

# STATE AUDITOR'S OFFICE PERFORMANCE AUDIT



## Annual Performance Audit Progress Report

**November 29, 2011**

**Report No. 1006818**



WASHINGTON  
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STATE AUDITOR

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# INTRODUCTION

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## From State Auditor Brian Sonntag

Citizens gave the State Auditor's Office the authority to conduct performance audits in November 2005 when they passed Initiative 900. This is our third report to citizens about how state and local government agencies have responded to our performance reports.

Since citizens approved Initiative 900, our Office has conducted more than 35 performance audits of almost 100 local and state governments. We have identified more than \$1 billion in potential savings and increased revenue and identified hundreds of ways to make government work better.

## Washington's performance audit law

Initiative 900 authorizes the State Auditor's Office to conduct independent, comprehensive performance audits of state and local governments. Specifically, the law directs the State Auditor's Office to "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."

We conduct performance audits according to generally accepted government auditing standards prescribed by the U.S. Government Accountability Office. In addition, state law identifies specific elements for auditors to consider during each performance audit, including potential cost savings; services that could be reduced, eliminated or transferred to the private sector; and gaps or overlaps in programs and services.

## About our progress reports

This report summarizes the results of performance audits we issued between January 1 and December 31, 2010. We have also followed up on earlier reports that spurred legislative action or produced significant results and financial benefits. To ensure agencies have time to adopt our recommendations before we attempt to analyze the results of their actions, we will follow up next year on the results of our 2011 audits.

We do not report on the state Legislature's response to our performance audits. That responsibility lies with the Joint Legislative Audit & Review Committee, whose reports can be found at [www.leg.wa.gov/JLARC/I-900/Pages/I-900](http://www.leg.wa.gov/JLARC/I-900/Pages/I-900).

State agencies under the direction of the Governor post their audit-related plans and actions at [www.accountability.wa.gov](http://www.accountability.wa.gov).

- Our first progress report, the **Status of Performance Audit Recommendations through June 30, 2009**, summarized the results of our first 16 performance audits.
- The **2010 Performance Audit Progress Report** focused on eight performance audits of local and state governments and assessed the status of more than 1,300 recommendations. At that time, state and local governments had partly or fully implemented 86 percent of our recommendations and identified millions in financial impacts.



- As part of our 2010 progress report, we reported on the status of options presented in our 2009 State Government Performance Review. The report, **Opportunities for Washington**, identified opportunities for the state to reduce spending and increase revenue by nearly \$325 million over the next five years.

### **Performance improvement highlights from earlier reports**

Our performance reports identify and evaluate opportunities to save money, to increase revenue without raising tax rates, and to reform state government services. Often it takes more than a year for legislative actions and program changes to take effect so that improved results and cost savings can be realized.

In this report we highlight the latest results from our previous analyses of:

- K-12 Employee Health Benefits
- Business Tax Amnesty
- State Liquor Sales and Distribution
- Medicaid Pharmacy Overpayments
- Pierce County Performance Measures Assessment

### **Performance audits issued during 2010**

This report reflects the status of recommendations as of June 30, 2011 for audits completed during 2010. This approach allows agencies six to 18 months to address audit recommendations before we follow up.

This report includes a summary of the status of recommendations from the following reports:

- Master Licensing Service
- Seattle City Light
- Department of Fish and Wildlife, Puget Sound Dungeness Crab Fishing
- Department of Fish and Wildlife, Selected Revenue and Expenditures
- Department of Fish and Wildlife, Delayed-Release Chinook Salmon
- Mid-Columbia Public Utility Districts
- Port of Seattle Real Estate Management

# RECOMMENDATION STATUS

When we evaluate agency responses to our audit recommendations, we categorize their status as follows:

- **Implemented:** Entity fully adopted the recommendation, either as described in the report or by resolving the underlying issue.
- **In progress:** Entity has begun to adopt the recommendation and intends to fully implement it.
- **Partially implemented:** Entity adopted parts of our recommendations.
- **Not implemented:** Entity has not adopted the recommendation and does not plan to do so.

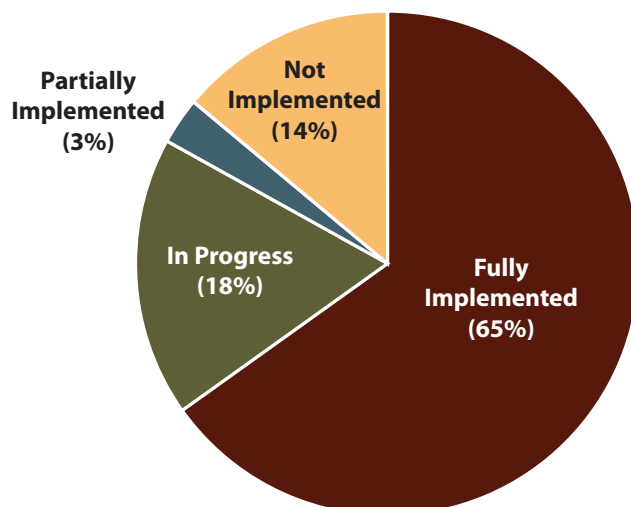
If we issued one recommendation to multiple entities, we counted it just once. In these cases, we used the lowest status reported by the entities. For example, if Entity A reported the status as “Not Implemented” and Entity B reported the status as “In Progress,” we reported “Not Implemented.” Because we often identify multiple policy options in our performance reviews, we did not include them when we calculated the adoption rate for our audit recommendations. This approach allows for conservative estimates of accrued benefits.

We defined two types of cost-savings in this report: *actual and potential*.

- **Actual** cost savings achieved: Actual savings as reported by the audited agencies. We did not independently verify cost savings.
- **Potential** cost savings estimated by the State Auditor’s Office: Identified specifically from performance audit reports, and estimated over a five-year period unless the savings were specified as one-time only.

The chart below summarizes the status of recommendations from all performance audits conducted since the beginning of the performance audit program in 2006.

## Overview of Recommendation Status February 2007 - June 2011



Total Recommendations = 1,385

**Total Savings and Revenue Possible:  
\$1.25 Billion\***

*Source:* Reports submitted to the State Auditor’s Office by the audited entities. We did not independently verify recommendation status.

*\*Note:* Based on five-year projected savings. Not all recommendations include cost savings.

# PERFORMANCE IMPROVEMENT HIGHLIGHTS

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## K-12 Health Benefits

Our February 2011 performance report recommended a major reform of the K-12 health benefits system, which has more than 200 medical plans, over 1,000 risk pools, and costs \$1.2 billion per year. We identified opportunities to simplify the system, standardize benefits and create a single, statewide K-12 benefits program that could save districts and employees up to **\$90 million** annually. That's enough to pay for 1,000 teachers.

Based on our study, the Legislature directed the Health Care Authority to develop a plan to reform the system. The Authority will provide this report to the Legislature on December 15, 2011.

## Tax Amnesty

In our 2009 Opportunities for Washington report, we said Washington state could benefit in two ways from a business tax amnesty program – by collecting delinquent debts and by bringing unregistered businesses into the tax system.

In December 2010, the Legislature and Governor authorized a tax amnesty program to run from February 1 through April 30, 2011, to help increase state revenue. According to the Department of Revenue's 2011 Amnesty Report, the amnesty generated **\$345.8 million** in new revenue. The state received \$284 million and the remaining \$61 million went to local governments.

Collections during the three months exceeded the initial Revenue Department estimate of \$28 million by more than 10 times. More than 9,000 businesses applied for amnesty – 5,095 applications were granted – including more than 400 that had never registered with the state and likely will continue paying taxes into the future.

## Liquor Sales and Distribution

In our 2009 performance review, we evaluated the possible financial effects of changing Washington's state-run liquor monopoly, recognizing that many citizens and state policy-makers believe the sale of liquor is not a core government function.

We estimated the five-year effect on state revenue using six operating models, ranging from the status quo to full privatization of the state's liquor stores and statewide distribution center. All six assumed the state would retain its liquor enforcement and public education responsibilities.

Our evaluation generated significant interest and debate, and in November 2011 voters approved Initiative 1183 to completely privatize liquor sales and distribution, while leaving enforcement responsibilities with the Liquor Control Board. Effective June 1, 2012, private retailers will replace Washington's state-owned liquor stores, and the state will auction off its liquor distribution facility. Contractors, who currently operate about half of the state's 315 liquor outlets, will have the opportunity to stay in business if they purchase the inventory.

I-1183 will make Washington the first state to allow retailers to buy directly from liquor manufacturers. The Office of Financial Management estimates the initiative will generate between **\$400 million to \$480 million in new revenue** to state and local governments over six years.

## **Medicaid Pharmacy Overpayments**

We identified an opportunity for the Department of Social and Health Services to increase its recovery of Medicaid overpayments to pharmacies by expanding a small but effective program that consistently recovers more money than it spends.

During the 2011 session, the Legislature appropriated funds for the Health Care Authority to expand this program by hiring five full-time employees to increase oversight and recovery from other medical payers.

We also suggested the agency investigate actions other states have taken to contract with private businesses to reduce inappropriate benefit payments at the point of sale. Options include a real-time system developed by a private vendor to determine the customer's eligibility for Medicaid and identify who should cover the claim. The system also helps with billing and collection of insurance payments.

## **Pierce County Performance Measures Assessment**

We assessed the Pierce County's performance measures and recommended ways the County could improve in:

- Demonstrating public value with performance measures.
- Linking measures and program activities to strategic goals.
- Balancing measures to reflect both operations and outcomes.
- Measuring what matters.
- Improving the quality of performance measures.
- Setting performance targets.

Pierce County is taking steps to strengthen its performance measures by developing what is known as the Baldrige Balanced Scorecard. Once adopted, executive department directors will use adopted outcome measures and strategies to develop department-specific balanced scorecards. Those scorecards will include strategic initiatives and output measures that support of county-wide goals. The departments will incorporate these initiatives and output measures into division-level measures and activities. Their goal is to begin reporting new performance measures based on these scorecards by 2013.



# 2010 PERFORMANCE AUDITS

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## Master Licensing Service

Our audit sought to determine if the state's master licensing service program is 1) achieving the goals established in state law to provide a convenient, accessible and timely one-stop business licensing system, 2) reducing paperwork and 3) eliminating obsolete and duplicative licensing requirements. We also assessed whether services to businesses could improve if more state agencies and local governments participated. We examined factors that might inhibit expansion and identified options and recommendations to overcome those barriers.

Following our audit, the Legislature and Governor moved the program from the Department of Licensing to the Department of Revenue, renamed it the Business License Service, and directed Revenue to modernize and expand one-stop service along the lines we recommended for business related licenses, permits and registrations.

## Seattle City Light

Our performance audit of Seattle City Light sought to determine whether the utility could improve the efficiency of its operations. The audit found opportunities for the utility to reduce duplication and costs, and to increase revenue.

For example, City Light has hundreds of miles of underground power lines. We recommended a cost-effective way to repair and increase the life of older underground cables. After our audit, the Seattle City Council decided to spend \$5 million annually for Seattle City Light to use this maintenance and replacement program, resulting in a one-time saving of **\$32.7 million**.

In addition, City Light renegotiated or established new rental agreements for 33 of its highest value properties in an effort to bring other rental agreements to true market value. This increased revenue by **\$522,030**.

The utility reported reducing actual 2009 capital project expenditures by approximately **\$1 million**. They also reported that they adjusted their six-year capital project plan to reduce further annual spending by **\$9 million**. The revised amounts are in its current plan.

## Department of Fish and Wildlife, Puget Sound Crab Fishing

Our audit of the Department of Fish and Wildlife's Puget Sound Dungeness Crab Fishing Program found the Department follows best practices in crab fishery management, but external factors beyond the Department's control can endanger the fishery. The Department has met the intent of the Fish and Wildlife Commission's policy to maintain an economically-viable commercial fishery and quality recreational fishery. However, increasing recreational crab activity has enhanced competition with the commercial fishery.

The Department adopted a revised policy in October 2010 that prioritized protection and conservation, provided guidance for recreational and commercial fisheries, established a base recreational season, and directed public education and outreach efforts to improve compliance with crab regulations and catch reporting.



## **Department of Fish and Wildlife, Delayed-Release Chinook Salmon**

Our audit of the Department of Fish and Wildlife's delayed-release Chinook salmon activity recommended the Legislature change the law requiring the Department to release three million delayed-release Chinook annually with outcome-oriented goals that align with the Hatchery Scientific Review Group's recommendations.

The goals should permit the Department to manage its hatcheries and funding to maximize recreational fishing opportunities in Puget Sound. We also recommended the Legislature require the Department to report regularly on its progress toward meeting the revised goals.

In 2011, the Legislature passed a bill directing the Department and the Fish and Wildlife Commission to develop goals and objectives to assess the effectiveness of the delayed-release Chinook salmon program. The Department must report to the Commission on these goals and objectives, agree on program activities and expenditures, and produce a report for the Legislature.

## **Department of Fish and Wildlife, Revenue and Expenditures**

Our audit of the Department of Fish and Wildlife's revenue and expenditures examined the Eastern Washington Pheasant Enhancement Account, Puget Sound Crab Endorsement Subaccount, Recreational Fisheries Enhancement Account, and administrative costs. We evaluated the administration of the pheasant, crab and fishery enhancement programs to determine whether they met the intent of state law.

The audit found the system the Department was using at the time to track license data was not always reliable and accurate. We recommended the Department prepare in advance, so if it decides to change vendors for that system to ensure it accurately captures all needed data. The Department reports it is developing a Request for Proposals to replace the existing contract that includes the recommended procedures and to ensure accurate data transition.

## **Mid-Columbia Public Utility Districts**

This audit considered opportunities to minimize utility rate increases through cost reductions and improvements in the management and operations of Chelan, Douglas and Grant County PUDs.

To reduce costs and improve operational effectiveness, we recommended Grant County PUD:

- Restructure its line crews from four to three workers when the nature of the work allows.
- Work with the Legislature to increase the threshold for work or materials contracts
- Increase the number of district crews and replace contractor crews with district crews.
- Evaluate the use of overtime and take steps to reduce line crews' overtime hours.

Grant County PUD responded it has gone from line crews of four to three workers, increased the number of district crews and replaced contractor crews with district crews, and reduced linemen overtime hours, saving **\$400,000**.

This audit also considered opportunities to minimize utility rate increases through cost reductions and improvements in the management and operation of the Grant, Chelan and Douglas County Public Utility Districts. It found an opportunity for the PUDs to share services to reduce costs and improve operations.

Following the audit, the PUDs' general managers discussed how to respond to its recommendations. On October 23, utility executives met to discuss challenges and opportunities to work more closely together. Ongoing work groups have been established.

### **Port of Seattle Real Estate Management and Selected Programs**

This audit reviewed the Port's real estate and leasing management functions over six years. It found the Port could improve how it buys, sells and leases its property, generates revenue, serves the community and invests in its future.

The Port Commission reported it reviewed our recommendations and, where possible, incorporated them into its strategic planning process known as the Century Agenda. The Commission will review and approve these strategic goals and Port staff will determine the five-year objectives necessary to achieve them. The Commission stated it anticipates final approval of the goals and objectives by December 2011.

# LOOKING AHEAD

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Here are a few examples of what we've looked at in 2011 and what we plan to evaluate in 2012-2013:

- **Opportunities to Reduce State Cell Phone Costs**, published November 18, 2011. Our [report](#) identified opportunities for state agencies to reduce costs immediately and to hold down expenses in the future.
- **Opportunities to Reduce State Mail Volume and Costs**, published November 1, 2011. Our [report](#) identified several opportunities for state agencies to reduce mail volume and costs and included examples of actions they have already taken.
- **Performance-based Contracting**, published July 1, 2011. Our [report](#) identified the status of performance-based contracting, opportunities for improvement and leading practices. Our recommendations highlighted areas where agencies could expand the use of performance-based contracting to improve contract management.
- **Streamlined Regulatory System**. We have begun a series of audits to identify opportunities to streamline business rule-revision, permitting and inspection processes. We created an inventory of more than 1,300 business licenses, permits, registrations and inspections administered by 26 state agencies and is available on our [website](#). Future audits will recommend ways to reduce the time it takes to obtain a permit decision, improve the inspection process, and reduce the cost of doing business with state government.
- **K-12 Education Spending**. We are comparing local school districts' spending for instructional and non-instructional purposes to identify strategies used by the most efficient districts to ensure limited public resources are maximized in the classroom.
- **Medicaid Fraud**. We plan to investigate the potential for fraud in the state Medicaid program. Focusing on prevention and detection of Medicaid fraud will also help us determine whether to audit other state programs susceptible to fraud.
- **State Ferry Construction**. The state ferry system has begun a program to purchase four 144-car ferries to replace vessels reaching the end of their useful lives. This audit will determine how Washington State Ferries is ensuring the best possible price for ferries, and whether it is appropriately accounting for the costs of those and other vessels.
- **State Highway Tolling**. Declining gas tax revenue has led Washington to increasingly rely on tolls to fund major transportation projects. To secure bond proceeds in the future, it is vital that the state demonstrates that it can generate a predictable stream of toll revenue. This audit will include a review of the contracting and accounting systems in the Department of Transportation's Toll Division.

# DETAIL OF 2010 AUDITS

The table below shows the realized cost savings and status of recommendations from the performance audits we issued between January 1 and December 31, 2010.

Entity						
Status of Recommendations as of June 30, 2011						
Performance audits issued from January through December 2010	Total cost savings achieved	Implemented	Partially implemented	In progress	Not implemented	Total
<b>Financial Impacts</b>						
Seattle City Light	\$43 million	5	0	5	0	10
Mid-Columbia Public Utility Districts	\$400,000	22	4	7	10	43
<b>Nonfinancial Benefits</b>						
Department of Fish and Wildlife, Puget Sound Dungeness Crab Fishing	n/a	9	0	4	0	13
Department of Fish and Wildlife, Delayed-Release Chinook Salmon	n/a	0	0	1	0	1
Department of Fish and Wildlife, Selected Revenue & Expenditures	n/a	2	0	2	1	5
Port of Seattle Real Estate Management	n/a	5	1	4	0	10
Master Licensing Service	n/a	0	0	7	0	7
<b>Subtotal of audits issued January – December 2010</b>	<b>\$43.4 million</b>	<b>43</b>	<b>5</b>	<b>30</b>	<b>11</b>	<b>89</b>
		<b>48%</b>	<b>6%</b>	<b>34%</b>	<b>12%</b>	<b>100%</b>
<b>Potential cost savings of all audits to date</b>	<b>\$1.25 billion</b>	<b>65%</b>	<b>3%</b>	<b>18%</b>	<b>14%</b>	<b>100%</b>
<b>Sources:</b> Reports submitted to the State Auditor's Office by the audited entities. We did not independently verify cost savings or recommendation status.						

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## The State Auditor's Office 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.