from a limited review of literature, primarily press reports citing the views of individuals and organizations in support or opposition to legislative bills on performance auditing (in 2005) and Initiative 900. With the exception cited above, the expectations and objections are not unusual. They reflect the sentiment one finds in reviewing literature on performance auditing.

### Expectation of Proponents

- Performance audits are a valuable management tool carefully structured around tough, nationally recognized auditing principles that evaluate whether tax dollars are being spent in an efficient, effective and economic manner. (The Heartland Institute)
- Voters instinctively want accountability and transparency. (Eyman, sponsor of I-900)
- A performance audit looks at government programs to see whether agencies are using public money efficiently. The audits root out the cause of wasteful practices and measure a program's actual performance against its goals and objectives. (Washington Policy Center)
- Supporters of both the legislature's plan and Initiative 900 agree citizens deserve the most "bang for their buck." The long-term goal would be to uncover any waste, inefficiency or unnecessary duplication of services and identify steps to resolve such problems. (Washington Policy Center)
- Our foundation is a strong advocate of using comprehensive performance audits as a tool to ensure the wisest possible use of taxpayer dollars and to decrease the cynicism people have about their government. (Evergreen Freedom Foundation)
- Regular performance audits determine if an organization is carrying out its responsibilities effectively and efficiently and determines if information reported in performance measures is accurate. (Evergreen Freedom Foundation)
- In authorizing performance audits (HB 1064), the legislature recognized that citizens demand and deserve accountability of public programs and that public programs must continuously improve in quality, efficiency and effectiveness to increase public trust. (The League of Women Voters of Seattle)
- Essential tools for improving the efficiency and effectiveness of government include fair, independent and professional performance audits of state agencies, performance reviews, a performance-based budgeting process and quality assessments. (House Bill 3109 giving the state auditor limited authority to conduct performance audits)

- Front-line employees are frustrated by waste and red tape. The front-line employees would benefit from a solid, honest performance audit. (Supporters of House Bill 1064)
- Not only would poor performance be identified and ended, but previously unpublished success stories would become a part of the public record, allowing state managers and workers to establish credibility with voters, something that today is severely lacking. (Washington Policy Center)

### Objections of Opponents

- Performance audits are not a cure-all for the ills facing state government. (Washington Policy Center)
- Initiative 900 is ill-conceived, not drafted with public input, and is not needed. Initiative 900 doesn't solve anything. It's like enlarging a wound instead of applying a bandage. (Permanent Defense)
- Initiative 900 overloads Washington state with audits. (Permanent Defense)
- The state auditor's office says implementing I-900 would cost \$90 million every two years. The office also says the initiative will require the auditor's office to expand four times its current size and will take a decade or longer to fully implement. (Permanent Defense)
- I-900, which, honestly, will pass by a large margin, is a bit of a boondoggle, a one-size-fits-all solution to a problem that really doesn't exist. (unknown source)
- It is more appropriate to fund performance audits in the budget process where citizens have an opportunity to participate. (The League of Women Voters of Seattle)
- It should not be the business of the state to manage and dictate state priorities on local government (re: state auditor's authority to audit local governments). This intrudes upon local control and home rule powers of cities and counties. (The League of Women Voters of Seattle)
- There is concern that comprehensive audits of every agency won't reap savings and that they are expensive to conduct. Also, performance audits aren't silver bullets, clear and disciplined leadership is the most effective way to increase performance, and performance audits do not build capacity to improve because they are too focused on the past. (Opponents of House Bill 1064)
- Initiative 900 is so unnecessary that even if it gets the needed signatures and passes, there will be no discernible impact. (Washington State Council of County and City Employees)



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