



# THE STATE OF AUDIT

---

## 2010 ANNUAL REPORT



WASHINGTON  
**BRIAN SONNTAG**  
STATE AUDITOR



# TABLE OF CONTENTS

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STATE AUDITOR’S OFFICE OVERVIEW ..... 4

PERFORMANCE AUDIT AND REVIEW ..... 8

STATE GOVERNMENT AUDITS..... 11

DIVISION OF SPECIAL INVESTIGATIONS ..... 18

LOCAL GOVERNMENT AUDITS ..... 24

SCHOOL PROGRAMS ..... 27

LOCAL GOVERNMENT SUPPORT ..... 30

INITIATIVE 937 AUDITS ..... 33

CONTACT INFORMATION ..... 35

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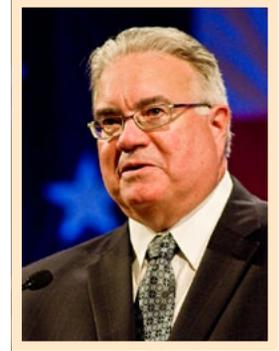
**State law requires the Auditor’s Office to publish an annual report by December 31 1 of each year. This report fulfills that requirement. The law also requires that we report on any appeals to bills for audits of local governments. We did not receive any of these appeals in 2010.**

# Letter from Washington State Auditor Brian Sonntag

December 31, 2010

Like all state agencies, the State Auditor's Office has a mission statement. Ours is:

"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."



Having such a statement is one thing. Living up to it is another. As always, I am pleased to report the accomplishments of our Office in the past year, and on how our work reflects our staff's understanding of our mission.

We expanded this year's annual report to make it more user-friendly and to give a fuller picture of the many ways our staff serves citizens and the local governments and state agencies we audit.

**Are we independent? Yes, uniquely so.** The state's founders created our Office in the Constitution to be the auditor of all public accounts and gave us the access to records and people that we need to carry out our work. Our audits are based on where we find the greatest risk to public resources, not on what governments want us to look at. That independence, combined with our many, many years of experience, puts us in a great position to offer constructive suggestions for improvements in everything from accountability measures to program efficiencies noted in our performance audits and reviews.

**Do we promote accountability, fiscal integrity and openness in government?** All of our audit work is based on this premise. And in 2010, we increased these efforts by using new methods to make our work even more understandable to those whom we audit, policy-makers and citizens. For example, for the first time this year, we summarized the state's Combined Annual Financial Report to make it understandable to citizens. We also plan to do this with our audit of the state's federal programs, including Medicaid.

**Do we work with citizens and governments to ensure the efficient and effective use of public resources?** Absolutely. Our whistleblower, fraud and citizen hotline programs demonstrate our commitment to examining relevant issues brought to our attention, no matter what the source. In 2010, we identified numerous instances in which public dollars were wasted or misappropriated. In these tight financial times, every penny counts.

**What lies ahead?** In the coming year, we will be working to institute a program to provide even more resources to governments, in an effort to keep audit costs down while ensuring public resources are safeguarded.

We will continue to offer bold ideas, maybe even controversial ones, for government reform. We know good economic times for our state are not just around the corner. Government will look different. Government will be different. We are here to assist in that reshaping.

Last, but not least, I want to publicly thank the amazingly talented staff of the State Auditor's Office. They are out there every day, working on your behalf.

Sincerely,

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

**BRIAN SONNTAG, CGFM**  
STATE AUDITOR

2010 ANNUAL REPORT  
STATE AUDITOR'S OFFICE  
OVERVIEW



WASHINGTON  
**BRIAN SONNTAG**  
STATE AUDITOR

## Emerging themes in 2010 and beyond

The Washington State Auditor's Office is established in the state's Constitution as part of the executive branch of state government. The State Auditor is elected to four-year terms. The Office employs approximately 350 people located all over the state.

Our audits look at financial information and compliance with state, federal and local laws on the part of all local governments, including schools, and all state agencies, including institutions of higher education. We also perform special investigations of fraud and whistleblower cases and referrals from our citizen hotline. In addition, we conduct performance audits of state agencies and local governments.

Like all other government and private entities, the State Auditor's Office has spent the past year adjusting to an ever-changing economic climate. This has given the Office an opportunity to reflect on how we carry out our mission and how

we will continue to monitor and protect public funds. Here are the themes that emerged this year and will remain important as we look to the future of government in Washington State:

### Uniquely Independent

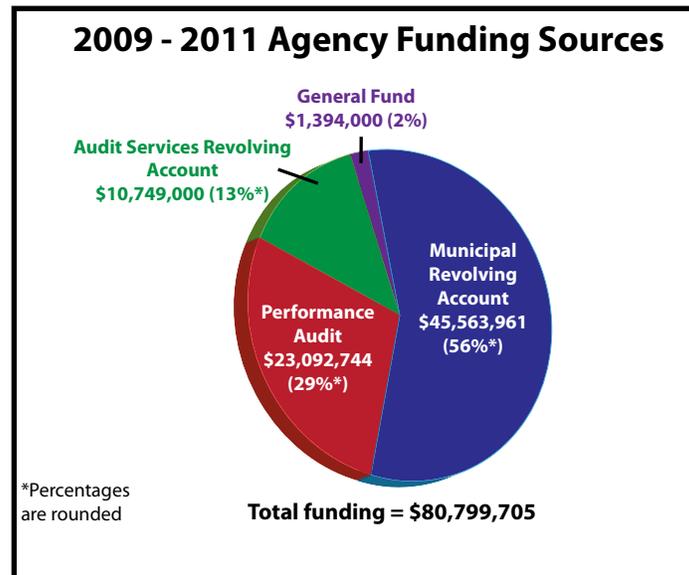
Independence is paramount to our audits. While the position of State Auditor is partisan, our work is not. It must remain fair, objective and free from bias or partiality. Our independence is established by both *Government Auditing Standards* set by The United States Government

Accountability Office (GAO) and through state law.

By adhering to GAO-established auditing standards, financial, single and performance audits conducted by the State Auditor's Office are independent, as demonstrated every three years by a required external peer review. Further, because the State Auditor is a statewide elected official, he 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 state

agencies. This unique independence allows us to carry out our mission without outside interference and to represent the sole interest of the public.

State law and citizen initiative give the State Auditor authority to audit all governments in the state. We report objectively and directly to taxpayers about all levels of government's stewardship of public funds.



### 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.

## Doing our work with less

The State Auditor’s Office has strived to maintain our commitment to our mission, with decreased funds and increased caseloads in our Division of Special Investigations, special audit requirements related to economic stimulus funding, and assisting small local governments.

## Increases in fraud

The Office’s fraud program has seen an increase in reporting due to an emphasis in education over the last year. We have increased training for our local and state auditors so they are able to work with entities to encourage reporting losses through the State Auditor’s Office website.

The State Employee Whistleblower program has cut staff, while taking on larger and more complex assertions. Of the 36 cases closed by the Whistleblower program in 2010, 50 percent were substantiated.

The Citizen Hotline program was established by the Legislature in 2007. It requires our Office to create, promote and operate the program. Although never funded by the Legislature, the State Auditor’s Office continues to accept and process hotline assertions through

our website, by phone or mail. Between January 1 and November 30 of this year, we received 641 assertions.

## Local Government Support

Our Local Government Support Team has seen loss of staff and turnover affecting services to small local government entities. With new local government employees taking over reporting responsibilities, our role has become very important. Without the education and guidance offered by Local Government Support, new employees would not understand reporting requirements, which could result in audit findings, and increased audit costs for small governments.

## School Programs

The School Programs team’s primary purpose is to audit state school district funding, which

represents approximately 50 percent of the state’s general fund expenditures each year. Over the past three years, we have recommended recovery of state funding totaling approximately \$10 million.

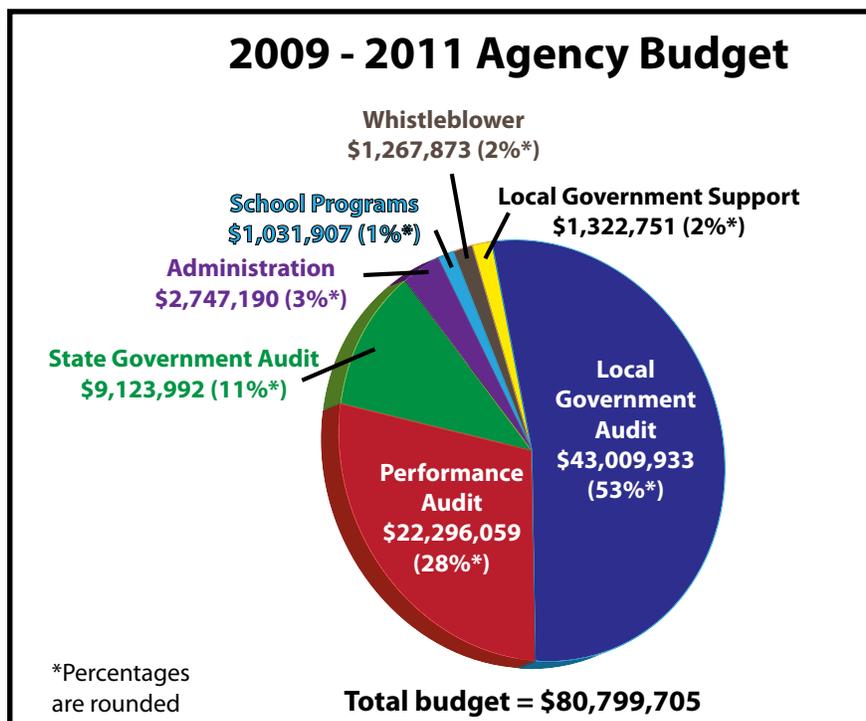
Our School Programs Team is uniquely positioned to develop efficient and effective audit techniques for K-12 school districts and identify funding errors that would otherwise go undetected.

## Transparency

The State Auditor’s Office has made significant strides over the past four years in producing user-friendly reports and documents by using plain talk, graphics to explain complex concepts and a consistent format. We have developed writing training for our auditors to ensure each report released is easy to understand.

In 2010, the State Auditor’s Office produced a summary document for the Comprehensive Annual Financial Report. It gives readers a quick overview of the important information contained in the 294-page document.

In March 2011, we will continue this trend by releasing a summary document for the





State of Washington Single Audit Report.

To improve the transparency between our Whistleblower reports and possible resulting sanctions, we are working with the state Executive Ethics Board. Once an investigation is released, we pass the information on the Board and it may impose sanctions. Once sanctions are decided for an investigation, the Board sends us a link, which we post next to the initial report so all of the informa-

tion is in one location.

### **Government reform**

The State Auditor's Office is committed to working with all entities to improve the effectiveness and efficiency of government. We have the advantage of seeing the inner workings of each entity individually, and we can take what we learn in each audit and create a big picture of government in Washington. No other office has such a vantage point and no other

office is in a position to offer a complete picture of reforms that could take place.

It has been said the government will look different when we come out of this economic downturn. The State Auditor's Office will continue to offer ideas to the Governor and Legislature on improving and streamlining government. We will offer value to our auditees by providing guidance, education and support. And we use our independence to report to citizens without bias or partiality.

## **State Auditor's Office reports go 100 percent digital**

Since 2008, the Washington State Auditor's Office has published and distributed reports approximately 85 percent electronically. In November 2010, we moved to 100 percent electronic report distribution.

We have been looking for ways to cut costs while achieving our mission to promote government accountability and transparency. We estimate we will save more than \$18,000 per year by distributing our reports electronically and cutting printed copies. We will not produce hard copies unless they are specifically requested and if the requestor cannot download and print copies from our website.

In addition, we are broadening our communication efforts through a new Twitter feed, through which we will also post new audit reports. Our Twitter tag is @WASStateAuditor and the link is: [www.twitter.com/WASStateAuditor](http://www.twitter.com/WASStateAuditor)

2010 ANNUAL REPORT  
PERFORMANCE AUDIT  
AND REVIEW



WASHINGTON  
**BRIAN SONNTAG**  
STATE AUDITOR



## Performance Audit and Review

The State Auditor's Office Performance Audit team ended 2009 with the release of Opportunities for Washington, our first performance review. The report identified opportunities to save money, increase revenue without raising taxes and suggested possible reforms for selected state services.

We timed its release to provide information for the 2010 Legislature and other policy makers dealing with difficult budget issues. It particularly affected liquor sales and distribution and state printing. Debate regarding the state's role in these two areas continues.

We identified opportunities for the state to reduce spending and increase revenue by up to \$325.5 million over the next five years.

We developed our work plan through 2013 based on questions we asked during the review, such as whether a program is a core function of government; could be scaled back, eliminated, or moved to the private sector; opportunities for cost-savings and ideas from other states or businesses.

What we're studying in 2011:

- K-12 school district health insurance. We're looking at whether costs could be reduced, for example by combining K-12 and state employee risk pools or by adopting other coverage models.
- Printing services. State agencies operate 11 separate print shops in addition to the

state Department of Printing. Technology is causing seismic changes in the printing industry, and we want to know if there are ways the state can save money by consolidating or outsourcing.

- Gaps and overlaps in social services. We're looking at how to improve and streamline services, starting with crime victims' services and exploring further opportunities in social services in 2011.
- Prescription drug spending. We're looking at whether the state can save money in the workers' compensation prescription drug program. We may look at the effectiveness of other state programs that buy substantial amounts of prescription drugs.
- High-risk federal stimulus funding. Washington is receiving about \$6.6 billion in federal economic recovery funds. The directive was to spend that money as quickly and prudently as possible to create jobs and stimulate the economy. Our questions: Did

we cut corners trying to get that money out the door? Are we getting the results we expected? We are scrutinizing two programs at the state Commerce Department – low-income weatherization and the State Energy Program.

In addition, we're following up on past audit and review results in our annual Performance Audit Progress Report.

We issued these reports in 2010:

- Department of Fish and Wildlife Puget Sound Dungeness Crab Fishing Program: We found two factors are critical to managing the program – accurate crab harvest data that is available to the program at critical decision-making points and an effective management framework that meets legal mandates and provides opportunities for recreational and commercial fisheries.
- Seattle City Light: We found the Utility's nonstandard practices contribute to higher than necessary operating costs and that some charges to the Utility for overhead are questionable. We identified ways for the Utility to reduce costs and increase revenue.
- Department of Fish and Wildlife Delayed-Release Chinook Salmon Program: We found the program is not meeting its annual statutory goal for release of these fish, and that the cost per fish has increased

**We identified opportunities for the state to reduce spending and increase revenue by up to \$325.5 million over five years.**



dramatically. We also recommended the Department use its high-quality data to better manage the program.

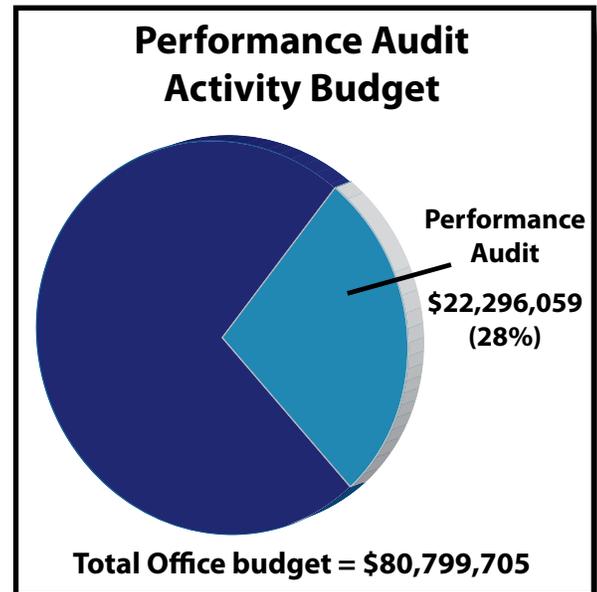
- Department of Fish and Wildlife Selected Revenue & Expenditures: We found the Department generally does a good job of administering three accounts as required. We identified opportunities for improvement, including verifying the accuracy of calculations, clarifying administrative rules and better record-keeping.
- Mid-Columbia Public Utility Districts: We identified opportunities to share services and reduce costs and improve the utilities' management and operations in the areas of procurement, asset management, contracting and labor.
- Port of Seattle Real Estate Management: We found the Port needs to better analyze current and future property needs, review the organizational structure of its property management function, improve its financial analysis of sales, purchases and leases and establish lease rates at fair market value. We found the Port does a good job overseeing promotional expenditures.
- Master License Service: We examined this key element of the state's effort to improve its business climate. We found it has been successful in streamlining licensing and reducing duplicative requirements for

many businesses. Our recommendations included development of a multiyear expansion plan for the program, resolving concerns about its financing and some short-term service improvements.

- Pierce County Performance Measures Assessment: The Pierce County Executive requested this work, which looked at how some County departments are assessing their performance. We found the County could improve in several areas, including demonstrating the public value of programs with performance measures, balancing the types of measures it uses, and setting performance targets.

We plan to release several performance reviews in 2011 that will offer options to make Washington work better, faster and cheaper. The options range from giving citizens one phone number for all state business to embracing a management approach across state government that focuses on customer service. The reviews will examine reforms to the state's regulatory system and explore improvements to public education.

We conduct performance audits and reviews under the authority of Initiative 900. It specifies performance audits shall identify:



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

2010 ANNUAL REPORT  
STATE GOVERNMENT  
AUDITS



WASHINGTON  
**BRIAN SONNTAG**  
STATE AUDITOR

# State Government Audits

Funding for state audits enables the State Auditor's Office to perform the following services:

## Accountability Audits

The scope of our accountability audits is twofold. First, we audit financial records to ensure public funds are accounted for and controls are in place to protect public resources from misappropriation, loss or misuse. Second, we audit to ensure agencies adhere to laws and regulations relating to financial matters. We promote prevention by helping state agencies improve internal controls, financial management and accountability. In addition, state accountability audits have helped prevent improper governmental action.

We reported a variety of issues in 2010 at large and small state agencies. Here are some examples:

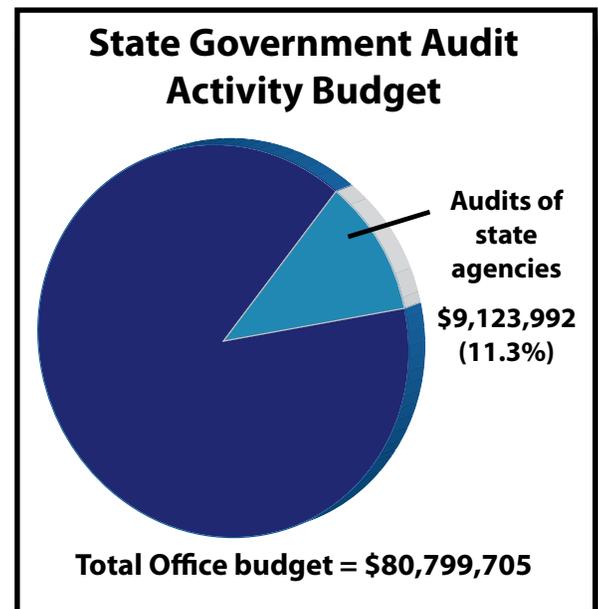
- The Department of Transportation's Automated Fuel System recorded more than five million gallons of gas dispensed at a cost of more than \$14 million from July 2008 through April 2009. The Department's records revealed missing fuel and a lack of system security and physical safeguards over fuel tanks, which increases the risk of fraud or inappropriate fuel use. Further, a purchase of \$1.5 million of bulk fuel without a formal bid process increased the risk the Department may not have received the lowest price possible

and also violated state bid laws.

- The Department of Labor & Industries' Workers Compensation Program paid approximately \$25 million in fiscal year 2007 for prescription medications, including more than \$780,000 for prescription opioids to treat accepted conditions of an injured worker's claim. Our audit in 2010 found the Department did not adequately monitor claims when opioids were prescribed to injured workers. We noted that required provider reports and treatment plans were not obtained or reviewed and claims managers did not properly approve 43 percent of the claims we reviewed. In four cases, payments for opioids were authorized indefinitely.
- The Department of Revenue received approximately \$91.5 million in unclaimed cash during fiscal year 2009 and holds approximately \$700 million. In 2010, we found a lack of security over property owner information, inadequate record retention, a failure to maintain an audit history, poor controls over scanning and inadequate monitoring of system activity, all of which created a risk that a Department em-

ployee could change owner data that might result in an unauthorized refund to someone other than the property's rightful owner. This risk of misappropriation was increased due to the fact the rightful owner may not be aware of the property and would not notify the Department if a refund was not received.

- The Department of Social and Health Services processed approximately \$1.1 billion in payroll for more than 18,000 employees. We found the Department had not reconciled its payroll account in a timely manner, resulting in overpayments not being recovered. As of July 2009, the Department recorded more than \$1.34 million in employee overpayments. Additionally, because of the lack of timely reconciliation, the Department paid more than \$350,000 in





medical insurance premiums for employees who had left the agency. These payments cannot be recovered and represent a loss to the state.

- The Puget Sound Partnership was created in 2007 to lead efforts to restore the Puget Sound. Our first audit of the Partnership, covering fiscal years 2008 and 2009, found it circumvented state contracting laws, exceeded its purchasing authority, and made unallowable purchases. As significant state and federal funds begin flowing through the Partnership, identifying and correcting these weaknesses early is critical to ensuring accountability.
- The Employment Security Department purchased more than \$123,000 in gasoline gift cards to assist certain clients who were looking for jobs. During our audit in 2010, we noted weaknesses in the internal controls over those gift cards, prompting us to perform testing to determine if all cards were accounted for. We found the Department could not account for more than \$25,000 worth of cards.

## Federal compliance

The federal Single Audit Act of 1984 and its amendments establishes uniform, entity-wide audit requirements for state and local governments that receive federal financial assistance. Pursuant to the Act, our Office audits the state's expenditures of federal money in accordance with the Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Single audits, as they are known, include an assessment of agencies' internal controls over federal programs, tests of those controls, and tests of compliance with federal requirements.

In addition, the American Reinvestment and Recovery Act has unique accountability requirements that are required to address in the coming fiscal year's audits.

The state of Washington reported more than \$18 billion in federal assistance for fiscal year 2010, including grants, loans, commodities, vaccines and other forms of aid. All together, our Office identified more than 40 conditions or concerns significant enough to report as federal findings.

The 2010 Statewide Single Audit Report, which contains the details of those findings as well as the overall results of the audit, is conducted by our Office and issued by the state Office of Financial Management. The report will be available on its website in March 2011 at [www.ofm.wa.gov/singleaudit](http://www.ofm.wa.gov/singleaudit).

## Reinventing state audit

In response to cuts in the state audit revolving fund, the State Auditor's Office has established a new framework for state accountability audits. Using a statewide risk assessment and planning process, we identified these topics as high priorities for audit:

**Benefit payments.** The state pays more than \$8 billion annually to client service providers. We will look for patterns of possible misuse or misappropriation by client service providers. The scope of this audit could include social service programs, Workers' Compensation, or others that pay providers on behalf of individuals.

**Grants.** The state pays more than \$10 billion a year with grant money. We believe a significant risk exists that some subrecipients may not be using this money in ways that are not appropriate and/or allowable. We will do work to determine if that is so.

**Purchase cards.** The use of purchase cards by state employees continues to be an area in which we find misuse. We will identify trends and high-risk transactions to look for possible misuse, waste and/or fraud.

We will also follow up on previous findings.

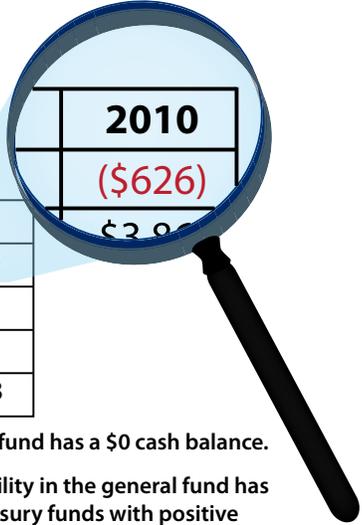
# A snapshot of Washington's financials

State law requires the State Auditor's Office to do an annual audit of the state's financial statements.

The Comprehensive Annual Financial Report (CAFR) contains the Director of Office of Financial Management's discussion and analysis, financial statements covering all state activities and a statistical section containing trend and nonfinancial data. The statements are prepared by OFM in accordance with national standards established by the Governmental Accounting Standards Board. We recognize the CAFR is a complex and lengthy document, and are providing this summary to highlight important information.

### State Treasurer's Ending Fiscal Year Cash Balances (in millions)

Fund Type	2009	2010
General Fund	(\$15)	(\$626)
Other Treasury Funds	\$2,900	\$3,861
Trust Funds	\$642	\$678
<b>TOTAL</b>	<b>\$3,527</b>	<b>\$3,913</b>



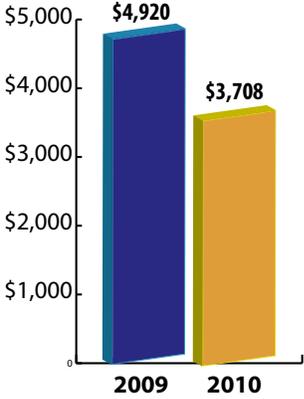
The state's financial statements indicate the general fund has a \$0 cash balance. Since the State Treasurer pools treasury funds, a liability in the general fund has been established to report amount due to other treasury funds with positive cash balances.

Our independent audit of fiscal year 2010 resulted in a clean audit opinion, meaning we did not identify any significant issues with the state's financial statements. Complete financial information is available in the full report, which is published by the Office of Financial Management <http://www.ofm.wa.gov/cafr/default.asp>.

As of June 30, 2010 the state's general fund had a negative cash balance. It is important to note that the general fund is one account among hundreds in the state treasury. It pays for a number of state services, primarily human

services and education. Treasury funds are under the control of the State Treasurer and are subject to appropriation by the Legislature. Examples of treasury funds include the Transportation Account and the State Building Construction Account. Treasury trust funds are placed in the custody of the State Treasurer but are not subject to Legislative appropriation. Examples of treasury trust funds include the Pollution Liability Insurance Program Trust Fund and Life Sciences Discovery Fund. Local accounts are under the control of an agency with cash on deposit in a local bank account. Examples of local funds include the Unemployment Compensation Fund and the Institutions of Higher Education - Grant and Contracts Account.

### Local Account Ending Fiscal Year Cash Balance (in millions)



The amounts include petty cash, cash in bank, cash with fiscal agents, pooled cash and short term investments with the local government investment pool. Sources do not fall under the State Treasurer.

## Highlights

- Tax revenues decreased \$1 billion or 6 percent in fiscal year 2010 from fiscal year 2009. The sluggish economy, slumping housing markets and reduced consumer spending have adversely affected state tax collections, especially sales use taxes and real estate excise taxes.
- State expenses continued to grow despite the reduction in tax revenues. Human services expenses increased by \$ 510 million or 4 percent in fiscal year 2010 from fiscal year 2009, reflecting an increased number of individuals who are seeking public assistance from state programs and services.
- At the end of fiscal year 2010,

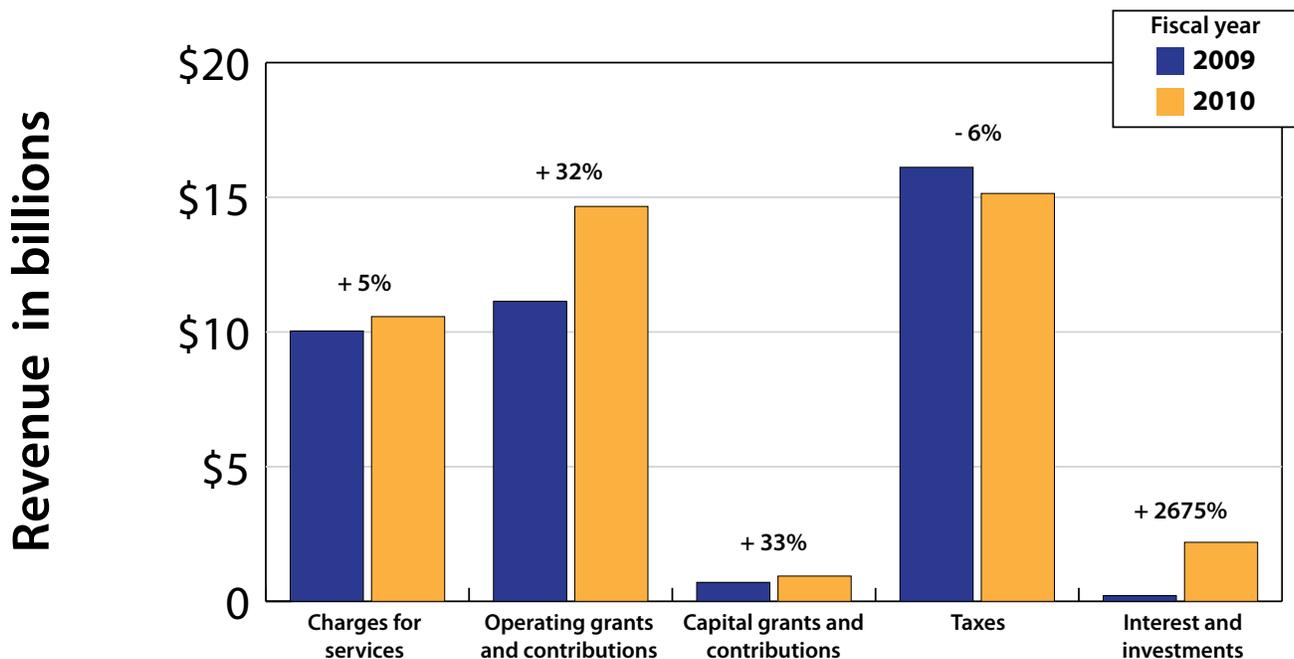
the state had general obligation debt of \$ 16.6 billion, an increase of 18 percent over fiscal year 2009. The state has pledged its full faith, credit and taxing power to repay this debt. On June 30, 2010, the state's general obligation debt was rated Aa1 by Moody's Investor Services, AA+ by Standard & Poor's Rating Group and AA+ by Fitch Ratings. Bond ratings are an important measure of the state's economic strength and accountability. They determine how much the state pays in interest when it borrows money.

- The state's Budget Stabilization Account (rainy day fund) had a balance of \$95 million as of June 30, 2010. The balance in the fund for the last five fis-

cal years has been:

- **June 30, 2010 - \$ 95.0 million**
- **June 30, 2009 - \$21.4 million**
- **June 30, 2008 - \$302.7 million**
- **June 30, 2007 - \$226.9 million**
- **June 30, 2006 - \$67.8 million**
- Workers' compensation activities reported a loss of \$1 billion in fiscal year 2010. Claims costs increased by \$1.8 billion or 82 percent in Fiscal Year 2010 compared with Fiscal Year 2009. The increase in claims costs is attributable to increases in forecasted future wage inflation, an increase in the number of pensions granted for permanent disability, and increases in the duration of time-loss claims affecting both current and prior year claims. Claims and claims adjustment liabilities grew to

## Total primary government revenue in billions



\$24 billion as of June 30, 2010. Only \$11.2 billion is funded by long-term investments.

- Unemployment compensation activity reported a loss of \$985 million in fiscal year 2010. Unemployment benefits rose \$2.4 billion in fiscal year 2010 as the annualized unemployment rate increased from 7.3 percent in fiscal year 2009 to 9.2 percent in fiscal year 2010.

### Challenges Ahead

The financial statements reveal several growing obligations that are not adequately funded. The following issues have the potential to affect state resources:

### State pension plans

Two of the state's closed pension plans, PERS 1 for retired state employees and TRS 1 for retired teachers, have significant unfunded liabilities. As of June 30, 2009, the unfunded liability for PERS 1 was \$ 4.2 billion and TRS 1 was \$ 2.7 billion. That means the state does not have money set aside to pay the promised retirement benefits to retirees in those two systems. This situation was caused by continuous underfunding and recent investment losses. Significant increases in future contributions will be needed to maintain sufficient assets to pay these benefits in the future. The remaining state retirement plans are fully funded and healthy.

### Post-employment benefits

The state administers a post-employment benefit plan of subsidized medical, dental, life and long-term disability insurance to employees who elect to continue coverage and pay the administratively established premiums at the time they retire. The plan had an unfunded liability of \$ 3.8 billion as of January 1, 2009, the most current information available from the State Actuary at the time of this report.

### Workers' Compensation

The Workers' Compensation Program had an unfunded liability of \$12.8 billion for supplemental pension cost-of-living increases (COLA) as of June 30, 2010. These COLAs are provided to injured workers and their dependents who receive disability payments. The state cannot save money in a fund to pay for these costs as state law requires this program to be operated on a pay-as-you-go basis. This puts pressure on the Department of Labor and Industries to raise employer and employee premium rates or revamp benefits. An independent actuary who reviewed the Workers' Compensation Fund concluded that significant premium rate increases would be necessary for the fund to break even. As of June 30, 2010, the Workers' Compensation Accident Fund was insolvent. Insolvency is defined as liabilities in excess of the value of assets. It is important to note that although the fund is insolvent, at this point the program has sufficient assets to pay claims and to perform day-to-day services.

## Total Government Expenses (in millions)

Expenses	2009	2010
General Government	\$1,815	\$1,738
Education - K-12	8,549	8,468
Education - Higher Education	6,044	6,051
Human Services	12,436	12,946
Adult Corrections	1,044	938
Natural Resources & Recreation	1,062	1,084
Transportation	1,883	2,073
Interest on Long-term Debt	728	810
Workers' Compensation	2,544	4,268
Unemployment Compensation	2,360	4,729
Higher Education Student Services	1,502	1,628
Liquor Control	540	552
Washington's Lottery	401	389
Other Activities	391	345
<b>TOTAL EXPENSES</b>	<b>\$41,299</b>	<b>\$46,019</b>



### **Risk management fund**

The Risk Management Fund has set aside only \$116 million in cash and investments to pay for future estimated claims of approximately \$727 million as of June 30, 2010. This fund pays tort claims, judgments, and settlements against the state. State law limits accumulating funds in the Self-Insurance Liability Program to 50 percent of total outstanding and actuarially determined claims.

### **Federal fiscal stabilization**

Washington has used federal grant money from the American Recovery and Reinvestment Act to avoid making significant service and workforce cuts in areas such as education and corrections. For the fiscal year ended June 30, 2010, the federal government has granted more than \$1.3 billion in Recovery Act money to the state. This funding ends in 2011.

### **Guaranteed Education Tuition (GET) Program**

The GET program, administered by the Higher Education Coordinating Board, was established in 1998, to make higher education more affordable and accessible to Washington State citizens. Due to reduced investment earnings and higher than projected tuition increases in recent years, GET's June 30, 2010 fund balance was negative \$254,619,000.

**Visit the Office of Financial Management website to view the full [Comprehensive Annual Financial Report](#).**

2010 ANNUAL REPORT

DIVISION OF SPECIAL  
INVESTIGATIONS



WASHINGTON  
**BRIAN SONNTAG**  
STATE AUDITOR

# Whistleblower Program

The State Employee Whistleblower program investigates assertions of improper governmental action (RCW Chapter 42.40).

Improper governmental action is defined as any action by an employee undertaken in the performance of the employee's official duties which:

- Is a gross waste of public funds or resources.
- Is in violation of federal or state law or rule, if the violation is not merely technical or of a minimum nature.
- Is of substantial and specific danger to the public health or safety.
- Is gross mismanagement.
- Prevents dissemination of scientific opinion or alters technical findings.

As of December 2010, we have 11 investigations pertaining to employees using state resources for

personal use. Some examples of cases we reported on in 2010:

## Department of Social and Health Services

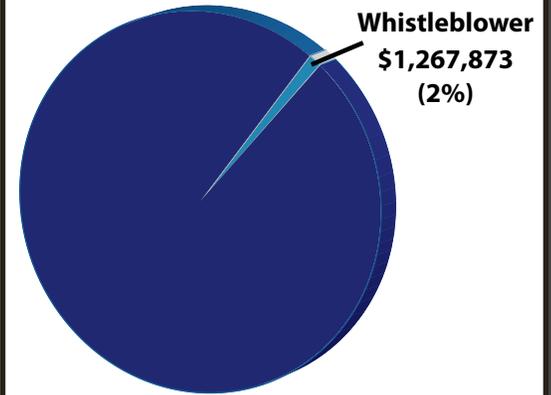
### Report 1004302

An employee worked at the Department and a nonprofit organization. The assertion stated the Department was paying the employee for hours she was working on behalf of the nonprofit.

The employee worked for both organizations since 1995. Due to state records retention rules, the Department's documentation dated back only six years, which is less than half of the 15 years the subject worked for the state and the nonprofit. We reviewed the documentation the Department provided – time sheets starting in 2002 and travel logs starting in 2005.

We identified \$154,730.40 in

## Whistleblower Activity Budget



Total budget = \$80,799,705

salary, benefits and travel reimbursements that the Department paid to the subject for time she was working for a nonprofit. From January 2002 through May 2009, the subject claimed a minimum of 5,380 hours of work for the Department that coincided with dates and times she worked for the nonprofit. In addition, we identified \$382,206.85 in payroll charges to the federal grants from January 2002 through August

## Program Statistics

January 1 - November 15, 2010

Whistleblower

Opened **43** new investigations

Closed **36** investigations

Total of **79** investigations



Whistleblower

The entities with the largest number of investigations in 2010:

**Dept. of Social & Health Services**

**Dept. of Corrections**

**University of Washington**

Exactly 50 percent of cases we closed in 2010 were substantiated.



2009 that were not adequately supported. We recommended the Department seek recovery of the salary, benefits and travel expenses it paid the employee, who resigned in August 2009.

## Western Washington University

We received an assertion questioning the amount of time and the business purpose of the travel by the Executive Director of Western's Center for International Studies. We investigated 18 months' of travel – starting with his first day at Western on December 1, 2007 through June 2009 – and found he spent \$38,000 in public funds on 22 trips. In addition, our investigation found the subject's previous employer, Wright State University in Ohio, had also investigated his travel practices and encouraged him to resign his position there.

At Western, we found the subject made trips to the same destinations, chained together trips to different destinations for different purposes, charged Western for only parts of certain trips without consistency even though he stated they were for a business purpose and did not properly document travel or leave. We recommended Western strengthen its travel policies and training. The employee resigned his position in September 2010 but remains on the faculty.

## Parks and Recreation Commission

We received an assertion of mismanagement and misuse of public funds related to a new sewer and water distribution system at Fort Flagler State Park in Jefferson County.

Our investigation focused on whether Parks mismanaged a consultant agreement and contracts and whether there was a gross waste of public funds, as outlined in the State Employee Whistleblower Act.

We determined that during the 10 years it took to complete the project – August 2000 to May 2009 – its cost grew from roughly \$140,000 to replace an RV dump station to more than \$7 million to replace the entire sewer and water delivery systems. Parks paid:

- \$106,096 to a construction contractor for an RV drainfield replacement system that did not work.
- \$1.4 million to a consulting firm to design a new sewer and water delivery system that failed one month after its completion.
- \$1.3 million to the same consulting firm to design a new system to replace the failed system.
- \$3.2 million to a construction firm to build the new system, which is still operating at the park.

- \$700,000 to a contractor to pump sewage from the failing system for more than seven years.

We found Parks did not monitor contractors or enforce contract terms; did not follow state bid or contract laws; and did not properly inspect or test systems.

## Employment Security Department

We received an assertion that the Department was rehiring retired employees without justification or authorization.

State law allows agencies to rehire retired employees if agencies have a written policy and can document a justifiable need. Those employees may not work more than 1,500 hours per year. Without such documentation, retirees may work 867 hours per year without a reduction in their pensions.

We found the Department rehired 47 retired employees into temporary positions, largely to help process an increased number of unemployment claims. Most of these employees' files included documentation that showed they would not work more than 867 hours per year.

However, we found six employees the Department hired without documentation showing a justifiable need. All six of the employees worked more than 867 hours per year. One of them worked 2,000 hours in 2009.

## Fraud Program

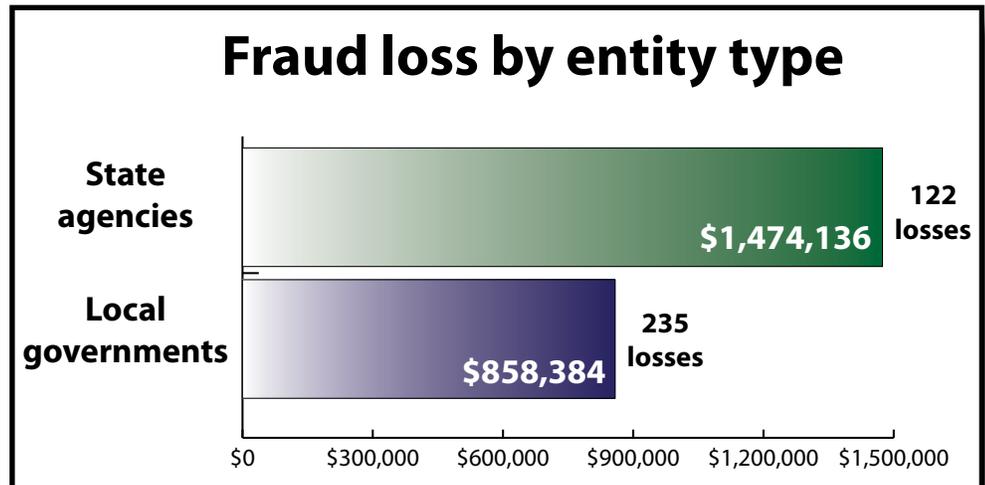
The State Auditor's Office operates a fraud program that focuses on education, prevention and investigations.

Between January 1, 2010 and November 15, 2010, state agencies and local governments reported more than 357 losses to our Office, totaling \$2,332,520. During this time, we reported on 62 of those cases totaling \$1,847,342.

In 2010, we expanded the types of losses we track. In recent years, we have noted a significant increase in the number of thefts of small and attractive assets, particularly laptops and digital cameras. We refer those cases to the appropriate audit team to follow up in the next audit.

Here are some cases we reported on in 2010:

- **Clallam County:** A cashier in the County Treasurer's Office misappropriated at least \$617,467 in public funds by pocketing general cash payments and replacing them in the deposit records with unrecorded tax payments that were made by check. The County Prosecutor's Office charged her with first-degree theft and the trial is scheduled for January 10, 2011. The County received an insurance settlement of \$597,516 after its \$10,000 deductible.
- **Ridgefield School District No. 122.** A School District



employee misappropriated at least \$806,644 in public funds by manipulating the payroll system and destroying records to conceal the loss. The Court sentenced the employee to two years in prison and three years of supervised release and ordered her to pay \$806,645 in restitution.

- **Department of Transportation:** A Department employee manipulated her work hours in the payroll system and was overpaid \$74,559. The employee also used the agency credit card for personal purchases totaling \$4,204. The employee

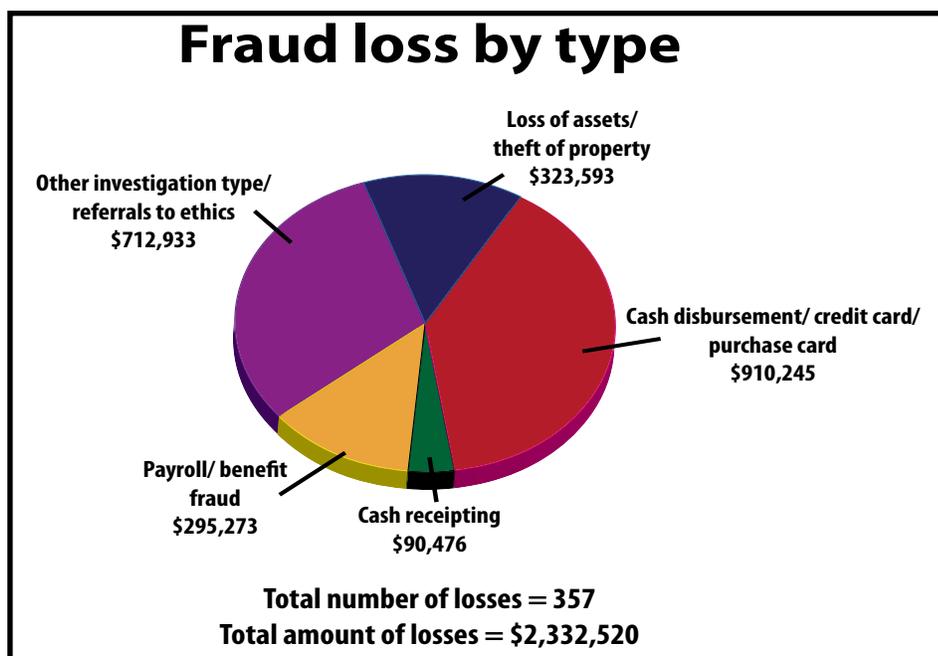
pleaded guilty to three counts of first-degree theft and was sentenced to nine months in jail. She agreed to repay the state more than \$74,000 plus interest, investigation costs and attorney fees.

- **City of Woodinville:** A City employee who was responsible for purchasing computer equipment personally profited from 15 purchases by collaborating with the vendor the City used to purchase equipment. The employee purchased equipment online with his own money; the vendor would then invoice the City for the equipment at a higher price, plus a \$100 transaction fee and a 3.5 percent handling fee. The vendor would then give the amount invoiced to the employee and keep the \$100 fee and the 3.5 percent fee. The investigation identified questionable transactions totaling at least \$78,827. Trial is scheduled for February 2011.

**In recent years, we have noted a significant increase in the number of thefts of small and attractive assets, particularly laptops and digital cameras.**

- **Pierce County Fire Protection District No. 5:** A District employee purchased at least \$51,058 in items not related to District business. Most of the purchases were for sprinkler system equipment; the employee operates a personal business installing sprinkler systems. Law enforcement is investigating the case.

In 2009, we launched an online tool to make it easier for state and local governments to report losses of public funds to our Office. Our Fraud Manager reviews each case and works with the audit teams to determine the best course of action. Sometimes we refer the reports to other areas of the Office,



such as the Citizen Hotline or the performance audit team. In some cases, we refer reports to the

Executive Ethics Board for action that is outside of our statutory authority.

## Citizen Hotline

The Washington State Auditor's Office has a toll-free hotline to improve government efficiency and accountability. The hotline is open to all citizens and government employees to:

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

Reports and assertions can pertain to all state and local governments, employees and contractors. Hotline users' confidentiality is maintained until a report is issued, at which time all records become subject to public records laws. Citizens can

submit assertions through our website, by phone or mail.

Through November 30, we received 641 assertions to our Citizen Hotline. We closed 183 cases; 21 were outside of our authority. When appropriate, we refer cases to our audit teams for investigation or to consider as part of an entity's next scheduled audit.

Examples of cases we reported on this year:

### Department of General Administration

We received an assertion that an office supply company that holds a statewide contract with the Department was overcharging other states and municipalities. We

investigated whether the Department was adequately monitoring the contract on behalf of state governments.

The contract started in 2006 and as of May 2010, the state had spent more than \$77 million under the contract.

We reviewed 12 weeks of payments and found:

- The Department paid \$271,500 more than agreed-upon prices.
- The contractor dropped from the deeply discounted list or raised prices on 149 items, for which the Department paid \$26,500
- Total = \$298,000



Over nine months, the contractor charged unallowed shipping totaling \$7,900.

In May 2010, the contractor's website for the state had higher prices than it did for the public on 27 out of 127 items we tested, which is 21 percent of the 25,000 items on the site.

We recommended the Department work with the contractor to recover amounts the state overpaid and monitor its contract. We also recommended the Department consider re-bidding the contract.

Our report cited the City of San Francisco, which was in the process of pursuing recovery of \$5.75 million in overcharges from the contractor on a five-year contract. In December 2010, the company settled with the City for \$4.25 million.

## City of Snoqualmie

We received an assertion citing concerns regarding the City's oversight of an engineering contractor and a forestry consultant for the Snoqualmie Ridge master-planned community.

In 1994 the City contracted with an engineering firm to review design plans, conduct inspections and approve projects. The City awarded a new contract to the same firm in 2003. In 1999 the City contracted with a forestry arboricultural firm to identify suitable trees for the development. Both contracts are still in place.

We found:

- The City paid a forestry consultant \$5,630.94 in total overcharges for hourly rates and mileage from January 2007 through June 2007.
- The City overpaid an engineering firm \$7,369.98 for items

not allowed by the contract and for overcharges in hourly rate.

- The City then passed on these charges, totaling \$13,000.92, to the developer of Snoqualmie Ridge.
- The City hired a contractor to conduct long-term and complex engineering reviews that could have been accomplished at significantly less cost to taxpayers had the City done the work itself. The City paid the engineering contractor \$5,357,642.13 between 2003 and 2009, an average of \$765,377 per year. We calculated the City could have hired at least six full-time employees for the same amount it paid the engineering contractor. At a minimum, the City could have hired one engineer to oversee the contractor's work to ensure it was not excessive.

2010 ANNUAL REPORT  
LOCAL GOVERNMENT  
AUDITS



WASHINGTON  
**BRIAN SONNTAG**  
STATE AUDITOR

# Local Government Audits

The State Auditor's Office audits of local governments are designed to promote accountability, fiscal integrity and openness in government. Working with these governments and with citizens, we strive to ensure the efficient and effective use of public resources. Our audits provide many services to local governments and citizens.

## Evaluate internal controls designed to ensure accountability

Our accountability audits of local government examine governments' financial records to ensure public funds are accounted for and controls are in place to protect public resources from misappropriation, loss or misuse. We also provide guidance on the importance and use of internal

controls to prevent the loss or misuse of public resources. Proper controls allow local governments to detect issues, such as loss of public funds, sooner rather than later or never. Each year, we train more than 2,200 government employees on preventing and detecting loss of public funds. As a result of this training, many of our local governments have identified misappropriations through detection methods and internal controls they have implemented.

## Financial activities

Our accountability audits also provide local governments an assessment of compliance with state laws and their own policies governing financial activities. In recent years, we have noted a significant trend of local governments performing operations that

## Local Government Audit Activity Budget



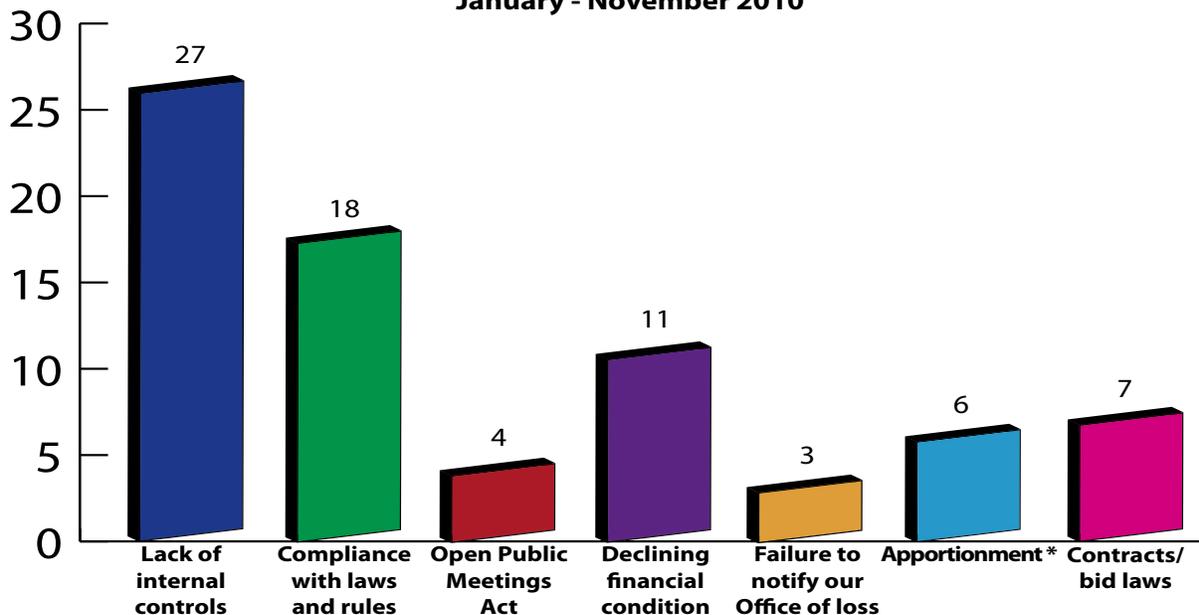
Total Office budget = \$80,799,705

exceed their authority under state law. For example, we found:

- A Fire District was operating a training facility to provide classes that were vocational courses and not directly related to fire prevention services.

## Local government accountability findings

January - November 2010



\*Apportionment includes school districts' transportation, enrollment and staff mix



- A joint operating agency was funding college scholarships with public money.
- A transit organization and a hospital district sponsored and made donations of public funds to a nonprofit.
- An educational service district acted as a treasurer for a group of local governments to administer a noneducational federal grant.

### Compliance with federal grant requirements

We regularly perform federal compliance audits for applicable local governments as required under federal Office of Management and Budget Circular A133, Audits of States, Local Governments, and Non-Profit Organizations.

The American Recovery and Reinvestment Act of 2009 resulted in state and local governments receiving billions of federal dol-

**Hourly billing rate for audits:**  
**\$78.50**

**What local governments receive for their money:**

- ✓ **Independent audits**
- ✓ **Understandable reports**
- ✓ **Budgeting, Accounting and Reporting Systems**
- ✓ **Local Government Advisory Committee**
- ✓ **Training on budgeting, accounting and financial reporting**
- ✓ **Client HelpDesk**
- ✓ **Guidance and education on changes to accounting standards**
- ✓ **Local Government Financial Reporting System**

lars. This Act resulted in additional audit requirements and new programs requiring audit work. The State Auditor's Office is committed to working with state and local governments to help ensure those dollars are properly accounted for and reported.

In addition to audits, we provide grant accounting training to local governments and have met with the Governor's Office and the

Office of Financial Management to discuss the accountability and transparency requirements of the Recovery Act.

### Assuring accurate financial reporting and future viability

Many local governments receive financial statement audits as a requirement of receiving federal funds or as condition of issuing bonds. We audit the amounts and disclosures in their financial statements and issue an opinion of whether they are fairly stated. We also evaluate

whether the local government has the internal controls, such as knowledgeable employees, processes and procedures to report accurately on their financial operations. The assessment of accurate financial reporting has become an area of increasing importance since many local governments are faced with unprecedented budget deficits and funding shortages.

### Audit Costs Compared to Total Expenditures Audited

For many years, our Office has measured audit costs as a percentage of local government expenditures by government type. Over time, that percentage has remained relatively stable. Five-year comparisons from 2004 to 2008 of the percentage are shown here:

Entity Type	2004 Audit costs as a percentage of total expenditures audited	2008 Audit costs as a percentage of total expenditures audited*	Percentage change
Counties	.06%	.07%	.01%
Cities	.06%	.06%	0
School districts	.04%	.05%	.01%
Transits	.06%	.06%	0

\* Most recent number available

2010 ANNUAL REPORT  
SCHOOL PROGRAMS



WASHINGTON  
**BRIAN SONNTAG**  
STATE AUDITOR

# School Programs conducts audits, training and collaboration

The State Auditor's Office School Programs team's primary purpose is to audit state school district funding. We report funding errors to the Office of the Superintendent of Public Instruction, which uses this information to determine how much money to recover from districts, in cases of overfunding, or pay to districts in cases of underfunding.

The School Programs team also supports school districts and educational service districts and through technical assistance, training and collaboration.

## Audit Results

During 2010, we audited school districts' reporting on transportation, teacher education and experience (staff mix), and basic enrollment. This reporting is what drives, in a large part, how much money districts receive from the

state. This funding, called apportionment funding, represents approximately 50 percent of the state's general fund expenditures each year. Our work resulted in more than \$3 million in recommended recoveries in 2010. In the past three years, we have recommended recovery of state funding totaling approximately \$10 million.

### Transportation

In 2010, we focused on districts where we had found issues in previous audits. These efforts resulted in recommended recoveries totaling \$571,181. Additionally, we found Districts were underpaid a total of approximately \$65,000. We chose the follow-up approach due to a 2009 change in the funding formula. We will audit districts' compliance with the new formula in 2011.

### Staff Mix

In our audits of staff mix – teacher education and experience – we identified overpayments of \$27,013 and underpayments of \$23,721.

### Enrollment

We focused our efforts in basic enrollment reporting on skills centers and Alternative Learning Experience (ALE)

programs. Our audits of two skills centers resulted in recommended recoveries of more than \$550,000. Our audit of one ALE program will result in recommended recovery of more than \$1.6 million. We will continue to focus enrollment audit efforts in skills centers and ALE programs. We identified enrollment underpayments of \$8,334.

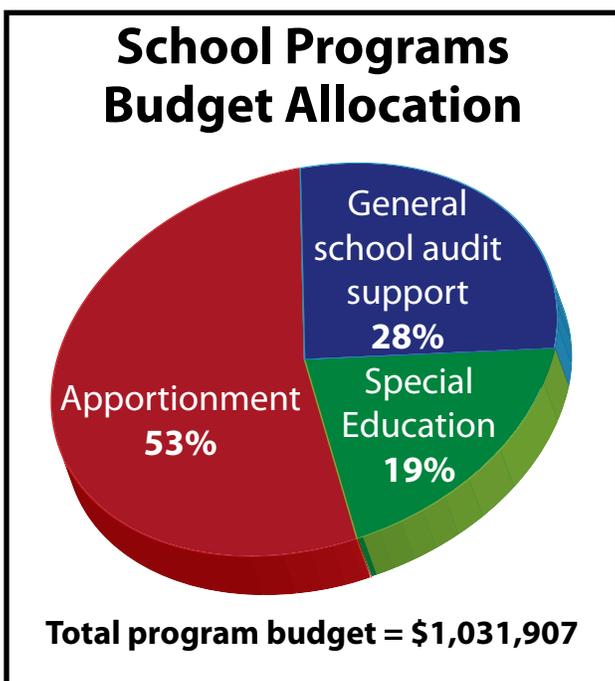
### Special Education Safety Net Funding

Our audits also focused on applications for safety net funding for high-need students. Safety net awards are based on the costs of a student's special education for the entire school year. If a student withdraws from a district prior to the end of the year, the balance of the award for that student is subject to recovery.

Safety net funding is separate from apportionment funding and has different requirements. In addition, it is partially federally funded.

In order to receive safety net awards, districts must demonstrate their expenses for high-need students exceed the resources available based on mid-year projections, which are sometimes inaccurate.

2010 Funding Errors Identified		
	Overpayments	Underpayments
Transportation	\$571,181	\$65,000
Staff Mix	\$27,013	\$23,721
Enrollment	\$2,150,000	\$8,334
Safety Net	\$282,456	N/A
<b>Totals</b>	<b>\$3,030,650</b>	<b>\$97,055</b>



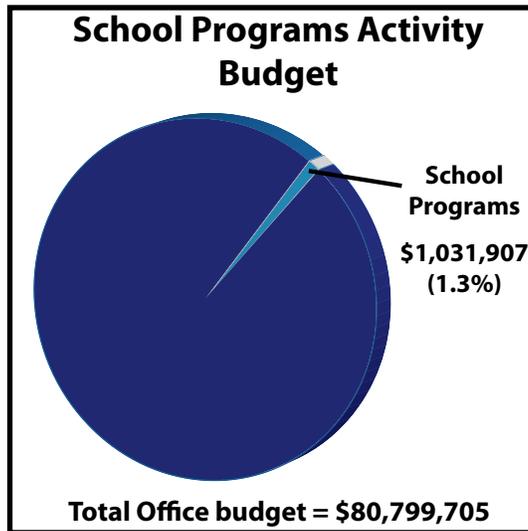


We identified overpayments of \$282,456 and recommended the state recover the money.

### 2011 Audit Work

In 2011, the team will focus on two high-risk areas: alternative learning experience (ALE) programs and vocational skills centers. Alternative learning includes Internet-based programs and other nontraditional instructional models that have the same funding as regular classrooms but have different rules for counting students for funding.

Our audit work in this area has identified some significant instances of noncompliance; in four audits of large ALE programs, we have recommended recoveries of funding exceeding \$6.5 million.



Our plan for the next few years includes significantly more audit work in this area, as well as providing assistance to OSPI in clarifying regulations that apply to alternative learning funding.

We also focused on vocational skills centers, which have programs in everything from basic

education to ALE and receive increased funding for both students and instructors.

In the next few years, several changes to the funding structure of K-12 education will require us to develop new audit techniques and programs. The funding changes include a new method of calculating transportation funding the state will phase in over the next few years and changes in funding allocation using the prototypical school model prescribed in SHB2776 that passed during the 2010 legislative session.

Our School Programs team is uniquely positioned to develop efficient and effective audit techniques for K-12 school districts and identifies funding errors that otherwise would go undetected.

2010 ANNUAL REPORT  
LOCAL GOVERNMENT  
SUPPORT



WASHINGTON  
**BRIAN SONNTAG**  
STATE AUDITOR

# Local Government Support Team provides technical help, training

The State Auditor's Office Local Government Support Team (LGS) provides support to local governments through technical assistance and training, prescription of the Budgeting, Accounting and Reporting System Manual, and compiling comparative statistics. The team also provides training and technical assistance to auditors and outside groups.

## Technical Assistance

Our Office provides technical assistance to local governments through the Client HelpDesk, e-mail and telephone support, and training to help them report accurate, timely data and possibly reduce their audit costs.

The Client HelpDesk provides a place for governments to submit accounting and pre-audit questions without having to conduct their own research. Our auditors respond to the questions, which are stored in a

database. Our auditors and audit specialists refer to the database of accounting and audit knowledge, reducing need for duplicate research. The Local Government Support team periodically reviews answers in the database to ensure they are consistent with new audit requirements.

The HelpDesk ensures local governments receive consistent and accurate information on how to report their financial information to the state and federal governments and to citizens.

Our Local Government Support team also provides training to local governments. The team typically conducts one-day sessions, often in conjunction with local government-specific conferences. Our training addresses new accounting and reporting standards as well as accounting for new legal requirements to educate local governments on how to accurately prepare their annual financial

reports in accordance with federal and state requirements. We provide training at a reasonable cost and it is tailored to their needs.

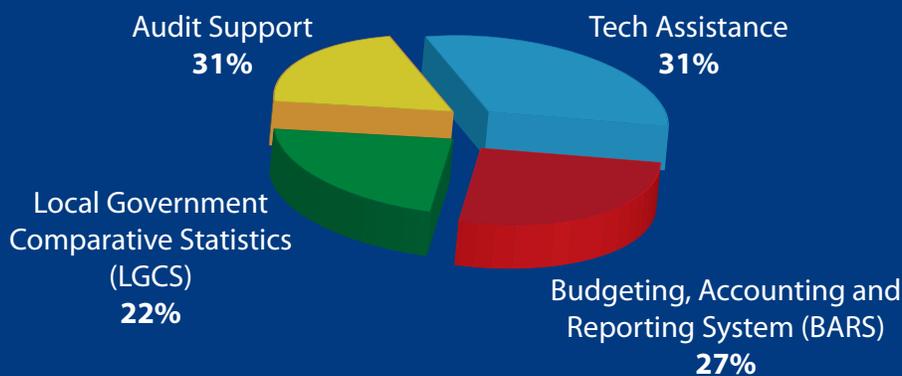
## BARS Prescription

Our Local Government Support team creates and maintains Budgeting, Accounting and Reporting System (BARS) manuals and reporting packages as required by state law (RCW 43.09.200). The BARS Manual consists of nine manuals and four reporting packages, which we update annually with current accounting, reporting and statutory requirements.

Before we publish the updated manual, we send it to the Local Government Advisory Committee to review. The Committee represents local governments, their associations, and other agencies, including our Office.

The BARS Manual provides consistent application of new requirements and reporting across local

## Local Government Support Budget Allocation





governments that allows policy makers, public officials and local government employees to make informed financial decisions.

The BARS Manual contains a uniform chart of accounts, which enables our Office to compile local government data into the Local Government Comparative Statistics, which is used by governments, policy makers and others to analyze government, including the cost of services and programs.

BARS is more than 20 years old, and the data needs have changed over time, necessitating a close review of all accounts and the types of data collected. During 2010, the team facilitated a project with local governments to review, refine, add or delete accounts, and provide better definitions of each BARS account. This project will provide for more consistent and accurate data collected and reported to all users.

### Financial Reports

State law requires all local governments to file annual reports with the State Auditor's Office. In 2009, the Local Government Support team started an effort to educate approximately 1,800 local governments in the state about this requirement and encourage them to report timely. As a result, local government annual report filings increased from 800 to approximately 1,600 in 2010.

We partially attribute the increase in filings to our new online reporting system for local governments. Online reporting made filing

easier, less expensive and faster for all local governments.

### Comparative Statistics

The BARS prescription allows us to compile revenue and expenditure data for all local governments and meets state law (RCW 43.09.230), which requires our Office to compile and report comparative data.

Once we receive the information, our Local Government Support team uploads, edits and reports revenues and expenditures in a web-based reporting application called the Local Government Finance Reporting System (LGFRS). This system provides accurate, reliable information about all local government revenues and expenditures in Washington. It is the single source for this information in one location. Legislators and other policy makers use this information to make decisions about local governments and their budgets.

data provided by local governments into a centralized system that allows for trend analysis and, in some cases, transaction-level analysis. Before this was available, auditors compiled the data and were unable to start an audit until they were onsite, which could increase audit costs.

The team also coordinates the audit assessments, which ensure accountability at small governments where an onsite audit may be not be practical or affordable.

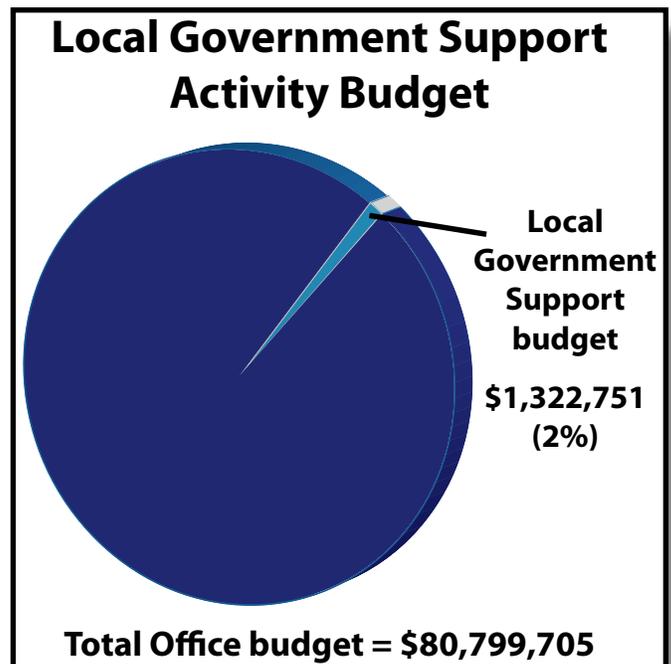
The team's review of comprehensive annual financial reports helps us provide efficient and consistent financial statement audits.

The team also provides training and technical assistance to auditors to keep them informed of new accounting and auditing requirements. In 2010, the team provided this training using remote technology to reduce or eliminate travel costs.

### Audit Support

Our Local Government Support team also provides support to our auditors through the financial analysis project, coordination of the audit assessment process, reviews of Comprehensive Financial Reports, technical assistance and training.

The financial analysis project pulls



2010 ANNUAL REPORT  
INITIATIVE 937 AUDITS



WASHINGTON  
**BRIAN SONNTAG**  
STATE AUDITOR

# Initiative 937 - Renewable energy sources and conservation programs

In 2006, Washington voters approved Initiative 937, establishing the Energy Independence Act. The Act requires electric utility companies to invest in renewable energy sources and energy conservation programs. Utility companies with more than 25,000 customers that are subject to these requirements include municipals, public utility districts, investor-owned utilities and cooperatives.

Initiative 937 calls on the State Auditor's Office to review municipal and public utility districts' compliance with these new regulations.

We will audit 10 public utility districts and two municipal utilities of greater than 25,000 customers for compliance with renewable energy and conservation requirements they must meet beginning in 2012.

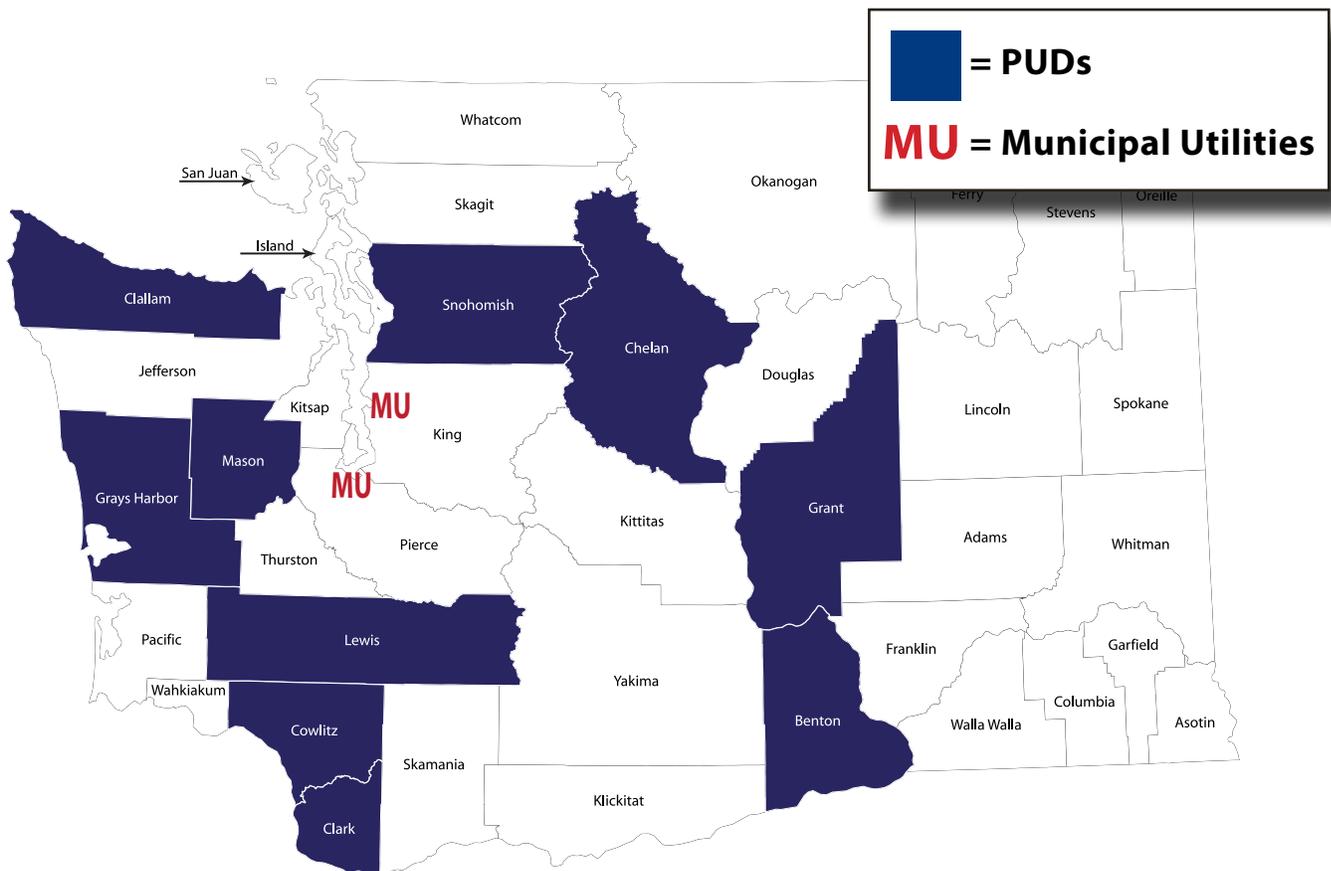
We welcome this new audit responsibility and have engaged in significant outreach to utilities, key agencies, and the Legislature in preparation for these new audits. We have been communicating with several key parties such as each electric utility, Department of Commerce, Utilities & Transporta-

tion Commission, Bonneville Power Administration, and respective energy committees of the state House and Senate.

We have already begun the planning phase of our audits and expect to commence fieldwork during 2011. It is our goal to issue all 12 audit reports – one for each utility – by December 31, 2012.

We are encouraged by the cooperation received from all parties. We look forward to our continued relationships as we start our first audits.

## Utilities to be audited





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**AMERICANS WITH DISABILITIES**

In accordance with the Americans with Disabilities Act, this document will be made available in alternate formats.  
Please call (360) 902-0370 for more information.