Challenges in Performance Auditing:

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

—Victor Hugo
mance Auditing: How a State Auditor with Intriguing New Performance Auditing Authority is Meeting Them

The purpose of the research study underlying this article was to document the initial actions taken by the Washington state auditor to implement his new authority to conduct performance audits. The research was prompted by the unique fact that the authority was granted by citizens. In the face of legislative resistance, Washington state voters, in an unprecedented action, approved a citizen-sponsored initiative giving their state auditor authority to independently select and conduct comprehensive performance audits. Moreover, they dedicated a source of revenue to finance the audits.

For details and a full list of the recommendations, see “Challenges in Performance Auditing: How a State Auditor with Intriguing New Performance Auditing Authority is Meeting Them” available online at www.agacgfm.org/research/downloads/CPResearchNo5perf.pdf.

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Lost Audit Authority Restored

Following a critical audit of legislature travel, the state legislature in 1969 placed a restriction on 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 was not applied to financial audits. The state auditor currently has an annual budget of $22.5 million and a staff of 320 (including support staff) to conduct financial statement, accountability and compliance audits. The audits encompass state and local government agencies and other special-purpose state and local entities. The audited units are required to pay for these audits at a rate set by the state auditor.

Common Challenges in Performance Auditing

Audit offices face a common set of challenges in conducting performance audits. Key challenges include: funding, staff salaries, staff quantity and skills, training, organizational structure, facilities, audit selection, when to conduct audits in-house and on contract, policies and procedures, audit protocol and quality assurance. In a rush to get started and produce results, Sonntag attempted to address these concerns—plus others unique to creating a new audit function—more or less simultaneously.

You wake at 6 a.m. Get out of bed and put on your robe. Step outside and pick up your newspaper. The front-page headline reads, “Citizens Give State Auditor Authority to Conduct Performance Audits.” You are the state auditor. What do you do now?

On November 8, 2005, the citizens of Washington state gave their state auditor, Brian Sonntag, authority to conduct performance audits of state and local government entities. Sonntag had advocated for such authority since his election in 1992. Fifty-seven percent of voters approved citizen-sponsored Initiative 900, which not only restored their elected state auditor’s authority to independently select and conduct comprehensive performance audits, but also dedicated a portion of the state’s sales and use tax to finance the audits. Having a dedicated source of funding free from legislative review is virtually unprecedented in the public sector audit profession in the United States. Less than a handful of audit offices in the United States that conduct performance audits enjoy the added independence afforded by a dedicated funding source.

Initiative 900 was introduced by Washington citizen Tim Eyman, who had been involved in many tax cut initiatives through the years. While past Eyman initiatives drew media opposition, I-900 enjoyed broad media support, particularly from talk radio hosts and most of the state’s newspapers. In supporting the 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. One supporting organization proclaimed that 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.

He Has the Authority: Now What to Do?

After Initiative 900 passed, Sonntag said he knew that his office had a difficult task ahead because it had no performance audit staff, no facilities, no computers, no audit selection method, no operations policies and procedures, no organization structure 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. 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.”

Sonntag said that since passage of the initiative, he has taken every opportunity to explain the challenges and actions his office is taking in gearing up to conduct performance audits. In the first 90 days of 2006, Sonntag and members of his audit team met and talked with numerous groups across the state.
The following sections will compare the actions planned and taken by Sonntag’s office as of March 31, 2006, with common practices in the performance audit community. The actions discussed are limited to those considered most significant.

Funding

Common Practice—Obtaining 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.

Washington State Auditor’s Actions—Initiative 900 dedicates 0.16 percent of the state’s sales and use tax revenue for the conduct of performance audits. The funding source and amount is not subject to approval by the legislature. For the audit community this is an intriguing precedent. The added measure of independence afforded by a secure funding source is worthy of study and emulation. Performance auditing is a tough, precarious job, and auditors need protection against retribution for doing it well. For Sonntag it also presents a challenge. Because funding is dedicated to performance auditing, a clear distinction must be made between performance audits and the type of legal compliance and accountability audits being conducted prior to the initiative.

The amount of dedicated money that accrues is not insignificant. An estimated $8.5 million to $12 million a year is enough to finance a staff of about 120 auditors, including salaries, facilities, equipment, supplies, etc. This is a relatively large performance audit staff in the state audit community, according to data from the National Association of State Auditors, Controllers and Treasurers (NASACT).

Staff Salaries

Common Practice—Offering adequate salaries is the No. 2 challenge for the government performance audit community. Recruiting and retaining competent, energetic, experienced staff is difficult without a competitive salary structure.

Washington State Auditor’s Actions—Washington state did not, upon passage of I-900, have a position description and salary scale for performance audit professionals. The existing salary structure for “financial auditors” was at the low end of the median for state audit offices. Sonntag granted a salary “exception” for higher pay to enable him to recruit his initial four performance audit managers.

Staffing

Common Practice—The general practice in performance auditing is to recruit professionals with a college degree, but not from a single discipline. Separate staffs are hired for both performance and financial audits; performance auditors are not expected to conduct financial audits, and vice versa. No formula exists for establishing how many performance auditors should be hired for an organization of a given size. In practice, the number varies significantly, from the U.S. Government Accountability Office with more than 3,000 staff to a few cities with only one performance auditor. Staffing at state audit offices that conduct performance audits is relatively low, ranging from five to around 45, with one state audit office having an exceptional high of more than 200.

Washington State Auditor’s Actions—Sonntag initially planned to hire a director of performance audit who would supervise a team of auditors. Audit team managers would be responsible for specific subject areas, with a staff of two, and be located in Olympia at the state auditor’s office. Sonntag was giving consideration to integrating compliance and accountability with performance audit (see “Training” below). By late February, Sonntag had assembled a staff of six performance audit managers. Four were hired and two were transferred from his accountability and compliance audit staff. Of the four outside hires, two had experience conducting performance audits plus a wide range of other experience; two had a variety of work experience, including expertise in working with contractors.

Training

Common Practice—Training is critical to an audit office’s success. No college or university in the United States specifically trains students to be performance auditors. As a consequence, audit organizations either hire from other audit offices or develop their own. Professionals often become performance auditors through a combination of formal and on-the-job training, coupled with experience doing audits. The value of training is recognized by the Government Auditing Standards requirement for continuing professional education.

Washington State Auditor’s Actions—Sonntag plans to pursue a cross-training program to expand the capacity of his staff who conduct 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 while expanding career opportunities within the office. Also, the state auditor’s office began working with two state universities to provide internship opportunities for students doing graduate work.

In March 2006, the new performance audit managers and top financial audit managers were trained on performance auditing. Also, materials were in place for state audit office staff to provide contractors (see “Contracting for Audit Services” below) with pre-audit training on working papers, public records, referencing and active listening. Training can take on added importance when staff and contractors have limited performance audit experience.

Contracting for Audit Services

Common Practice—Federal and state auditors commonly hire outside firms to conduct financial statement audits. They and their colleagues in local government seldom contract out for the conduct of performance audits. Contracting out is generally limited to obtaining special technical knowledge and skills needed in a particular audit.

Washington State Auditor’s Actions—Under Initiative 900, Sonntag can decide whether to do audits in-house or on contract. To get audits under way quickly, Sonntag’s office will conduct some audits using private firms and some will be done in-house. His goal over time is to conduct about 25 percent of performance audits on contract and about 75 percent with in-house auditors.
Protocol for Audit Selection

Common Practice—To exercise full 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 data. Performance audit offices use a variety of methods in audit selection, including risk assessment, receiving requests, acting on issues uncovered by other audits and seeking input from the legislature or officials of the entity to whom they report. Seeking input from citizens is not widely publicized.

Washington State Auditor’s Actions—Sonntag has authority to independently select subjects for audit. He must, of course, conduct audits mandated by the legislature and he may accept requests. Initiative 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 about subjects that will yield opportunities for cost savings and improved services.

Sonntag insists that his office engage the public—citizens, business, interest groups and government employees—in selecting topics for audit. To this end, the performance audit team established a website survey to enlist citizen ideas. The office also contracted with a professional firm experienced in obtaining ideas from diverse public groups through opinion polls, focus groups and other means. In a mid-March telephone survey, 405 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. This input from citizens weighed heavily in the subjects initially selected for audit.

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 use of measures in managing. The Washington state legislature has enacted two performance management initiatives (the first in 1996). They require state agencies to engage in strategic planning, including the development of an agency mission statement, measurable goals, program objectives, and budget proposals that incorporate performance measures indicating the relative success in achieving program objectives and goals.

Washington State Auditor’s Actions—Initiative 900 cites as one item (of 11) to be included in each performance audit, “an analysis of departmental performance data, performance measures, and self-assessment systems.” In keeping with this requirement, two of Sonntag’s visions for performance audit are that his audits will complement the state’s performance management programs and that his audits will be valued and implemented as a management tool. The latter could prove to be a considerable challenge. Sonntag is elected and not considered a member of either the legislative or the executive management team.

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? Can audit be an accepted and respected third member of the legislative and performance management team? Some auditors might perceive such a role as compromising their independence, citing the Government Auditing Standards as their support.

Conclusions and Recommendations

Washington state voters, with the encouragement of Sonntag, have shown great innovation in tying a dedicated revenue stream to performance audit authority. Other jurisdictions may want to consider seeking similar dedicated funding to ensure the independent voice that citizens want and expect from their government audit agencies.

Sonntag is undertaking an extensive, perhaps one-of-a-kind, effort to obtain ideas from citizens on subjects for future audit. Because this approach may provide valuable lessons, Sonntag should carefully document the proceedings and the results. Other audit offices may want to consider seeking input on audit topics from citizens, if they are not currently doing so.

The state auditor’s office can partner with others to develop model legislation for meaningful performance measures that could apply both to local governments and to other jurisdictions.

Further research could explore the appropriate role for public sector auditors in government performance measurement and management initiatives.

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